

Managing Credit Programs in a Time of Federal Retrenchment

EXECUTIVE SUMMARY

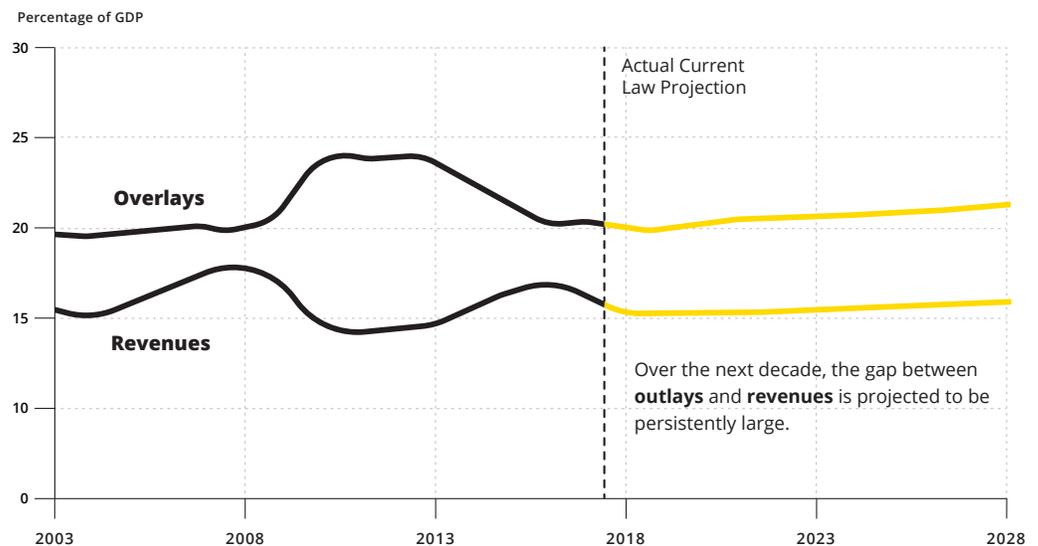
Business Problem:

There is over \$3 Trillion in outstanding balances across 19 U.S. agencies that administer direct loans and loan guarantees. While federal credit outstanding continues to grow exponentially, federal funding for those loan programs is shrinking. This Whitepaper explores ways for federal agencies to leverage and effectively manage these credit programs in an era of fewer resources and increased scrutiny.

GROWING FEDERAL BUDGET PRESSURES

Long term federal deficits are increasing budget pressures on federal programs, and especially spending on discretionary parts of the budget. Figure 1 presents an overview of projected federal revenues and outlays according to an April 2017 Congressional Budget Office (CBO) report:

Figure 1
The Growing Federal Deficit

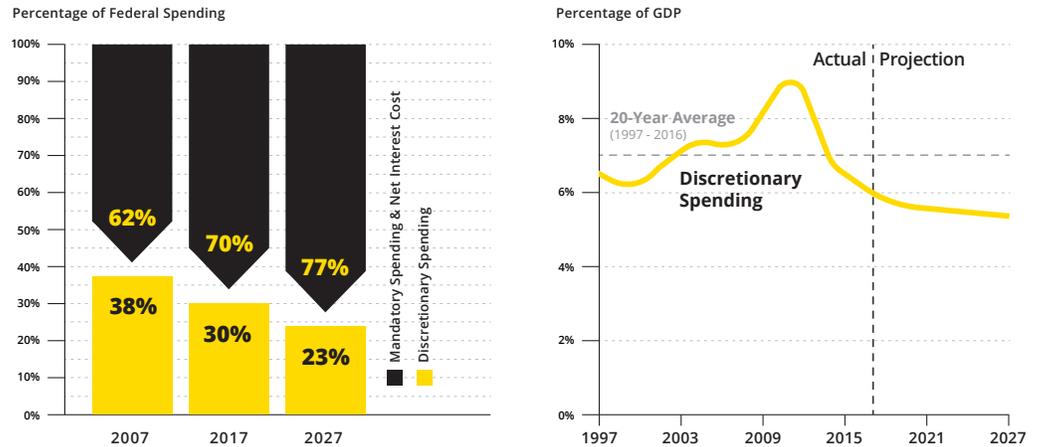


Source: Congressional Budget Office, *The Budget and Economic Outlook: 2018 to 2028*, April 2018, cover.

CBO projects that an increasing proportion of outlays will be consumed by entitlement programs, especially Social Security and Medicare, and by interest payments on the federal debt. That means that discretionary spending, which is already declining, is likely to come under additional and possibly sustained pressure. This is seen in Figure 2.

Figure 2
Budget Pressures on Discretionary Federal Programs

Mandatory spending and interest cost will climb significantly, while discretionary spending will fall to well below historical averages.



Source: Peter G. Peterson Foundation, "CBO: Unsustainable Deficits Threaten Future Economic Growth," June 29, 2017

For federal credit programs, these budget pressures create a paradox. On one hand, because credit budgeting rules underprice the cost of federal loans and loan guarantees compared to grants and direct spending, there is likely to be a continuing increase in the volume of federal credit outstanding. The underpricing of federal credit stems from the use of Treasury borrowing costs in calculating the cost of federal credit. Because Treasury borrowing is "risk-free" compared to commercial borrowing, the associated interest rate is lower, thereby decreasing the budget cost of federal credit compared to similar credit in the commercial markets.¹ Outright grants and other federal spending, by contrast, do not benefit from this unbudgeted subsidy.

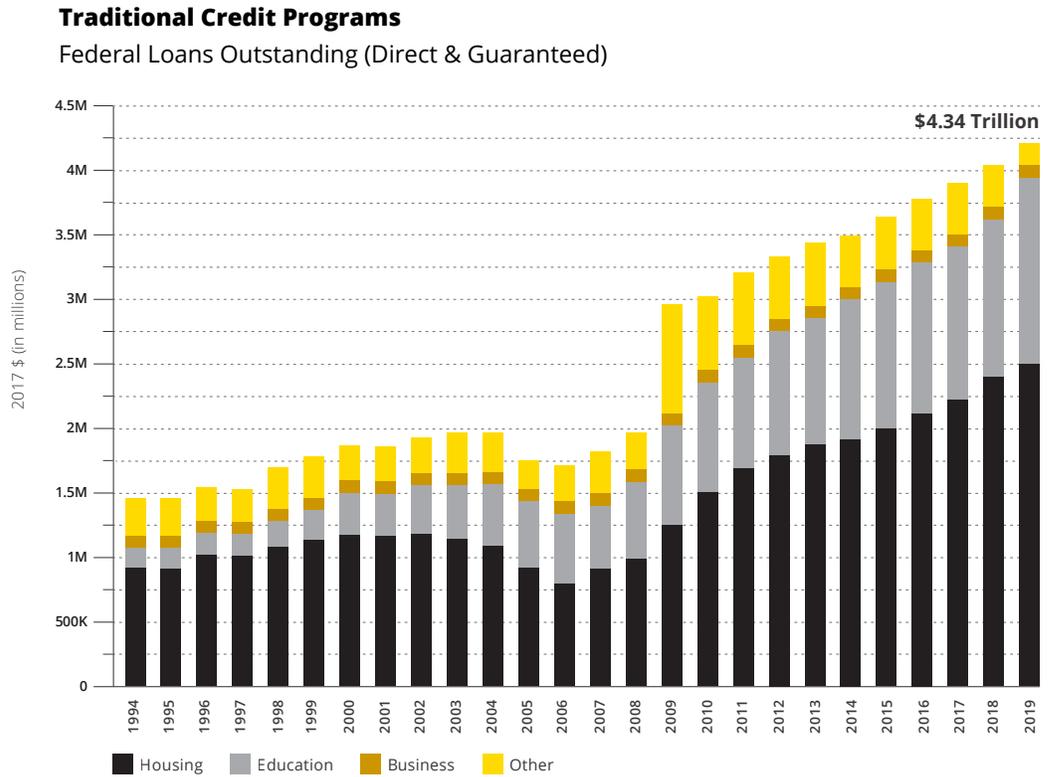
The consequences can be seen in Figure 3, which shows projected increases under the Trump Administration's FY 2019 budget, which sought significant cuts to federal discretionary spending while increasing the volume of federal credit outstanding.²

Figure 3 on Next Page

¹ For more detail, See, e.g., U.S. Government Accountability Office, "CREDIT REFORM: Current Method to Estimate Credit Subsidy Costs Is More Appropriate for Budget Estimates Than a Fair Value Approach," GAO-16-41, January 2016.

² In the end, the bipartisan budget agreement of February 9, 2018, and Consolidated Appropriations Act of March 23, 2018, increased spending for many discretionary programs. This is symptomatic of the budget uncertainties that can arise as policymakers seek to satisfy their constituencies despite continuing pressure on federal discretionary resources.

Figure 3
Increased Volume of Federal Credit Outstanding, FY1994-FY2019 Budget



Source: MIT Golub Center for Finance and Policy, "The President's FY 2019 Budget: Proposals Affecting Credit, Insurance and Financial Regulators," available at <http://gcfp.mit.edu/2019budget/>, accessed June 11, 2018.

In contrast to the unbudgeted subsidy that makes federal credit relatively less expensive, funding for program administration contains no unbudgeted subsidy and is usually a part of the discretionary budget, subject to the pressures seen in Figure 2, above. The consequence for managing federal credit programs is significant. Figure 4, from the US Department of Agriculture Rural Development Mission (USDA RD), shows how the volume of USDA RD credit and other spending increased while resources for management of those programs declined.

Figure 4
Administrative Expenses Over Time

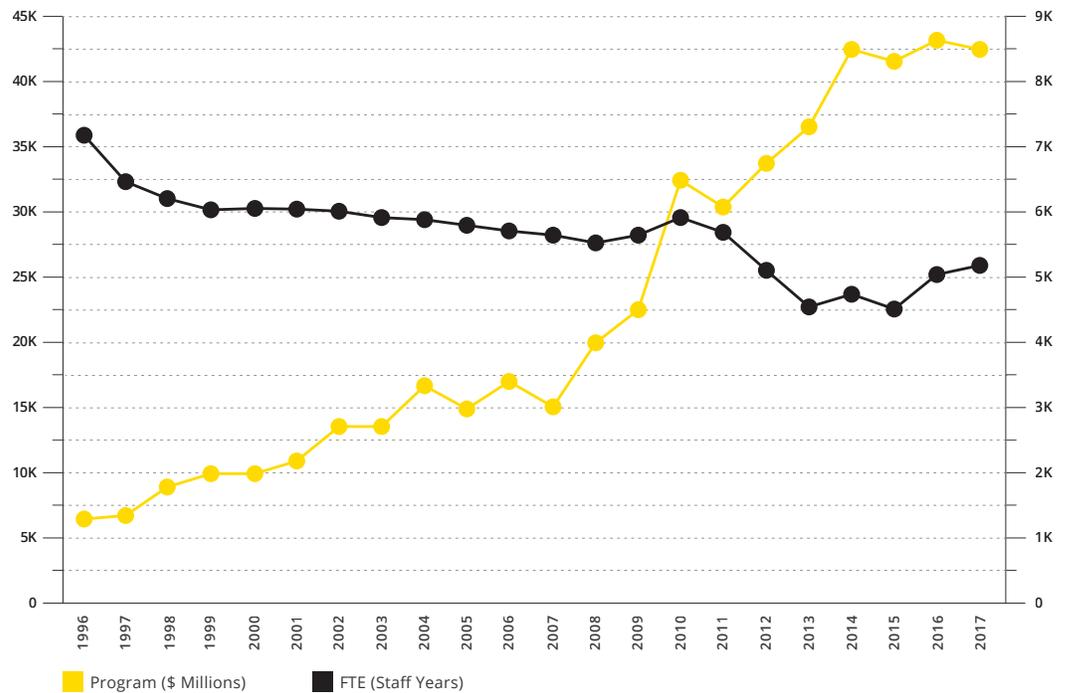
OUTSTANDING PORTFOLIO & OBLIGATIONS FOR ADMINISTRATIVE EXPENSES (\$M)						
	2007		2017		2007-2017	
	Portfolio	Admin	Portfolio	Admin	Portfolio	Admin
Single Family						
USDA	41,731	453	145,025	412	248%	-9%
FHA	322,150	116	1,227,947	150	281%	29%
VA	232,841	152	604,020	195	159%	28%
Student Loans	467,169	718	1,239,898	1,586	165%	121%

Similar patterns, with variations, hold for other federal credit programs and agencies as well. Figure 4 shows how administrative spending for the single-family mortgage credit programs and federal student loans has lagged substantially compared to the increase in outlays for loans and loan guarantees. Thus, for the largest single-family program of the Federal Housing Administration (FHA), the outstanding portfolio grew by 281% from FY 2007 to FY 2017 while administrative budgets rose by only a tenth of that amount.

The experience of some credit agencies in administering their programs shows that, to some extent, economies of scale and improved ways of doing business can take up the slack between burgeoning portfolios and administrative resources that fail to keep pace. On the other hand, “doing more with less” is an idea that has limits. The increasing gap between program size and administrative resources requires program managers to consider the risks they are running and ways to address those risks before possible harm materializes. Figure 5 makes clear that the gap between the volume of credit outstanding and available administrative resources is part of a long-term issue that can be expected to increase in intensity over time.

Figure 5
 USDA Rural Development Program Levels vs. Full Time Employees (FTE),
 FY 1996-2017

Program Level vs FTE (excluding Recovery Act)



Source: USDA Rural Development, “President’s Budget Justification 2017”, p. 28-15, available at http://www.obpa.usda.gov/fy17explan_notes.html, accessed June 11, 2018.

METHODOLOGIES FOR ADDRESSING FEDERAL BUDGET CONSTRAINTS AND MANAGING RISK

The present Whitepaper suggests a variety of approaches for agencies to navigate their way through the vagaries of the budget process. While some of these approaches apply to federal agencies generally, the benefits to federal credit agencies can be especially great, to help deal with the increasing gap between volumes of credit extended and constraints on agency administrative budgets.

This section presents first an overview of an increasingly widespread management approach, known as Enterprise Risk Management (ERM), that can help agencies to improve the processes by which they address budget uncertainties and budget constraints. The section then looks at ways to increase agency resilience to address budget uncertainties that are likely to increase in volatility as budget pressures increase.

A. Managing Risks of Budget Constraints and Budget Uncertainty and the Importance of a Thoughtful Process

Enterprise Risk Management helps agencies to focus on the question, “What are the risks that could prevent us from achieving our mission?” With respect to management in a time of retrenchment, the question can be phrased, “In a time of sustained budget uncertainty and budget constraints, what are the risks that could prevent us from achieving our mission?”

The strength of ERM as a management tool comes from its reliance on good information flow, up and down the hierarchy, across silos and with stakeholders, to surface major risks and a disciplined process for prioritizing risks so that agency leaders can allocate scarce resources (management attention, funding, staffing) to address the most important risks. ERM operates as a flexible but disciplined supplement to usual risk management processes, e.g., to control credit and operational risks, that a credit agency already conducts.³

When an agency is hit with budget cuts, issues often arise due to a lack of preparation by the agency for potential financial constraints. For example, overly hasty responses occurred during the FY 2013 budget cycle when political gridlock led to sequestration according to a pre-existing formula that imposed substantial cuts on many agencies and programs. Faced with a sudden need to cut their budgets substantially, some agencies opted for an easy solution: offer buyouts to their workforce and thereby save the associated salaries and expenses for the rest of the fiscal year. That solution, while easy, led to substantial harm that lasted for years after the President and Congress reached a budget agreement and lifted the sequester. What these agencies had failed to consider was that their most seasoned people, often ready for retirement anyway, were most likely to take the buyout payment and leave. Agencies that had not prepared in advance suddenly found themselves without people with the needed deep understanding of their programs and how to operate them.

Agencies must consider such risks in advance and develop methods to mitigate or eliminate negative effects. For instance, agencies beforehand could have documented critical processes to help new program managers carry out the functions of those who had taken a buyout and left. Or agencies could have systematically cross-trained staff so that a knowledgeable person could step in when a program lost a seasoned manager. Or an agency could have created a succession plan so that lower level people were prepared to advance when a higher-level person left. Or an agency might have considered a multiplicity of options other than buy-outs and selected an option causing less harm to the agency's ability to carry out its mission. Management tools like ERM let an agency consider ways to address major risks carefully, before an event occurs, in this case a budget event, that otherwise would force hasty action.

³ See, Office of Management and Budget, OMB Circular No. A-123, “Management's Responsibility for Enterprise Risk Management and Internal Control,” July 15, 2016. For more information on ERM, see, e.g., Thomas H. Stanton, “An Agency Guide for ERM Implementation,” Association of Government Accountants, available at https://www.agacgfm.org/AGA/Resources/Online%20Library/Research%20Reports/AGA_ERM_Research_Series_2017.pdf, accessed June 12, 2018; more extensive information is available at the website of the Association for Federal Enterprise Risk management, www.AFERM.org.

The influence of key stakeholders with relevant congressional committees can make it wise to consult stakeholders as early as possible – when options are tentative – to obtain a sounding of the nature and degree of their concerns and the extent to which they can be accommodated. In the end, if budget cuts are being mandated, an agency will need to rely on providing trustworthy information and the reality of the zero-sum nature of budget cuts to obtain support for options that might not otherwise find acceptance.

Depending on an agency's existing authority, some actions may require legislation; especially for those options it would seem wise to inform relevant policymakers in advance so that they are not surprised. It is always beneficial to build a constituency to support agency actions; once stakeholders understand that alternatives to a proposed agency action may be more disadvantageous, they are more likely to be supportive than if they are surprised by an action.

B. Managing Risks of Budget Uncertainty

For federal credit managers, today's growing federal deficits mean more pressure on the discretionary side of the budget, including funding of credit program administration. Especially as discretionary resources become tight, competition for those resources can be expected to become more intense, making outcomes less predictable. The FY 2018 budget showed this when, after the Administration's budget proposed major cuts on many programs, Congress reached an agreement, with Administration approval, to increase the federal budget significantly.⁴ From the perspective of a credit program manager, this sequence of events posed major problems: after taking steps to anticipate severe program reductions or even termination of some programs, managers found themselves with ample funding in the middle of the fiscal year that they needed to spend, despite complete uncertainty about likely program levels the following year.

There is no easy way to manage consequences of budget uncertainty. However, as seen when the FY 2013 sequester hit agencies especially hard that had failed to prepare, the effort at preparation is essential. The key attribute needed to deal with uncertainties is resilience. Just as agencies could have improved their protection against harm from sequestration and buy-outs, as described above, resilience means accepting the increasing uncertainty of the budget process and strengthening the agency's ability to manage long-term variations in workload, responsibilities, and available resources.

When he was Undersecretary for Management at the Department of Homeland Security, Rafael Borrás devised an excellent way to respond to budget uncertainties in the IT acquisition process.⁵ He created a centralized process to review the largest-scale DHS acquisitions, supported by analytical capabilities of a new office of Program Accountability and Risk Management (PARM). One of the key issues that PARM reviewed involved major procurements that relied on multiple years of congressional appropriations. In the past, an acquiring agency could be left with nothing if appropriations ceased, for example after year two of a five-year process. PARM looked for ways to move towards modular development. Then, if funding unexpectedly ended in year two, the acquiring agency would have useful components to deploy rather than being left with a partially-built system. Today, agile development would seem to be valuable in building such resilience.

Concern for resilience in staffing may require an agency to increase its training budget despite increased spending pressures. A trained workforce is a workforce that is better equipped to deal with management and budget uncertainties. Once again, the essential focus is on accomplishing the agency's mission and objectives. A review of scenarios and associated risks of budget uncertainties can help an agency to devise its own approaches that avoid leaving managers and their programs unprepared.

⁴ See, e.g., Thomas Kaplan, "Congress Approves \$1.3 Trillion Spending Bill, Averting a Shutdown," *The New York Times*, March 22, 2018.

⁵ Rafael Borrás, "Strengthening Acquisition and Program Management – Program Management & Execution Playbook," Memorandum for Component and Directorate Heads and Component Acquisition Executives, Department of Homeland Security, December 27, 2011.

C. Managing Risks of Increasing Budget Pressure

Managing the problem of increasing budget pressure requires first that managers understand that budget pressure could well be a fact of agency life for many years to come. Major mistakes can occur when an organization, whether in the public or private sector, fails to change its strategy despite significant changes in the operating environment. The extent of availability of budget resources is a major part of the environment that agencies must continually assess. The Challenger space shuttle disaster occurred when agency leadership tried to maintain the usual launch schedule despite significant budget cuts that made that schedule unsustainable. More recently, the Navy's Seventh Fleet reported several collisions at sea that resulted in deaths of sailors; the GAO reported that the Navy was seeking to expand operations in Asian waters despite significant budget resource challenges.⁶ Many other examples of failure while trying to “do more with less” could be cited.

A focus on achieving the mission can help to avoid making budget-driven cuts that ultimately harm an agency's ability to achieve its objectives. A mission focus allows agency leaders to prioritize activities for allocation of resources. When done well, the agency may also be able to improve service to its mission.⁷ The core of this idea is to rank activities by priority so that mission critical activities continue to receive the resources that they need. Useful general categories of the priority ranking might be:

- 1)** Core mission activities (including statutorily required responsibilities)
- 2)** Key mission support activities (high-priority IT, HR, procurement, legal, etc.)
- 3)** Key activities for important stakeholders
- 4)** “Nice to have”

Only a few agencies have undertaken risk-based budgeting. The Office of Federal Student Aid (FSA) is a leader in this regard. Over a decade ago FSA created an Investment Committee, now the Investment Review Board (IRB), chaired by the Chief Operating Officer (the chief executive of FSA) and attended by senior FSA managers, to make investment decisions more systematically. The IRB hears requests for approval to spend money that has been budgeted for the fiscal year. The FSA strategic plan includes metrics for achieving each strategic goal and the IRB reviews the status of each ongoing project and maintains scorecards for each approved project. Following a review, the IRB might allocate support to a troubled project or otherwise help project managers to deal with problems in a proactive way.

The role of the IRB has grown over time; the board now reviews and prioritizes all of FSA's appropriated funds. Along with the investment portfolio, budget allocations for staffing get especially close attention. Decisions are based on risk. The CFO's office prepares explanations of the risks of budget shortfalls, compared to the president's requested budget, so that congressional committees can make informed decisions about the level of funding to appropriate. The sidebar below, from the FSA's FY 2016 Annual Report, shows how FSA explained the problem of managing resources for a program with significant variations in volume and provided seven examples of mission-related risks that could result from substantial budget cuts the Congress was considering. Depending on the agency, program, and views of the relevant members of Congress, providing credible information can make a great difference in where and the extent to which cuts are made.

⁶ US Government Accountability Office, “NAVY READINESS: Actions Needed to Address Persistent Maintenance, Training, and Other Challenges Facing the Fleet,” Statement of John H. Pendleton, GAO-17-798T, September 7, 2017.

⁷ Paul Leinwand and Cesare Mainardi, “Cut Costs to Grow Stronger,” chapter 5 of *Strategy That Works: How Winning Companies Close the Strategy-Execution Gap* (Harvard Business Review Press, 2016).

Articulating Risks of Budget Cuts So Policymakers Understand Consequences in Advance

"...even a small variation in any of FSA's volumes can significantly impact its budget. This places all other expenditures and plans associated with those expenditures at risk. This risk must be managed as long as the federal government pays for mandatory Direct Loan expenditures using discretionary administration funding. As of the end of this fiscal year, the House and Senate are proposing to fund Student Aid Administration loan-servicing activities at \$855 million, \$44 million short of the level proposed in the FY 2017 President's Budget. In addition, the anticipated FY 2017 costs of loan servicing have increased... In total, these changes will result in a \$61 million loan servicing budget shortfall that must be cut from other operations, given the risky budgeting process. These cuts would have devastating impacts on the operations of Federal Student Aid. A few examples are listed below:

- Increases the likelihood of a data breach or system intrusion, which would place personally identifiable information of over 130 million students and borrowers at risk;
- Increases the risk of school oversight failures and limits the ability to address school oversight challenges for over 6,000 schools;
- Decreases ability to provide loan servicing oversight necessary to protect over 42 million borrowers and limits the ability to address contractor oversight and system implementation issues;
- Increases the risk of a systems infrastructure failure and limits the ability to manage system change, which would jeopardize the delivery of over \$125.7 billion of aid annually;
- Decreases transparency to the public and limits the ability to support policy decisions with data;
- Decreases the outreach and awareness efforts to tens of thousands of students that are most in need of assistance and financial analysis."
- Eliminates plans to address thousands of Office of Inspector General (OIG) fraud referrals."

Source: Office of Federal Student Aid Annual Report FY 2016, pp. 49-50

POSSIBLE APPROACHES

Approaches to protecting core elements of an agency's mission at a time of sustained budget pressure include, (1) transferring functions to vendors or other third parties who can perform with high quality but less expensively than the agency can and possibly with fee-based revenues, (2) changing business processes, (3) collaborating with other programs and agencies to share information, services, and operations, (4) consolidating agency organizations and especially field offices, and (5) when the time is right, adopting new technologies such as Artificial Intelligence (AI) and Blockchain, to the extent that the experience of other public and private sector organizations shows cost savings and improved efficiencies.

(1) Transfer functions to vendors or other third parties, possibly funded with fee-based revenues

Federal agencies have a tradition of relying on the growing capabilities of the private sector to shed costly activities while maintaining the capacity to serve their missions. One early example was the delegation of responsibilities to lenders in federal guarantee programs to resolve defaulted loans and make claims on the government, rather than pushing a defaulted loan back to the agency. Another was the use of loan asset sales to companies in the private sector so that they, rather than the credit agency, would seek to manage and resolve seriously delinquent or defaulted loans or the associated loan collateral.

An attractive model for funding program improvements from fee-based revenues comes from the Small Business Administration (SBA). Two of SBA's loan programs have contracted servicing agent functions that support the orderly flow of funds among borrower, lender, and SBA, in addition to serving as a central registry of owners of guaranteed interests and of all SBA guaranteed interests sold or resold in the secondary market. The servicing agents are compensated through fees from borrower loan payments and/or cash flows from loans underlying the secondary market securities, depending on the loan program. SBA retains a servicing agent through a contract that SBA rebids every five years.

SBA has been able to use its servicing agent procurements to define and finance technology enhancements for the financial systems the agency uses to process loan information and track loan program data. In its contract solicitations, SBA invites vendors to propose technological modernization initiatives that can save money and increase IT security for both SBA and the servicing agent. SBA has been able to achieve incremental enhancements to processes and systems associated with these loan programs without requiring appropriations or additional funding sources. For example, when financial systems that manage loan data needed to be migrated and modernized to meet Federal Risk and Authorization Management Program standards and strengthen data security, SBA was able to leverage a no cost contract vehicle, traditionally meant for loan operation functions, to accomplish this work in parallel to the operational functions at no additional cost. SBA program managers note that this use of fee-based funding for program improvements can occur only if SBA and the winning vendor develop a trusting relationship that allows collaboration as program improvements are proposed and implemented. This trusting relationship is possible because of the way that SBA retains leverage over the winning vendor through a well-designed contract that focuses on excellent loan operational support at the forefront, followed by opportunities to streamline functions for both contractor and the government.

Federal credit agencies may be able to generalize the SBA experience to their own programs. For instance, it may be possible to hire vendors, paid from proceeds, to collect on uncollected fees that lenders are obligated to pay when participating in federal guaranteed loan programs. Other fee-based approaches may be possible once federal agencies begin to consider the possibilities for their programs.

Whenever an agency changes the way it does business, it's important to determine new types of risk that could emerge. SBA has considered and addressed risks that managers perceive in the use of zero cost/fee-based improvements, including being mindful that the scope of technology enhancements shouldn't make contracts unattractive to bidders or overwhelm the statement of work so that essential operational functions become neglected. Pilot programs also may help to identify risks before they cause significant harm.

Although collaboration between service providers and the government is key to project success, equally critical is synchronizing modernization strategies with the industry's vision. Incorporating industry inputs, including from private vendors, lenders and not for profit entities that participate in federal loan programs, can create a win-win. Optimum cost savings and smart technology modernization investments can be realized for both industry and agency when federal loan program leaders consider industry inputs while gathering requirements for upgrades and changes.

(2) Change business processes

Another example also comes from the Small Business Administration, which in the late 1990s faced pressure to reduce staffing levels despite a significant increase in the volume of credit it extended through the Section 7(a) business loan program. The SBA assessed each major element of its loan processes to try to determine where budget reductions might be achieved without affecting accomplishment of program objectives. In SBA's case, a Cost Allocation Study revealed that, while the cost of making a small business guaranteed loan was low and servicing, which generally involves little work so long as a loan is performing, cost even less per loan, the cost of managing and liquidating nonperforming loans (in severe delinquency or default) was multiples greater. The relevant figures appear in Figure 6, below.

Based on these numbers, SBA changed regulations governing its Section 7(a) business loan program to require lenders to liquidate defaulted loans rather than (as had been the case until then) simply pushing nonperforming loans back to SBA for resolution. Then, to deal with nonperforming loans still on its books, SBA engaged in sales of billions of dollars of those loans to private companies for collection under contractual requirements to ensure borrower protections against unfair practices. Under the system, SBA could free up large numbers of staff, especially in field offices, to engage in more productive mission activities such as promoting SBA loans to small businesses and lenders. These actions were prudent: while SBA had almost 4,000 staff (so-called FTEs) in 1988, this had dropped to just over 3,000 by 1996 and today stands at just over 1,900. Many credit program managers foresee the possibility that loan asset sales again will become attractive to policymakers as budget pressure grows.

Figure 6
SBA Cost Allocation Study: The Cost of Executing Key Parts of the Loan Process

LOAN TYPE	FUNCTION	TOTAL COST (1000's)	UNIT COST
7(a) Guaranteed Business Loans	Making Loans	\$36,905	\$814
	Servicing Performing Loans	\$19,665	\$107
	Managing & Liquidating Non-performing Loans	\$34,283	\$4,071

As noted above, an agency must assess the risks of new ways of doing business before rather than after something can go wrong. In the case of SBA's loan asset sales, the agency engaged in an extensive strategic planning process and studied lessons from experiences of other agencies that had sold nonperforming loans.⁸

Agencies can change smaller business processes as well. A backlog can be a sign of an imbalance between limited resources and greater demands. Addressing backlogs can be important for an agency, not only to deal with the consequences for people and enterprises that may be affected by the backlog, but also because of the reputational risk that can attach if a serious backlog comes to public attention.

⁸ See, e.g., Thomas H. Stanton, "Lessons Learned: Obtaining Value from Federal Asset Sales," Public Budgeting & Finance, Spring 2003.

Depending on the type of backlog, agencies may devise a variety of solutions. To take a recent example, one credit agency found that staffing shortages had led to a backlog of thousands of claims by lenders when guaranteed loans had defaulted. The agency had to pay interest during the time it took to assess the amount of the claim; also, the relevant properties tended to decline in value if left unused for a long period of time. The agency decided on a global resolution: it approached lenders that had many claims outstanding and a track record of claims in recent years and offered settlements based on the average cost of past claims. Lenders, happy to receive their money on time, tended to sign settlements quickly. Removing that backlog left sufficient agency staff to undertake the assessments needed to clear out the backlog of claims from lenders with smaller numbers of claims and without a proven track record. Based on experience, the agency calculated that available staff and contractors would be able to process the flow of future claims in a timely manner once the backlog was resolved.

(3) Collaborate with other programs and agencies to share information, services, and operations

The Economy Act, 31 U.S.C. § 1535, gives authority to federal agencies to contract with one another to save money. The first section of the act provides that:

(a) The head of an agency or major organizational unit within an agency may place an order with a major organizational unit within the same agency or another agency for goods or services if—

- (1)** amounts are available;
- (2)** the head of the ordering agency or unit decides the order is in the best interest of the United States Government;
- (3)** the agency or unit to fill the order is able to provide or get by contract the ordered goods or services; and
- (4)** the head of the agency decides ordered goods or services cannot be provided by contract as conveniently or cheaply by a commercial enterprise.”

Federal credit agencies frequently may find that economies of scale save money when they provide services through a common platform. That is definitely true for asset sales. For instance, acting under terms of the Economy Act, two federal agencies guaranteeing single-family home loans recently managed to combine the function of selling real estate assets that came into agency hands when mortgages defaulted. The smaller agency discovered that its per-unit costs were several times the per-unit costs of the larger agency. Allowing the larger agency to manage the process saved considerable staff resources for the smaller agency. In addition, the smaller agency discovered that further savings might be possible if it harmonized some processes more closely with those of the larger agency.

Interagency communication across the federal housing agencies, including Ginnie Mae, FHA, VA, and the Rural Housing Service is much more common now than it was in years past. Especially given the overlap of Ginnie Mae’s responsibilities with those of the other three agencies, one would hope that the interagency cooperation for sale of real estate assets might grow into cross-agency collaboration to begin to harmonize processes more and to jointly manage contracts in a number of areas, for the benefit of all of the federal housing agencies as tailored to each of their needs. One constraint at the moment would seem to be the way that Ginnie Mae perhaps may be understaffed to take a lead in promoting such cost-saving and efficiency-based activities. Also, Ginnie Mae might improve its own efficiency if it were given increased ability to make decisions on such matters on a somewhat more independent basis, comparable to other wholly-owned federal government corporations.

One caveat should be noted here: cross-agency collaboration sometimes can take time and consume resources, especially legal resources. In the case of interagency cooperation to sell real estate assets, the process of reaching an actual interagency agreement took about a year, even in a case where both sides were acting with good will and eagerness to make the agreement work well.

Sharing of information across organizations can be easier than sharing delivery of services and operations. The Federal Housing Finance Agency and the Consumer Financial Protection Bureau are currently developing the National Mortgage Database (NMDB) that for the first time combines information about credit characteristics of mortgages held or guaranteed by private parties or government.⁹ Had it been in place before the financial crisis this database could have helped provide more complete information to lenders, regulators, academics, and policymakers about the inflating housing bubble and associated declining mortgage credit standards. The database also will provide important information for federal single-family mortgage program managers who will be able to benchmark with one another and obtain useful information about ways to enhance program performance. The database can help policymakers and federal managers to explore issues such as why the VA single-family loan program has a lower default rate than the FHA single-family mortgage insurance program across a range of FICO scores.¹⁰

(4) Consolidate agency organizations and especially field offices

Especially with the spread of Internet access, teleconferencing, and other technologies, many agencies have found that they can save resources by seeking to consolidate field offices. This can be especially beneficial in cases when removal of administrative layers can improve organizational efficiency. In 2012 the US Government Accountability Office pointed with approval to Census Bureau consolidation of field offices, noted above, and reduce the number from 12 to six:

“Census officials told us that as the bureau was weighing alternatives for consolidating its field office structure, it developed costs and benefits for each alternative....Costs ranged from relocation expenses for employees who would remain with the agency, to separation incentives and severance pay for those who could not or would not remain with the agency, to training costs for new positions....Census also identified [other] potentially recurring savings, which it attributed to the closure of six offices and the net reduction of ...positions across the field structure. A Census official said that such data helped to persuade stakeholders of the consolidation’s value.”¹¹

In today’s environment of constant reductions in available staff resources, when a credit agency engages in office or program consolidation or other protective actions, it seems that they may well want to retain all of the staff willing to stay. This was true of past loan asset sales: when agencies shed difficult burdens such as managing nonperforming loans, staff were freed to engage in outreach and other loan management activities that ultimately prove more rewarding than their duties before the assets were sold.

The GAO pointed out that reorganization and consolidation often cost money beforehand that is recouped later. That is yet another reason why constructive dialogue with stakeholders, and especially with members of the relevant appropriations subcommittees, is needed to obtain funding for reorganization. The need for up front funding also was an issue for credit agencies that engaged in loan asset sales, even though the sales resulted in potentially immense administrative savings once they were complete.

9 For information about the NMDB, its contents and the current status, see, Federal Housing Finance Agency, “National Mortgage Database,” available at <https://www.fhfa.gov/PolicyProgramsResearch/Programs/Pages/National-Mortgage-Database.aspx>.

10 Laurie Goodman, Ellen Seidman, and Jun Zhu, “VA Loans Outperform FHA Loans. Why? And What Can We Learn?” Urban Institute, July 2014.

11 US Government Accountability Office, “STREAMLINING GOVERNMENT: Questions to Consider When Evaluating Proposals to Consolidate Physical Infrastructure and Management Functions,” GAO-12-542, May 2012.

Another problem, of course, is that members of Congress may be reluctant to close field offices in their districts. That is an especially significant problem when trying to close or consolidate field offices in rural areas, where government employment is valued in the face of declining private sector employment. The result sometimes can be “hollow government,” the process of reducing staffing of uneconomic offices but failing to close them because of reluctance of stakeholders to accept that the offices no longer may be needed. One senior federal credit program official recounted, in a not-for-attribution recollection, that he had carefully consulted with members of relevant congressional committees who all had agreed that office consolidation was a worthwhile step. However, once offices were designated to be closed, some members of Congress reversed their positions and objected to closures in their districts. Especially at a time of sustained budget pressure, when local interests may object to losing employment in an office slated to be closed, this experience suggests that field office closures might sometimes be placed lower than other options on an agency’s list of proposed actions.

(5) When the time is right, adopt new technologies

The pace of technological change is accelerating dramatically. Artificial Intelligence (AI), Blockchain, and new platform-based approaches that streamline back office operations are disrupting many firms in the financial services industry. For federal credit programs, growing deployment of AI by financial institutions means that adverse selection of federal credit portfolios is likely to continue to increase. AI is allowing commercial enterprises to recalibrate indicators of creditworthiness and select prospective or current federal credit program customers to take out commercial rather than federal program loans. While some policymakers welcome this trend, others may see the acceleration of adverse selection as a sign that default risks of some federal credit programs could increase. On the other hand, today’s new credit scoring models are being rolled out at an economically favorable moment; they have not yet weathered an entire credit or economic cycle to test their validity in bad times as well as good.

Perhaps most important, the acceleration of technological change forces any credit operation, whether in the public or private sector, to revisit the basic business school questions: Who are we? Who are our customers? What value do we add with our offerings to those customers? For federal credit programs, the value added often may focus on providing credit to disadvantaged borrowers who are not well served commercially.

Serving disadvantaged borrower segments can be technically more challenging than serving more creditworthy borrowers. To preserve their missions, credit programs will need to improve their back office operations continuously despite reductions in administrative budgets. This is where new technologies will provide great help once commercial banks manage to adopt those technologies, overcome associated risks, and show their practicality:

“Digitizing a mortgage application would involve creating and manipulating data fields, such as borrower income and liabilities, in a largely automated manner in the cloud. This would be a multiyear process for banks, as it would require the integration of multiple legacy systems and potential replatforming to enable truly digitized processes. Simplification, digitization, and streamlining opportunities exist across large swaths of banking operations. The sooner banks attack these opportunities, the more prepared they will be to compete with fintech attackers that have a structurally lower cost base. New technologies will offer banks opportunities to test and scale to achieve efficiencies. For example [a promising possibility] may well be distributed ledger technologies that enable more cost-effective storage and rapid clearing and settlement of transactions in the banking back office.”¹²

12. Miklos Dietz, Somesh Khanna, Tunde Olanrewaju, and Kausik Rajgopal, “Cutting through the noise around financial technology,” McKinsey and Company, February 2016, p. 13.

Considering the ongoing pressure on administrative budgets, the federal government, perhaps led by the Treasury Department, may want to consider encouraging emergence of large platform companies able to take over back office operations of some federal credit programs, starting with a smaller pilot and moving towards a larger scale with the single-family mortgage programs, for instance. The result may be to reduce the cost and, if designed and managed well, increase cybersecurity and efficiency of back-office operations, leaving federal program staff to manage more hands-on activities.

A current pilot program of the Treasury's Bureau of the Fiscal Service with blockchain raises an important issue. The bureau decided to apply Blockchain to management of agency-issued cellphones as a representative area that would benefit from a more efficient system of trying to reconcile detailed records of government-owned assets with the actual assets as they come into the inventory and leave. While a success, the proof-of-concept demonstration indicated that roughly half of the time taken to move the cellphone tracking system to a Blockchain ledger was consumed by mapping the government's complicated asset management life cycle, from acquiring a cell-phone to disposing of it. Only after careful mapping were the data ready to place into the Blockchain system.¹³ This reflects a lesson noted in the example of interagency collaboration above: one of the big benefits of adopting a technology such as Blockchain may be the way it leads agencies to map complex processes and then simplify them after unnecessary steps come to light. The experience also highlights the need for federal officials to see technology absorption as a longer-term process than merely procuring the latest innovation.

CONCLUSION

This report concludes:

- (1)** Budget pressures and budget uncertainty are likely to increase in coming years; growing deficits will mean increasing reductions in federal discretionary programs;
- (2)** Because of budget scoring rules that favor providing federal support through credit rather than through grants or other direct programs, many federal credit agencies face a squeeze between diminishing administrative resources and increasing volumes of credit they provide in their programs;
- (3)** Effective responses to budget cutbacks can include, (a) transferring functions to vendors or other third-parties, possibly funded with fee-based revenues, (b) changing business processes, (c) collaborating with other programs and agencies to share information, operations, and joint provision of services, (d) consolidating operations or field offices, and (e) when the time is right, adopting new technologies to reduce costs while improving cybersecurity and efficiency.
- (4)** ERM can help improve information flow up and down the hierarchy, across silos, and with stakeholders to help agency leaders decide about cuts that pose least harm to the agency's ability to achieve its mission on a sustained basis.
- (5)** Agencies need to pay careful attention to the process of considering budget cutbacks; not only employees, but also other stakeholders and members of congress need to be brought into a process that is responsive to their legitimate needs. Options need to be carefully researched and vetted in consultations with affected parties.
- (6)** To cope effectively with budget uncertainties, agencies need to build their resilience, for instance by increasing training and succession planning so that knowledgeable staff are ready to take the places of staff who leave an agency through retirement or other processes.

13 Tajha Chappellet-Lanier, "Treasury's Fiscal Service wraps up 'incredibly positive' blockchain proof of concept," FedScoop, April 2, 2018.

Experience teaches that employees seek three attributes from a leader: a sense of mission, stewardship of the institution, and fair play. Times of budget pressures and uncertainty test these three leadership qualities. There is also a time when leaders can prove themselves especially worthy of the trust placed by American taxpayers, those benefiting from federal credit, and agency employees, in those who serve and lead in the public service.

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