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Historically Black College and University (HBCU) Capital Financing Program; Modification of Terms and Conditions of Gulf Hurricane Disaster Loans; Notice

DEPARTMENT OF EDUCATION

DEPARTMENT OF THE TREASURY

OFFICE OF MANAGEMENT AND BUDGET

Historically Black College and University (HBCU) Capital Financing Program; Modification of Terms and Conditions of Gulf Hurricane Disaster Loans

AGENCY: Department of Education, Department of the Treasury, Office of Management and Budget.

ACTION: Notice.

SUMMARY: The Secretary of Education (Secretary) is authorized to modify the terms and conditions of loans made to the following four institutions affected by Hurricanes Katrina and Rita under the Historically Black College and University (HBCU) Capital Financing Program: Dillard University, Southern University at New Orleans, Tougaloo College, and Xavier University. The loan modifications are required by statute to be on such terms as the Secretary, the Secretary of the Treasury, and the Director of the Office of Management and Budget (OMB) jointly determine are in the best interests of both the United States and the borrowers and necessary to mitigate the economic effects of the hurricanes, provided that the modifications do not result in any net cost to the Federal Government. This notice (1) establishes the terms and conditions of the loan modifications, (2) outlines the methodology undertaken and factors considered in evaluating the loan modifications, and (3) describes how the loan modifications do not result in any net cost to the Federal Government.

DATES: The effective date of the determination of the loan modification terms and conditions that will be available to gulf hurricane disaster loan borrowers under the HBCU Capital Financing Program is March 26, 2013.

FOR FURTHER INFORMATION CONTACT: Donald E. Watson at (202) 219–7048 or by email at: *Donald.Watson@ed.gov.*

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SUPPLEMENTARY INFORMATION:

Introduction

In 1992, the HBCU Capital Financing Program was created under the Higher Education Act of 1965, as amended (HEA), to help HBCUs fund capital projects, such as repair, renovation, and, in exceptional circumstances, construction of physical infrastructure by offering low-cost loans. 20 U.S.C. 1066. Congress found that HBCUs often face significant challenges in accessing traditional funding resources at reasonable rates. Operation of the HBCU Capital Financing Program is partially contracted to the Designated Bonding Authority (DBA), a private issuer of taxable bonds. The DBA finances the loans by issuing bonds that are purchased by the Federal Financing Bank (FFB) at an interest rate equal to the six-month Treasury bill rate, as determined semiannually. The bonds are backed by letters of credit issued by the Department of Education (Department). The DBA then loans the proceeds from the sale of the bonds to eligible HBCUs.

In 2006, Congress passed the 2006 Emergency Supplemental Appropriations Act for Defense, the Global War on Terror, and Hurricane Recovery (Emergency Act), Public Law 109–234. Section 2601 of the Emergency Act authorized loans under the HBCU Capital Financing Program on special terms for a one-year period to HBCUs that qualified as institutions affected by Hurricanes Katrina and Rita. The special loan terms included, but were not limited to: exemption from the program requirement that borrowing institutions each deposit five percent of loan proceeds in a pooled escrow account; interest payable by the borrowing institution capped at one percent, with any interest accruing on the bonds at higher rates to be paid by the Secretary; and an authorization for the Secretary to waive or modify other program provisions. To establish eligibility, affected institutions were required to demonstrate, among other things, that physical damage caused by one of the hurricanes prevented them from fully reopening existing facilities or from fully reopening to the levels that had existed before the hurricane.

Loans were made under the Emergency Act to the four aforementioned institutions, the first three of which are private non-profit HBCUs and the last one is a public HBCU. The loans to the three private nonprofit HBCUs are general obligations secured by mortgages, revenue pledges, and other collateral. The loan to the public HBCU is a special obligation payable solely from the revenues of the dormitory the loan proceeds were used to construct. The bonds issued to finance the loans are pegged to the six-month Treasury bill rate. As required by the Emergency Act, the Secretary is responsible for paying any interest on the bonds in excess of one percent. The HBCUs' loan payments also include: (1) A monthly ''servicing fee,'' payable to the DBA, that is equal to the product of 0.0000833 and the principal amount of the loan outstanding; and (2) a monthly ''FFB fee,'' payable to the Secretary, that is equal to 0.00125, multiplied by both the percentage of a year that has elapsed since the last monthly payment was due and by the principal amount of the loan outstanding.

General Provisions section 307, Title II, Division F of the Consolidated Appropriations Act, 2012, Pub. L. 112–74, as extended under the Continuing Appropriations Resolution, 2013, Public Law 112–175 (2012 Appropriations Law), allows for modifications to the loans to the four schools as collectively agreed upon by the Secretary, the Secretary of the Treasury, and the Director of OMB, as long as: (1) The terms of the modifications are in the best interests of both the United States and the borrowers and necessary to mitigate the economic effects of the hurricanes; and (2) any modifications will not result in any net cost to the Federal Government.

The three agencies have determined that, due to the impact of Hurricanes Katrina and Rita, the current financial conditions and enrollment levels at the HBCU borrowers remain below expectations, despite having made capital improvements since the hurricanes. Accordingly, the agencies have agreed that loan modifications are appropriate to: Facilitate the original intent of the loans, protect the Federal financial interest, put the schools on a path to increased enrollment and net income, and align debt payments with enrollment, income levels, and operating expenses. This notice establishes the significant terms and conditions of the modifications, outlines the methodology undertaken and factors considered in evaluating the loan modifications, and explains how the loan modifications do not result in any net cost to the Federal Government.

Loan Modification Terms and Conditions

The loan modifications have three principal components: payment forbearance, expense-based repayment (EBR),[1] and debt adjustment. The complete terms and conditions of the loan modifications, including the terms and conditions described below, will be

[1] As described in the next subsection, each of the four HBCUs' payments under EBR will be set at the lesser of the reamortized scheduled payments resulting from the modifications to the loans (plus DBA servicing and FFB fees) or the prescribed percentage of each HBCU's adjusted operating expenses.

set forth in executed amendments to the original loan documents, including an amendment to the promissory note to reflect the school's additional indebtedness to the Secretary, and provisions accordingly clarifying that in each case the Bond, Trust Indenture, Loan Agreement and Note will not terminate upon repayment of the amounts owing to the FFB.

Payment Forbearance: Beginning on execution of the amendments to the loan documents, and absent default or prepayment, the participating schools will receive a five-year forbearance during which no principal, interest, servicing fees, or FFB fees will be due on the loans made to these schools in 2007. During the forbearance, the Department will pay to the FFB the principal and interest due on the 2007 bonds and the DBA's servicing fees. The Department will also defer borrower payment of the FFB fees.

The payment support by the Department will not reduce the amount owed by the schools on their loans, and the Department will become the holder of the bonds to the extent of its payments on behalf of a borrower and deferment of borrower repayments. The amount of that payment support, together with outstanding principal, interest, and late fees, will be due in the event of default or prepayment.

At the end of forbearance, the accrued interest, together with the unpaid servicing and FFB fees that the Department paid on the schools' behalf or deferred, will be capitalized into principal. The balance of each loan, with interest accruing at up to one percent, will then be reamortized at substantially level semiannual payments, due each April 1 and October 1, until June 1, 2037, the original maturity date for each of the loans. In addition, the schools will resume their monthly payments of servicing and FFB fees.

Each school will be charged an insurance fee based on the school's individual circumstances. This fee will be the amount necessary to offset the cost of delaying repayments and to compensate for the increased risk assumed by the taxpayer for delaying principal and interest payments as well as offset the cost of the Secretary's payment of the DBA servicing fees and the deferral of the FFB fees during the forbearance period. A pro rata portion of the insurance fee, with accrued interest at up to one percent, becomes payable if default or prepayment occurs before the five-year forbearance ends; otherwise, the insurance fee and accrued interest on it is included in the amortization schedule of substantially level semiannual payments established by the Secretary at the end of the forbearance.

Beginning 60 days after execution of the modification documents, and every February thereafter, each participating institution seeking to establish or maintain eligibility for EBR will provide the Secretary with a detailed operating plan and performance data addressing goals agreed to by the school and the Secretary. The content required to be submitted as part of the operating plan includes financial statements, budgets (including narrative analyses of the budget's line items), census information on employees and students, and short-term and long-term strategies regarding enrollment, auxiliary services income, and the academic core. Performance data must address benchmarks approved by the Secretary to evaluate financial health as well as core revenue-generating and cost-saving strategies. If the Secretary determines that a school's submissions for the first four years of forbearance reflect a good faith effort to devise and implement a reasonable strategic plan, and that the performance data reflect reasonable progress in the circumstances towards the benchmarks adopted, the Secretary will designate the Borrower as eligible for EBR.

Thereafter, the Secretary will carry out a similar review annually of the operating plan and performance data a school submits, to determine if it reflects a reasonable effort and approach to improving the school's financial standing. If it does, eligibility for EBR will continue. A number of options is available to the Secretary in the event a school's submissions are deficient, ranging from providing technical assistance to enable the school to correct the deficiencies in its plan, to denying eligibility for EBR for a year or more until a satisfactory plan and performance data are submitted, to determining a school with a consistent history of deficient submissions ineligible to participate in EBR for the remainder of the term of the loan. Under the modifications, an uncured material failure to perform the terms and conditions of the operating plan, or the making of any false or incorrect material warranty or representation in connection with the operating plan, is an event of default, with remedies available to the Trustee and Secretary including, but not limited to, acceleration of the entire outstanding balance, including all EBR payments previously made by the Secretary on behalf of the school, or establishment of a reamortization schedule that includes all EBR payments previously made.

Expense-Based Repayment: Once a school has been initially determined eligible for EBR and the five-year forbearance has ended, the payments to be made by an EBR-eligible school will be based on the individual school's adjusted operating expenses. For purposes of these payments, ''adjusted operating expenses'' are the operating expenses as reported on the school's audited financial statements for the most recently completed fiscal year, less depreciation and amortization as reported on those statements. ''Depreciation'' shall mean the allocation of the cost of tangible assets over the assets' useful lives, if reported by the Borrower as depreciation on its audited year-end financial statements. ''Amortization'' shall mean the allocation of the cost of intangible assets over the assets' useful lives, if reported by the Borrower as amortization on its audited year-end financial statements.

For the three non-profit schools, payments will be set at the lesser of the reamortized scheduled payments (plus servicing and FFB fees) or six percent of the adjusted operating expenses. Based on reviews of both private sector analyses and the Department's analysis, including institutional enrollment and tuition demand, incremental revenue sources, historical financial statements, budget projections, and other information, we have determined that a manageable debt service payment equates to six percent of net adjusted operating expenses for the three non-profit schools. For the public school, payments will be set at the lesser of the reamortized scheduled payment (plus servicing and FFB fees) or three percent of the net adjusted operating expenses. The public school's rate is lower because its existing loan agreement finances only a specific asset—the dormitory—and the Federal Government has rights only to the revenues of the asset.

If a school's EBR payment amount is less than the reamortized scheduled payment, the school will pay the EBR payment amount, and the Department will pay, on its behalf, the difference. As with the amounts paid by the Department on a school's behalf during the forbearance, the EBR payment support by the Department will not reduce the amount owed by the schools on their loans; and those amounts, plus interest and late fees, will be due in the event of default or prepayment.

Debt Adjustment: Provided that a school has made payments in the amounts and at the times specified in the loan documents as modified throughout the term of the loan, without default except such default as has been timely cured, and has not prepaid the loan, upon certification of foregoing by the Trustee and approval by the Secretary, any loan amounts outstanding, due to the difference between the EBR payment amounts and reamortized scheduled payment amounts, at the original loan maturity date—June 1, 2037—will be forgiven. The Secretary reserves the right to deny forgiveness if the borrower has breached, falsified, or misrepresented (i) any covenants, representations or warranties in any loan document, or (ii) any information delivered to the Secretary, the DBA or the Trustee in connection with the loan, the loan documents or any payments of the Borrower or the Secretary.

The Secretary and the Trustee must both agree that the conditions for forgiveness have been met for it to apply, due to their distinct contractual responsibilities for monitoring borrower compliance with the operating plan and repayment requirements.

Final Terms and Conditions; Administration of the Modification: The terms and conditions will include those terms generally described above, as well as restrictive covenants that will govern the operations of the schools during the terms of the loans and other customary terms. The Secretary will provide each school in writing an option to elect to modify the school's loan, which will expire on March 28, 2013 unless exercised by the school through written notice to the Secretary in the form and in the manner specified in the option. The Secretary will provide each school, together with the option, copies of the documents that would amend the school's existing loans, as well as a description of the authorizing documents, legal opinion, consents, and any other documentation the school would need to supply at closing. It is expected that the option and accompanying documents will be finalized and sent to the four schools within [15] business days of the publication of this notice.

Outline of Methodology and Factors in Determining Loan Modifications

The 2012 Appropriations Law allows for the modification of the four loans only upon terms and conditions that the Secretary, the Secretary of the Treasury, and the Director of OMB jointly determine are in the best interests of both the United States and the borrowers and are necessary to mitigate the economic effects of the hurricanes. The Secretaries and the Director have jointly determined that the loan modifications meet these requirements. In making this determination, they considered, among other factors:

- The importance of HBCUs as a national resource;
- The financial condition and enrollment levels of the four HBCUs prior to and after the gulf hurricanes;
- The original intent of the loans; and
- The U.S. Government's interest in maximizing its return on investment by reducing the likelihood of default on program loans.

The five-year forbearance will give the schools adequate time to strengthen their financial status and prepare for their first payments. This is an important first step in the path to financial recovery for these institutions and will ensure adequate working capital to make necessary investments that improve the operations of each campus.

Since these schools' campuses will depreciate in value over time and lose their ability to generate revenue without the school taking out more debt to repair the facilities, it seems unlikely that the financed assets will continue to service debt obligation beyond twenty-five years. For this reason, outstanding debts from this program that exist beyond the year 2037 will be forgiven in the circumstances described above, provided a school has complied with all other terms of the loan. Enforcing any remaining debt obligation beyond twenty-five years would most likely be debilitating to the institutions in the future when they must borrow additional funds for maintenance and repair of their existing facilities.

The following are detailed explanations of how the loan modifications meet applicable requirements.

Best interest of the borrower: The terms and conditions of modification offer the schools time and resources to establish financial and institutional reforms that will help the schools' long-term health. The future debt burden is calibrated to the size of each school's operating budget, significantly reducing the likelihood that the schools will be overextended and default. By decreasing the scheduled debt burden in the event that the schools' operation cannot reasonably support it, the modification supports the long term growth and viability of the schools.

Best interest of the United States: It is in the best interest of the United States to mitigate the risk of loan default in the short term, maximize the prospect of repayment in the long term, and maintain viable HBCUs as a national educational and cultural resource. The modifications further these objectives.

While the four institutions have made significant progress toward recovery since Hurricanes Katrina and Rita, their financial climate is still difficult, and enrollment levels remain below expectations. Reduced governmental grant and contract funding also puts downward pressure on the institutions' revenue sources. Accordingly, institutional expenses and debt service need to be realigned with the current revenue environment. This action is necessary to facilitate further recovery by the schools and to ensure the schools' respective debt burdens do not lead to serious financial consequences that could, in turn, result in problems repaying their debt. Setting reasonable payments amounts as a percentage of adjusted operating expenses will allow the schools to satisfactorily meet the obligations of these loans and continue operating.

In addition to the cost neutrality estimates described below in the No Net Cost to the Federal Government section, the Secretaries and Director also considered an analysis of expected payments from the borrowers, based on their most recent financial statements and on budgetary projections. While each school has a unique financial circumstance, the schools seem overextended and may not be able to make the current scheduled debt service payments without serious consequences to the long-term viability of the institutions. The schools have either generated negative net income, putting pressure on liquid assets, or have such anemic net revenue that operations are constrained. Revenue and expense forecasts indicate financial improvement to meet current debt obligations is highly unlikely in some cases. Therefore, the modifications increase the likelihood that the taxpayer will be repaid. Analyses also indicate the designated expense based repayment thresholds align each institution's future payments with their unique financial circumstance and maximizes the ability to make debt service payments.

Necessary to mitigate the impact of Hurricanes Katrina or Rita: The intent of the original loans was to mitigate the effects of these two hurricanes, which included damage to school facilities, enrollment reductions, and increased debt levels. While the loans have helped the schools reconstruct damaged facilities, the institutions still suffer from increased debt burdens disproportionate with enrollment levels. The modifications put the schools on a path to increase enrollment and net income, and align debt payments with enrollment and income levels.

No Net Cost to the Federal Government: In accordance with the 2012 Appropriations Law, the Secretary, the Secretary of the Treasury, and the Director of OMB have jointly determined that the loan modifications will not result in any net cost to the Federal Government, beginning on the date on which the Secretary modifies the loans.

The cost-neutrality analysis used credit subsidy modification cost estimation procedures established under the Federal Credit Reform Act of 1990 (FCRA, 2 U.S.C. 661a *et seq.*), as amended, and OMB Circular A–11. Per FCRA and the implementing guidance, the cost estimates compare the present value of future cash flows to and from the Government under the original contracts from the point of modification, and the present value of the cash flows under the contracts as modified. To estimate the present value cost, the analysis used discount rates provided by OMB to estimate credit subsidy costs for all Federal credit programs. The results of the analysis were estimates expressed as a dollar amount of the change in Federal costs of modifying the contractual terms of the loans.

The metric to determine cost neutrality was that the modification costs under the modified contract should not exceed costs expected under the current loan contracts, had no changes to the contracts taken place. Thus, all costs of the modified loans were compared to estimates in the President's Budget baseline assumptions for such loans.

Consistent with the requirements included in the 2012 Appropriations Law that any modification under this authority shall not result in any net cost to the Federal Government as jointly determined by the Secretaries and the Director, separate credit reform modification cost estimates were developed to assess the Federal cost incurred for modifying the terms of loans to each of the four schools. This discussion outlines the analysis of the changes to the loan contracts with respect to the following critical aspects affecting the Federal cost:

- Terms of the modification;
- Default assumptions; and
- Administrative costs.

Terms of the modification. Under the current loan contracts, borrowers are required to make monthly payments to the Trustee, which, in turn, makes semiannual payments to the FFB. Under the budget baseline assumptions, for each of the schools, those payments began in 2011 and are scheduled to end in 2037. Under the modified loan contracts, schools would receive a five-year forbearance starting on April 1, 2013, and no principal, interest, servicing or FFB payments would be paid by the schools. The Trustee would not make principal or interest payments during that period. The Secretary also would make the monthly servicing fee payments due from the borrower during the forbearance as they came due. Loans would still mature in 2037, but the insurance fee plus forborn servicing and FFB fees would be capitalized into the principal and interest payment schedule. The payment schedule would be re-amortized in substantially level, semiannual payments after the end of the forbearance.

To reach cost neutrality, the modified contract terms include for each of the schools an insurance fee, calculated as described above. The fee is added to the principal of the loan at the start of forbearance and accrues interest at the borrowers' interest rates, which is also capitalized. These amounts are included in the reamortized repayments. This increase to the scheduled payments including the insurance fee offsets the additional costs of the modification to reach cost neutrality.

Default assumptions. As required by FCRA, the modifications used the technical assumptions from the latest President's Budget, including the default and other borrower performance assumptions. For the purposes of the cost estimate, the borrower performance assumptions were assumed to represent the likelihood of EBR trigger and loan forgiveness. Those assumptions include a high expectation of repayment from each of the schools. However, because time has passed since the budget borrower performance assumptions were determined, the Secretaries and Director also considered an analysis that relied on the most recent annual operating expenses reported by the schools in their audited financial statements, discussed above in the Best Interest of the United States section.

Administrative Costs. Under FCRA, Federal administrative costs are not included in credit subsidy cost calculations. Instead, those costs are appropriated or obligated at their nominal value at the year they are incurred. The analysis assumed no change in the future federal cost of administering the modified loans versus the administering the loans under the current contract; thus the administrative costs associated with the modifications are necessarily zero.

Conclusion. After taking into account alternative borrower performance scenarios and appropriate risk factors, the Secretaries and Director determine that modified terms of the contracts to the four schools will result in no net cost to the Federal Government.

TABLE—HISTORICALLY BLACK COLLEGE AND UNIVERSITY CAPITAL FINANCING PROGRAM COST ESTIMATES FOR MODIFIED GULF HURRICANE DISASTER LOANS

[In millions of dollars]

	Loan characteristics				Value/costs	
	Outstanding principal April 2013	Outstanding principal April 2018	Scheduled interest	Insurance fees	PV cashflows with the public	Subsidy cost
Baseline	353	324	53	N/A	246	108
Modified	353	405	45	30	246	108

Note: Estimates reflect a loan modification effective date of April 1st, 2013.

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Dated: March 22, 2013.

Arne Duncan,

Secretary of Education.

Jacob J. Lew,

Secretary of the Treasury.

Jeffrey Zients,

Acting Director, Office of Management and Budget.

[FR Doc. 2013–07071 Filed 3–22–13; 4:15 pm]

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