Modifications

OMB Annual Credit Training

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Executive Office of the President • Office of Management and Budget

Topics

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- What is a modification?
- How do I estimate the modification subsidy cost or savings?
- What impact does the modification have on the Budget?
- What do I need to know about financing account transfers?
- What do I need to know about loan asset sales?

Definition

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- Modification is defined in FCRA
- A **modification** is a government action that

  (1) Differs from actions assumed in the baseline estimate of cashflows in the budget, and

  (2) Changes the estimated cost of an outstanding direct loan (or direct loan obligation) or an outstanding loan guarantee (or loan guarantee commitment).

Modifications

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- Require a Government action -- new legislation or administrative action.
- Apply to:
  - Outstanding direct loan or direct loan obligations.
  - Outstanding loan guarantee or loan guarantee commitments.
- May affect one or a group of direct loans or guarantees.
- Apply to pre-credit and post-credit reform credit.
- Have costs/savings reflected in dollars. (Not rates!)

Direct vs. Indirect

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- It is possible to modify directly, or indirectly.
- Direct:
  - Alters the terms of existing contracts (forgiveness, interest rate reduction, extension of maturity, prepayments without penalty)
  - Sale of loan assets
  - Purchase of undefaulted guaranteed loans
- Indirect:
  - Legislation alters administration of the portfolio (new debt collection tools, restrictions on debt collection)
  - Change in covenant requirements

What is not a modification?

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- Non-Government actions permitted within terms of existing contracts (e.g., prepayment without penalty)
- Administrative workouts:
  - Applies to troubled loans & loans in imminent default
  - Actions to maximize loan repayments or minimize guarantee claims
- Additional disbursements to borrowers under the same contract (these are treated as new loans)
- Changes before obligation or commitment

Modification cost or savings

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- Difference between the estimated PV of the remaining cash flows **before** and **after** the modification.
- If you don't have the BA to cover the cost, you can't do a modification.
- If a law mandates a modification, it provides the BA.
- Modification costs are expressed in dollars.

Estimating the modification subsidy cost—cashflows

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- Before cashflows—truncated to ignore all activity prior to the point of modification
- After cashflows—the "before" cashflows altered ONLY for the effects of the modification
  - Cashflows to the Government have a positive sign
  - Cashflows from the Government have negative signs
  - *Note: If you are using cashflows formatted for the Credit Subsidy Calculator 2, you may have to change some of the signs*

Truncated cashflows

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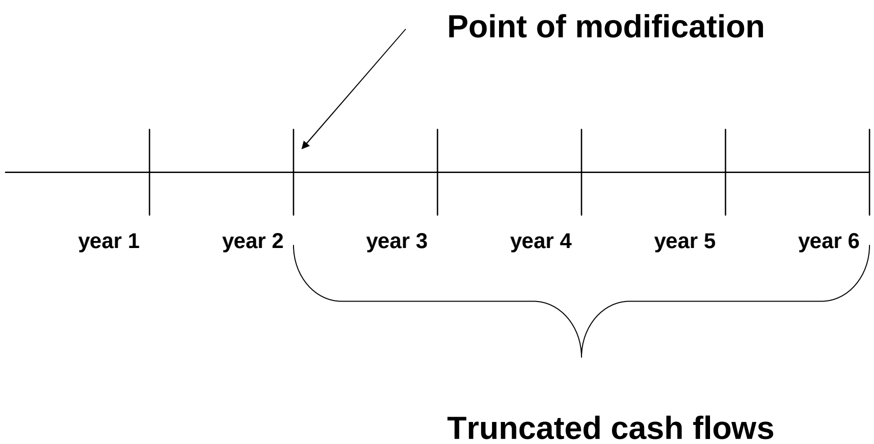

Modification Cost Estimate for a Loan Guarantee

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Starting with the baseline cashflow, truncated from the point of modification

	Year 1 **2006**	Year 2 **2007**	Year 3 **2008**	Year 4 **2009**	Year 5 **2010**	Year 6 **2011**
Disbursements	100,000					
Up front fees	1,000					
Default claim payments	-1,950	-2,050	-2,000	-2,000	-2,000	-2,000
Recoveries	900	1,100	1,000	1,000	1,000	1,000

Modification Cost Estimate for a Loan Guarantee

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Modification Cost Example

Change expected to reduce recoveries

	Year 2008	2009	2010	2011
Before Modification				
Default claim payments	-2,000	-2,000	-2,000	-2,000
Recoveries	1,000	1,000	1,000	1,000
Total cashflow	-1,000	-1,000	-1,000	-1,000
2008 PV factor (annual, end)	0.952	0.907	0.865	0.825
PV Pre-modification cash flows	-952	-907	-865	-825
After Modification				
Default claim payments	-2,000	-2,000	-2,000	-2,000
Recoveries	750	750	750	750
Total cashflow	-1,250	-1,250	-1,250	-1,250
2008 PV factor (annual, end)	0.952	0.907	0.865	0.825
PV Post-modification cash flows	-1190	-1134	-1082	-1031

PV of Pre-modification	-3549
- PV of post-modification	-4437
Modification Cost	887

Modification Adjustment Transfer

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Modification Adjustment Transfer

	Year 2008	2009	2010	2011
Before Modification				
Default claim payments	-2,000	-2,000	-2,000	-2,000
Recoveries	1,000	1,000	1,000	1,000
Total cashflow	-1,000	-1,000	-1,000	-1,000
Cohort discount rate	0.962	0.925	0.889	0.855
PV of Pre-modification	-962	-925	-889	-855
After Modification				
Default claim payments	-2,000	-2,000	-2,000	-2,000
Recoveries	750	750	750	750
Total cashflow	-1,250	-1,250	-1,250	-1,250
Cohort discount rate	0.962	0.925	0.889	0.855
PV of Post-modification	-1202	-1156	-1111	-1069

Using Cohort rate of 4%	
PV of Pre-modification	-3630
- PV of post-modification	-4537
Difference	907

Modification Adjustment Transfer	
Modification Cost at Cohort Rate	907
Modification Cost at PB	887
Modification Adjustment Transfer	20

Review of Modification Cost Estimates

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- Step 1: Calculate the net present value of remaining pre-modification cashflows
- Step 2: Calculate the net present value of remaining post-modification cashflows
- Step 3: Compute the cost of the modification (Step 1 minus Step 2)
- Step 4: Compute the net present value of pre-modification cashflows using the cohort rate
- Step 5: Compute the net present value of post-modification cashflows using the cohort rate
- Step 6: Calculate the difference (Step 4 minus Step 5)
- Step 7: Calculate the Modification Adjustment Transfer (Step 6 minus Step 3)