CREDIT MODIFICATIONS

- OMB Annual Training
- June 20, 2006

Topics

- What is a modification?
- How do I estimate the subsidy cost or savings?
- What impact does the subsidy cost or savings 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

A government action that:

Differs from actions assumed in the baseline estimate of cashflows and…

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

Modifications --

- 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.

Direct vs. Indirect

- Direct:
  - Altering the terms of existing contracts (forgiveness, interest rate reduction, extension of maturity, prepayments without penalty)
  - Selling loan assets
  - Purchasing undefaulted guaranteed loans
- Indirect:
  - Legislation alters administration of the portfolio (new debt collection tools, restrictions on debt collection)
  - Change in covenant requirements

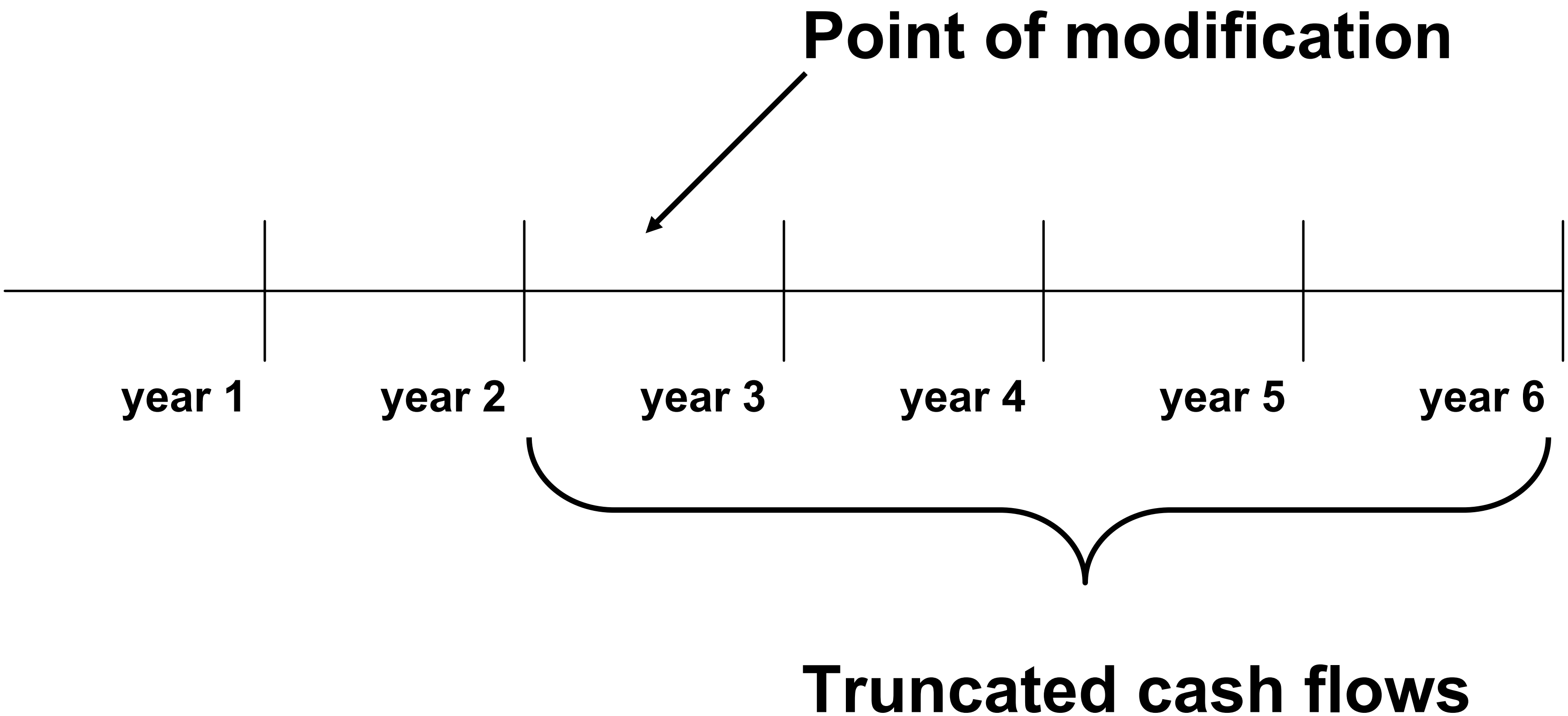
Not modifications

- 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

- Difference between the estimated PV of the remaining cash flows **before** and **after** the modification.
- “Before” cash flows:
  - Use truncated cash flows as assumed in the most recent President's budget.
- "After" cash flows:
  - Use "before" cash flows adjusted **only** for effects of 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.

Truncated Cash Flows



Estimating the subsidy cost

(Where cash flows to the Government have positive signs and cash flows from the Government have negative signs)

1. Calculate the net PV of “before” cash flows using current year budget assumption discount rates .
2. Calculate the PV of “after” cash flows using current year budget assumption discount rates .
3. Calculate the cost of modification
   - #1 above minus #2= cost of modification
   - cost (+), savings (-), or no cost (zero).

Microsoft Excel - CSC example

A1 | Credit Subsidy Calculator version....................

	A	B	C	D
1	Credit Subsidy Calculator version..............	Revision 1h of the 11-26-99 release (12-03-03)		
2	Run date/time..	Wed 09 Jun 2004 13:32:44		
3	Display type..	Present value factor display		
4	Program name..	Direct Loan Example D-1		
5	Description...	Direct Loan Example D-1		
6	Program type...	direct loan		
7	Spreadsheet name......................................	G:\CR_CREW\TRAINING\Annual 04\Cash Flows\dlexs04.xls		
8	Range name and coordinates.....................	DLEX1 A:A11..A:G23		
9	Last updated on..	Tue 08 Jun 2004 18:49:27		
10	Pro-rata method...	Construction model		
11	All content displayed..................................	See Tips-Views-Limitations menu for potential problems		
12	Purpose of this calculation..........................	Budget formulation		
13	Interest rate assumptions............................	Budget forecast rates, Budget 2005 [2003-12-03]		
14	--	--	--	--
15		Beginning	Middle	End
16	Annual factors	of year	of year	of year
17	--	--	--	--
18	Year 1.................................	1.000	0.990	0.978
19	Year 2.................................	0.978	0.962	0.945
20	Year 3.................................	0.945	0.926	0.907
21	Year 4.................................	0.907	0.886	0.865
22	Year 5.................................	0.865	0.843	0.821
23	Year 6.................................	0.821	0.799	0.778
24	Year 7.................................	0.778	0.756	0.735
25	Year 8.................................	0.735	0.715	0.695
26	Year 9.................................	0.695	0.675	[illegible]
27	Year 10...............................	0.655	[illegible]	0.618
28	Year 11...............................	[illegible]	0.600	0.582
29	Year 12...............................	0.582	0.565	0.547

Cash flow data | Subsidy | **PV factors** | Disb pd data | PV calculation | Subsidy calc | Messages

Use the PV factors in the CSC. Multiply Each future cash flow by its Factor to get PV of that flow.

PV Tab

Budget treatment of the cost/savings

- **Cost** = Obligate and outlay BA in the program account (paid to the financing account).
- **Savings** = obligate and disburse in the financing account (paid to a negative subsidy receipt account).

Modification adjustment transfers (post 1991)

4. Calculate the PV of remaining pre-modification cash flows using cohort discount rates
5. Calculate the PV of post-modification cash flows using cohort discount rates
6. Compute the difference between steps 4 and 5 (4 minus 5)
7. MAT = step 6 minus step 3 (cost of modification)

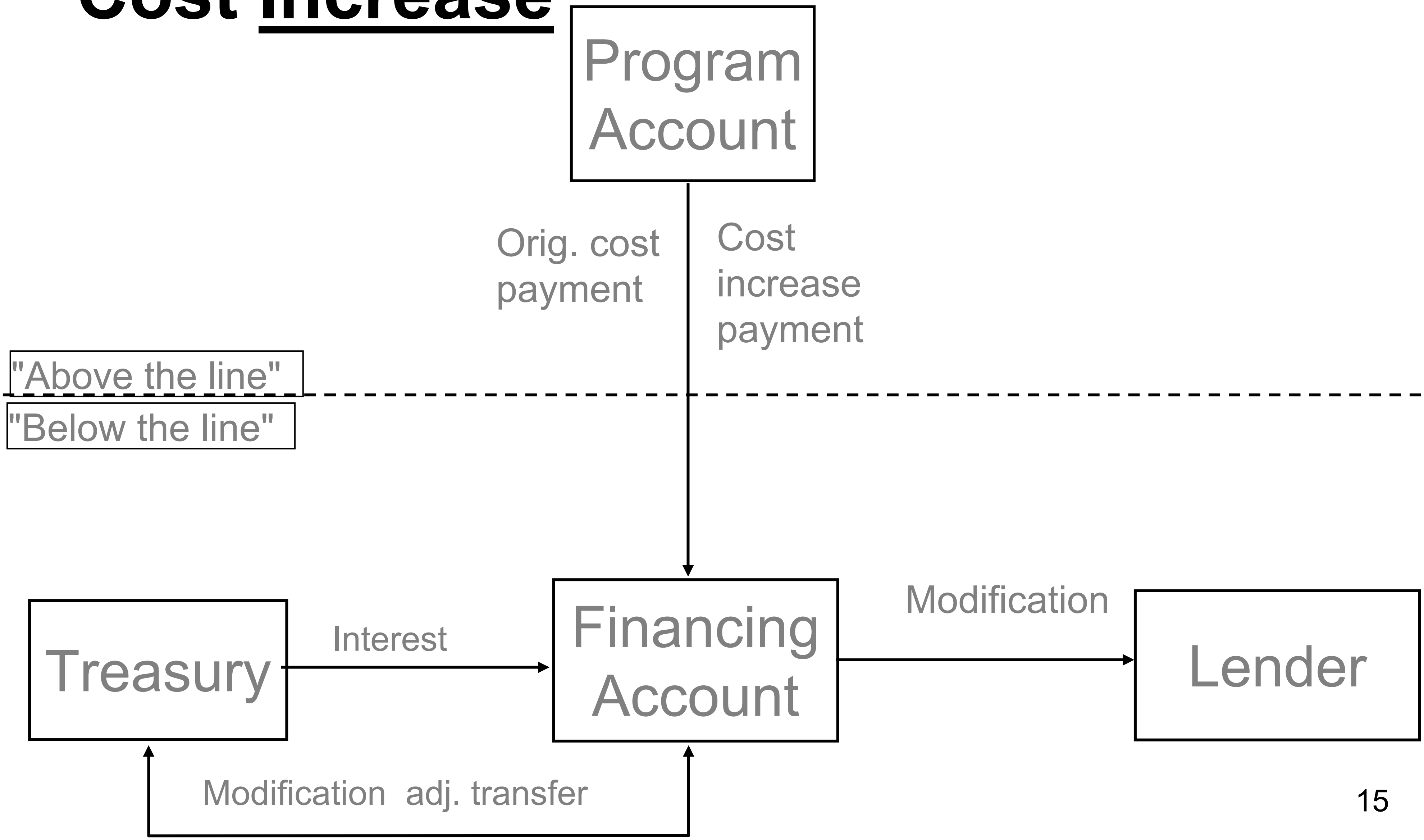
Direct loan example

Step 1		$1,000	PV pre-mod cash flows	
Step 2	minus	$900	PV post-mod cash flows	Uses current discount rates
Step 3	=	$100	Cost of Modification	
Step 4		$950	PV pre-mod cash flows	
Step 5	minus	$855	PV post-mod cash flows	Uses cohort discount rates
Step 6	=	$95	difference	
Step 7		$95	result of step 6	
	minus	$100	cost of modification	
		-$5	Modification Adjustment Transfer	

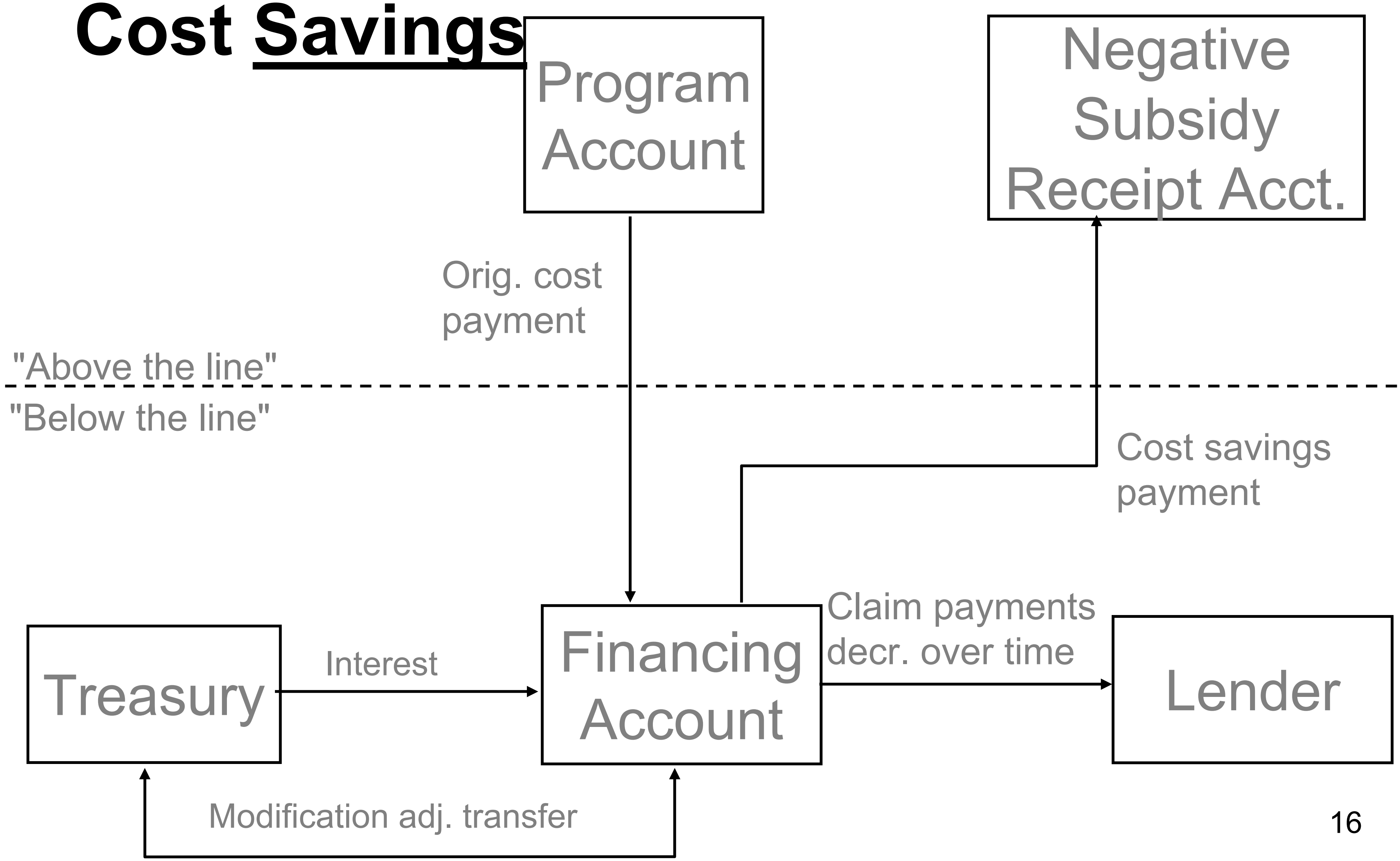
Additional financing account transfer

- **Pre-1992:** *asset or liability transfers* -- transfers assets or liabilities from liquidating account to financing account.

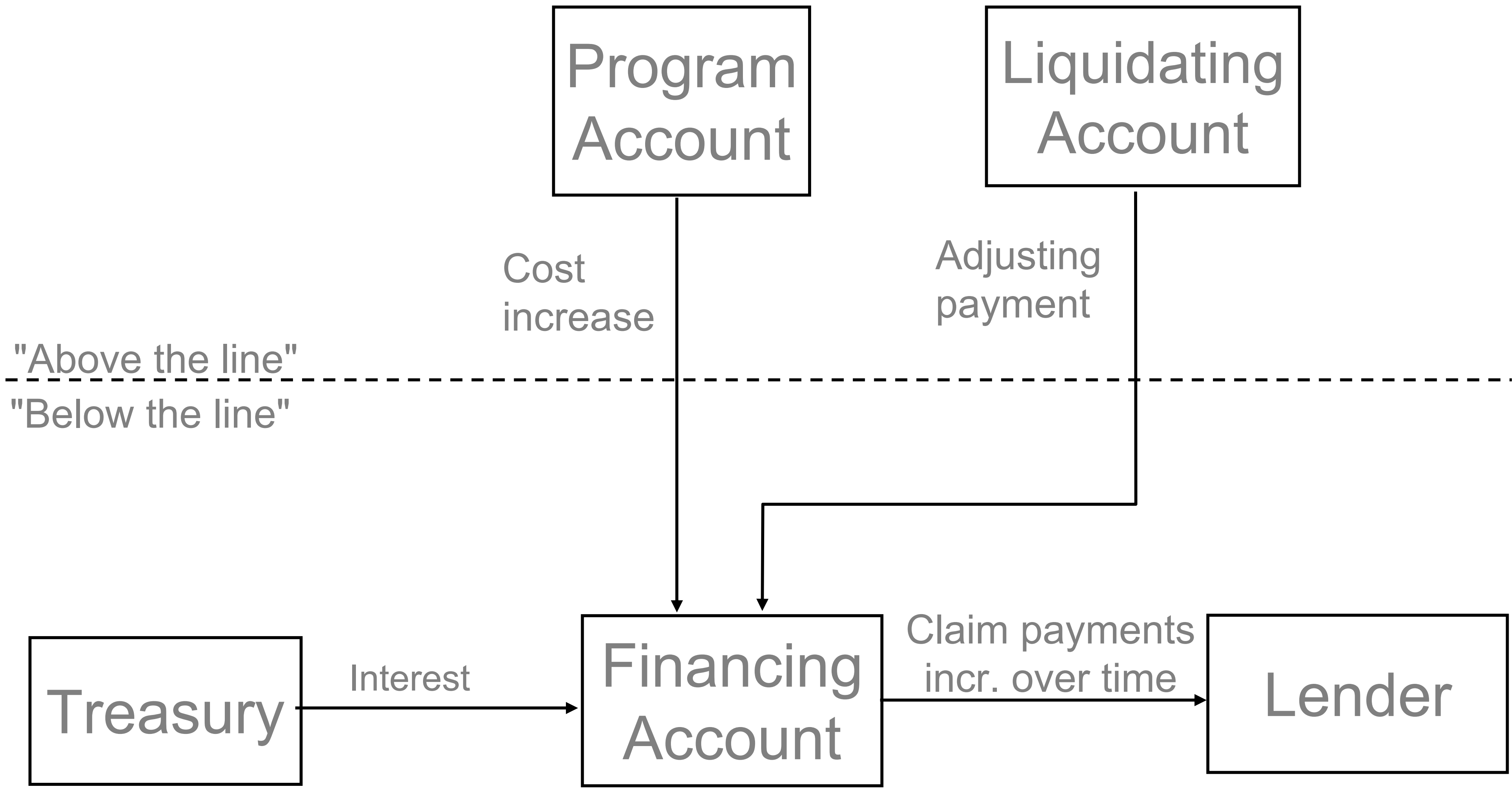
Post-1991 Loan Guarantee Modification Cost Increase



Post-1991 Loan Guarantee Modification Cost Savings



Pre-1992 Loan Guarantee Modification Cost <u>Increase</u>



Delinquent loan asset sales

- Requirement:

  Agencies with over $100 million in loan assets are expected to sell loans that are more than one year delinquent.

- OMB must approve sales -- and exceptions -- based on specific information submitted by the agency.

Exceptions...

- Loans to foreign countries or entities
- Loans in structured forbearance
- Loans written off as unenforceable
- Loans in adjudication or foreclosure
- Loans that have been submitted to Treasury for offset and are expected to be extinguished within 3 years
- Agency can demonstrate that PV of expected cash flows would exceed sales proceeds
- Sale would be inconsistent with Administration policy

Cost of loan asset sales

- If the cash flows for existing loans don’t explicitly assume a sale, the sale is a modification.
- The cost or savings is the difference between the net sales proceeds and the PV to the government of keeping the loan assets (hold value).
- Certain costs are netted from gross proceeds (e.g., underwriting, rating agency, due diligence,…see A-11).
- If the sale was assumed in the cash flows, the difference between the estimated and the actual proceeds from the sale is a <u>reestimate</u> (not a modification).

Special Cases

- If asset are sold with recourse, treat as two separate transactions:
  - Sale without recourse (modification), and
  - New loan guarantee.
- If asset sales are sold with a government equity stake (or participation) in cash flows, count the:
  - Cash proceeds from the sale, plus
  - PV of the proceeds from the equity position, minus
  - Transaction costs

Summary

- Definition:
  - Government action
  - New legislation or administrative action
  - Affects one loan or a group
  - Applies to pre-1992 and post-1991 credit
  - Direct and indirect
  - Not:
    - Workouts
    - Actions permitted within terms of contract
    - Additional disbursements
    - Changes before obligation or commitment

Summary (continued)

- Estimating the subsidy cost/savings - calculate pre- and post-modification subsidy cost

- Budget treatment of cost/savings:
  - Cost = obligation, outlay from program account to financing account.
  - Savings = obligation, disbursement from financing account to receipt account.

Summary (continued)

- Financing account transfers:

  Post-1991: modification adjustment transfer

  Pre-1992: direct loan asset or loan guarantee liability transfer from liquidating account to financing account and a one-time adjustment payment.

- Delinquent loan asset sales: Required for agencies w/ $100 million in loan assets (some exceptions).

-- End -- Questions?