



Modifications

OMB Annual Credit Training
June 28, 2012



Topics

Executive Office of the President • Office of Management and Budget

- What is a modification?
- What is the typical process for OMB review?
- How do I estimate the modification subsidy cost or savings?



What is a modification?

Executive Office of the President • Office of Management and Budget

Section [185.3 of A-11](#): A **modification** is a government action that:

1. Differs from actions assumed in the baseline estimate of cash flows 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

Executive Office of the President • Office of Management and Budget

- Modifications require a government action:
 - Direct loans or guarantees may be modified *directly* or *indirectly*.
- Modifications apply to:
 - Outstanding direct loans or direct loan obligations.
 - Outstanding loan guarantees or loan guarantee commitments.
 - Both pre- and post-credit reform cohorts.
- Modifications may affect just *one* or a *group* of direct loans or guarantees.
- Modifications generate costs or savings and may be made only to the extent that budget authority for the additional cost has been provided in advance and is available in the program account.



Examples of modifications

Executive Office of the President • Office of Management and Budget

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



What is not a modification?

Executive Office of the President • Office of Management and Budget

- **Reestimates:** changes in costs that occur without government action and if, in general, the possibility of the action was explicitly included in the cash flows for the baseline subsidy estimates.
- **Administrative workouts:** actions taken to minimize the cost to the Government of resolving troubled loans or loans in imminent default. The expected effects of work-outs on cash flows are included in the original subsidy estimate. The effects would be included in the reestimates of the subsidy.



Typical process for OMB review of modifications

Executive Office of the President • Office of Management and Budget

What do I typically need to provide to OMB?

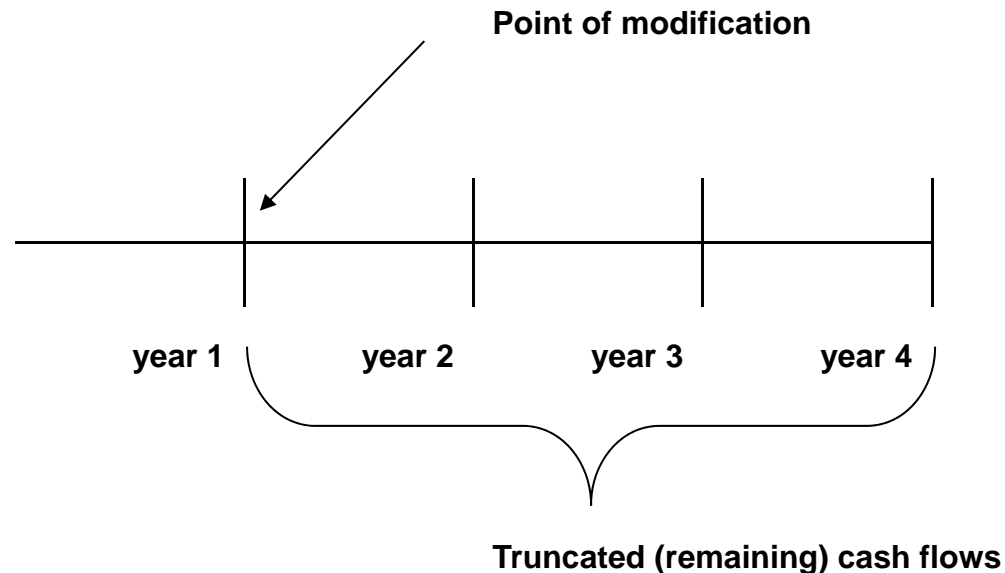
- Analysis of whether the change constitutes a *modification*, *reestimate* or an *administrative work-out*.
- An agency's policy governing changes in loan terms and documentation of how this policy has been reflected in baseline cash flows.
- Whether an agency has the *legal authority* to perform loan modifications.
- Whether an agency has sufficient *budgetary authority* to perform loan modifications.
- Modification cost calculations, as appropriate.



Part 1: Estimating the modification subsidy cost

Executive Office of the President • Office of Management and Budget

- The subsidy cost of a modification is the difference between the estimated PV of the remaining cash flows **before** and **after** the modification:
 - Step 1: Calculate the PV of remaining pre-modification cash flows
 - Step 2: Calculate the PV of remaining post-modification cash flows
 - Step 3: Compute the subsidy cost of the modification: the difference in step 2 and step 1.





Part 1: Estimating the modification subsidy cost

Executive Office of the President • Office of Management and Budget

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

1) Baseline Cashflow: Cashflows from the latest budget reestimate.

	Year 1 2005	Year 2 2006	Year 3 2007	Year 4 2008
Baseline Cashflow				
Disbursements	200,000			
Scheduled Principal Payments (+)	50,000	50,000	50,000	50,000
Scheduled Interest Payments (+)	8,000	6,000	4,000	2,000
Defaults	-20,000	-15,000	-15,000	-15,000
Recoveries	5,000	5,000	5,000	5,000

Discount cashflows to the point of modification.



Part 1: Estimating the modification subsidy cost

Executive Office of the President • Office of Management and Budget

Step 1: Calculate the NPV of remaining pre-modification cashflows

Pre-modification cashflow	2006	2007	2008
Disbursements	0	0	0
Scheduled Principal Payments (+)	50,000	50,000	50,000
Scheduled Interest Payments (+)	6,000	4,000	2,000
Defaults	-15,000	-15,000	-15,000
Recoveries	5,000	5,000	5,000
Present Value Factors (Budget, 2006) (annual, end)	96.6%	92.8%	88.9%
Present Value of pre-modification cashflow	44,431	40,828	37,325
Net Present Value	122,583		

Step 2: Calculate the NPV of remaining post-modification cashflows

Post-modification cashflow	2006	2007	2008
Disbursements	0	0	0
Scheduled Principal Payments (+)	50,000	50,000	50,000
Scheduled Interest Payments (+)	6,000	4,000	2,000
Defaults	-15,000	-15,000	-15,000
Recoveries	5,000	0	0
Present Value Factors (Budget, 2006) (annual, end)	96.6%	92.8%	88.9%
Present Value of post-modification cashflow	44,431	36,188	32,881
Net Present Value	113,500		

Use the discount rates assumed in formulating the subsidy estimates in the President's Budget for the year in which the modification will take place.

Step 3: Compute the cost of the modification (Step 1 minus Step 2)

Step 1: NPV	122,583
Step 2: NPV	113,500
Step 3: Modification Cost	9,083

A positive estimate indicates the government will incur an additional subsidy cost.



Part 2: Estimating the modification adjustment transfer

Executive Office of the President • Office of Management and Budget

- Post-1991 direct loans or loan guarantees require a “modification adjustment transfer” (MAT) to account for the disconnect between the discount rate used to calculate the cost of the modification and the interest rate at which the cohort pays or earns interest.
- The transfer is not a cost to the government, but is a transfer between the financing account and the general fund.

Step 4: Calculate the PV of remaining pre-modification cash flows using cohort interest rates

Step 5: Calculate the PV of remaining post-modification cash flows using cohort interest rates

Step 6: Compute the difference between step 4 and step 5.

Step 7: Compute the MAT: the difference between step 6 and step 3.



Part 2: Estimating the modification adjustment transfer

Executive Office of the President • Office of Management and Budget

Step 4: Calculate the NPV of remaining pre-modification cashflows using cohort rate.

Pre-modification cashflow	2006	2007	2008
Disbursements	0	0	0
Scheduled Principal Payments (+)	50,000	50,000	50,000
Scheduled Interest Payments (+)	6,000	4,000	2,000
Defaults	-15,000	-15,000	-15,000
Recoveries	5,000	5,000	5,000
Present Value Factors (Cohort Rate: 3.6) (annual, end)	96.5%	93.2%	89.9%
Present Value of pre-modification cashflow	44,402	40,995	37,772
Net Present Value	123,169		

Post-modification cashflow	2006	2007	2008
Disbursements	0	0	0
Scheduled Principal Payments (+)	50,000	50,000	50,000
Scheduled Interest Payments (+)	6,000	4,000	2,000
Defaults	-15,000	-15,000	-15,000
Recoveries	5,000	0	0
Cohort PV factor (annual, end)	96.5%	93.2%	89.9%
Present Value of post-modification cashflow	44,402	36,337	33,275
Net Present Value	114,014		

Use the cohort rate (SER) to discount cash flows.

Step 6: Compute the difference (Step 3 minus Step 4)

Step 4: NPV (Pre-Mod)	123,169
Step 5: NPV (Post-Mod)	114,014
Step 6: Difference (cohort rate cost)	9,155

Step 7: Calculate the modification adjustment transfer

Step 6: Cohort Rate Cost	9,155
Step 3: Modification Cost	9,083
Step 7: Modification Adjustment Transfer	72

If the MAT is positive, the financing account will receive funds from the general fund.



Recording modifications

Executive Office of the President • Office of Management and Budget

- Modifications produce a *one-time* change in the subsidy cost of *outstanding* direct loans and loan guarantees, direct loan obligations and loan guarantee commitments.
- Modifications resulting in cost increases can *only* be made if budget authority for the additional cost is available.
- [A-11 185.3, 185.7, 185.10, 185.11 and 185.30](#) provide information on recording these transactions in the budget.



References

Executive Office of the President • Office of Management and Budget

Federal Credit Reform Act

OMB Circular A-11, Section 185

- **Section 185.3:** definitions.
- **Section 185.7:** step-by-step instructions on calculating modification costs.
- **Section 185.10, 185.11, 185.30:** recording transactions in the budget.