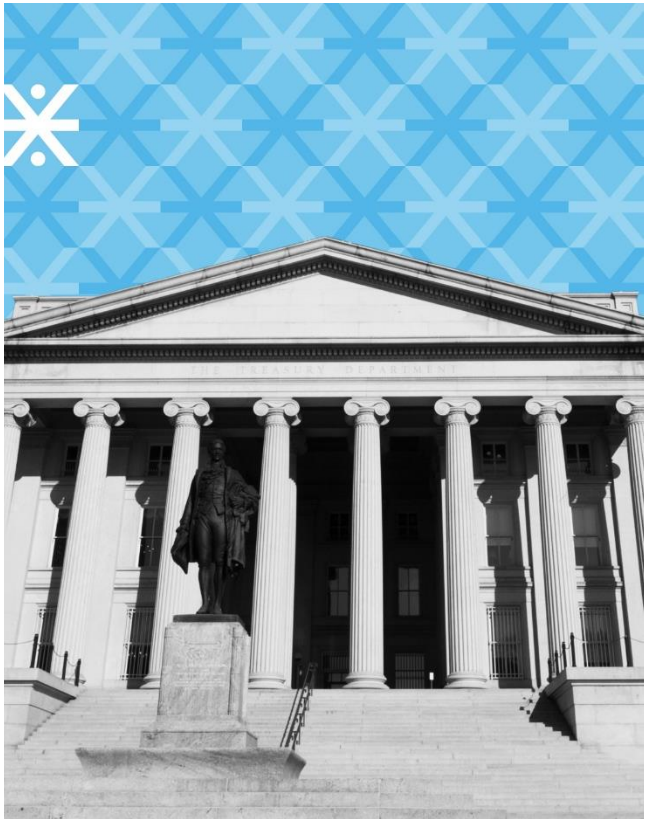
A Primer On Federal Credit Programs

How Government Loan Programs are Operated, Governed, and Scored



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Agenda

- **Summit Consulting**
- **Survey of Federal lending**
- **Federal Credit Reform Act of 1990 (FCRA)**
- **The role of key players, including the Office of Management and Budget (OMB) Circulars A-11 and A-129**
- **An overview of governing circulars**
- **Case studies**

About Summit

- **Located in Washington, D.C., Summit is an analytics advisory firm that uses quantitative techniques to model risk and evaluate program performance with 90 staff and experts**
- **Summit offers an all-inclusive suite of specialized Federal Credit advisory and risk analytics services**
- **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)

About Summit

Federal Credit Experience

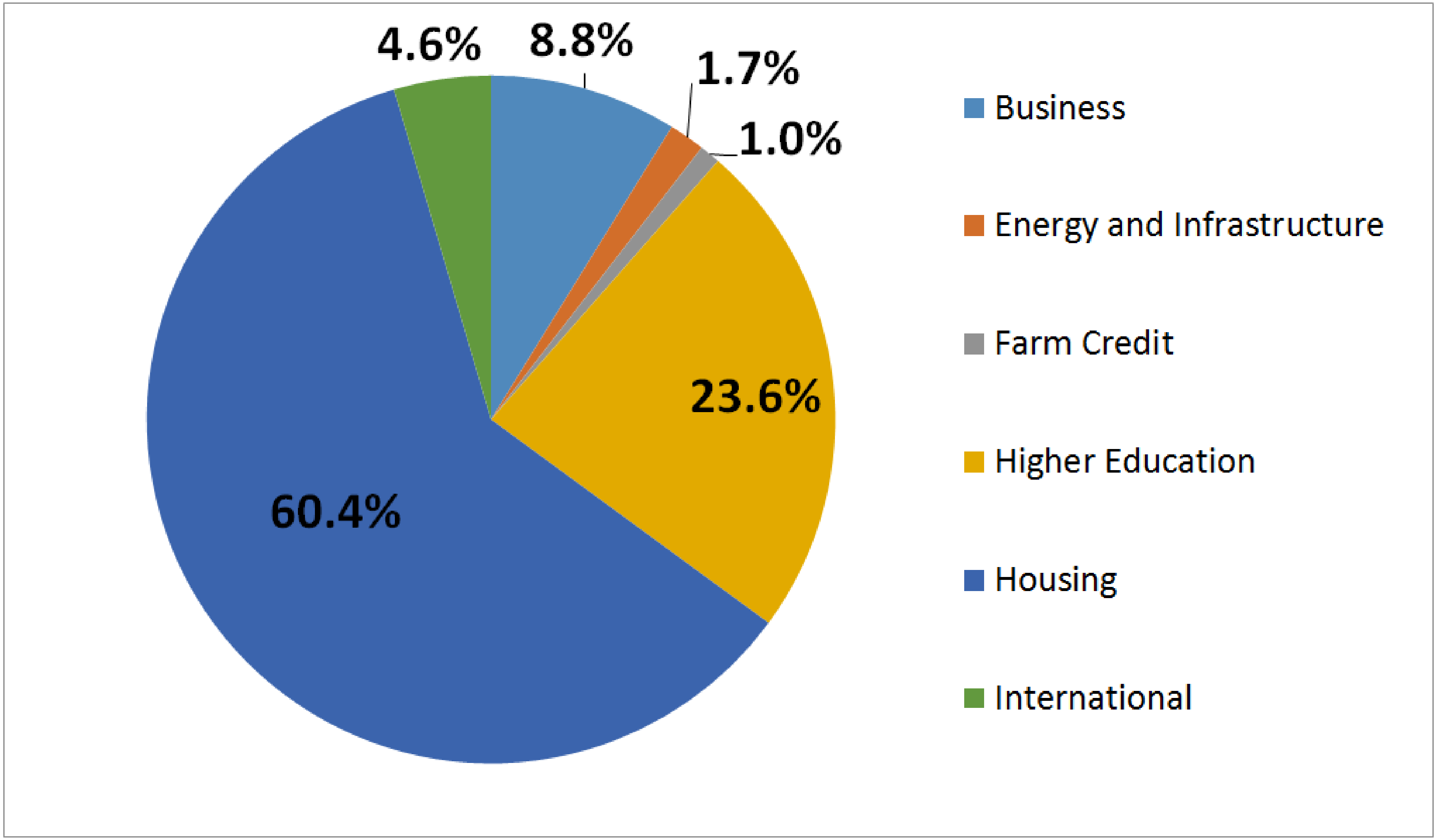
Fed Credit and Risk Analysis Services	Agencies Served: Treasury	DOE	OPIC	SBA	USDA	HUD	DOT	Ed	HHS	VA	DHS	Exim Bank	EPA
Design and Justification of Programs	✓	✓											✓
President's Budget and Financial Statement Preparation Support	✓	✓	✓	✓	✓	✓			✓		✓		✓
Creditworthiness Evaluation, Loan Underwriting, and Loan Closing	✓						✓						✓
Loan Monitoring and Restructuring Support	✓	✓	✓	✓	✓	✓							
Cash Flow Modeling and Risk Analytics	✓	✓	✓	✓	✓	✓	✓						✓
Quantitative Anlaytics, including Modification Scoring	✓	✓	✓	✓	✓	✓					✓		
Accounting Support		✓	✓		✓	✓			✓				
Auditing and Independent Verification and Validation (IV&V)				✓		✓	✓	✓		✓		✓	
Training for Federal Credit Accounting and Budget Requirements	✓	✓	✓		✓	✓							✓

How many Federal Credit Programs Exist?

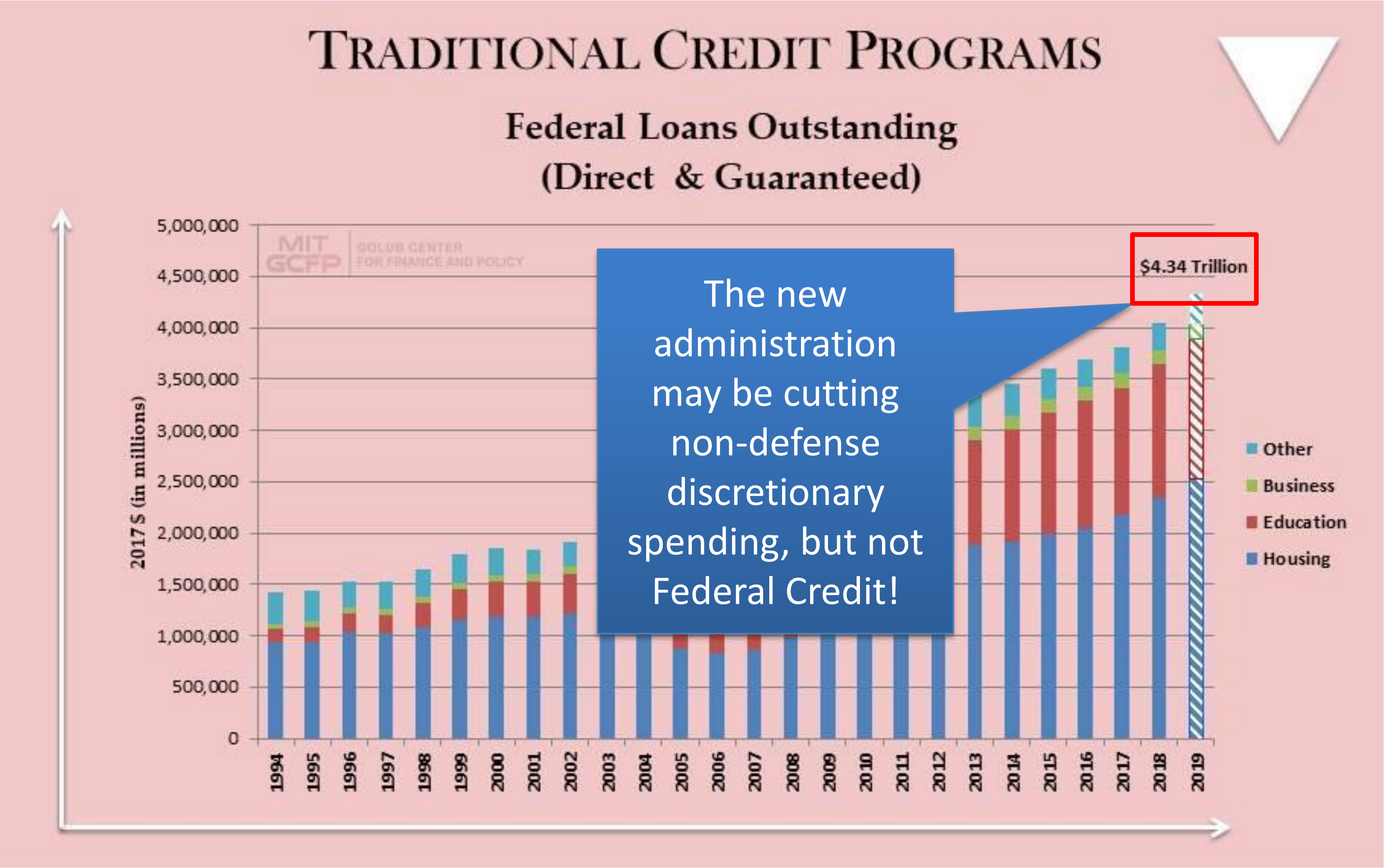
Major Policy Areas of Federal Credit

- Small Business
- Energy and Infrastructure
- Farm Credit
- Higher Education Credit
- Housing Credit
- International/Export

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)

- **Legislation that created Federal Credit budgeting & brought budget parity to guaranteed and direct loan programs**
- **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."
  - "§ 503(b)-The Director may delegate to agencies authority to make estimates of costs. The delegation of authority shall be based upon written guidelines, regulations, or criteria consistent with the definitions in this title."

Does FCRA Apply to the Pension Benefit Guaranty Corporation (PBGC)?

- **§ 506 TREATMENT OF DEPOSIT INSURANCE AND AGENCIES AND OTHER INSURANCE PROGRAMS**
  - "§ 506(a) IN GENERAL.-This title shall not apply to the credit or insurance activities of the FDIC, NCUA, Resolution Trust Corporation, Pension Benefit Guaranty Corporation, National Flood Insurance, National Insurance Development Fund, Crop Insurance, or Tennessee Valley Authority."
- **This exemption is pursuant to the PBGC's role as an insurer**
- **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**

The Role Of OMB, The Auditors, and the Agency

OMB

- Retains approval authority for all credit subsidy rates
- Oversees and approves the Cash Flow Model used by each credit program

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

OMB Circular A-11, Section 185

- **Main source of guidance for preparation of the President's Budget**
  - Updated each July

- **Section 185 is dedicated to Federal Credit and includes guidance on:**
  - Budget formulation reporting requirements
  - Apportionment and reapportionment
  - Budget execution reporting requirements
  - Financing account interest expense and income
  - MAX schedules

OMB Circular A-129

- **High-level guidance and policies for establishing Federal Credit programs**
  - Last updated in January 2013 in the wake of the Solyndra default
  - Calls for greater credit risk management
- **Includes guidance on:**
  - Responsibilities of Departments and Agencies
  - Budget and legislative policy for credit programs
  - Credit extension and management policy
  - Managing the Federal Government’s receivables
  - Delinquent debt collection
  - Very important when standing up a new program

Case Studies

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**

Considerations For Loan Program Proposals For Pensions

- **Authorization by statute creates a program on paper, but it doesn't ensure that loans are extended**
- **Historically, many authorized loan programs have been unable to make loans in a timely manner or at all**
- **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. Without these features, OMB is unlikely to score the loan reasonably or even allow an obligation to occur**
- **Loans with concessionary borrower interest rates (< Treasury rates) are scored expensively and are even more reliant upon high credit quality as well as the ability to impose fees**

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, enactment is not the same as loan making**
- **Once a program is authorized, prudent credit policies must be followed**
- **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