7. CREDIT AND INSURANCE

Federal credit programs offer direct loans and loan guarantees for a wide range of activities, primarily housing, education, business and community development, and exports. At the end of 2003, there were $249 billion in Federal direct loans outstanding and $1,184 billion in loan guarantees. Through its insurance programs, the Federal Government insures bank, thrift, and credit union deposits, guarantees private defined-benefit pensions, and insures against other risks such as natural disasters, all up to certain limits.

The Federal Government also enhances credit availability for targeted sectors indirectly through Government-Sponsored Enterprises (GSEs)—privately owned companies and cooperatives that operate under Federal charters. GSEs increase liquidity by guaranteeing and securitizing loans, as well as by providing direct loans. In return for serving social purposes, GSEs enjoy many privileges, which differ across GSEs. In general, GSEs can borrow from Treasury in amounts ranging up to $4 billion at Treasury's discretion, GSEs' corporate earnings are exempt from state and local income taxation, GSE securities are exempt from SEC registration, and banks and thrifts are allowed to hold GSE securities in unlimited amounts and use them to collateralize public deposits. These privileges leave many people with the impression that their securities are risk-free. GSEs, however, are not part of the Federal Government, and their securities are not federally guaranteed. By law, GSE securities carry a disclaimer of any U.S. obligation.

This chapter discusses the roles and risks of these diverse programs and entities in the context of evolving financial markets and assesses their effectiveness and efficiency.

- The first section analyzes the roles of Federal credit and insurance programs. Federal programs play useful roles when market imperfections prevent the private market from efficiently providing credit and insurance. Financial evolution has partly corrected many imperfections and generally weakened the justification for Federal intervention. The roles of Federal programs, however, may still be critical in some areas.
- The second section examines how credit and insurance programs fared with the Program Assessment Rating Tool (PART) and discusses special features of credit programs that may need to be considered in interpreting and refining this tool.
- The third section reviews Federal credit programs and GSEs in four sectors: housing, education, business and community development, and exports. This section discusses program objectives, recent developments, performance, and future plans for each program.
- The final section describes Federal deposit insurance, pension guarantees, disaster insurance, and insurance against terrorism and other security-related risks in a context similar to that for credit programs.

I. FEDERAL PROGRAMS IN CHANGING FINANCIAL MARKETS

The Federal Role

The roles of Federal credit and insurance programs can be broadly classified into two categories: helping disadvantaged groups and correcting market imperfections. Subsidized Federal credit programs redistribute resources from the general taxpayer to disadvantaged regions or segments of the population. Since disadvantaged groups can be assisted through other means, such as direct subsidies, the value of a credit or insurance program critically depends on the extent to which it corrects market imperfections.

In most cases, private lending and insurance businesses efficiently meet societal demands by allocating resources to the most productive uses, and Federal intervention is unnecessary or can even be distortionary. However, Federal intervention may improve the market outcome in some situations.

Insufficient Information. Financial intermediaries promote economic growth by allocating credit to the most productive uses. This critical function, however, may not be performed effectively when there is little objective information about borrowers. Some groups of borrowers, such as start-up businesses, start-up farmers, and students, have limited incomes and credit histories. Many creditworthy borrowers belonging to these groups may fail to obtain credit or be forced to pay excessively high interest. Government intervention, such as loan guarantees, can reduce this inefficiency by enabling these borrowers to obtain credit more easily and cheaply and also by providing opportunities for lenders to learn more about those borrowers.

Externalities. Decisions at the individual level are not socially optimal when individuals do not capture the full benefit (positive externalities) or bear the full cost (negative externalities) of their activities. Examples of positive and negative externalities are education and pollution. The general public benefits from the high productivity and good citizenship of a well-educated person and suffers from pollution. Without Government intervention, people will engage less than socially optimal in activities that generate positive externalities and more in activities that generate negative externalities. Federal programs can address externalities by influencing individuals' incentives.

Limited Ability to Secure Resources. The ability of private entities to absorb losses is more limited than that of the Federal Government, which has general taxing authority. For some events potentially involving a very large loss concentrated in a short time period, therefore, Government insurance commanding more resources can be more credible and effective. Such events include massive bank failures and some natural and man-made disasters that can threaten the solvency of private insurers. Resource constraints can also limit the lending ability of private entities. Small lenders operating in a local market, in particular, may have limited access to capital and occasionally be forced to pass up good lending opportunities.

Imperfect competition. Competition is imperfect in some markets because of barriers to entry, economies of scale, and foreign government intervention. For example, legal barriers to entry or geographic isolation can cause imperfect competition in some rural areas. If the lack of competition forces some rural residents to pay excessively high interest on loans, Government credit programs aiming to increase the availability of credit and lower the borrowing cost for those rural residents may improve economic efficiency.

Effects of Changing Financial Markets

Financial markets have undergone fundamental changes that greatly enhanced competition and economic efficiency. The main forces behind these changes are financial services deregulation and technological advances. Deregulation, represented by the Riegle-Neal Interstate Banking and Branching Act of 1997 and the Financial Services Modernization Act of 1999, has increased competition and prompted consolidation by removing geographic and industry barriers. By increasing the availability of information and lowering transaction costs, technological advances have significantly contributed to enhancing liquidity, refining risk management tools, and spurring globalization. These developments have significant implications for Federal credit and insurance programs.

Financial evolution has generally increased the private market's capacity to serve the populations traditionally targeted by Federal programs, and hence has weakened the role of Federal credit and insurance programs. The private market now has more information and better technology to process it, has better means to secure resources, and is more competitive. To improve the effectiveness of credit and insurance programs, therefore, the Federal Government may focus on more specific objectives that have been less affected by financial evolution and on narrower target populations that still have difficulty in obtaining credit from private lenders. Problems related to externalities, for example, are likely to persist because the price mechanisms that drive the private market will continue to ignore the value of the externality. In addition, the benefits of deregulation and technological advances may have been uneven across populations. The Federal Government also needs to pay more attention to new challenges introduced by financial evolution and other economic developments.

Information about borrowers is more widely available and easier to process, thanks to technological advances. Lenders now have easy access to large databases, powerful computers, and sophisticated analytical models. Thus, many lenders use credit scoring models that evaluate creditworthiness based on various borrower characteristics derived from extensive credit bureau data. As a result, creditworthy borrowers are less likely to be turned down, while borrowers that are not creditworthy are less likely to be approved for credit. The Federal role of improving credit allocation, therefore, is generally not as strong as it once was. The benefit from financial evolution, however, can be uneven across groups and over time. Credit scoring, for example, is still difficult to apply to some borrowers with unique characteristics that are difficult to standardize. In times of economic downturn or financial instability, lenders can be overly cautious, turning away some creditworthy borrowers.

Financial evolution has also alleviated resource constraints faced by private entities. Financial derivatives, such as options, swaps, and futures, have improved the market's ability to manage and share various types of risk such as price risk, interest rate risk, credit risk, and even catastrophe-related risk. An insurer can distribute the risk of a natural or man-made catastrophe among a large number of investors through catastrophe-related derivatives, although the extent of risk sharing in this way is still limited because of the small size of the market for those products. Securitization (pooling a certain type of asset and selling shares of the asset pool to investors) facilitates fund raising and risk management. By securitizing loans, even a lender with limited access to capital can make a large amount of loans, while limiting its exposure to credit and interest risk.

Imperfect competition is much less likely in general. Financial deregulation removed legal barriers to competition. More commercial firms borrow directly in capital markets, bypassing financial intermediaries; the use of commercial paper (short-term financing instruments issued by corporations) has been particularly notable. Nonbank financial institutions, such as finance companies and venture capital firms, have increased their presence, providing more financing alternatives to small, start-up firms that formerly relied heavily on banks. Internet-based financial services have lowered the cost of financial transactions and reduced the importance of physical location. Due to globalization, foreign financial institutions actively compete in the U.S. market. All of these developments have increased competition.

Nevertheless, concerns remain. The removal of geographic barriers spurred consolidation among banks.

Consolidation can negatively affect the markets that were traditionally served by small banks. Large financial institutions with global operations may want to focus more on large customers and business lines that utilize economies of scale and scope more fully, leaving out small borrowers in remote rural areas and inner city areas. Another concern is that nontraditional financing sources, such as commercial paper and venture capital, can become unavailable when they are needed most. For example, commercial-paper issuance by nonfinancial companies and venture capital investments plunged during the last recession. The decreased volume of these instruments may have mostly reflected changed market conditions, such as decreased investment demand. A part of the reason, however, may have been the investors' overreaction to unfavorable market conditions, which could cause financing difficulties for creditworthy firms. Federal credit programs can play useful roles on these occasions.

Overall, the financial market is evolving to be more efficient and safer. Financial evolution and other economic developments, however, are often accompanied by new risks. Federal agencies need to be vigilant to identify and, when appropriate, to manage new risks. Consolidation, for example, has increased bank size. Thus, the failure of even a single large bank can seriously drain the federal deposit insurance fund. As a result of deregulation, banks engage in more activities. While diversification across business lines may generally improve the safety of banks, new businesses introduce new risks. For example, one concern raised recently is that the motive to obtain underwriting business from borrowing firms may have affected lending decisions, undermining loan quality at some large banking organizations. Globalization also has both an upside and a downside. A financial institution with a worldwide operation may overcome difficulties in the U.S. market more easily, but it is more heavily exposed to economic turmoil in other countries, especially those that are less-developed or politically unstable. The large size of some GSEs is also a potential problem. Financial trouble of a large GSE could cause repercussions in financial markets, affecting federally insured entities and economic activity. Three years of stock market declines following the 2000 peak and the slow economic recovery have increased the risk and uncertainty for the pension benefit guaranty program by impairing the financial health of many pension funds and firms offering pension benefits. New and amended insurance programs for security-related risks also make the Federal Government's liability more uncertain. Security-related events such as terrorism and war are highly uncertain in terms of both the frequency of occurrence and the magnitude of potential loss.

II. PERFORMANCE OF CREDIT AND INSURANCE PROGRAMS

The Program Assessment Rating Tool (PART) produces an assessment of the performance of federal programs, which is designed to be consistent across programs. This section analyzes the PART score for credit and insurance programs as a group to identify the strengths and weaknesses of credit and insurance programs. Also discussed are special features of credit programs that may need to be considered in interpreting and refining the common assessment of performance.

PART Scores

The PART classifies performance into four categories (program purpose and design, strategic planning, program management, and program results) and assigns a numerical score (0 to 100 percent) to each category. For the final evaluation, the PART weights the four categories, placing a particularly heavy weight on program results.

There are 14 credit programs and 2 insurance programs among 399 programs that have been rated by the PART (excluding programs that were assessed for the 2004 Budget but are being reassessed as components of a different program in 2005 to avoid double-counting). Overall, the PART scores for credit and insurance programs are fairly similar to those for other programs (see Table "Summary of PART Scores"). When appropriately weighted, higher scores for credit and insurance programs in some categories are roughly offset by lower scores in other categories. A detailed analysis suggests that the dispersion of scores across programs is also similar for the two groups of programs.

Across categories, there are some similarities, as well as differences, between credit and insurance programs and other types of programs. For most programs, the scores are relatively high for program purpose and design and for program management, while the scores are low for program results. This general pattern holds for credit and insurance programs. Relative to other programs, however, credit and insurance programs scored low in program purpose and design and high in program management.

The PART indicates that most credit and insurance programs have clear purposes. Some credit and insurance programs, however, fail to score high in program design. Some are duplicative of other federal programs or private sources, and some have outdated designs due to failure to adapt to changed economic and financial environments. For example, Federal involvement in venture capital financing is difficult to justify, given that the venture capital market has matured.

Regarding strategic planning, many credit and insurance programs reveal the need to improve on setting targets and time frames for their long-term measures, evaluating program effectiveness and improvements on a regular basis, and tying budgets to accomplishment of performance goals.

Program management is a relatively strong area for credit and insurance programs. They are particularly

SUMMARY OF PART SCORES

Programs	Purpose and Design	Strategic Planning	Program Mgmt	Program Results	Rating
ED Student Loan Guarantees	60	75	33	53	Adequate
ED Direct Studen Loans	60	75	33	53	Adequate
ED Perkins Loans	20	50	33	0	Ineffective
SBA Section 504	60	50	100	60	Adequate
SBA Disaster Assistance	100	100	78	73	Moderately Effective
SBA SBIC Venture Capital	60	88	67	60	Adequate
FSA Loan Guarantees	100	63	100	67	Moderately Effective
RHS Community Facilities	80	50	100	33	Results Not Demonstrated
RUS Rural Electric Utility	80	17	90	25	Results Not Demonstrated
RUS Telecommunications	60	50	100	33	Results Not Demonstrated
RBS Business and Industry	80	75	100	33	Adequate
Ex-Im Bank L-T Guarantees	100	86	100	67	Moderately Effective
OPIC Insurance	100	75	100	42	Adequate
OPIC Finance	100	75	100	42	Adequate
Crop Insurance	80	67	86	58	Results Not Demonstrated
National Flood Insurance	90	86	100	67	Moderately Effective
Credit and Insurance Programs					
Average	77	68	83	48	
Standard Deviation	22	20	26	19	
Other Programs (all programs excluding credit and insurance programs)					
Average	85	70	79	47	
Standard Deviation	19	24	19	26	

strong in basic financial and accounting practices, such as spending funds for intended purposes. The financial complexity of credit and insurance programs may have forced program managers to develop better financial management tools. Nevertheless, some credit and insurance programs show weaknesses in more sophisticated financial management, such as cost control. Another weakness for some credit and insurance programs is in collecting and effectively utilizing performance information.

Program results, the most important category of performance, are a weak area for credit and insurance programs, as well as for other programs assessed by the PART. While most credit and insurance programs had some success in achieving short-term performance and efficiency goals, most of them have had trouble making progress toward long-term goals. A more troubling indication from detailed analyses is that many credit and insurance programs have a low PART score for program effectiveness and achieving results. Based on this finding, the managers of credit and insurance programs need to place much more emphasis on results-driven management.

Common Features

Credit programs share many features that distinguish them from other programs. For example, the cost is uncertain because of various risks, such as default risk, prepayment risk, and interest rate risk. Given these risks, risk management is an important aspect of credit programs. Most credit programs are also intended to address imperfections in financial markets. These common features are discussed in the context of the four areas of the PART. Although this section focuses on credit programs, much of the discussion also applies to insurance programs. For example, the cost is uncertain for insurance programs, too, because insured events occur unexpectedly. Financial market imperfections are also the main justification for insurance programs.

In analyzing the PART scores of credit programs, it is important to understand the common features of credit programs. Understanding common features facilitates the comparison of efficiency across credit programs and helps lead to improvements in performance. For example, if the PART score related to a common feature, such as risk management, is particularly low for a credit program, managers of the program may significantly improve performance by emulating the practice of other credit programs. A uniformly low PART score for all credit programs, on the other hand, may indicate that credit programs are facing a unique difficulty. In that case, program managers may need to make collective efforts to identify the difficulty and to address the problem. Individual efforts would be less efficient.

Program purpose and design. Program purposes widely vary across credit programs. They include increasing homeownership, increasing college graduates, promoting entrepreneurship, and promoting exports. The private market serves some of these distinctive purposes better now than it did in the past. Thus, it can be useful to compare the effects of changes in financial markets on the need for various credit programs.

Credit programs share many critical elements of design. Using the common tool, credit, they try to correct imperfections in financial markets. Thus, credit programs mostly target those borrowers who would not be able to obtain credit in the private market without government assistance. In addition, the lending business involves many complexities, such as setting appropriate lending terms, screening borrowers, and monitoring borrowers. Given these complexities, it is important to utilize the private sector's expertise. Targeting the right borrowers and utilizing the private sector's expertise require careful program design, which needs to consider various factors, such as borrowers' incentives, private lenders' incentives, the state of financial markets, and general economic conditions. Excessively low lending rates, for example, might attract many borrowers who could obtain credit from private lenders. To be effective, partnership with the private sector should be designed such that the private partner's profit is closely tied to its performance in achieving the public purpose. Private lenders are generally better at screening borrowers, but their incentive to screen borrowers effectively evaporates if the Government provides a 100-percent loan guarantee. Credit programs with low PART scores related to these aspects of program design may draw useful lessons from the practices of other credit programs.

Strategic planning. Credit programs operate in rapidly changing financial markets. Thus, an important aspect of strategic planning for credit programs is to adapt to changes in financial markets. To achieve the maximum efficiency, program managers need to watch closely and adapt their programs quickly to new developments. For example, private lenders are more willing to serve many customers to whom they did not want to lend in the past. Thus, some Federal credit programs may need to focus more narrowly on customers who are still underserved by private lenders. Quickly adopting new technologies is also important, because financial institutions are increasingly applying advanced technologies to risk management.

Program management. Some elements of program management are more important for credit programs than for other programs. To address these areas of special interest, the PART adds two extra items for credit programs: risk management and estimation models. Credit programs face similar risks in the lending business. To minimize the risks, program managers must carefully manage the loan portfolio that is held either directly or by private lenders. Once a loan defaults, effective collection efforts can reduce the loss. Estimating the program cost is a critical feature of credit programs. The cashflow is uncertain for credit programs. Some loans default, while some others are prepaid. The program cost must be estimated based on the expected default, prepayment, and recovery rates. This estimation is critical for program evaluation. Without knowing the cost, one cannot tell if a program is effective.

Some other management issues that apply to all government programs are particularly important for credit programs. Data collection is essential for effective risk management and cost estimation. Effective risk management requires accurate and timely information. Default and prepayment histories are key ingredients in cashflow estimation. In addition, accurate estimation requires detailed data on borrower and lender characteristics. Thus, managers of credit programs need to make extensive efforts to collect and process relevant information. To achieve efficiency and effectiveness, it is also important to have well organized procedures and to coordinate with other credit programs to carry out many complex functions, such as loan origination, loan servicing, lender monitoring, and collection of defaulted loans. Financial management is more challenging for credit programs because of the complex structure of cashflows.

Program Results. The main difficulty in evaluating program performance is to measure the net outcome of the program (improvement in the intended outcome net of what would have occurred in the absence of the program). For example, although many Federal programs help college students, it is difficult to tell how many of those would not have obtained a college education without Federal assistance. For credit programs, this difficulty is compounded by the uncertainty of the program cost. In evaluating programs, the outcome must be weighed against the cost. For a program intended to increase the number of college graduates, the relevant statistic is the number of college graduates due to the program per dollar spent by the program, not just the total number of college graduates produced by the program. For credit programs, the validity of this evaluation critically depends on the accuracy of the cost estimation. An underestimation (overestimation) of the cost would make the program appear unduly effective (ineffective). Thus, results for credit programs need to be interpreted in conjunction with the accuracy of the cost estimate. In some cases, whether a program's performance has improved over the past may be more meaningful than whether it performs better than others.

It is also important to evaluate credit programs in the context of changing financial markets. The financial sector is very dynamic, and the net outcome of a credit program may change quickly with the state of financial markets. The net outcome can decrease, as private entities become more willing to serve those customers whom they were reluctant to serve in the past, or it can increase if financial markets fail to function smoothly due to some temporary disturbances. A subpar performance by a credit program could be related to financial market developments; the program might fail to adapt to rapid changes in financial markets, or its function might become obsolete due to financial evolution. The program should be restructured in the former case, and discontinued in the latter case.

III. CREDIT IN FOUR SECTORS

Housing Credit Programs and GSEs

The Federal Government makes direct loans, provides loan guarantees, and enhances liquidity in the housing market to promote homeownership among low- and moderate-income people and to help finance rental housing for low-income people. While direct loans are largely limited to low-income borrowers, loan guarantees are offered to a much larger segment of the population, including moderate-income borrowers. Increased liquidity achieved through GSEs benefits virtually all borrowers in the housing market.

Federal Housing Administration

In June 2002, the President issued America's Homeownership Challenge to increase first-time minority homeowners by 5.5 million through 2010. During the first 15 months since the goal was announced, over one million minority families have become homeowners, setting a pace to exceed this goal. HUD's Federal Housing Administration (FHA) accounted for over 250,000 of these first-time minority homebuyers through its insurance funds, mainly the Mutual Mortgage Insurance Fund. FHA mortgage insurance provides access to homeownership for people who lack the financial resources or credit history to qualify for a conventional home mortgage. In 2003, FHA insured $159 billion in mortgages for over 1.3 million households. Most of these were people buying their first homes, many of whom were minorities. The dollar volume of FHA mortgages exceeded the 2002 volume by seven percent, driven by high housing demand and increased refinancings in response to lower interest rates.

For fiscal year 2005, FHA is proposing two new mortgage programs that reduce the biggest barriers to homeownership—the down payment and impaired credit. The Zero Down mortgage allows first-time buyers with a strong credit record to finance 100 percent of the purchase price and closing costs. For borrowers with limited or weak credit histories, Payment Rewards initially charges a higher insurance premium, but reduces the borrower's premiums once they have established a history of regular payments, thereby demonstrating their creditworthiness.

The Budget expands HUD's support for new homeowners by increasing funds for pre- and post-purchase housing counseling services through a network of counseling agencies. At the proposed funding level, almost 800,000 potential and existing homeowners will receive counseling in 2005.

The President's Management Agenda sets out several critical tasks for FHA to complete to combat fraud and improve risk management. In 2005, as in 2004, HUD will conduct quarterly rounds of Credit Watch—a lender monitoring program that rates lenders and underwriters by the performance of their loans and allows FHA to sever relationships with those showing poor performance. HUD also will have in place an automated system to enforce its regulations prohibiting the predatory practice of property flipping and will refine the Appraiser Watch system established in 2003 in order to closely monitor appraiser performance and hold appraisers accountable for the quality of their work. These efforts will reduce the possibility of improperly originated FHA loans that victimize the borrower and expose FHA to excessive losses.

VA Housing Program

The Department of Veterans Affairs (VA) assists veterans, members of the Selected Reserve, and active duty personnel to purchase homes as recognition of their service to the Nation. The program substitutes the Federal guarantee for the borrower's down payment. In 2003, VA provided $66 billion in guarantees to assist 508,436 borrowers. Both the volume of guarantees and the number of borrowers increased substantially from 2002 as lower interest rates increased loan originations and refinancings in the housing market.

Since the main purpose of this program is to help veterans, lending terms are more favorable than loans without a VA guarantee. In particular, VA guarantees zero down payment loans. The subsidy rate decreased due to an improved default rate methodology that more appropriately recognizes the relationship between defaults and interest rates.

In order to help veterans retain their homes and avoid the expense and damage to their credit resulting from foreclosure, VA plans aggressive intervention to reduce the likelihood of foreclosures when loans are referred to VA after missing three payments. VA was successful in 45 percent of its 2003 interventions, and its goal is to achieve at least a 47 percent success rate in 2005. VA is continuing its efforts to reduce administrative costs through restructuring and consolidations.

In order to refocus VA's housing loan program towards its original intent of serving as a readjustment benefit from military to civilian life, the Administration will be transmitting legislation that would limit eligibility for veterans' housing loans to one-time use in lieu of the lifetime multi-use entitlement it has become. For those who are already veterans upon enactment of this bill, the proposal allows unlimited usage for the next five years, and then only once thereafter. The proposal would not limit use by active duty members.

Rural Housing Service

The U.S. Department of Agriculture's (USDA's) Rural Housing Service (RHS) offers direct and guaranteed loans and grants to help very low- to moderate-income rural residents buy and maintain adequate, affordable housing. The single family guaranteed loan program guarantees up to 90 percent of a private loan for low to moderate-income rural residents. The program's emphasis is on reducing the number of rural residents living in substandard housing. In 2003, $3.1 billion of guarantees went to 31,100 households, of which 30 percent went to very-low and low-income families (with income 80 percent or less than median area income).

In 2002, RHS approved separate risk categories for guarantee refinancing (refis) and guarantees of new loans. As part of that change, RHS also reduced the guarantee fee to 0.5 percent for the refis. This change reflected the lower risk on refis as compared to an unseasoned borrower receiving a new loan. It is also consistent with the rate HUD and VA charge on their refis of similar loans. For 2005, RHS will increase the guarantee fee on new loans to 1.75 percent from 1.5 percent. This will be coupled with language that would allow the guarantee fee to be financed as part of the loan. The ability to finance the guarantee fee is more in line with the housing industry, including HUD and VA, and will allow more lower income rural Americans to realize the dream of home ownership.

In 2003, RHS continued to enhance a web-based system that will, with future planned improvements, provide the capacity to accept electronic loan originations from their participating lenders. RHS is also continuing development of an automated underwriting system (AUS) that will add significant benefits to loan processing efficiency, consistency and timeliness for RHS, the lenders, and customers. RHS continues to operate under the "best practice" for asset disposition for its guaranteed loan program. For single family guarantees, the lender is paid the loss claim, including costs incurred for up to three months after the default. After the loss claim is paid, RHS has no involvement in the property, and it becomes the sole responsibility of the lender for disposition. RHS is also developing the capacity to partner with lenders to seek recovery of loss claims from the former homeowner. They are also in the process of centralizing and automating the loss claim process to improve consistency and efficiency.

RHS programs differ from other Federal housing loan guarantee programs. RHS programs are means-tested and more accessible to low-income, rural residents. In addition, the RHS direct loan program offers deeper assistance to very-low-income homeowners by reducing the interest rate down to as low as 1 percent for such borrowers. The program helps the "on the cusp" borrower obtain a mortgage, and requires graduation to private credit as the borrower's income and equity in their home increases over time. The interest rate depends on the borrower's income. Each loan is reviewed annually to determine the interest rate that should be charged on the loan in that year based on the borrower's projected annual income. The program cost is balanced between interest subsidy and defaults. For 2005, RHS expects to provide $1.1 billion in loans with a subsidy cost of 11.58 percent.

RHS also offers multifamily housing loans, which includes farm labor housing loans. Direct loans are offered to private developers to construct and rehabilitate multi-family rental housing for very-low to low-income residents, elderly households, or handicapped individuals. As an incentive to the developers to provide low income rental housing in rural areas, these loans are heavily subsidized; the interest rate is between 1 and 2 percent. RHS rental assistance grants supplement the loan to the developer in the form of project based rent subsidies for very low-income rural households (for continuation of this assistance plus new commitments, the cost will be $592 million in 2005). RHS will address management issues in its multifamily housing portfolio in 2005 by restricting the $60 million loan level to repair and rehabilitation of its existing portfolio (17,400 projects, 446,000 units). Farm labor housing will have a program level of $59 million and will provide for new construction as well as repair/rehabilitation. RHS also offers guaranteed multifamily housing loans with a loan level of $100 million a year.

Housing GSEs

Three organizations were chartered by Congress to increase the flow of credit for housing. These government-sponsored enterprises (GSEs) are privately owned companies; the shares of two of them are listed on the New York Stock Exchange. They receive special benefits as a result of their Government sponsorship, including exemption from State and local taxes. Their missions are to increase the liquidity and improve the distribution of mortgage financing, particularly for low- and moderate-income borrowers. Two of the GSEs, Fannie Mae and Freddie Mac, primarily accomplish this mission by guaranteeing mortgages for sale as securities to investors. The third GSE, the Federal Home Loan Bank System, provides loans at preferred rates to member financial institutions. The three GSEs have grown significantly since they were chartered decades ago and are now three of the largest financial companies in the world.

The GSEs are increasingly in the asset management business, growing significant portfolios of mortgages

GROWTH OF THE GSEs IN THE LAST DECADE

Dollars in millions

	Balance Sheet Assets		Change	Balance Sheet Liabilities		Change
	1992	2002		1992	2002	
Fannie Mae	$ 172,055	$ 887,515	416%	$ 163,602	$ 871,227	433%
Federal Home Loan Bank System	$ 161,834	$ 763,631	372%	$ 151,210	$ 727,307	381%
Freddie Mac	$ 62,739	$ 752,249	1099%	$ 59,281	$ 718,610	1112%
Total	$396,628	$2,403,395	506%	$374,093	$2,317,144	519%

Note: Freddie Mac data not audited. Freddie Mac liabilities exclude minority interest in consolidated subsidiaries.

and mortgage-backed securities. The GSEs are highly leveraged, holding much less capital in relation to their assets than similarly sized financial institutions. A consequence of that highly leveraged condition is that a misjudgment or unexpected economic event could quickly deplete this capital, potentially making it difficult for a GSE to meet its debt obligations. Given the very large size of each enterprise, even a small mistake by a GSE could have consequences throughout the economy. More than six out of ten institutions in the banking industry hold as assets GSE debt in excess of 50 percent of their equity capital. As shown in the accompanying table (Growth of the GSEs in the Last Decade), the outstanding liabilities of the GSEs have grown by more than five hundred percent since 1992, to $2.3 trillion at the end of December 2002. For comparison, the privately held debt of the Federal Government at that time was $3.0 trillion.[1] In 2003, the Office of Federal Housing Enterprise Oversight (OFHEO), which oversees the safety and soundness of Fannie Mae and Freddie Mac, studied the risks posed by these GSEs to the financial system. Its study indicated that should a GSE experience large unexpected losses, the market for its and other GSEs' debt might become illiquid. Institutions holding this debt would see a rapid depletion in the value of their assets and a loss of liquidity, spreading the problems of the GSEs into financial sectors beyond the housing market.

Freddie Mac. In 2003, serious accounting problems surfaced at Freddie Mac, leading its Board of Directors in June to remove the company's top management, including its Chairman and CEO, its President and COO, and its Chief Financial Officer. This triggered multiple lawsuits on behalf of investors, and investigations by OFHEO, the Securities and Exchange Commission, and the Department of Justice, some still underway. The company restated its earnings, both up and down, over the period 2000–2002. OFHEO reported that Freddie Mac misstated its financial results and assessed Freddie Mac a monetary penalty of $125 million. The magnitude of the accounting restatement was large. The net impact is a cumulative increase of $5 billion in reported earnings over 2000–2002, which will result in a decrease in reported earnings in future years. Most of these amounts are linked to changes in the valuation of derivative financial instruments under relatively new accounting standards. The $5 billion increase in earnings represented over twenty percent of Freddie Mac's total capital available to cover losses and illustrates why an error by a GSE, intentional or not, may pose risks to investors. To date, Freddie Mac has made progress towards, but has not achieved, accurate and timely financial reporting and controls. Freddie Mac expects to provide an annual report for 2002 in the first quarter of 2004. Freddie Mac expects to publish 2003 results by June 2004.

Fannie Mae. Fannie Mae reported an accounting error in November 2003, requiring it to file a correction with the Securities and Exchange Commission. The correction of Fannie Mae's reported balance sheet showed a change of over $1 billion in shareholders' equity. The company reported that the error was unintentional, the result of a computational mistake made when implementing a new accounting standard. OFHEO has begun an investigation of the accounting practices at Fannie Mae.

Federal Home Loan Bank System. The Federal Home Loan Bank System, a cooperative of twelve regional banks that issue debt for which all are jointly and severally liable, suffered a significant decline in profits in 2003, primarily stemming from investment losses and a failure to hedge interest rate risk adequately at several Federal Home Loan Banks. As a result, one ratings organization downgraded its outlook for some individual banks of the 12-bank System.

The Administration stated in September and October 2003 that the Government's supervisory system for the three housing GSEs has neither the tools nor the stature to deal effectively with the current size, complexity, and importance of these companies. Department of the Treasury Secretary John Snow and then Department of Housing and Urban Development (HUD) Secretary Mel Martinez proposed a set of reforms on behalf of the Administration to give housing finance a regulatory framework as strong as those in place for other financial sectors. The reforms follow the principles accepted throughout the world as requirements for first-class regulation, based on a three-pronged regulatory approach: strong market discipline, effective supervision, and adequate capital requirements.

Market discipline. Chief among the factors that guide a company in its decision-making is the discipline imposed by the market. Market participants can signal to a company that it is making risky choices, for example, by charging the company more to borrow, or paying less for its stock. This discipline places constraints on companies. As Federal Reserve Chairman Alan Greenspan has noted, however, market discipline is not as strong for the GSEs as it is for other private companies. Some mistakenly perceive that GSE securities are backed by the Government—despite the fact that the Government explicity does not guarantee their securities. In both domestic and international markets, therefore, investors pay a premium for GSE debt by accepting a relatively low rate of return. As a result, the enterprises are able to finance their activities at a lower cost than others. The Congressional Budget Office estimated that in 2002 the value of the resulting subsidy exceeded $15 billion per year.

Market discipline also is hindered because GSE investors do not enjoy the same level of disclosure, or oversight of disclosures, as investors in fully private companies. The GSEs have a statutory exemption from the registration and disclosure requirements of the Securities and Exchange Commission (SEC). Recognizing this disadvantage to GSE investors, the Administration in 2002 called upon the three housing GSEs to register voluntarily their equity securities under the 1934 Secu-

[1] Privately held debt differs from debt held by the public (the measure generally used in the budget) by not including the Federal debt held by the Federal Reserve Banks.

rities Exchange Act, triggering mandatory SEC disclosures. To date, only Fannie Mae has complied, registering with the SEC in March 2003. Freddie Mac does not anticipate being in compliance until 2005, and the Federal Home Loan Bank System has not committed to comply voluntarily. The Federal Housing Finance Board has proposed a rule that would require each Federal Home Loan Bank to register voluntarily with the SEC under the 1934 Securities Exchange Act. Mandatory SEC disclosures would improve market discipline, and additional disclosures might further enhance investor awareness of and discipline over the GSEs' risk-taking.

Market discipline also requires that a company be controlled by those who represent the best interests of its owners. An independent Board of Directors, therefore, is essential. A board unduly influenced by the company's management may have reason not to provide investors timely and adequate information. In 2002, the President established a 10-point plan for corporate governance practices that emphasized the importance of corporate board independence. In addition, the Administration proposed in 2003 to eliminate the Presidential appointees to the Fannie Mae and Freddie Mac Boards.

Supervision. An effective financial regulator must possess authorities and capabilities commensurate with its responsibilities. The Administration has determined that the safety and soundness regulators of the housing GSEs lack sufficient powers and stature to meet their responsibilities, and therefore that both OFHEO, regulator of Fannie Mae and Freddie Mac, and the Federal Housing Finance Board, regulator of the Federal Home Loan Bank System, should be replaced with a new, strengthened regulator.

The Administration has proposed a new regulator, empowered with expanded enforcement authorities, independent litigation authority, receivership authority, and control over its funding levels independent of Congressional appropriations. It regards such authorities as essential to a world-class regulator.

A new regulator must have full authority together with accountability for the prudential supervision of the enterprises, which includes the authority to approve new activities of the enterprises. Under current law, the responsibility for new program approval of Fannie Mae and Freddie Mac has been split between OFHEO, an independent agency within HUD, and HUD itself. Neither, therefore, is fully accountable for this key element of effective supervision of these two large and complex entities. The Administration's proposal would remedy this by establishing a single new regulator with consolidated responsibility for the prudential operation of Fannie Mae, Freddie Mac, and the Federal Home Loan Banks, as well as authority to review their ongoing business activities and reject new ones proposed by the GSEs, if they would be inconsistent with the charter or prudential operations of the GSEs, or incompatible with the public interest. HUD would continue to be consulted on new activities.

A new regulator must have the stature to avoid regulatory capture, i.e., undue influence by the entities it regulates. This is difficult for a regulator of a small number of very large entities. The Administration proposes placing the new regulator within the Department of the Treasury to provide the necessary stature and other supervisory benefits, provided the Department is given adequate oversight authority. The Administration, however, does not support an outcome that would create the illusion of greater oversight by the Treasury without the authority to make it a reality.

Capital requirements. Because neither investors nor regulators can predict all of the impacts of possible errors by a company or unexpected economic changes, requirements that ensure that the GSEs hold capital adequate to cushion such shocks are essential. Capital requirements must be set with an eye to both known risks and unknown or unquantifiable risks. Losses from these latter risks can well exceed losses from measured risks, as shown by the rapid depletion of capital in 1998 for the highly leveraged hedge fund, Long-Term Capital Management. For this reason, it is essential that the new regulator of the housing GSEs have ongoing authority to adjust both risk-based and minimum capital requirements. The accompanying table (Capital Held by the GSEs and 10 of the Largest U.S. Financial Institutions) contrasts the capital held by the GSEs with that held by similarly sized financial institutions. On average, the GSEs hold less than one-half the capital of these other companies.

Risks, and how they are measured, evolve over time. The Administration proposes to give the new GSE regulator full flexibility to establish risk-based capital standards. The current risk-based capital standards for Fannie Mae and Freddie Mac are rigidly defined by a 10-year old statute. The risk-based capital standards for the Federal Home Loan Bank System, while more flexible, have not been fully implemented.

Affordable housing mission. As noted above, many investors perceive an implicit guarantee of GSE securities by the Government, and convey a large subsidy to the GSEs by paying a premium for their securities. Fannie Mae and Freddie Mac purchase two-thirds of all single-family mortgages originated (non-governmental, non-jumbo). With this large subsidy, and with their substantial market share, the GSEs conceivably could have a considerable impact on lowering mortgage costs. Yet the Congressional Budget Office estimated in 2001 that Fannie Mae and Freddie Mac lower mortgage rates by no more than 25 basis points, or one-quarter of one percentage point. A 2003 working paper by a member of the Federal Reserve Board staff estimates that the two GSEs lower mortgage rates by an even smaller amount. At the higher estimate of 25 basis points, a homeowner saves about $25 on the monthly payment for a median-priced $160,000 thirty-year mortgage. One reason the effect is not larger is that Fannie Mae and Freddie Mac do not pass through the entire subsidy to mortgage borrowers. According to CBO, 37 percent is retained by the companies, their executives,

CAPITAL HELD BY THE GSEs AND 10 OF THE LARGEST U.S. FINANCIAL INSTITUTIONS

(Dollars in millions; December 31, 2002)

Companies ranked by assets	Balance Sheet Assets	Stock-holders' Equity	Capital Ratio: Equity to Assets
Citigroup Inc	$1,097,190	$86,718	7.9%
Fannie Mae	$887,515	$16,288	1.8%
Federal Home Loan Bank System	$763,631	$36,324	4.8%
JP Morgan Chase & Co	$758,800	$42,306	5.6%
Freddie Mac	$752,249	$31,330	4.2%
Bank of America Corp	$660,458	$50,319	7.6%
Wells Fargo & Co	$349,259	$30,358	8.7%
Wachovia Corp	$341,839	$32,078	9.4%
Bank One Corp	$277,383	$22,440	8.1%
Washington Mutual Inc	$268,298	$20,134	7.5%
FleetBoston Financial Corp	$190,453	$16,833	8.8%
US Bancorp	$180,027	$18,101	10.1%
American Express Company	$157,253	$13,861	8.8%
Average all companies	....	....	7.2%
Average GSEs	....	....	3.6%
Average excluding GSEs	....	....	8.2%

Notes: In addition to GSEs, this table includes the ten largest publicly traded U.S. companies in the finance industry, in terms of balance sheet assets, excluding insurance companies and security brokers and dealers. Capital defined as stockholders' equity. Financial regulators may use an alternative definition of capital.

Data sources: Securities and Exchange Commission public filings, Federal Home Loan Bank System Office of Finance, and Freddie Mac. Freddie Mac data not audited.

shareholders, or other stakeholders. Current market and regulatory mechanisms are not sufficient to force the GSEs to pass on greater savings to borrowers.

To encourage the GSEs to use their Government sponsorship to benefit those less likely to have access to mortgage credit and households with moderate or low incomes, the governing statutes require them to address affordable housing needs. For Fannie Mae and Freddie Mac, HUD is required to set and enforce annual housing goals. These require that a certain percentage of the two companies' mortgage purchases be mortgages for low- and moderate-income borrowers or from geographic areas that have been underserved by the market. For the Federal Home Loan Bank System, the Federal Housing Finance Board enforces a requirement to dedicate 10 percent of the System's profits to affordable housing and to provide subsidized loans to members' community investment programs. Given the different methods used to convey affordable housing subsidies, comparing the relative efforts of the Federal Home Loan Bank System with Fannie Mae and Freddie Mac is not simple. Comprehensive research in this area has not been undertaken. Such a comparative analysis would be useful to policy makers and GSE regulators.

The Administration has identified weaknesses in the system for setting and enforcing the affordable housing goals for Fannie Mae and Freddie Mac. These weaknesses could result in their failure to perform the targeted housing mission for which they were created. For example, HUD needs new administrative authority to enforce the goals. Current law does not permit the Secretary to impose timely and appropriate penalties for a GSE's failure to meet a goal. This authority is necessary to ensure that the goals are strict requirements that the GSEs must meet.

The Administration also has proposed that these two GSEs be required to meet a national home purchase goal, a tool specifically to promote affordable homeownership, particularly for first-time homebuyers. This goal would ensure that the GSEs' activities support home purchases, even in years when refinance activity is high. Although Fannie Mae and Freddie Mac provide liquidity in the refinance market, the share of funding they provide for home purchases declines during years when many mortgages are refinanced.

HUD has conducted analyses showing that private lenders operating without the benefits and subsidies enjoyed by the GSEs contribute more to affordable housing than do Fannie Mae and Freddie Mac. For example, during 1999–2002, home loans for low- and moderate-income families accounted for 44.3 percent of all home purchase mortgages originated by lenders in the conventional conforming market. Yet these loans accounted for only 42.5 percent of Fannie Mae's purchases and 42.3 percent of Freddie Mac's purchases. The GSEs particularly lag the market in funding first-time homebuyers. First-time homebuyers accounted for 26.5 percent of each GSE's purchases of mortgages used to buy homes, compared with 37.6 percent of home purchase mortgages originated in the conventional conforming market.

The GSEs' risk management affects not only their owners and investors, but the entire financial system. Despite their Government sponsorship and mission, the GSEs do not lead the market in creating homeownership opportunities for less advantaged Americans. The

Administration's proposed reforms to the supervisory system for the GSEs address these problems by promoting a strong and resilient financial system, while increasing opportunities for affordable housing and homeownership.

Education Credit Programs and GSEs

The Federal Government guarantees loans through intermediary agencies and makes direct loans to students to encourage post-secondary education. The Student Loan Marketing Association (Sallie Mae), a GSE, makes secondary market purchases of guaranteed student loans from banks and other eligible lenders.

Student Loans

The Department of Education helps finance student loans through two major programs: the Federal Family Education Loan (FFEL) program and the William D. Ford Federal Direct Student Loan (Direct Loan) program. Eligible institutions of higher education may participate in one or both programs. Loans are available to students regardless of income. However, borrowers with low family incomes are eligible for loans with additional interest subsidies. For low-income borrowers, the Federal Government subsidizes loan interest costs while borrowers are in school, during a six-month grace period after graduation, and during certain deferment periods.

In 2005, nearly 9 million borrowers will receive over 14.5 million loans totaling over $85 billion. Of this amount, nearly $57 billion is for new loans, and the remainder reflects the consolidation of existing loans. Loan levels have risen dramatically over the past 10 years as a result of rising educational costs and an increase in eligible borrowers.

The FFEL program provides loans through an administrative structure involving over 3,500 lenders, 36 State and private guaranty agencies, roughly 50 participants in the secondary market, and approximately 6,000 participating schools. Under FFEL, banks and other eligible lenders loan private capital to students and parents, guaranty agencies insure the loans, and the Federal Government reinsures the loans against borrower default. In 2005, FFEL lenders will disburse over 11 million loans totaling almost $65 billion in principal, roughly a third of which involve consolidations of existing loans. Lenders bear two percent of the default risk, and the Federal Government is responsible for the remainder. The Department also makes administrative payments to guaranty agencies and, at certain times, pays interest subsidies on behalf of borrowers to lenders.

The William D. Ford Direct Student Loan program was authorized by the Student Loan Reform Act of 1993. Under the Direct Loan program, the Federal Government provides loan capital directly to more than 1,100 schools, which then disburse loan funds to students. In 2005, the Direct Loan program will generate more than 3.5 million loans with a total value of nearly $21 billion, including over $6 billion in consolidations of existing loans. The program offers a variety of flexible repayment plans including income-contingent repayment, under which annual repayment amounts vary based on the income of the borrower and payments can be made over 25 years with any residual balances forgiven.

The Congress is currently considering legislative reforms to both FFEL and DL as part of this year's Higher Education Act reauthorization. These reforms come at a critical time with college costs continuing to rise at increasing rates and the widening gap between the number of high income and low income students that attend college. The President's Budget proposes several legislative changes to the student loan programs to help make college more affordable for millions of students while making both student loan programs more cost efficient. To help students meet rising tuition costs, the Budget proposes to increase loan limits for first year students, retain variable interest rates beyond 2006 so students can continue to take advantage of historically low interest rates, expand borrower repayment options, and increase loan forgiveness for highly qualified teachers who teach math, science, or special education for five years in high-need schools. To fund these changes, the Administration proposes to reduce program costs through modest changes to lender subsidies and Guaranty Agency fees. For example, the Budget proposes to eliminate an expensive loophole that provides lenders with a federally financed 9.5% guaranteed return on loans that are tied to out-dated tax exempt bonds.

The Administration's proposed changes are consistent with the PART findings for the student loan programs, which found that program benefits were not well targeted to student borrowers while they are attending school. The PART also found that both programs could meet their goals in a more cost effective manner if financial benefits for program participants were more closely tied to market realities. The PART generated specific proposals for addressing these areas, many of which are included in the HEA reforms package in the President's Budget.

Sallie Mae

The Student Loan Marketing Association (Sallie Mae) was chartered by Congress in 1972 as a for-profit, shareholder-owned, Government-sponsored enterprise (GSE). Sallie Mae was reorganized in 1997 pursuant to the authority granted by the Student Loan Marketing Association Reorganization Act of 1996. Under the Reorginization Act, the GSE became a wholly owned subsidiary of SLM Corporation and must wind down and be liquidated by September 30, 2008. In January 2002, the GSE's board of directors announced that it expects to complete dissolution of the GSE by September 30, 2006. The Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 allows the SLM Corporation to affiliate with a financial institution upon the approval of the Secretary of the Treasury. Any affiliation will require SLM Corporation to dissolve the GSE within two years of the affiliation date (unless such period is extended by the Department of the Treasury).

Sallie Mae makes funds available for student loans by providing liquidity to lenders participating in the FFEL program. Sallie Mae purchases guaranteed student loans from eligible lenders and makes warehousing advances (secured loans to lenders). Generally, under the privatization legislation, the GSE cannot engage in any new business activities or acquire any additional program assets other than purchasing student loans. The GSE can continue to make warehousing advances under contractual commitments existing on August 7, 1997. SLM Corporation and its affiliates, including the GSE, currently hold approximately 38 percent of all outstanding guaranteed student loans.

Business and Rural Development Credit Programs and GSEs

The Federal Government guarantees small business loans to promote entrepreneurship. The Government also offers direct loans and loan guarantees to farmers who may have difficulty obtaining credit elsewhere and to rural communities that need to develop and maintain infrastructure. Two GSEs, the Farm Credit System and the Federal Agricultural Mortgage Corporation, increase liquidity in the agricultural lending market.

Small Business Administration

The Small Business Administration (SBA), created in 1953, helps entrepreneurs start, sustain, and grow small businesses. As a "gap lender" SBA works to supplement market lending and provide access to credit where private lenders are reluctant to do so without a Government guarantee. Additionally, SBA assists home- and business-owners cover the uninsured costs of recovery from disasters.

The 2005 Budget requests $326 million, including administrative funds, for SBA to leverage nearly $25 billion in financing for small businesses and disaster victims. The 7(a) General Business Loan program will support $12.5 billion in guaranteed loans—a more than 25 percent increase over 2004—while the 504 Certified Development Company program will support $4.5 billion in guaranteed loans. SBA will supplement the capital of Small Business Investment Companies (SBICs), which provide equity capital and long-term loans to small businesses, with up to $7 billion in participating securities and guaranteed debentures.

To continue to serve the needs of small businesses, SBA will focus program management in three areas:

1) Targeting economic assistance to the neediest small businesses

SBA seeks to target assistance more effectively to credit-worthy borrowers who would not be well-served by the commercial markets in the absence of a Government guarantee to cover defaults. SBA is actively encouraging financial institutions to increase lending to start-up firms, low-income entrepreneurs, and borrowers in search of financing below $150,000. Preliminary evidence shows that SBA's outreach for the 7(a) program has been successful. Average loan size has decreased from $258,000 in 2000 to $167,000 in 2003, while the number of small businesses served has grown from 43,748 to 67,306 during the same time period. In addition, SBA issued new regulations for the Section 504 program that foster additional competition among intermediaries, thereby allowing borrowers greater access to loans.

2) Improving program and risk management

Improving management by measuring and mitigating risks in SBA's $45 billion business loan portfolio is one of the agency's greatest challenges. As the agency delegates more responsibility to the private sector to administer SBA guaranteed loans, oversight functions become increasingly important. SBA established the Office of Lender Oversight, which is responsible for evaluating individual SBA lenders. This office has made progress in employing a variety of analytical techniques to ensure sound financial management by SBA and to hold lending partners accountable for performance. These analytical techniques include financial performance analysis, industry concentration analysis, portfolio performance analysis, selected credit reviews, and credit scoring to compare lenders' performance. The oversight program is also developing on-site safety and soundness examinations and off-site monitoring of Small Business Lending Companies (SBLCs) and compliance reviews of SBA lenders. In addition, the office will develop incentives for lenders to minimize defaults and to adopt sound performance measures.

Improving risk management also means improving SBA's ability to more accurately estimate the cost of subsidizing small businesses. During 2003, the SBA followed through on its commitment to improve its accuracy in estimating the cost of the Section 7(a) General Business Loan program by developing a loan-level econometric credit and reestimate model for the program. The improved model should help SBA avoid repeating its experience during the 1990's, when subsidy costs for the 7(a) program were overestimated by $1 billion. (These subsidy overestimates, however, were significantly offset by program administrative costs during the same period.) More recent analysis, using the new model, shows that during the last few years the 7(a) program has cost almost $230 million more than previously estimated. Building upon the 7(a) modeling improvements, a comparable model was developed for the 2005 subsidy estimates for the Section 504 loan program.

Improving risk management is especially important for the Small Business Investment Company (SBIC) venture capital program. Like the private venture capital market, performance in the SBIC program began to decline in 2000. The SBIC program is now expected to cost taxpayers approximately $2 billion due to defaults and other cash loses. In addition to the overall market decline, the poor performance in the SBIC program is due to the following structural flaws.

- The Federal Government's financial returns are not proportional to its investment. SBA invests up to two-thirds of total funds but, on average, receives only about ten percent of SBICs' profits. Ninety percent of those profits were generated by only 14 of 170 SBICs licensed in the Participating Securities program since 1994.
- SBICs do not have adequate incentives to pay back funds expeditiously to the Government. Under the current statute, SBICs make "profit" payments to SBA but these are generally insufficient to repay the original principal investment in a timely manner which extends SBA's risk exposure.
- The prior subsidy model underestimated the cost of the program. The technical assumptions (e.g., defaults, recoveries, and profits) have turned out to be more optimistic than actual program performance.

The 2005 Budget takes steps to address the first of these issues by proposing to increase borrowers' fees and SBA's share of profits in the SBIC Participating Securties program. The Budget also proposes to accelerate repayments to the Government. In addition, the subsidy model for the Participating Securities program has been improved by incorporating more realistic technical assumptions, which are generally based upon historical experience. During 2004, SBA expects to reexamine the methodology used to calculate the cost to subsidize the SBIC Participating Securities program. With realized and projected losses of about $2 billion (reflected in an upward mandatory subsidy reestimate) on an outstanding portfolio of about $5 billion, these steps are critical if the program is to be fiscally sound and not rely on large taxpayer subsidies.

SBA is improving oversight and accounting practices of its Secondary Market Guarantee (SMG) program for 7(a) guaranteed loans. To properly manage any risk associated with this fund which is authorized under section 5(g) of the Small Business Act, SBA is budgeting for the Government's liability in accordance with the Federal Credit Reform Act. In accordance with the commitment that SBA made last year, it refined its estimate of the Government's liability for the program, which is reflected in the $105 million upward mandatory reestimate cost in the 2005 budget. Due to reforms that are being implemented in 2004, this program will not require discretionary subsidy appropriations to operate in 2005.

In 1999, SBA initiated an asset sales program as a means of improving portfolio management and curtailing the growing level of assets—primarily disaster loans—serviced by SBA. More than $5 billion in direct and repurchased (defaulted) guaranteed loans were sold to investors in seven separate sales through 2002. These assets were sold to private sector buyers without any recourse for future default claims or interest supplements from the Government. While the sales reduced loan management burdens on SBA, discrepancies eventually appeared between accounting and budgetary records; the agency's financial statements indicated losses on the program of $1.8 billion while the model used to value loans for purposes of sales showed gains of approximately $800 million. SBA and the General Accounting Office attempted to identify the source of the discrepancies in early 2002, but neither was able to explain the inconsistencies. As a result, SBA assembled a team of financial experts and undertook a detailed review of the financial records relating to the program between October 2002 and February 2003. The assessment revealed three sources of discrepancies. First, accounting entries overstated loan values and did not fully reconcile to subsidy estimates. Second, the agency's credit subsidy model, which assessed costs at an aggregate program level, did not always provide reliable loan cost estimates. Third, the model used to provide individual loan values for asset sales significantly underestimated the worth of those assets and did not reconcile to the subsidy model. Because of the findings, SBA halted its eighth sale scheduled for April 2003 and all subsequent sales. In addition, SBA has adjusted its accounting records and developed a single new loan-level credit model that can also determine the value of individual loans proposed for sale. Adjustments in the financial records have revealed that selling repurchased SBA guaranteed loans was profitable, while the sale of performing disaster loans resulted in budgetary costs to the Federal Government. On net, SBA's asset sales program has resulted in an $828 million loss.

3) Operating more efficiently

To operate more efficiently, SBA has automated loan origination activities in the Disaster Loan program with a paperless loan application. As a result, loan-processing costs, times, and errors will decrease, while Government responsiveness to the needs of disaster victims will increase. SBA is also transforming the way that staff perform loan management functions in both the 7(a) and 504 programs. In 2003, SBA implemented a pilot program at three of its 68 district offices to consolidate and expedite Section 504 loan processing. Results have been very positive with the average loan processing time reduced from four weeks to only a few days. SBA is expanding the pilot nationally. Similarly, SBA is also shifting additional responsibilities to intermediaries by centralizing loan liquidation functions for the Section 504 program and requiring intermediaries to assume increased liquidation responsibilities.

USDA Rural Infrastructure and Business Development Programs

USDA provides grants, loans, and loan guarantees to communities for constructing facilities such as health-care clinics, day-care centers, and water and wastewater systems. Direct loans are available at lower interest rates for the poorest communities. These programs have very low default rates. The cost associated with them is due primarily to subsidized interest rates that are below the prevailing Treasury rates.

The program level for the Water and Wastewater (W&W) treatment facility loan and grant program in the 2005 President's Budget is $1.4 billion. These funds are available to communities of 10,000 or less residents. The program finances W&W facilities through direct or guaranteed loans and grants. Applicant communities must be unable to finance their needs through their own resources or with commercial credit. Priority is given based on their median household income, poverty levels, and size of service population as determined by USDA. The community typically receives a grant/loan combination. The grant is usually for 35–45% of the project cost (it can be up to 75%). Loans are for 40 years with interest rates based on a three-tiered structure (poverty, intermediate, and market) depending on community income. The community facility programs are targeted to rural communities with fewer than 20,000 residents and have a program level of $527 million in 2005. USDA also provides grants, direct loans, and loan guarantees to assist rural businesses, including cooperatives, to increase employment and diversify the rural economy. In 2005, USDA proposes to provide $600 million in loan guarantees to rural businesses (these loans serve communities of 50,000 or less).

These community programs are all part of the Rural Community Advancement Program (RCAP). Under RCAP, States have increased flexibility within the three funding streams for Water and Wastewater, Community Facilities, and Business and Industry (B&I). USDA also provides loans through the Intermediary Relending Program (IRP), which provides loan funds at a 1 percent interest rate to an intermediary such as a State or local government agency that, in turn, provides funds for economic and community development projects in rural areas. In 2005, USDA expects to retain or create over 66,000 jobs through its business programs, which will be achieved primarily through the B&I guarantee and the IRP loan programs.

Electric and Telecommunications Loans

USDA's Rural Utilities Service (RUS) has programs that provide loans for rural electrification, telecommunications, distance learning, telemedicine, and broadband and grants for distance learning and telemedicine. The electric and telecommunications program makes new loans to maintain existing infrastructure and to modernize electric and telephone service in rural America. Historically, the Federal risk associated with the $40 billion loan portfolio in electric and telephone loans has been small, although several large defaults have occurred in the electric program.

The Distance Learning and Telemedicine (DLT) provides loans and grants to improve distance learning and telemedicine services in rural areas and encourage students, teachers, medical professionals, and rural residents to use telecommunications, computer networks, and related advanced technologies. The USDA Broadband programs provide loans to provide broadband service to rural communities.

The subsidy rates for several of the electric and telecommunication programs remain negative, though changes to the interest rate assumptions resulted in positive subsidy rates for the Electric Hardship and Municipal rate programs. Recent problems in the telecommunications industry have not had a significant impact on rural telecommunications cooperatives. The number of electric loans has been increasing due to large increases in loan level appropriated over the last several years. The average size for electric loans has also been increasing. The number and the size of telecommunications loans have remained steady. The subsidy rate for the DLT loan program increases in FY2005 from negative to positive due to a few defaults that were not included in the original assumptions. The Broadband subsidy rates increase slightly due to interest rate assumption changes.

Providing funding and services to needy areas is of concern to USDA. Many rural cooperatives provide service to areas where there are high poverty rates. Based on PART findings, USDA will review its current method of issuing telecommunications loans, "'first in; first out," to determine if it allows for adequate support for areas with the highest priority needs. In addition, to ensure the electric and telecommunications programs' focus on rural areas, legislation will be proposed to require recertification of rural status for each electric and telecommunications borrower on the first loan request received in or after FY 2005 and on the first loan request received after each subsequent Census. Legislation will be sought to allow for the rescission of loans that are more than ten years old.

RUS proposes to make $2.5 billion in direct and guaranteed electric loans in 2005, including provision for guaranteeing $100 million in electric loans made by private banks. The demand for loans to rural electric cooperatives has been increasing and is expected to increase further as borrowers replace many of the 40-year-old electric plants. With the $2.5 billion in loans, RUS borrowers are expected to upgrade 225 rural electric systems, which will benefit over 3.4 million customers.

USDA's RUS proposes to make $495 million in direct telecommunications loans in 2005. With the $495 million in loans, RUS borrowers are expected to fund over 50 telecommunication systems for advanced telecommunications services which will provide broadband and high-speed Internet access and benefit over 300 thousand rural customers.

With the $25 million in DLT grants RUS borrowers are expected to provide distance learning facilities to 300 schools, libraries, and rural education centers and also provide telemedicine equipment to 150 rural health care providers, benefiting millions of residents in rural America. Loan funds are not provided due to the positive subsidy rate and the lack of interest in DLT loans. The budget proposes converting the mandatory broadband funding into discretionary funding and provides discretionary funding that supports $331 million in broadband loans.

Loans to Farm Operators

Farm Service Agency (FSA) assists low-income family farmers in starting and maintaining viable farming operations. Emphasis is placed upon aiding beginning and socially disadvantaged farmers. FSA offers operating loans and ownership loans, both of which may be either direct or guaranteed loans. Operating loans provide credit to farmers and ranchers for annual production expenses and purchases of livestock, machinery, and equipment. Farm ownership loans assist producers in acquiring and developing their farming or ranching operations. As a condition of eligibility for direct loans, borrowers must be unable to obtain private credit at reasonable rates and terms. As FSA is the "lender of last resort," default rates on FSA direct loans are generally higher than those on private-sector loans. However, in recent years the loss rate has decreased with a rate of 5.1 percent in 2003, compared to 5.6 percent in 2002.

FSA guaranteed farm loans are made to more creditworthy borrowers who have access to private credit markets. Because the private loan originators must retain 10 percent of the risk, they exercise care in examining the repayment ability of borrowers. As a result, losses on guaranteed farm loans remain low with default rates of .71 percent in 2003 as compared to .70 percent in 2002.

The 2002 Farm Bill changed some of the requirements for managing inventory property. Property acquired through foreclosure on direct loans must now be sold at auction within 165, rather than 105 days of acquisition. The new rule allows more time to advertise and encourage participation from beginning farmers.

The subsidy rates for these programs have been fluctuating over the past several years. These fluctuations are mainly due to the interest component of the subsidy rate. The default rates for these programs tend to be below ten percent. As shown above, both the direct and guaranteed loans have experienced a decreasing default rate.

In fiscal year 2003, FSA provided loans and loan guarantees to approximately 32,000 family farmers totaling $3.94 billion. The number of loans provided by these programs has fluctuated over the past several years. The average size for farm ownership loans has been increasing. The majority of assistance provided in the operating loan program is to existing FSA farm borrowers. In the farm ownership program, new customers receive the bulk of the benefits furnished.

In the last few years, the demand for FSA direct and guaranteed loans has been high due to crop/livestock price decreases and some regional production problems. In 2005, USDA's FSA proposes to make $3.8 billion in direct and guaranteed loans through discretionary programs.

A PART evaluation of the guaranteed loan portfolio was conducted in 2003. The review found that the program is well-managed and serves a clear purpose in helping farmers who have difficulty in demonstrating creditworthiness obtain credit at reasonable rates from private lenders. However, while the program has a low loss rate, it is unable to adequately demonstrate whether it is achieving the objective of improving the economic viability of U.S. farmers and ranchers. Over the next year, FSA will be conducting an in-depth review of its direct and guaranteed loan portfolios to assess program performance, including the effectiveness of targeted assistance and the ability of borrowers to graduate to private credit.

The Farm Credit System and Farmer Mac

The Farm Credit System (FCS or System) and the Federal Agricultural Mortgage Corporation (Farmer Mac) are Government-Sponsored Enterprises (GSEs) that enhance credit availability for the agricultural sector. The FCS provides production, equipment, and mortgage lending to farmers and ranchers, aquatic producers, their cooperatives, and related businesses, while Farmer Mac provides a secondary market for agricultural real estate and rural housing mortgages.

The Nation's agricultural sector and, in turn, its lenders continue to exhibit stability in their income and balance sheets. This is due, in part, to government assistance payments being provided from 1998 through 2003. Also, the low interest rate environment seen over the past two years has reduced interest expense for the capital-intensive agricultural sector and bolstered farmland values. Favorable growing conditions were widespread, and commodity prices generally rose in 2003, although weakness continued for some products. Farmland values increased moderately, up 5.0 percent in 2002, due to a combination of government payments, urban influences, and declining interest rates. Projections for 2003 see a smaller rise of 3.0 percent for farmland values

Commercial banks maintained their predominant farm debt market share of 40 percent in 2002. The FCS trailed at a 29.8 percent share. The United States Department of Agriculture (USDA) direct farm loan programs market share was 3.7 percent, though it would more than double if adjusted for guaranteed loans issued through private institutional lenders. In 2003, USDA expects the market-share gap between commercial banks and the FCS to have narrowed marginally.

The Farm Credit System

During 2003, the financial condition of the System's banks and associations continued a 15-year trend of improving financial health and performance. Sound asset quality and strong income generation enabled FCS banks and associations to post record capital levels. As of September 30, 2003, capital increased 6.4 percent for the year and stood at $16.2 billion. These capital numbers exclude $2.0 billion of restricted capital held by the Farm Credit System Insurance Corporation (FCSIC). Loan volume has increased since 1989 to $91.3 billion in September 2003, which surpasses the high of $90.0 billion, set in December 2002. The rate of asset growth for the preceding three-year period (2000–2002) has been averaging 7.6 percent. However, the rate of capital accumulation has been greater resulting in total capital equaling 15.4 percent of total assets at yearend 2002 compared to 14.9 percent at yearend 1999. Nonperforming assets increased slightly to 1.4 percent of the portfolio in September 2003 compared to 1.3 percent in December 2002. Competitive pressures and a falling interest rate environment have narrowed the FCS's net interest margin to 2.62 percent in September 2003 from 2.76 percent in 2002. The net interest margin is expected to remain stable in the near-term, given the expectations for a continued low interest rate environment into 2004. Consolidation continues to affect the structure of the FCS. In January 1995, there were nine banks and 232 associations; by September 2003, there were six banks and 99 associations.

The FCSIC ensures the timely payment of interest and principal on FCS obligations. FCSIC's net assets, largely comprised of premiums paid by FCS institutions, supplement the System's capital and support the joint and several liability of all System banks for FCS obligations. On September 30, 2003, FCSIC's net assets totaling $1.7 billion were slightly below (1.98 percent) the statutory minimum of 2.0 percent of outstanding debt. In 2003, the premium rate was increased to bolster FCSIC's net assets to meet the expansion in the System's outstanding debt caused by strong growth in its asset base. The premium rate is slated to be reduced slightly in 2004.

Improvement in the FCS's financial condition is also reflected in the examinations by the Farm Credit Administration (FCA), its Federal regulator. Each of the System institutions is rated under the FCA Financial Institution Rating System (FIRS) for capital, asset quality, management, earnings, liquidity, and sensitivity. At the beginning of 1995, 197 institutions carried the best FIRS ratings of 1 or 2, 36 were rated 3, one institution was rated 4, and no institutions received the lowest rating of 5. In September 2003, all 105 banks and associations had ratings of 1 or 2 and no institution was under an enforcement action.

Over the past 12 months, the System's loans outstanding have grown by $3.4 billion, or 3.9 percent, while over the past five years they have grown $25.2 billion, or 38.1 percent. The volume of lending secured by farmland increased 52.6 percent, while farm-operating loans have increased 32.1 percent since 1998. Total members served increased about 2 percent during the past year. Agricultural producers represented the largest borrower group, with $72.8 billion including loans to rural homeowners and leases, or just under 80 percent of the dollar amount of loans outstanding. As required by law, all borrowers are also stockholder owners of System banks and associations. The System has more than 453,000 stockholders; about 83 percent of these are farmers with voting stock. Over half of the System's total loan volume outstanding (53.6 percent) is in long-term real estate loans, over one-quarter (26.2 percent) is in short- and intermediate-term loans to agricultural producers, and 17 percent is to cooperatives. International loans (export financing) represent 3.2 percent of the System's loan portfolio. Young, beginning, and small farmers and ranchers loans represented 12.7, 18.0, and 30.1-percent, respectively, of the total dollar volume outstanding in 2002, which is slightly higher than in 2001. These percentages cannot be summed given significant overlap in these categories. Providing credit and related services to young, beginning, and small farmers and ranchers is a legislated mandate and a high priority for the System.

The System, while continuing to record strong earnings and capital growth, remains exposed to numerous risks, including concentration risk, changes in government assistance payments, the volatility of exports and crop prices, and lower non-farm earnings of farm households associated with weakness in the economy's employment sector.

Farmer Mac

Farmer Mac was established in 1987 to facilitate a secondary market for farm real estate and rural housing loans. Since the Agricultural Credit Act of 1987, there have been several amendments to Farmer Mac's chartering statute. Perhaps the most significant amending legislation for Farmer Mac was the Farm Credit System Reform Act of 1996 that transformed Farmer Mac from a guarantor of securities backed by loan pools into a direct purchaser of mortgages, enabling it to form pools to securitize. The 1996 Act increased Farmer Mac's ability to provide liquidity to agricultural mortgage lenders. Since the passage of the 1996 Act, Farmer Mac's program activities and business have increased significantly.

Farmer Mac continues to meet statutory minimum core capital and regulatory risk-based capital requirements. Farmer Mac's total program activity (loans purchased and guaranteed, and AgVantage bonds purchased, and real estate owned) as of September 30, 2003, totaled $5.6 billion. That volume represents growth of 8 percent over program activity at September 30, 2002. Of total program activity, $2.4 billion were on-balance sheet loans and agricultural mortgage-backed securities and $3.2 billion were off-balance sheet obligations. Total assets were $4.2 billion at the close of the third quarter, with non-program investments accounting for $1.6 billion of those assets. Farmer Mac's net income for the first three quarters of 2003 was $20 million, an increase of $1.56 million, or 8.8 percent over the same period in 2002.

International Credit Programs

Seven Federal agencies, the Department of Agriculture (USDA), the Department of Defense, the Department of State, the Department of the Treasury, the Agency for International Development (USAID), the Export-Import Bank, and the Overseas Private Investment Corporation (OPIC), provide direct loans, loan guarantees, and insurance to a variety of foreign private and sovereign borrowers. These programs are intended to level the playing field for U.S. exporters, deliver robust support for U.S. manufactured goods, stabilize international financial markets, and promote sustainable development.

Leveling the Playing Field

Federal export credit programs counter subsidies that foreign governments, largely in Europe and Japan, provide their exporters, usually through export credit agencies (ECAs). The U.S. Government has worked since the 1970's to constrain official credit support through a multilateral agreement in the Organization for Economic Cooperation and Development (OECD). This agreement has significantly constrained direct interest rate subsidies and tied-aid grants. Further negotiations resulted in a multilateral agreement that standardized the fees for sovereign lending across all ECAs beginning in April 1999. Fees for non-sovereign lending, however, continue to vary widely across ECAs and markets, thereby providing implicit subsidies.

The Export-Import Bank attempts to strategically "level the playing field" and to fill gaps in the availability of private export credit. The Export-Import Bank provides export credits, in the form of direct loans or loan guarantees, to U.S. exporters who meet basic eligibility criteria and who request the Bank's assistance. USDA's "GSM" programs similarly help to level the playing field. Like programs of other agricultural exporting nations, GSM programs guarantee payment from countries and entities that want to import U.S. agricultural products but cannot easily obtain credit. The U.S. has been negotiating in the OECD the terms of agricultural export financing, the outcome of which could affect the GSM programs.

Stabilizing International Financial Markets

In today's global economy, the health and prosperity of the American economy depend importantly on the stability of the global financial system and the economic health of our major trading partners. The United States can contribute to orderly exchange arrangements and a stable system of exchange rates by providing resources on a multilateral basis through the IMF (discussed in other sections of the Budget), and through financial support provided by the Exchange Stabilization Fund (ESF).

The ESF may provide "bridge loans" to other countries in times of short-term liquidity problems and financial crises. In the past, "bridge loans" from ESF provided dollars to a country over a short period before the disbursement of an IMF loan to the country. Also, a package of up to $20 billion of medium-term ESF financial support was made available to Mexico during its crisis in 1995. Such support was essential in helping to stabilize Mexican and global financial markets. Mexico paid back its borrowings under this package ahead of schedule in 1997, and the United States earned almost $600 million more in interest than it would have if it dollars had not been lent. There was zero subsidy cost for the United States as defined under credit reform, as the medium-term credit carried interest rates reflecting an appropriate country risk premium.

The United States also expressed a willingness to provide ESF support in response to the financial crises affecting some countries such as South Korea in 1997 and Brazil in 1998. It did not prove necessary to provide an ESF credit facility for Korea, but the United States agreed to guarantee through the ESF up to $5 billion of a $13.2 billion Bank for International Settlements credit facility for Brazil. In the event, the ESF guaranteed $3.3 billion in BIS credits to Brazil and earned $140.3 million in commissions. Such support helped to provide the international confidence needed by these countries to begin the stabilization process.

Using Credit to Promote Sustainable Development

Credit is an important tool in U.S. bilateral assistance to promote sustainable development. USAID's Development Credit Authority (DCA) allows USAID to use a variety of credit tools to support its development activities abroad. This unit encompasses newer DCA activities, such as municipal bond guarantees for local governments in developing countries, as well as USAID's traditional microenterprise and urban environmental credit programs. DCA provides non-sovereign loans and loan guarantees in targeted cases where credit serves more effectively than traditional grant mechanisms to achieve sustainable development. DCA is intended to mobilize host country private capital to finance sustainable development in line with USAID's strategic objectives. Through the use of partial loan guarantees and risk sharing with the private sector, DCA stimulates private-sector lending for financially viable development projects, thereby leveraging host-country capital and strengthening sub-national capital markets in the developing world. While there is clear demand for DCA's facilities in some emerging economies, the utilization rate for these facilities is still very low.

OPIC also supports a mix of development, employment, and export goals by promoting U.S. direct investment in developing countries. OPIC pursues these goals through political risk insurance, direct loans, and guarantee products, which provide finance, as well as associated skills and technology transfers. These programs are intended to create more efficient financial markets, eventually encouraging the private sector to supplant OPIC finance in developing countries. OPIC has also created a number of investment funds that provide equity to local companies with strong development potential.

Ongoing Coordination

International credit programs are coordinated through two groups to ensure consistency in policy design and credit implementation. The Trade Promotion Coordinating Committee (TPCC) works within the Administration to develop a National Export Strategy to make the delivery of trade promotion support more effective and convenient for U.S. exporters.

The Interagency Country Risk Assessment System (ICRAS) standardizes the way in which agencies budget for the cost associated with the risk of international lending. The cost of lending by the agencies is governed by proprietary U.S. government ratings, which correspond to a set of default estimates over a given maturity. The methodology establishes assumptions about default risks in international lending using averages of international sovereign bond market data. The strength of this method is its link to the market and an annual update that adjusts the default estimates to reflect the most recent risks observed in the market.

For 2005, OMB updated the default estimates using the default estimate methodology introduced in FY 2003 and the most recent market data. The 2003 default estimate methodology implemented a significant revision that uses more sophisticated financial analyses and comprehensive market data, and better isolates the expected cost of default implicit in interest rates charged by private investors to sovereign borrowers. All else being equal, this change expands the level of international lending an agency can support with a given appropriation. For example, the Export-Import Bank will be able to generally provide higher lending levels using lower appropriations in 2005.

Adapting to Changing Market Conditions

Overall, officially supported finance and transfers account for a tiny fraction of international capital flows. Furthermore, the private sector is continuously adapting its size and role in emerging markets finance to changing market conditions. In response, the Administration is working to adapt international lending at Export-Import Bank and OPIC to dynamic private sector finance. The Export-Import Bank, for example, is developing a sharper focus on lending that would otherwise not occur without Federal assistance. Measures under development include reducing risks, collecting fees from program users, and improving the focus on exporters who truly cannot access private export finance.

OPIC in the past has focused relatively narrowly on providing financing and insurance services to large U.S. companies investing abroad. As a result, OPIC did not devote significant resources to its mission of promoting development through mobilizing private capital. In 2003, OPIC implemented new development performance measures and goals that reflect the mandate to revitalize its core development mission.

These changes at the Export-Import Bank and at OPIC will place more emphasis on correcting market imperfections as the private sector's ability to bear emerging market risks becomes larger, more sophisticated, and more efficient.

Performance Assessment

For FY 2005, the Administration used the Performance Assessment Rating Tool (PART) to rate OPIC's insurance and finance programs. The PART revealed the insurance program is generally well-managed and that it has instituted a meaningful policy to ensure it does not compete with private insurance companies. The PART found that the finance program could improve its credit function by ensuring the independence of the Credit Committee and the credit review process from the deal originating departments.

IV. INSURANCE PROGRAMS

Deposit Insurance

Federal deposit insurance promotes stability in the U.S. financial system. Prior to the establishment of Federal deposit insurance, failures of some depository institutions often caused depositors to lose confidence in the banking system and rush to withdraw deposits. Such sudden withdrawals caused serious disruption to the economy. In 1933, in the midst of the Depression, the system of Federal deposit insurance was established to protect small depositors and prevent bank failures from causing widespread disruption in financial markets. The federal deposit insurance system came under serious strain in the late 1980s and early 1990s when over 2,500 banks and thrifts failed. The Federal Government responded with a series of reforms designed to improve the safety and soundness of the banking system. These reforms, combined with more favorable economic conditions, helped to restore the health of depository institutions and the deposit insurance system.

The Federal Deposit Insurance Corporation (FDIC) insures deposits in commercial banks and savings associations (thrifts) through separate insurance funds, the Bank Insurance Fund (BIF) and the Savings Association Insurance Fund (SAIF). The National Credit Union Administration (NCUA) administers the insurance fund for most credit unions (certain credit unions are privately insured and not covered by the fund). FDIC and NCUA insure deposits up to $100,000 per account. FDIC insures over $3.4 trillion of deposits at almost 8,000 commercial banks and 1,500 savings institutions. NCUA insures about 9,500 credit unions with $474 billion in insured shares.

Current Industry and Insurance Fund Conditions

Four BIF members with combined assets of $1.2 billion dollars failed during fiscal year 2003, while no SAIF members failed. In the last five years, assets associated with BIF failures have averaged $1.1 billion per year, while failures associated with SAIF averaged $465 million. During 2003, 8 federally insured credit unions with $25 million in assets failed (including assisted mergers). The FDIC currently classifies 116 institutions with $30 billion in assets as “problem institutions,” compared to 148 institutions with $42 billion in assets a year ago. By comparison, at the height of the banking crisis in 1989, failed assets rose to over $150 billion.

In the third quarter ending September 30, 2003, banks and thrifts reported record-high earnings. In fiscal year 2003, the industry net income totaled $115 billion, an increase of 13 percent over fiscal year 2002. The largest factor in the earnings increase is higher non-interest income, particularly growth in securitization income and gains on loan sales. Credit quality continues to improve and banks are reporting higher returns on assets. Despite the improving trends, prospects for higher interest rates cause concerns for the industry as increased interest rates usually reduce lending margins.

In fiscal year 2003, the reserve ratio (ratio of insurance reserves to insured deposits) of BIF stayed above the 1.25-percent statutory target. As of September 30, 2003, BIF had estimated reserves of $33 billion, or 1.31 percent of insured deposits. Factors that helped BIF stay above the statutory target in fiscal year 2003 include slower deposit growth, increases in unrealized gains on securities available for sale, and reductions to reserves previously set aside for future estimated losses. In 2003, FDIC developed a new model to estimate the amount of reserves needed for losses after it completed a study that found faults in its current methodology. FDIC continues to refine its new model as it looks to incorporate it in their reserve estimating process. The SAIF reserve ratio remained comfortably above the designated reserve ratio throughout the year. As of September 30, 2003, SAIF had reserves of $12 billion, or 1.40 percent of insured deposits. Through June 30, 2004, the FDIC will continue to maintain deposit insurance premiums in a range from zero for the healthiest institutions to 27 cents per $100 of assessable deposits for the riskiest institutions. In May, the FDIC will set assessment rates for July through December of this year. Due to the strong financial condition of the industry and the insurance funds, less than 10 percent of banks and thrifts paid insurance premiums in 2003.

The National Credit Union Share Insurance Fund (NCUSIF) ended fiscal year 2003 with assets of over $6 billion and an equity ratio of 1.28 percent, below the NCUA-set target ratio of 1.30 percent. Each insured credit union is required to deposit and maintain an amount equal to 1 percent of its member share accounts in the fund. Premiums were waived during 2003 because sufficient investment income was generated. As the Fund’s equity ratio did not exceed 1.30 percent, NCUA did not provide a dividend to credit unions in fiscal year 2003.

As a result of consolidation, fewer large banks control an increasingly substantial share of banking assets. Thus, the failure of even one of these large institutions could strain the insurance fund. Banks are increasingly using sophisticated financial instruments such as asset-backed securities and financial derivatives, which could have unforeseen effects on risk levels. Whether or not these new instruments add to risk, they do complicate the work of regulators who must gauge each institution’s financial health and the potential for deposit insurance losses that a troubled institution may represent.

Federal Deposit Insurance Reform

While the deposit insurance system is in good condition, the Administration supports reforms to make improvements in the operation and fairness of the deposit insurance system for banks and thrifts. In 2003, the Treasury Department and federal banking regulatory agencies submitted to the U.S. Senate a draft bill that would accomplish this objective. Specifically, the proposal would merge the BIF and the SAIF, which offer an identical product. A single merged fund would be stronger and better diversified than either fund alone. A merged fund would prevent the possibility that institutions posing similar risks would pay significantly different premiums for the same product. Under the current system, the FDIC is required to maintain a ratio of insurance fund reserves to total insured deposits of 1.25 percent. If insurance fund reserves fall below the required ratio, the FDIC must charge either sufficient premiums to restore the reserve ratio to 1.25 percent within one year, or no less than 23 basis points if the reserve ratio remains below 1.25 percent for more than one year. The Administration’s proposal would give the FDIC authority to adjust the ratio periodically within prescribed upper and lower bounds and greater discretion in determining how quickly it restores the ratio to target levels. This flexibility would help the banking industry to stabilize the premium costs over time and to avoid sharp premium increases when the economy might be under stress. Finally, the FDIC has been prohibited since 1996 from charging premiums to "well-capitalized" and well-run institutions as long as insurance fund reserves equal or exceed 1.25 percent of insured deposits. Therefore, less than 10 percent of banks and thrifts pay insurance premiums, allowing a large number of financial institutions to rapidly increase their insured deposits without any contribution to the insurance fund. The Administration proposal would repeal this prohibition to ensure that institutions with rapidly increasing insured deposits or greater risks appropriately compensate the insurance fund.

Pension Guarantees

The Pension Benefit Guaranty Corporation (PBGC) insures most defined-benefit pension plans sponsored by private employers. PBGC pays the benefits guaranteed by law when a company with an underfunded pension plan becomes insolvent. PBGC's exposure to claims relates to the underfunding of pension plans, that is, to any amount by which vested future benefits exceed plan assets. In the near term, its loss exposure results from financially distressed firms with underfunded plans. In the longer term, additional loss exposure results from the possibility that currently healthy firms become distressed and currently well-funded plans become underfunded due to inadequate contributions or poor investment results.

PBGC monitors troubled companies with underfunded plans and acts, in bankruptcies, to protect its beneficiaries and the future of the program. Such protections include, where necessary, initiating plan termination. Under its Early Warning Program, PBGC negotiates settlements with companies that improve pension security and reduce PBGC's future exposure to risk.

PBGC's single-employer program ended 2002 at a deficit of $3.6 billion, which deepened in 2003 to about $11.3 billion. The deficit has resulted from record losses on plan terminations in 2001 through 2003. In 2002 LTV, a steel company, terminated its plan with underfunding of nearly $2 billion, which then was PBGC's largest claim ever. But in December 2002, an even larger pension plan terminated. Bethlehem Steel's plan covered 95,000 workers and retirees and was underfunded by about $4.3 billion, of which PBGC is liable for about $3.6 billion. Other large underfunded terminations in 2003 included Columbia Hospital for Women, Consolidated Freightways, Geneva Steel, Hawaii Baking Company, National Steel, and US Airways' Pilots Plan. Since year's end, PBGC has terminated Kaiser Aluminum Salaried Plan, Pillowtex, and Weirton Steel.

Moreover this "snapshot" measure of PBGC's deficit could hide significant risk of further losses. It includes the financial effects only of pension plans that have already terminated and of seriously underfunded large plans for which termination is considered "probable." Additional risk and exposure may remain for the future because of economic uncertainties and significant underfunding in single-employer pension plans, which exceeded an estimated $350 billion at year end, compared to $50 billion in December 2000. Some of the companies with the most underfunded plans are in financially troubled industries (like airlines or the old-line steel companies), or are already in Chapter 11 bankruptcy proceedings.

The smaller multiemployer program guarantees pension benefits of certain unionized plans offered by several employers in an industry. It ended 2003 with its first deficit in over 20 years, of about $261 million. Underfunding in multiemployer plans approximated $100 billion at year end.

PBGC is not in crisis—the agency has sufficient assets to meet its obligations for a number of years into the future—but it is clear that the financial integrity of the federal pension insurance system is at risk.

Looking to the long term, in order to avoid benefit reductions, strengthen PBGC, and help stabilize the defined-benefit pension system, the 2005 Budget proposes legislative reforms to:

- Give employers two years of relief from current pension plan contribution requirements—now tied to 30-year Treasury bond interest rates—and base requirements on more appropriate corporate bond rates.
- After the two-year transition period, base pension funding requirements on a "yield curve" (commonly used in corporate finance), which would better tie funding requirements to the timing of the payout of retiree benefits.
- Make additional changes to restrict promises of added benefits by severely underfunded plans and to provide better information on pension finances to workers, retirees, and stockholders.

Additionally, the Administration is developing a plan for comprehensive reform of the pension funding rules to: strengthen funding for workers' defined-benefit pensions; simplify funding rules; offer sponsors new, flexible approaches to finance their plans without the present yearly volatility; and make additional reforms to ensure PBGC's continued ability to safeguard pension benefits.

Disaster Insurance

Flood Insurance

The Federal Government provides flood insurance through the National Flood Insurance Program (NFIP), which is administered by the Emergency Preparedness and Response Directorate of the Department of Homeland Security (DHS). Flood insurance is available to homeowners and businesses in communities that have adopted and enforced appropriate flood plain management measures. Coverage is limited to buildings and their contents. By 2005, the program is projected to have approximately 4.7 million policies from more than 19,000 communities with $699 billion of insurance in force.

Prior to the creation of the program in 1968, many factors made it cost prohibitive for private insurance companies alone to make affordable flood insurance available. In response, the NFIP was established to make insurance coverage widely available. The NFIP requires building standards and other mitigation efforts to reduce losses, and operates a flood hazard mapping program to quantify the geographic risk of flooding. These efforts have made substantial progress.

The number of policies in the program has grown significantly over time. The number of enrolled policies grew from 2.4 to 4.3 million between 1990 and 2002, and by about 34,000 policies in 2003. DHS is using three strategies to increase the number of flood insurance policies in force: lender compliance, program simplification, and expanded marketing. DHS is educating financial regulators about the mandatory flood insurance requirement for properties with mortgages from federally regulated lenders. The NFIP also has a multi-pronged strategy for reducing future flood damage. The NFIP offers mitigation insurance to allow flood victims to rebuild to code, thereby reducing future flood damage costs. Further, through the Community Rating System, DHS adjusts premium rates to encourage community and State mitigation activities beyond those required by the NFIP.

Despite these efforts, the program faces financial challenges. The program's financing account, which is a cash fund, has sometimes had expenses greater than its revenue, preventing it from building sufficient long-term reserves. This is mostly because a large portion of the policyholders pay subsidized premiums. DHS charges subsidized premiums for properties built before a community adopted the NFIP building standards. Properties built subsequently are charged actuarially fair rates. The creators of the NFIP assumed that eventually the NFIP would become self-sustaining as older properties left the program. The share of subsidized properties in the program has fallen, but remains substantial; it was 70 percent in 1978 and is 28 percent today.

Until the mid-1980s, Congress appropriated funds periodically to support subsidized premiums. However, the program has not received appropriations since 1986. During the 1990s, FEMA, which is now part of DHS, relied on Treasury borrowing to help finance its loss expenses (the NFIP may borrow up to $1.5 billion). As of October 31, 2002, the NFIP had repaid all of its outstanding debt.

Although the program is generally well run, it receives some criticism about the low participation rate and the inclusion of subsidized properties, especially those that are repetitively flooded. The program has identified approximately 11,000 properties for mitigation action. To the extent they are available; funds will come from the Hazard Mitigation Grant Program, the Predisaster Mitigation Grant Program, and the Flood Mitigation Grant Program. There is also current legislation pending to address the problem of repetitive loss properties. An additional problem is the fairly low participation rate. Currently, less than half of the eligible properties in identified flood plains participate in this program. In comparison, the participation rate for private wind and hurricane insurance is nearly 90 percent in at-risk areas. Given that flood damage causes roughly $6 billion in property damage annually, DHS will have to evaluate its incentive structure to attract more participation in the program, while not encouraging misuse of the program.

Crop Insurance

Subsidized Federal crop insurance administered by USDA's Risk Management Agency (RMA) plays an important role in assisting farmers to manage yield and revenue shortfalls due to bad weather or other natural disasters. RMA continues to evaluate and, as appropriate, provide new products so that the Government can further reduce the need for ad-hoc disaster assistance payments to the agriculture community in bad years.

The USDA crop insurance program is a cooperative effort between the Federal Government and the private insurance industry. Private insurance companies sell and service crop insurance policies. These companies rely to varying degrees on reinsurance provided by the Federal Government and the commercial reinsurance market to manage their individual risk portfolio. The Federal Government also reimburses private companies for the administrative expenses associated with providing crop insurance and reinsures the private companies for excess insurance losses on all policies. The Federal Government also subsidizes premiums for farmers. In crop year 2003, 215 million acres were insured, with an estimated $3.4 billion in total premiums collected, including $2 billion in premium subsidy.

During FY 2004 RMA will be renegotiating the Standard Reinsurance Agreement (SRA). The SRA contains the operational and financial risk sharing terms between the Federal government and the private companies. The Agriculture Risk Protection Act of 2000 (ARPA) allowed these terms to be renegotiated once during the 2001 and 2005 reinsurance years. RMA is taking this opportunity to strengthen the document now to address such issues as company oversight and quality control. In addition, significant attention will be given to evaluating all the financial incentives, risk sharing scenarios and administrative cost reimbursement percentages to ensure that the companies and the Federal government are bearing an appropriate amount of the costs associated with the crop insurance program. RMA is seeking to finalize the new SRA by June of 2004.

There are various types of insurance programs. The most basic type of coverage is Catastrophic Crop Insurance (CAT), which compensates the farmer for losses up to 50 percent of the individual's average yield at 55 percent of the expected market price. The CAT premium is entirely subsidized, and farmers pay only a small administrative fee. Commercial insurance companies deliver the product to the producer in all states. Additional coverage is available to producers who wish to insure crops above the basic coverage. Premium rates for additional coverage depend on the level of coverage selected and vary from crop to crop and county to county. The additional levels of insurance coverage are more attractive to farmers due to availability of optional units, other policy provisions not available with CAT coverage, and the ability to obtain a level of protection that permits them to use crop insurance as loan collateral and to achieve greater financial security. Private companies sell and service the catastrophic portion of the crop insurance program, and also provide higher levels of coverage, which are also federally subsidized. Approximately 80 percent of eligible acres participated in one or more crop insurance programs in 2003.

There are also a wide range of yield and revenue-based insurance products are available through the crop insurance program. Revenue insurance programs protect against loss of revenue stemming from low prices, poor yields, or a combination of both. These programs extend traditional multi-peril crop insurance protection by adding price variability to production history. Indemnities are due when any combination of yield and price results in revenue that is less than the revenue guarantee. The price component common to these plans uses the commodity futures market for price discovery.

USDA also continues to expand coverage. In September 2001, RMA published an interim rule that allows RMA to reimburse developers of private crop insurance products for their research and development costs and maintenance costs.

Two pilot insurance programs for Iowa swine producers to protect them from lower hog prices began in 2002. The Livestock Gross Margin (LGM) and the Livestock Risk Protection (LRP). The LRP program was expanded in August 2003 to 10 additional states.

In April 2003, RMA announced two pilot programs that will extend insurance protection to fed and feeder cattle. They are designed to insure against declining market prices. Both offer coverage prices based on expected cash prices. The Federal Crop Insurance Corporation (FCIC) will subsidize 13 percent of the producer's gross premium under both programs. LRP-Feeder Cattle is available in 10 states. LRP-Fed Cattle is available to producers in three states.

For more information and additional crop insurance program details, please reference RMA's web site: (*www.rma.usda.gov*).

Insurance against Security-Related Risks

The Federal Government offers terrorism risk insurance and Airline War Risk Insurance on a temporary basis, and has created the smallpox injury compensation program. After the September 11 attacks, private insurers became reluctant to insure against security-related risks such as terrorism and war. Those events are so uncertain in terms of both the frequency of occurrence and the magnitude of potential loss that private insurers have difficulty estimating the expected loss. Furthermore, terrorism can produce a large loss that could wipe out private insurers' capital. These uncertainties make the private sector reluctant to provide security-related insurance. Thus, it is necessary for the Federal Government to insure against security-related risks, until the private sector learns enough to be comfortable about estimating those risks, to ensure the smooth functioning of the economy.

Terrorism Risk Insurance

On November 26, 2002, President Bush signed into law the Terrorism Risk Insurance Act of 2002. The Act was designed to address disruptions in economic activity caused by the withdrawal of many insurance companies from the marketplace for terrorism risk insurance in the aftermath of the terrorist attacks of September 11, 2001. Their withdrawal in the face of great uncertainty as to their risk exposure to future terrorist attacks led to a moratorium in construction projects, increased business costs for the insurance that was available, and substantial shifting of risk—from reinsurers to primary insurers, and from insurers to policyholders (e.g., investors, businesses, and property owners). Ultimately, these costs were borne by American workers and communities through decreased development and economic activity.

The Act establishes a temporary Federal program that provides for a system of shared public and private compensation for insured commercial property and casualty losses arising from acts of terrorism. The program is administered by the Treasury Department and will sunset on December 31, 2005.

Under the Act, insurance companies included under the program must make available to their policyholders during the first two years of the program coverage for losses from acts of terrorism (as defined by the Act), and Treasury is required to determine whether to extend this requirement into the third and final year of the program. The Act also requires as a condition for Federal payment that insurance companies disclose to policyholders the premium charged for terrorism risk insurance and the Federal share of compensation under the program.

In the event of a future terrorist attack on private businesses and others covered by this program, insurance companies will cover insured losses up to each company's deductible as specified in the Act. Insured losses above that amount in a given year would be shared between the insurance company and the Treasury, with Treasury covering 90 percent of the losses above the company's deductible. However, neither the Treasury nor any insurer would be liable for any amount exceeding the statutory annual cap of $100 billion in aggregate insured losses. The Act also provides authority for the Treasury to recoup Federal payments via surcharges on policyholders. In some circumstances this recoupment is mandatory, in other circumstances, as specified in the Act, its exercise is optional.

Promptly after the Act was signed into law, Treasury issued a number of interim guidance notices to assist the insurance industry in complying with the requirements of the Act. The interim guidance notices were directly followed by the issuance of formal regulations to implement the Act. Treasury has also created a separate Terrorism Risk Insurance Program office to implement the Act, which includes setting up an infrastructure to handle potential claims under the Act.

Airline War Risk Insurance

After the September 11, 2001 attacks, private insurers cancelled third party liability war risk coverage for airlines and dramatically increased the cost of other war risk insurance. In response, the Department of Transportation (DOT) provided a short-term reimbursement to airlines for the increased cost of aviation hull and passenger liability war risk insurance under the authority provided in P.L. 107–42. Under Presidential Determination No. 01–29, the President delegated the authority to extend the duration of aviation insurance to the Secretary of Transportation. Due to the extended disruption in the marketplace, DOT also offered airlines third-party liability war risk insurance coverage at subsidized rates to replace coverage initially withdrawn by private insurers. DOT has continued to provide insurance coverage in 60-day increments since 2001.

The Homeland Security Act of 2002 included airline war risk insurance legislation. This law extended the term of third party war risk coverage and expanded the scope of coverage to include war risk hull, passenger, crew, and property liability insurance. Under the law, the Secretary of Transportation was directed to extend insurance policies until August 31, 2003. In addition, the law also limited the total premium for the three types of insurance to twice the premium rate charged for the third party liability insurance as of June 19, 2002. In 2003 the Department of Defense supplemental appropriation further extended the mandatory provision of insurance through August 31, 2004. Consequently, in December 2003 the President issued Presidential Determination 2004–13 which authorizes the continued provision of insurance now in force through August 31, 2004 and the DOT expects to amend current policies to conform to that date. Recently, the basic authority of the insurance program was extended through December 31, 2008 by P.L. 108–176, Vision 100—Century of Aviation Reauthorization Act.

Currently 76 air carriers are insured by DOT. Coverage for individual carriers ranges from $80 million to $4 billion per carrier with the median insurance coverage at approximately $1.8 billion per occurrence. Premiums collected by the Government are deposited into the Aviation Insurance Revolving Fund. In FY 2003, the fund collected approximately $136 million in premiums for insurance provided by DOT. In FY 2004, it is anticipated that up to $125 million in premiums may be collected by DOT for the provision of insurance. At the end of FY 2003, the balance of the Aviation Insurance Revolving Fund used to pay claims was $218 million. Any claims by the airlines that exceed the balance in the aviation insurance revolving fund would be paid by the Federal Government.

Smallpox Injury Compensation

The Administration has taken steps to insure the immediate mobilization of emergency response personnel in the event of a smallpox attack. The Smallpox Injury Compensation Program, set up under the Smallpox Emergency Personnel Protection Act of 2003, encourages vaccination of designated emergency personnel by providing benefits and/or compensation to certain persons harmed as a direct result of receiving smallpox countermeasures, including the smallpox vaccine. Only persons receiving the smallpox vaccine under the Department of Health and Human Services Declaration Regarding the Administration of Smallpox Countermeasures are eligible for benefits. Also, the Homeland Security Act of 2002 provided medical liability protection to doctors, drug manufacturers, and hospitals that administer smallpox vaccine and other countermeasures during an emergency declaration.

Chart 7-1. Face Value of Federal Credit Outstanding

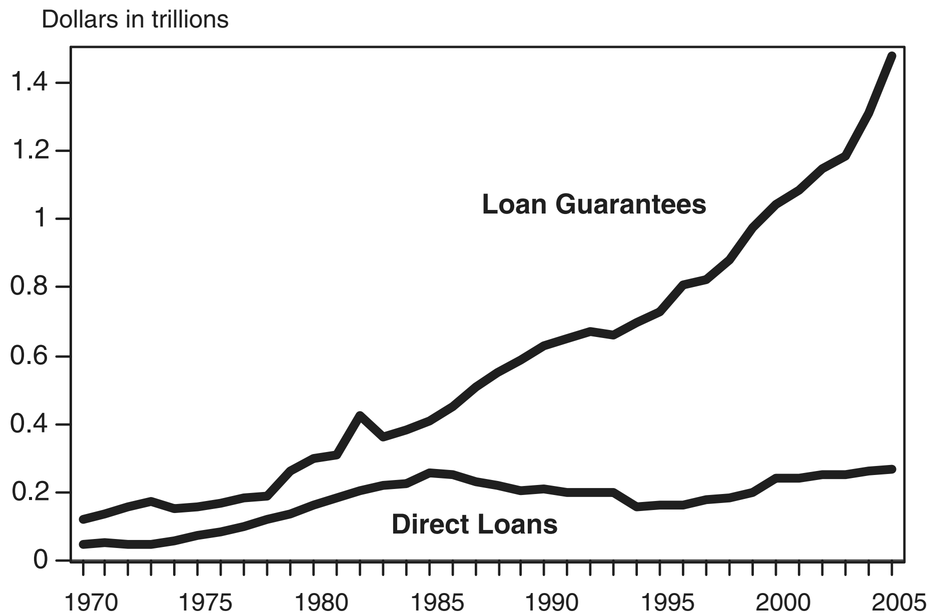

Table 7–1. ESTIMATED FUTURE COST OF OUTSTANDING FEDERAL CREDIT PROGRAMS

(in billions of dollars)

Program	Outstanding 2002	Estimated Future Costs of 2002 Outstanding [1]	Outstanding 2003	Estimated Future Costs of 2003 Outstanding [1]
Direct Loans [2]				
Federal Student Loan Programs	99	14	102	10
Farm Service Agency (excl.CCC), Rural Development, Rural Housing	45	11	44	11
Rural Utilities Service and Rural Telephone Bank	32	2	32	3
Housing and Urban Development	12	2	13	3
Agency for International Development	9	7	9	4
Public Law 480	11	2	11	7
Export-Import Bank	12	4	11	4
Commodity Credit Corporation	5	3	7	3
Federal Communications Commission	5	*	5	1
Disaster Assistance	4	*	3	1
Other Direct Loan Programs	14	*	12	*
Total Direct Loans	248	45	249	47
Guaranteed Loans: [2]				
FHA Mutual Mortgage Insurance Fund	467	3	407	2
VA Mortgage	265	6	323	5
Federal Family Education Loan Program	182	12	213	15
FHA General/Special Risk Insurance Fund	96	5	89	4
Small Business	41	1	53	2
Export-Import Bank	31	5	34	3
International Assistance	19	2	19	2
Farm Service Agency and Rural Housing	23	*	24	1
Commodity Credit Corporation	5	1	4	*
Other Guaranteed Loan Programs	17	2	18	2
Total Guaranteed Loans	1,146	37	1,184	36
Total Federal Credit	**1,394**	**82**	**1,433**	**83**

* Less than $500 million.

[1] Direct loan future costs are the financing account allowance for subsidy cost and the liquidating account allowance for estimated uncollectible principal and interest. Loan guarantee future costs are estimated liabilities for loan guarantees.

[2] Excludes loans and guarantees by deposit insurance agencies and programs not included under credit reform, such as CCC commodity price supports. Defaulted guaranteed loans which become loans receivable are accounted for as direct loans.

Table 7–2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992–2003 [1]

(Budget authority and outlays, in millions of dollars)

Program	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
DIRECT LOANS:											
Agriculture:											
Agriculture credit insurance fund	–72	28	2	–31	23	....	331	–656	921	10	–701
Farm storage facility loans	....	....	....	....	....	....	....	....	–1	–7	–8
Apple loans	....	....	....	....	....	....	....	....	–2	1	....
Emergency boll weevil loan	....	....	....	....	....	....	....	....	....	1	*
Agricultural conservation	–1	....	....	....	....	....	....	....	....	....	....
Distance learning and telemedicine	....	....	....	....	....	....	....	....	1	–1	....
Rural electrification and telecommunications loans	*	61	–37	84	....	–39	....	–17	–42	101	....
Rural telephone bank	1	....	....	10	....	–9	....	–1	....	–3	–7
Rural housing insurance fund	2	152	46	–73	....	71	....	19	–29	–435	....
Rural economic development loans	....	....	....	1	....	–1	*	....	–1	–1	....
Rural development loan program	....	1	....	....	....	–6	....	....	–1	–3	....
Rural community advancement program [2]	....	....	....	8	....	5	....	37	3	–1	....
P.L. 480	....	....	–37	–1	....	....	....	–23	65	–348	33
P.L. 480 Title I food for progress credits	....	84	–38	....	....	....	....	....	....	–112	–44
Commerce:											
Fisheries finance	....	....	....	....	....	....	....	–19	–1	–3	1
Defense:											
Military housing improvement fund	....	....	....	....	....	....	....	....	....	....	–1
Education:											
Federal direct student loan program: [3]											
Volume reestimate	....	....	....	....	....	22	....	–6	....	43	....
Other technical reestimate	....	....	3	–83	172	–383	–2,158	560	....	3,678	2,005
College housing and academic facilities loans	....	....	....	....	....	....	....	–1	....	....	....
Homeland Security:											
Disaster assistance	....	....	....	....	....	....	47	36	–7	–6	*
Interior:											
Bureau of Reclamation loans	....	....	....	....	....	....	3	3	–9	–14	....
Bureau of Indian Affairs direct loans	....	....	....	....	....	1	5	–1	–1	2	*
Assistance to American Samoa	....	....	....	....	....	....	....	....	....	....	*
Transportation:											
High priority corridor loans	....	....	....	....	–3	....	....	....	....	....	....
Alameda corridor loan	....	....	....	....	....	....	–58	....	....	....	–50
Transportation infrastructure finance and innovation	....	....	....	....	....	....	....	18	....	....	–4
Railroad rehabilitation and improvement program	....	....	....	....	....	....	....	....	....	....	–5
Treasury:											
Community development financial institutions fund	....	....	....	....	....	....	1	....	....	*	–2
Veterans Affairs:											
Veterans housing benefit program fund	–39	30	76	–72	465	–111	–52	–107	–697	17	–178
Native American veteran housing	....	....	....	....	....	....	....	....	....	–3	*
Vocational rehabilitation loans	....	....	....	....	....	....	....	....	....	*	*
Environmental Protection Agency:											
Abatement, control and compliance	....	....	....	....	....	....	....	3	–1	*	–3
General Services Administration:											
Columbia hospital for women	....	....	....	....	....	....	....	....	–6	....	....
International Assistance Programs:											
Foreign military financing	....	....	....	13	4	1	152	–166	119	–397	–64
U.S. Agency for International Development:											
Micro and small enterprise development	....	....	....	....	....	....	....	....	*	....	*
Overseas Private Investment Corporation:											
OPIC direct loans	....	....	....	....	....	....	....	....	....	–4	–21
Debt reduction	....	....	....	....	....	....	36	–4	....	*	–48
Small Business Administration:											
Business loans	....	....	....	....	....	....	....	1	–2	1	....
Disaster loans	....	....	....	....	–193	246	–398	–282	–14	266	624
Other Independent Agencies:											
Export-Import Bank direct loans	–28	–16	37	....	....	....	–177	157	117	–640	–353
Federal Communications Commission spectrum auction	....	....	....	....	4,592	980	–1,501	–804	92	346	380

Table 7–2. REESTIMATES OF CREDIT SUBSIDIES ON LOANS DISBURSED BETWEEN 1992–2003 [1]—Continued

(Budget authority and outlays, in millions of dollars)

Program	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
LOAN GUARANTEES:											
Agriculture:											
Agriculture credit insurance fund	5	14	12	–51	96		–31	205	40	–36	–32
Agriculture resource conservation demonstration project								2		1	*
Commodity Credit Corporation export guarantees	3	103	–426	343				–1,410		–13	–431
Rural development insurance fund	49			–3							
Rural housing insurance fund	2	10	7	–10		109		152	–56	32	
Rural community advancement program [2]				–10		41		63	17	91	
Commerce:											
Fisheries finance					–2			–3	–1	3	*
Emergency steel guaranteed loans										50	*
Emergency oil and gas guaranteed loans								*	*	*	*
Defense:											
Military housing improvement fund											–2
Defense export loan guarantee											–4
Education:											
Federal family education loan program: [3]											
Volume reestimate			535	99		–13	–60	–42		277	
Other technical reestimate	97	421	60			–140	667	–3,484		–2,483	–3,278
Health and Human Services:											
Heath center loan guarantees							3		*	*	*
Health education assistance loans										–5	–37
Housing and Urban Development:											
Indian housing loan guarantee								–6	*	–1	*
Title VI Indian guarantees										–1	1
Community development loan guarantees											19
FHA-mutual mortgage insurance				–340		3,789		2,413	–1,308	1,100	5,947
FHA-general and special risk	–175		–110	–25	743	79		–217	–403	77	351
Interior:											
Bureau of Indian Affairs guaranteed loans				31				–14	–1	–2	–1
Transportation:											
Maritime guaranteed loans (title XI)						–71	30	–15	187	27	–16
Minority business resource center									1		*
Treasury:											
Air transportation stabilization program										113	–199
Veterans Affairs:											
Veterans housing benefit fund program	–447	167	334	–706	38	492	229	–770	–163	–184	–1,547
International Assistance Programs:											
U.S. Agency for International Development:											
Development credit authority									–1		*
Micro and small enterprise development											4
Urban and environmental credit	–2	–1	–7		–14				–4	–15	48
Assistance to the new independent states of the former Soviet Union [4]									–34		
Loan guarantees to Israel											–76
Overseas Private Investment Corporation:											
OPIC guaranteed loans									5	77	60
Small Business Administration:											
Business loans			257	–16	–279	–545	–235	–528	–226	304	1,750
Other Independent Agencies:											
Export-Import Bank guarantees	–11	–59	13				–191	–1,520	–417	–2,042	–1,031
Total	**–616**	**995**	**727**	**–832**	**5,642**	**4,518**	**–3,641**	**–6,427**	**–1,860**	**–142**	**3,083**

* Less than $500,000.

[1] Excludes interest on reestimates. Additional information on credit reform subsidy rates is contained in the Federal Credit Supplement.

[2] Includes rural water and waste disposal, rural community facilities, and rural business and industry programs.

[3] Volume reestimates in mandatory loan guarantee programs represent a change in volume of loans disbursed in the prior years. These estimates are the result of guarantee programs where data from loan issuers on actual disbursements of loans are not received until after the close of the fiscal year.

[4] Closing reestimate executed in fiscal year 2002.

Table 7–3. DIRECT LOAN SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2003–2005

(in millions of dollars)

Agency and Program	2003 Actual			2004 Enacted			2005 Proposed		
	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels
Agriculture:									
Agricultural credit insurance fund	14.71	155	1,054	13.10	109	832	8.11	74	912
Farm storage facility loans	1.28	2	147	0.46	....	82	–2.44	–2	82
Rural community advancement program	10.00	104	1,040	1.96	30	1,532	7.85	102	1,300
Rural electrification and telecommunications loans	–0.85	–38	4,454	–1.73	–76	4,404	–1.15	–35	3,035
Rural telephone bank	1.38	2	168	–4.32	–7	174	....	....	....
Distance learning, telemedicine, and broadband program	1.30	1	77	2.30	49	2,131	2.75	8	291
Farm labor	49.02	30	61	42.73	18	42	47.06	20	42
Rural housing insurance fund	22.47	269	1,197	12.11	184	1,520	13.48	164	1,217
Rural development loan fund	48.26	19	40	43.27	17	40	46.38	16	34
Rural economic development loans	21.36	3	15	18.61	3	15	18.79	5	25
Public law 480 title I	62.84	51	81	78.90	30	38	86.42	26	30
Commerce:									
Fisheries finance	–5.52	–8	145	–2.44	–4	164	–13.33	–4	30
Defense—Military:									
Family housing improvement fund	21.71	28	129	69.23	153	221	34.22	181	529
Education:									
College housing and academic facilities loans	....	....	269	....	....	269	....	....	170
Federal direct student loan program	–1.50	–318	21,205	–1.19	–250	21,013	–2.93	–648	22,287
Homeland Security:									
Disaster assistance direct loan	–4.10	–1	25	–2.02	–1	25	–2.60	–1	25
Housing and Urban Development:									
FHA-mutual mortgage insurance	....	....	50	....	....	50	....	....	50
FHA-general and special risk	....	....	50	....	....	50	....	....	50
State:									
Repatriation loans	80.00	1	1	70.75	1	1	69.73	1	1
Transportation:									
Federal-aid highways	7.10	10	140	5.96	127	2,400	5.94	131	2,400
Treasury:									
Community development financial institutions fund	32.85	1	4	34.37	4	11	36.52	4	11
Veterans Affairs:									
Vocational rehabilitation and employment administration	1.50	....	3	1.33	....	4	1.14	....	4
Housing	–1.54	–7	566	–0.44	–5	1,135	–4.49	–77	1,715
International Assistance Programs:									
Foreign military financing loan	....	....	3,800	–0.05	....	550	....	....	....
Debt restructuring	....	211	....	....	59	....	....	105	....
Overseas Private Investment Corporation	4.97	20	394	16.78	24	143	17.12	19	111
Small Business Administration:									
Disaster loans	15.21	117	769	11.72	56	758	12.86	79	614
Business loans	13.05	4	29	9.55	2	20	10.25	....	....
Export-Import Bank of the United States:									
Export-Import Bank loans	1.72	1	58	34.00	17	50	34.00	17	50
Total	**N/A**	**657**	**35,971**	**N/A**	**540**	**37,674**	**N/A**	**185**	**35,015**

N/A = Not applicable.
[1] Additional information on credit subsidy rates is contained in the Federal Credit Supplement.

Table 7–4. LOAN GUARANTEE SUBSIDY RATES, BUDGET AUTHORITY, AND LOAN LEVELS, 2003–2005

(in millions of dollars)

Agency and Program	2003 Actual			2004 Enacted			2005 Proposed		
	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels	Subsidy rate [1]	Subsidy budget authority	Loan levels
Agriculture:									
Agricultural credit insurance fund	3.38	90	2,662	3.27	79	2,416	2.83	81	2,866
Commodity Credit Corporation export loans	4.10	170	4,146	6.96	289	4,155	6.82	309	4,528
Rural community advancement program	3.28	35	1,067	2.99	25	837	3.28	29	885
Rural electrification and telecommunications loans	0.08	....	....	0.06	....	99	0.06	....	100
Distance learning, telemedicine, and broadband program	....	....	....	3.75	3	80	5.00	2	40
Local television loan guarantee	....	....	....	8.46	44	520	....	....	....
Rural housing insurance fund	1.22	39	3,186	1.64	46	2,808	1.31	37	2,825
Rural business investment	20.00	....	....	20.00	....	....	20.00	....	....
Commerce:									
Emergency steel guaranteed loan	27.69	69	250	....	....	....	....	....	....
Defense—Military:									
Procurement of ammunition, Army	3.34	1	17	3.38	1	16	....	....	....
Family housing improvement fund	3.70	7	189	1.54	4	259	9.65	14	145
Education:									
Federal family education loan	9.57	6,411	66,976	9.19	6,501	70,760	9.47	7,050	71,349
Health and Human Services:									
Health education assistance loans	15.76	16	100	16.48	25	150	....	....	....
Health resources and services	3.65	1	4	4.68	1	17	5.64	1	17
Housing and Urban Development:									
Indian housing loan guarantee fund	2.43	5	197	2.73	5	197	2.58	1	29
Native Hawaiian housing loan guarantee fund	2.43	1	40	2.73	1	40	2.58	1	37
Native American housing block grant	11.07	2	17	10.56	2	18	10.32	2	18
Community development loan guarantees	2.30	6	275	2.30	6	275	....	....	....
FHA-mutual mortgage insurance	–2.53	–3,584	165,000	–2.47	–3,545	185,000	–1.73	–2,627	185,000
FHA-general and special risk	–1.02	–254	25,000	–1.17	–293	25,000	–0.69	–242	35,000
Interior:									
Indian guaranteed loan	6.91	5	72	6.13	5	84	6.76	5	86
Transportation:									
Minority business resource center program	2.69	....	9	2.53	....	18	2.08	1	18
Federal-aid highways	....	....	....	4.77	10	200	4.68	9	200
Maritime guaranteed loan (title XI)	6.09	21	345	6.10	25	410	6.76	25	370
Treasury:									
Air transportation stabilization [2]	13.70	180	1,276	–8.93	–3	30	....	....	....
Veterans Affairs:									
Veterans housing benefit program	0.83	547	66,074	0.58	275	47,312	–0.21	–86	41,829
International Assistance Programs:									
Loan guarantees to Israel	....	....	1,600	....	....	3,460	....	....	3,650
Development credit authority	6.44	18	280	3.11	21	675	4.31	21	487
Overseas Private Investment Corporation	–8.01	–57	712	1.81	5	276	0.49	3	615
Small Business Administration:									
Business loans	0.77	118	15,318	0.38	79	20,986	....	....	29,000
Export-Import Bank of the United States:									
Export-Import Bank loans	3.06	320	10,449	3.03	349	11,507	3.94	474	11,976
Presidio Trust:									
Presidio Trust	....	....	....	0.14	....	200	0.05	....	....
Total	**N/A**	**4,167**	**365,261**	**N/A**	**3,960**	**377,805**	**N/A**	**5,110**	**391,070**
ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS									
GNMA:									
Guarantees of mortgage-backed securities loan guarantee	–0.33	–398	252,870	–0.27	–405	200,000	–0.23	–368	200,000

N/A = Not applicable.

[1] Additional information on credit subsidy rates is contained in the Federal Credit Supplement.

[2] Numbers shown for 2004 include estimates for loan guarantees that have received either conditional or final approval. This presentation should not be construed as prejudging the outcome of the Air Transportation Stabilization Board's deliberations. The Board does not anticipate making any loan guarantees in 2005.

Table 7–5. SUMMARY OF FEDERAL DIRECT LOANS AND LOAN GUARANTEES

(In billions of dollars)

	Actual								Estimate	
	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
Direct Loans:										
Obligations	23.4	33.6	28.8	38.4	37.1	39.1	43.7	45.4	46.4	44.5
Disbursements	23.6	32.2	28.7	37.7	35.5	37.1	39.6	39.7	39.0	41.5
New subsidy budget authority [2]	*	*	–0.8	1.6	–0.4	0.3	*	0.7	0.5	0.2
Reestimated subsidy budget authority [1]	....	....	7.3	1.0	–4.4	–1.8	0.5	2.9	2.3	....
Total subsidy budget authority [3]	1.8	2.4	6.5	2.6	–4.8	–1.5	0.5	3.5	2.8	0.2
Loan Guarantees:										
Commitments	175.4	172.3	218.4	252.4	192.6	256.4	303.7	345.9	338.4	349.5
Lender disbursements	143.9	144.7	199.5	224.7	180.8	212.9	271.4	331.3	318.1	333.5
New subsidy budget authority [2]	*	*	3.3	*	3.6	2.3	2.9	3.8	3.6	4.7
Reestimated subsidy budget authority [1]	....	....	–0.7	4.3	0.3	–7.1	–2.4	–3.5	1.5	....
Total subsidy budget authority	4.0	3.6	2.6	4.3	3.9	–4.8	0.5	0.3	5.0	4.7

* Less than $50 million.
[1] Includes interest on reestimate.
[2] Prior to 1998 new and reestimated subsidy budget authority were not reported separately.
[3] GNMA secondary guarantees of loans that are guaranteed by FHA, VA and RHS are excluded from the totals to avoid double-counting.

Table 7–6. DIRECT LOAN WRITE-OFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS

Agency and Program	In millions of dollars			As a percentage of outstanding loans [1]		
	2003 actual	2004 estimate	2005 estimate	2003 actual	2004 estimate	2005 estimate
DIRECT LOAN WRITEOFFS						
Agriculture:						
Agricultural credit insurance fund	158	151	140	1.95	1.99	1.98
Farm storage facility loans program	1	1	....	0.54	0.44	
Rural community advancement program	5	....	....	0.07	....	....
Rural electrification and telecommunications loans	....	109	98	....	0.34	0.29
Rural telephone bank	....	....	3	....	....	0.44
Rural development insurance fund	1	1	1	0.03	0.04	0.04
Rural housing insurance fund	153	142	135	0.57	0.54	0.53
Rural development loan fund	1	1	1	0.25	0.24	0.23
P.L.480	34	....	....	0.32	....	....
Debt reduction (P.L.480)	....	29	37	....	6.44	6.85
Commerce:						
Economic development revolving fund	1	1	1	3.84	4.54	5.55
Education:						
Student financial assistance	3	4	4	0.92	1.24	1.26
Housing and Urban Development:						
Revolving fund (liquidating programs)	1	1	1	8.33	16.66	25.00
Guarantees of mortgage-backed securities	3	4	21	2.91	3.47	16.53
Interior:						
Indian direct loan	2	2	2	3.92	4.44	5.12
Labor:						
Pension Benefit Guaranty Corporation	5	11	39	....	....	....
State:						
Repatriation loans	....	1	....	....	33.33	....
Transportation:						
Railroad rehabilitation and improvement	....	2	4	....	0.85	0.98
Treasury:						
Community development financial institutions fund	....	....	1	....	....	1.58
Veterans Affairs:						
Veterans housing benefit program	15	13	11	0.87	0.75	0.59
International Assistance Programs:						
Military debt reduction	....	....	14	....	....	5.83
Debt reduction (AID)	....	19	13	....	10.61	7.64
Overseas Private Investment Corporation	....	1	1	....	0.47	0.38
Small Business Administration:						
Disaster loans	47	43	43	1.39	1.35	1.18
Business loans	11	10	9	3.23	3.54	4.05
Other Independent Agencies:						
Export-Import Bank	570	48	45	5.17	0.47	0.48
Debt reduction (ExIm Bank)	13	17	41	4.65	3.61	8.24
Spectrum auction program	95	....	....	1.82	....	....
Tennessee Valley Authority	1	1	1	2.08	1.81	1.63
Total, direct loan writeoffs	**1,119**	**612**	**667**	**0.50**	**0.27**	**0.28**
GUARANTEED LOAN TERMINATIONS FOR DEFAULT						
Agriculture:						
Agricultural credit insurance fund	92	77	80	0.92	0.73	0.72
Commodity Credit Corporation export loans	102	172	184	2.38	3.81	3.27
Rural community advancement program	72	60	55	1.66	1.36	1.27
Rural electrification and telecommunications loans	....	6	6	....	0.57	0.37
Rural development insurance fund	27	....	....	41.53	....	....
Rural housing insurance fund	170	117	121	1.25	0.85	0.87
Commerce:						
Emergency oil and gas guaranteed loan program	....	1	....	....	100.00	....
Emergency steel guaranteed loan program	....	32	12	....	15.53	5.74
Defense—Military:						
Family housing improvement fund	....	3	4	....	0.78	1.06

Table 7–6. DIRECT LOAN WRITE-OFFS AND GUARANTEED LOAN TERMINATIONS FOR DEFAULTS—Continued

Agency and Program	In millions of dollars			As a percentage of outstanding loans [1]		
	2003 actual	2004 estimate	2005 estimate	2003 actual	2004 estimate	2005 estimate
Education:						
Federal family education loan	3,509	4,708	5,334	1.77	2.08	2.12
Health and Human Services:						
Health education assistance loans	56	58	58	2.42	2.43	2.44
Housing and Urban Development:						
Indian housing loan guarantee	....	1	1	....	1.56	1.38
Title VI Indian Federal guarantees program	....	1	1	....	1.36	1.25
FHA—Mutual mortgage insurance	7,410	4,681	4,533	1.69	1.08	0.90
FHA—General and special risk	1,740	1,903	1,773	1.87	2.13	1.90
Interior:						
Indian guaranteed loan	1	1	1	0.38	0.32	0.28
Transportation:						
Maritime guaranteed loan (Title XI)	....	30	35	....	0.81	0.87
Treasury:						
Air transportation stabilization	....	448	60	....	29.35	5.18
Veterans Affairs:						
Veterans housing benefit program	1,345	2,917	3,016	0.45	0.85	0.79
International Assistance Programs:						
Foreign military financing	....	3	11	....	0.09	0.37
Micro and small enterprise development	3	1	1	7.69	1.81	1.33
Urban and environmental credit program	54	41	42	2.71	2.23	2.49
Development credit authority	....	1	1	....	1.11	0.56
Overseas Private Investment Corporation	33	45	45	0.99	1.37	1.27
Small Business Administration:						
Business loans	1,255	2,325	1,272	2.65	4.19	2.03
Pollution control equipment	....	1	1	....	16.66	33.33
Other Independent Agencies:						
Export-Import Bank	215	368	391	0.66	1.07	1.11
Total, guaranteed loan terminations for default	**16,084**	**18,001**	**17,038**	**0.95**	**1.02**	**0.87**
Total, direct loan writeoffs and guaranteed loan terminations	**17,203**	**18,613**	**17,705**	**0.90**	**0.94**	**0.81**
ADDENDUM: WRITEOFFS OF DEFAULTED GUARANTEED LOANS THAT RESULT IN LOANS RECEIVABLE						
Agriculture:						
Agricultural credit insurance fund	1	1	1	11.11	11.11	11.11
Commerce:						
Fisheries finance	13	....	....	28.26	....	....
Education:						
Federal family education loan	213	196	198	1.16	1.08	1.05
Health and Human Services:						
Health education assistance loans	26	24	24	2.93	2.68	2.65
Housing and Urban Development:						
FHA—Mutual mortgage insurance	2	....	....	1.63	....	....
FHA—General and special risk	309	362	354	10.61	11.06	9.43
Interior:						
Indian guaranteed loan	18	3	....	51.42	13.63	....
Treasury:						
Air transportation stabilization	....	....	383	....	....	150.78
Veterans Affairs:						
Veterans housing benefit program	87	83	95	7.63	6.87	6.97
International Assistance Programs:						
Urban and environmental credit program	40	....	....	8.43	....	....
Small Business Administration:						
Business loans	543	302	574	28.10	9.98	14.33
Total, writeoffs of loans receivable	**1,252**	**971**	**1,629**	**3.93**	**2.83**	**4.46**

[1] Average of loans outstanding for the year.

Table 7–7. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS[1]

(In millions of dollars)

Agency and Program	2003 Actual	Estimate	
		2004	2005
DIRECT LOAN OBLIGATIONS			
Agriculture:			
Agricultural credit insurance fund	1,006	844	937
Distance learning, telemedicine, and broadband	300	898	291
Rural electrification and telecommunications	4,454	4,404	3,035
Rural telephone bank	172	174	....
Rural water and waste disposal direct loans	789	1,032	1,000
Rural housing insurance fund	1,260	1,563	1,259
Rural community facility direct loans	255	500	300
Rural economic development	15	15	25
Rural development loan fund	40	40	34
P.L. 480 direct credit	44	38	30
Commerce:			
Fisheries finance	24	24	30
Education:			
Historically black college and university capital financing	269	269	170
Homeland Security:			
Disaster Assistance Direct Loan Financing Account	25	25	25
Housing and Urban Development:			
FHA-general and special risk	50	50	50
FHA-mutual mortgage insurance	50	50	50
Interior:			
Assistance to American Samoa	1	1	1
State:			
Repatriation loans	1	1	1
Transportation:			
Transportation infrastructure finance and innovation program	2,200	2,200	2,200
Transportation infrastructure finance and innovation program line of credit	200	200	200
Treasury:			
Community development financial institutions fund	11	11	11
Veterans Affairs:			
Native American and transitional housing	....	50	30
Vocational rehabilitation and education	3	4	4
International Assistance Programs:			
Foreign military financing	3,800	550	....
Military debt reduction	....	32	....
Small Business Administration:			
Business loans	25	20	....
Total, limitations on direct loan obligations	**14,994**	**12,995**	**9,683**
LOAN GUARANTEE COMMITMENTS			
Agriculture:			
Agricultural credit insurance fund	2,766	2,401	2,866
Rural electrification and telecommunications guaranteed loans	....	100	100
Rural water and waste water disposal guaranteed loans	75	75	75
Distance learning and telemedicine	....	....	40
Rural housing insurance fund	3,186	2,809	2,825
Rural community facility guaranteed loans	210	210	210
Rural business and industry guaranteed loans	845	552	600
Defense—Military:			
Arms initiative	17	16	....
Health and Human Services:			
Health education assistance loans	160	150	....
Housing and Urban Development:			
Indian housing loan guarantee fund	197	197	29
Title VI Indian Federal guarantees	17	18	18
Native Hawaiian housing loan guarantee fund	40	40	37
Community development loan guarantees	273	273	....

Table 7–7. APPROPRIATIONS ACTS LIMITATIONS ON CREDIT LOAN LEVELS [1]—Continued

(In millions of dollars)

Agency and Program	2003 Actual	Estimate	
		2004	2005
FHA-general and special risk	25,000	25,000	35,000
FHA-mutual mortgage insurance	165,000	185,000	185,000
Interior:			
Indian loan guarantee	72	84	86
Transportation:			
Minority business resource center	18	18	18
Transportation infrastructure finance and innovation program loan guarantee	200	200	200
International Assistance Programs:			
Loan guarantees to Israel	3,000	3,000	3,000
Development credit authority	....	700	700
Small Business Administration:			
Business guarantee	15,318	20,986	29,000
Total, limitations on loan guarantee commitments	**216,394**	**241,829**	**259,804**
ADDENDUM: SECONDARY GUARANTEED LOAN COMMITMENT LIMITATIONS			
Housing and Urban Development:			
Guarantees of mortgage-backed securities	200,000	200,000	200,000
Total, limitations on secondary guaranteed loan commitments	**200,000**	**200,000**	**200,000**

[1] Data represents loan level limitations enacted or proposed to be enacted in appropriation acts. For information on actual and estimated loan levels supportable by new subsidy budget authority requested, see Tables 7–3 and 7–4.

Table 7–8. FACE VALUE OF GOVERNMENT-SPONSORED ENTERPRISE LENDING [2]

(In billions of dollars)

	Outstanding	
	2002	2003
Government Sponsored Enterprises: [1]		
Fannie Mae[1]	1,689	2,086
Freddie Mac [2]	1,255	N/A
Federal Home Loan Banks [3]	524	758
Sallie Mae [4]	....	....
Farm Credit System	83	86
Total [2]	**3,551**	**N/A**

N/A = Not applicable.

[1] Net of purchases of federally guaranteed loans.

[2] 2003 financial data for Freddie Mac is not presented here because the company has not yet reported financial results for 2003. In addition, on November 21, 2003, Freddie Mac announced the results of its restatement of previously issued consolidated financial statements for the years 2000 and 2001 and the first three quarters of 2002 and the revision of fourth quarter and full-year consolidated financial statements for 2002 (collectively referred to as the "restatement"). This restatement has changed the data provided last year in the 2004 Budget. Restated data for 2002 has not yet been audited.

[3] The lending by the Federal Home Loan Banks measures their advances to member thrift and other financial institutions. In addition, their investment in private financial instruments at the end of 2003 was $186 billion, including federally guaranteed securities, GSE securities, and money market instruments. The change between 2002 and 2003 is not comparable because of discontinuity in the data series.

[4] The face value and Federal costs of Federal Family Education Loans in the Student Loan Marketing Association's portfolio are included in the totals for that program under guaranteed loans in table 7–1.

Table 7–9 LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs) [1,2]

(In millions of dollars)

Enterprise	2003
Student Loan Marketing Association:	
Net change	–14,009
Outstandings	27,923
Federal National Mortgage Association:	
Portfolio programs:	
Net change	162,939
Outstandings	922,672
Mortgage-backed securities:	
Net change	220,989
Outstandings	1,210,263
Federal Home Loan Mortgage Corporation: [1]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Farm Credit System:	
Agricultural credit bank:	
Net change	2,997
Outstandings	23,463
Farm credit banks:	
Net change	188
Outstandings	58,353
Federal Agricultural Mortgage Corporation:	
Net change	....
Outstandings	6,000
Federal Home Loan Banks:	
Net change	232,687
Outstandings	770,499
Less guaranteed loans purchased by:	
Student Loan Marketing Association:	
Net change	–14,009
Outstandings	27,923
Federal National Mortgage Association:	
Net change	–12,843
Outstandings	47,300
Other:	
Net change [3]	N/A
Outstandings [1]	13,897
BORROWING	
Student Loan Marketing Association:	
Net change	–18,899
Outstandings	26,821
Federal National Mortgage Association:	
Portfolio programs:	
Net change	175,479
Outstandings	975,734
Mortgage-backed securities:	
Net change	220,989
Outstandings	1,210,263
Federal Home Loan Mortgage Corporation: [1]	
Portfolio programs:	
Net change	N/A
Outstandings	N/A
Mortgage-backed securities:	
Net change	N/A
Outstandings	N/A
Farm Credit System:	
Agricultural credit bank:	
Net change	3,938
Outstandings	26,451

Table 7–9 LENDING AND BORROWING BY GOVERNMENT-SPONSORED ENTERPRISES (GSEs) [1,2]—Continued

(In millions of dollars)

Enterprise	2003
Farm credit banks:	
Net change	4,255
Outstandings	68,049
Federal Agricultural Mortgage Corporation:	
Net change	764
Outstandings	3,838
Federal Home Loan Banks:	
Net change	49,325
Outstandings	716,886
DEDUCTIONS	
Less borrowing from other GSEs:	
Net change [3]	N/A
Outstandings [1]	78,370
Less purchase of Federal debt securities:	
Net change [3]	N/A
Outstandings [1]	3,094
Less borrowing to purchase loans guaranteed by:	
Student Loan Marketing Association:	
Net change	–14,009
Outstandings	27,923
Federal National Mortgage Association:	
Net change	–12,843
Outstandings	47,300
Other:	
Net change [3]	N/A
Outstandings [1]	13,897

N/A = Not applicable.

The estimates of borrowing and lending were developed by the GSEs based on certain assumptions that are subject to periodic review and revision and do not represent official GSE forecasts of future activity, nor are they reviewed by the President. The data for all years include programs of mortgage-backed securities. In cases where a GSE owns securities issued by the same GSE, including mortgage-backed securities, the borrowing and lending data for that GSE are adjusted to remove double-counting.

[1] Financial data for Freddie Mac is not presented here because the company has not yet reported financial results for 2003. In addition, on November 21, 2003, Freddie Mac announced the results of its restatement of previously issued consolidated financial statements for the years 2000 and 2001 and the first three quarters of 2002 and the revision of fourth quarter and full-year consolidated financial statements for 2002 (collectively referred to as the "restatement"). This restatement has changed the data provided last year in the 2004 Budget. Restated data for 2002 has not yet been audited.

[2] Totals and subtotals have not been calculated because a substantial portion of the total, Freddie Mac, is subject to the above-described restatement.

[3] Not calculated due to discontinuity in the data series.