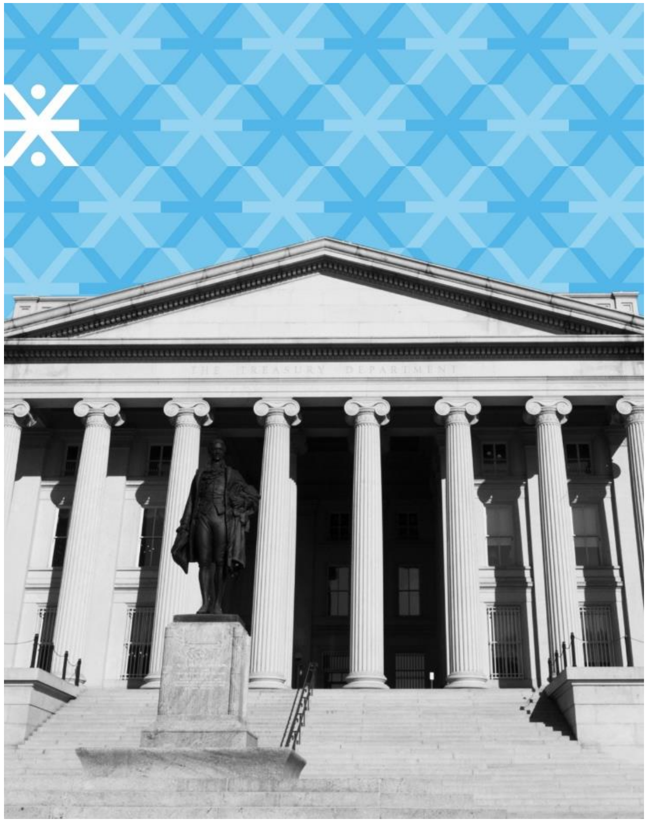
A Primer On Federal Credit Programs

Welcome to the Family



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Agenda

- **Who am I?**
- **The Use of Federal Loans Is Common: Welcome To The Family**
- **This Family Has Rules: Federal Credit Reform Act of 1990 (FCRA) & The Office of Management and Budget**
- **Case studies**

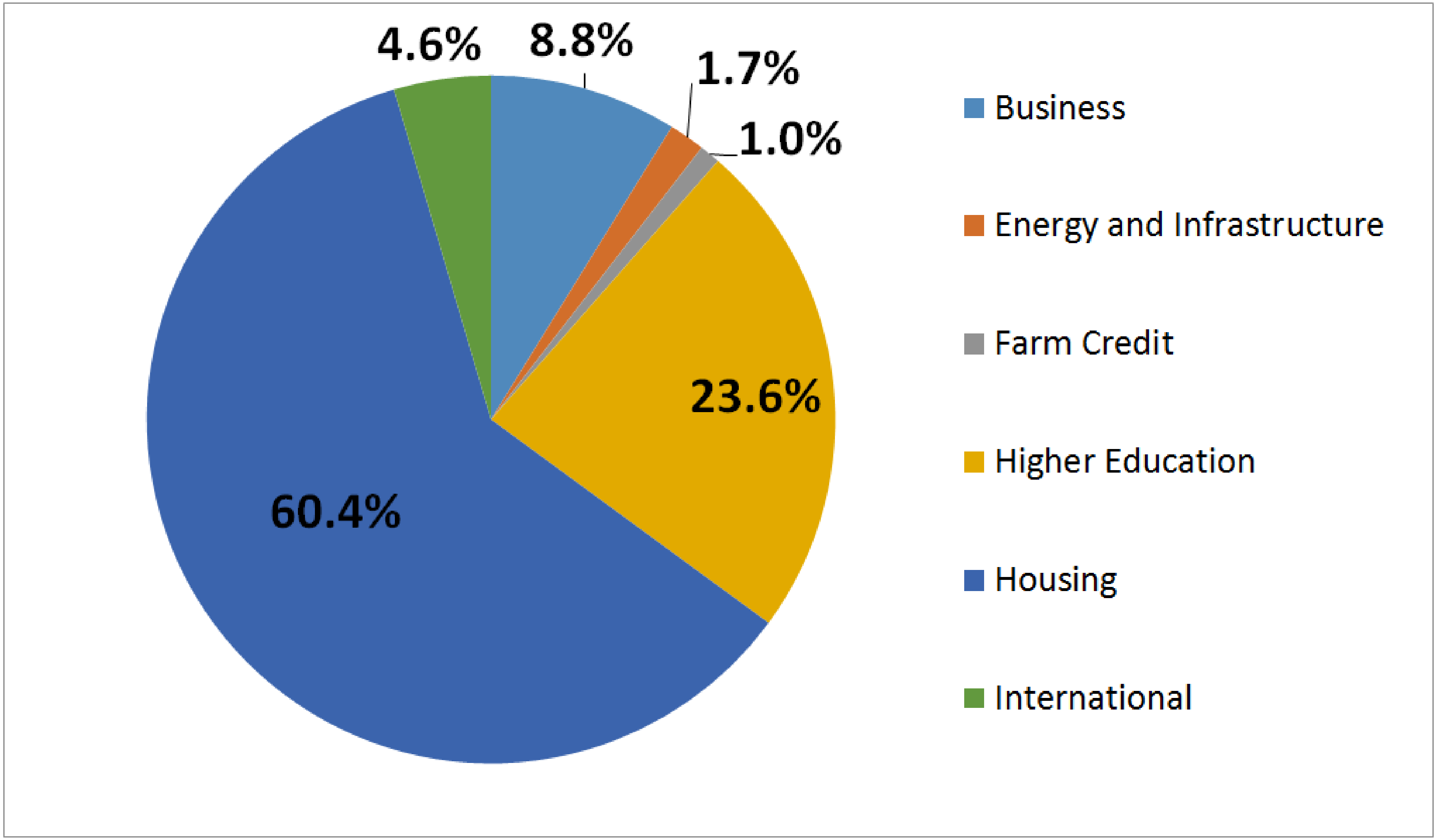
Summit Specializes in Federal Loan Program Development

- **Summit offers an all-inclusive suite of specialized Federal Credit advisory and risk analytics services with almost 90 staff and experts**
- **I am a former member of the OMB Credit Crew, a published Federal Credit Expert, and served as a credit subsidy expert (detailee) on the House Budget Committee**
- **Summit is the only firm to have worked on the below three federal credit programs developed in the last ten years:**
  - Department of Energy Title XVII
  - Department of the Treasury Community Development Financial Institutions (CDFI) Bond Guarantee Program
  - EPA Water Infrastructure Finance and Innovation Act (WIFIA)

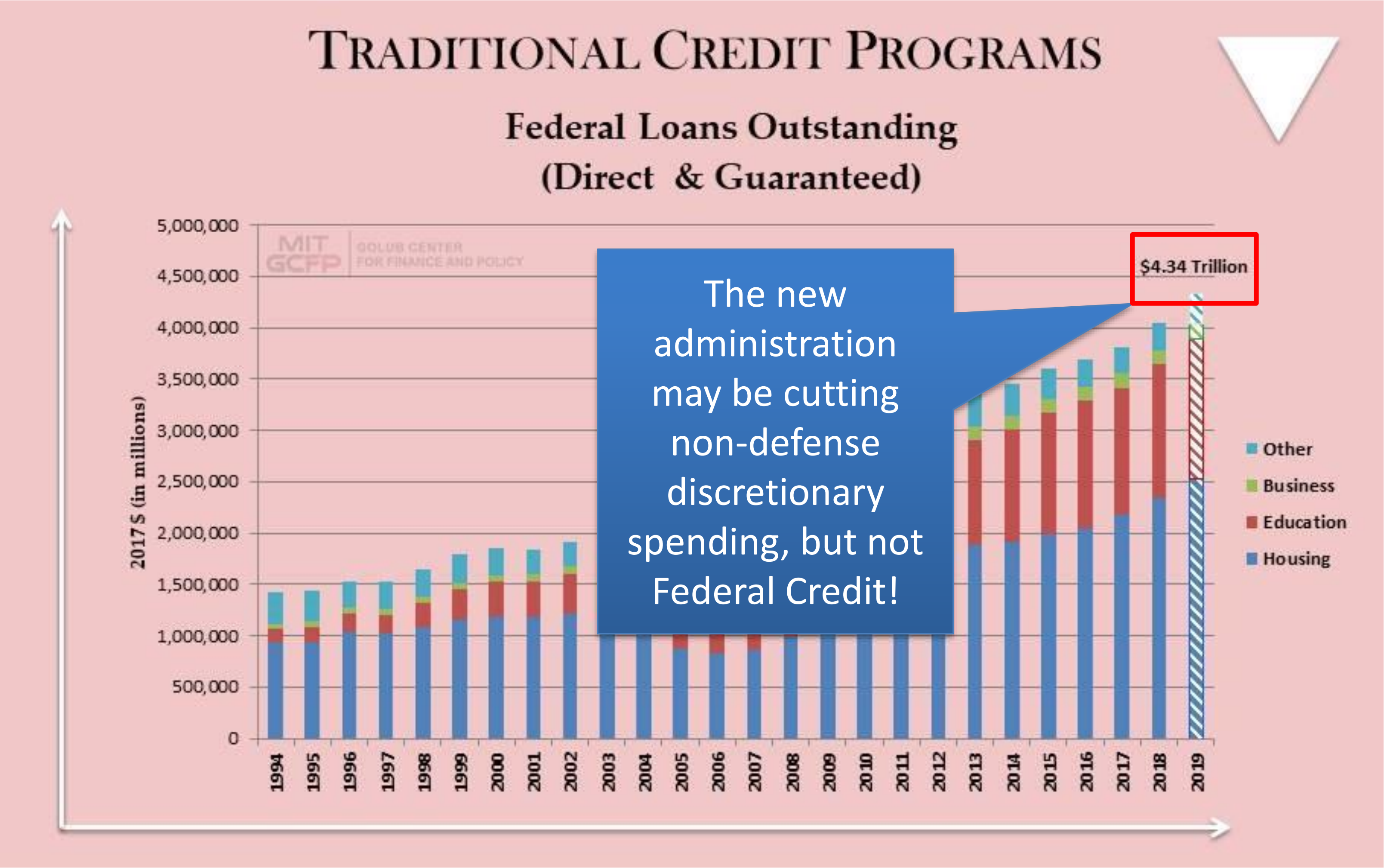
Any New Federal Loan Program Will be Part of a Big Family

Dozens of Federal Loan Programs have been around for decades

Total Lending Since 1992 Also Reveals Housing As the Largest Policy Area (excluding Ginnie Mae: 1992-2015)



Federal Credit Is Growing



Source: *"The President's 2019 Budget: Proposals Affecting Credit, Insurance and Financial Regulators". MIT Golub Center for Finance and Policy. 2018.*

Federal Credit Reform Act (FCRA) Gives Special Powers to Lend & Will Most Likely Apply to Any New Loan Program

- **Allows extraordinary power to borrow capital from the Treasury's Fiscal service for direct lending that doesn't score as an outlay**
- **Places OMB at the center of the estimates:**
  - "§ 503(a)-For the executive branch, the (OMB) Director shall be responsible for coordinating the estimates required by this title. The Director shall consult with the agencies that administer direct loan or loan guarantee programs."
- **It would be unprecedented if Congress were to allow a new loan program to avoid FCRA treatment**
- **Avoiding FCRA seems highly unlikely for a new loan program no matter which agency is chosen to administer it**
- **If FCRA did not apply, the fallback would likely be cash scoring of the full value of the loan**

FCRA Applies to both Direct and Guaranteed Loans

- **This covers two types of credit assistance**
  - § 502(1) The term "**direct loan**" means a disbursement of funds by the Government to a non-Federal borrower under a contract that requires the repayment of such funds with or without interest.
  - § 502(3) The term "**loan guarantee**" means any guarantee, insurance, or other pledge with respect to the payment of all or a part of the principal or interest on any debt obligation of a non-Federal borrower to a non-Federal lender…..
- **It doesn’t matter if the government makes the loan or guarantees the loan from a private lender, these rules cover both**

The Role Of OMB, The Auditors, and the Agency

OMB

- Retains approval authority for all credit subsidy rates
- Oversees and approves risk assumptions for all applicants

Auditors

- Audit Financial Statements to verify that loss reserve balances and footnotes are fairly stated and that OMB Circulars and Accounting Guidance are followed

Agency

- Runs the program, issues application guidelines, underwrites the applicants, monitors the loans, reports to the Congress

Case Studies Of Active & Successful Loan Programs

Water Infrastructure Finance and Innovation (WIFIA)

- **EPA lends up to 35 years and may finance up to 49% of project costs**
- **Interest rates are set to equal Treasury rates of a comparable maturity and the borrower must demonstrate dedicated revenue source for repayment**
- **Rating letters from independent rating agencies are required to establish that the applicant is Investment Grade**
- **Loans are internally underwritten at EPA and creditworthiness is independently verified by a third-party financial advisor under contract with EPA**
- **Overall, credit quality was high and interest rates were set a Treasury rates: OMB allowed for low scoring**

Troubled Asset Relief Program, Capital Purchase Program (TARP, CPP)

- **Government made an investment of 1–3% of their risk-weighted assets, up to $25 billion**
- **Dividends were paid at a rate of:**
  - S-Corps: 7.7% the first 5 years and 13.8% for the remaining years
  - The rest paid 5% for the first 5 years, then paid 9% for the remaining years
  - This dividend/interest income represented a huge spread for the government over its cost of capital, which offset the risk of default
- **Government insisted upon warrants and control over executive compensation**
- **Overall, the Government insisted on high repayment interest rates (triple the Treasury rate), limited each participant to $25 billion, exerted control over executive compensation and a very high initial score was still imposed by OMB**

Be Careful What You Ask For……

- **It is possible that a loan program that allows for aggressive credit assumptions can be enacted into law: however, many authorized loan programs have been unable to make loans in a timely manner or at all**
- **Enactment is not the same as loan making**
- **For a loan to be made from an authorized program, applicants must demonstrate a strong source of repayment and strong collateral in the event of default**
- **Risk-conscious Agency and OMB officials can greatly hinder or even stop the progress of any loan deemed too risky**

Be sure that any proposal that is pushed can survive a rigorous credit test, otherwise, it may be a waste of time

Questions