Appendix B – Description of Projected Losses Calculation

Projected losses are estimated first in the "liquidations" portfolio, and then in the "active" portfolio as follows:

- Liquidations Portfolio Projected Losses:
  - The Office of SBIC Liquidations performs an estimate of all projected net recoveries for all outstanding leverage that has been transferred to its office at the end of each fiscal year. The assets of an SBIC from which the SBA will seek to recover the leverage may include outstanding equities, debt securities, notes, or tangible property as well as any investment instrument an SBIC might have utilized in providing financing. At that time, using a detailed bottoms-up approach, on an asset by asset basis, the office reviews the recoverable value of the asset based on valuations, estimates, and appraisals as well as payment history, security, and other pertinent and available information dependent upon the type of holding, the priority of the investment, and the overall market conditions. The Office of SBIC Liquidations reassesses this estimate each year.
  - Since it applies to the outstanding leverage in the Liquidations Portfolio, the total projected loss estimate appears in the balance sheet. To maintain the correct loss reserve, the change to this amount appears in the P&L.
  - In comparing Total Projected and Actual Losses to the Gross Transferred Leverage in the Balance sheet through FY 2002, historically, about 63% of all leverage transferred into Liquidations is anticipated to be recovered. Prioritized payments transferred into Liquidations only project a 19% recovery rate, as these payments are contingent capital based on SBIC profits.

- Projected losses are estimated in the "active" portfolio as follows:
  - Losses in the Active Portfolio are estimated using the equation below. The calculation is based on an estimated default rate multiplied by an estimated loss rate multiplied by outstanding leverage plus advances. SSBICs are calculated separately from SBICs.

Projected Losses in Active Portfolio = (Outstanding Leverage + Outstanding Advanced Prioritized Payments) x Default Rate x Loss Rate

where

$$\text{Default Rate} = \frac{\text{Amount of Cash Defaulted}}{\text{Total Cash Disbursed}} = \frac{\text{Leverage + Advances Transferred to Liquidations}}{\text{Totals Disbursements + Advances}}$$

$$\text{*Loss Rate} = \frac{\text{Projected Current Losses in Liquidations}}{\text{Amount of Cash Defaulted}} = \frac{\text{Projected Losses in Liquidation}}{\text{Leverage + Advances Transferred to Liquidations}}$$

*Note on Loss Rate Equation: The "Projected Losses in Liquidation" figure is based on the estimate from the liquidations/restructurings portfolio, discussed above. The "Leverage + Advances Transferred to Liquidations/Restructurings" figure only includes cases that are still open.

  - As with Projected Losses in Liquidations, since this number applies to the outstanding leverage in the Active Portfolio, the resulting estimate appears in the balance sheet. The change to this amount each year appears in the P&L. The following chart looks at the projected losses estimated by this calculation over time.