

PART 1980 - GENERAL

Subpart E - Business and Industrial Loan Program

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Note: This subpart supplements the provisions of Subpart A of this part of the regulations with respect to loans guaranteed by Rural Development.

PART 1980 - GENERAL

Subpart E - Business and Industrial Loan Program

§1980.401 Introduction.

(a) Direct Business and Industry (B&I) loans are disbursed by the Agency under this subpart. B&I loan guarantees are to be processed and serviced under the provisions of subparts A and B of part 4279 and subpart B of part 4287 of this title. Any processing or servicing activity conducted pursuant to this subpart involving authorized assistance to relatives, or business or close personal associates, is subject to the provisions of subpart D of part 1900 of this chapter. Applicants for this assistance are required to identify any known relationship or association with any Agency employee. (Revised 12-23-96, SPECIAL PN.)

(b) The purpose of the B&I program is to improve, develop or finance business, industry and employment and improve the economic and environmental climate in rural communities, including pollution abatement and control. This purpose is achieved through bolstering the existing private credit structure through guarantee of quality loans which will provide lasting community benefits. It is NOT intended that the guarantee authority will be used for marginal or substandard loans or to "bail out" lenders having such loans.

(c) This subpart and its appendices (especially Appendix I and Appendix K) also contain regulations for Drought and Disaster (D&D) and Disaster Assistance for Rural Business Enterprises (DARBE) guaranteed loans authorized by §331 of the Disaster Assistance Act of 1988 (P.L. 100-387) and §401 of the Disaster Assistance Act of 1989 (P.L. 101-82). D&D loans must be to alleviate distress caused to rural business entities, directly or indirectly, by drought, hail, excessive moisture, or related conditions occurring in 1988, or to provide for the guarantee of loans to such rural business entities that refinance or restructure debt as a result of losses incurred, directly or indirectly, because of such natural disasters and are limited to a guarantee of principal only. DARBE loans must be to alleviate distress caused to rural business entities, directly or indirectly, by drought, freeze, storm, excessive moisture, earthquake or related conditions occurring in 1988 or 1989, or to provide for the guarantee of loans to such rural business entities that refinance or restructure debt as a result of losses incurred, directly or indirectly, because of such natural disasters and within certain parameters guarantee both principal and interest. (Revised 05-09-90, PN 133.)

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(d) The B&I loan program is administered by the Administrator through a State Director serving each State. The State Director is the focal point for the program and the local contact person for processing and servicing activities, although this subpart refers in various places to the duties and responsibilities of other Rural Development employees. (Renumbered 01-03-89, SPECIAL PN.)

(e) Throughout this subpart there appear Administrative provisions for the State Director, District Director, and County Supervisor. These provisions establish the internal duties, responsibilities and procedures to carry out the requirements of the program. These provisions are identified as "ADMINISTRATIVE" and follow appropriate sections of this subpart. (Renumbered 01-03-89, SPECIAL PN.)

(f) This subpart also contains regulations for Business and Industry Disaster (BID) loans under the authority of the Dire Emergency Supplemental Appropriations Act, 1992, Public Law 102-368. This program provides B&I guarantees for loans needed as a result of natural disasters. Some of the requirements of this subpart are waived or altered for BID loans. The waivers and alterations are provided in §1980.498 of this subpart. (Added 10-05-92, SPECIAL PN.)

§ 1980.402 Definitions. (Added 07-26-06, PN 400.)

(a) The following general definitions are applicable to the terms used in this subpart.

Adjusted tangible net worth. Tangible balance sheet equity plus allowed tangible asset appreciation and subordinated owner debt.

Allowed tangible asset appreciation. The difference between the current net book value recorded on the financial statements (original cost less cumulative depreciation) of real property assets and the lesser of their current market value or original cost, where current market value is determined using an appraisal satisfactory to the Agency.

Area of high unemployment. An area in which a B&I loan guarantee can be issued, consisting of a county or group of contiguous counties or equivalent subdivisions of a State which, on the basis of the most recent 12-month average or the most recent annual average data, has a rate of unemployment 150 percent or more of the national rate. Data used must be those published by the Bureau of Labor Statistics, U.S. Department of Labor.

Biogas. Biomass converted to gaseous fuel.

Biomass. Any organic material that is available on a renewable or recurring basis including agricultural crops, trees grown for energy production, wood waste and wood residues, plants, including aquatic plants and grasses, fibers, animal waste and other waste materials, fats, oils, greases, including recycled fats, oils and greases. It does not include paper that is commonly recycled or unsegregated solid waste.

Borrower. A borrower may be a cooperative organization, corporation, partnership, trust or other legal entity organized and operated on a profit or nonprofit basis; an Indian Tribe on a Federal or State reservation or other Federally recognized tribal group; a municipality, county, or other political subdivision of a State; or an individual. Such borrower must be engaged in or proposing to engage in improving, developing or financing business, industry and employment and improving the economic and environmental climate in rural areas, including pollution abatement and control.

Business and Industry Disaster Loans. Business and Industry loans guaranteed under the authority of the Dire Emergency Supplemental Appropriations Act, 1992, Public Law 102-368. These guaranteed loans cover costs arising from the direct consequences of natural disasters such as Hurricanes Andrew and Iniki and Typhoon Omar that occur after August 23, 1992, and receive a Presidential declaration. Also included are the costs to any producer of crops and livestock that are a direct consequence of at least a 40 percent loss to a crop, 25 percent loss to livestock, or damage to building structures from a microburst wind occurrence in calendar year 1992.

Commercially available. Energy projects utilizing technology that has a proven operating history, and for which there is an established industry for the design, installation, and service (including spare parts) of the equipment.

Community facilities. For the purposes of this subpart, community facilities are those facilities designed to aid in the development of private business and industry in rural areas. Such facilities include, but are not limited to, acquisition and site preparation of land for industrial sites (but not for improvements erected thereon), access streets and roads serving the site, parking areas extension or improvements of community transportation systems serving the site and utility extensions all incidental to site preparation. Projects eligible for assistance under Subpart A of Part 1942 of this chapter are not eligible for assistance under this subpart.

Development cost. These costs include, but are not limited to, those for acquisition, planning, construction, repair or enlargement of the proposed facility; purchase of buildings, machinery, equipment, land easements, rights-of-way; payment of startup operating costs, and interest during the period before the first principal payment becomes due, including interest on interim financing.

Disaster Assistance for Rural Business Enterprises. Guaranteed loans authorized by §401 of the Disaster Assistance Act of 1989 (P.L. 101-82), providing for the guarantee of loans to assist in alleviating distress caused to rural business entities, directly or indirectly, by drought, freeze, storm, excessive moisture, earthquake or related conditions occurring in 1988 or 1989, and providing for the guarantee of loans to such rural business entities that refinance or restructure debt as a result of losses incurred, directly or indirectly, because of such natural disasters. See this subpart and its appendices, especially Appendix K, containing additional regulations for these loans.

Drought and Disaster Guaranteed loans. Guaranteed loans authorized by §331 of the Disaster Assistance Act of 1988 (P.L. 100-387), providing for the guarantee of loans to assist in alleviating distress caused to rural business entities, directly or indirectly, by drought, hail, excessive moisture, or related conditions occurring in 1988, and providing for the guarantee of loans to such rural business entities that refinance or restructure debt as a result of losses incurred, directly or indirectly, because of such natural disasters. (Added 01-03-89, SPECIAL PN.)

Energy projects. Commercially available projects that produce or distribute energy or power and/or projects that produce biomass or biogas fuel.

Farmers Home Administration (FmHA). The former agency of USDA that previously administered the programs of this Agency. Many Instructions and forms of FmHA are still applicable to Agency programs.

Hurricane Andrew. A hurricane that caused damage in southern Florida on August 24, 1992, and in Louisiana on August 26, 1992.

Hurricane Iniki. A hurricane that caused damage in Hawaii on September 11, 1992.

Letter of conditions. Letter issued by Rural Development under Public Law 103-354 to a borrower setting forth the conditions under which Rural Development will make a direct (insured) loan from the Rural Development Insurance Fund.

Loan classification system. The process by which loans are examined and categorized by degree of potential for loss in the event of default.

Microburst wind. A violently descending column of air associated with a thunderstorm which causes straight-line wind damage.

Problem loan. A loan which is not performing according to its original terms and conditions or which is not expected in the future to perform according to those terms and conditions.

Public body. A municipality, political subdivision, public authority, district, or similar organization.

Qualified Intellectual Property. Trademarks, patents or copyrights included on current (within one year) audited balance sheets for which an audit opinion has been received that states the financial reports fairly represent the values therein and the reported value has been arrived at in accordance with GAAP standards for valuing intellectual property. The supporting work papers must be satisfactory to the Administrator.

Refinancing loan. A loan, all of the proceeds of which are applied to extinguish the entire balance of an outstanding debt.

Seasoned loan. A loan which:

- (1) Has a remaining principal guaranteed loan balance of two-thirds or less of the original aggregate of all existing B&I guaranteed loans made to that business.
- (2) Is in compliance with all loan conditions and B&I regulations.
- (3) Has been current on the B&I guaranteed loan(s) payments for 24 consecutive months.
- (4) Is secured by collateral which is determined to be adequate to ensure there will be no loss on the B&I guaranteed loan.

State. Any of the 50 States, the Commonwealth of Puerto Rico, the Virgin Islands of the United States, Guam, American Samoa, the Commonwealth of the Northern Mariana Islands, the Republic of Palau, the Federated States of Micronesia, and the Republic of the Marshall Islands.

Subordinated owner debt. Debt owed by the borrower to one or more of the owner(s) that is subordinated to debt owed by the borrower to the Agency or guaranteed by the Agency (aggregate B&I Loan Exposure) pursuant to a subordination agreement satisfactory to the Agency. The debt must have been issued in exchange for cash loaned to the borrower for the benefit of the borrower's business. The terms of the subordination agreement must provide that repayment will not commence until the earlier of the date all aggregate B&I loan exposure has been repaid or when a period of three consecutive years has passed during which the borrower has met all loan covenants and evidenced operating profit sufficient to commence partial repayment of this subordinated debt after giving effect to the annual debt service requirements of the aggregate B&I loan exposure. The partial repayment schedule in the case of the latter scenario is subject to annual Agency concurrence and may not be more accelerated than the rate of the debt repayment schedule in effect for the Agency's aggregate B&I loan exposure.

Tangible balance sheet equity. Total equity less the value of intangible assets recorded on the financial statements, as determined from balance sheets prepared in accordance with generally accepted accounting principles (GAAP), plus qualified intellectual property.

Typhoon Omar. A typhoon that caused damage in Guam on August 28, 1992.

Working capital. The excess of current assets over current liabilities. It identifies the relatively liquid portion of total enterprise capital which constitutes a margin or buffer for meeting obligations within the ordinary operating cycle of the business.

(b) Accounting terms not otherwise defined in this part shall have the definition ascribed to them under generally accepted accounting principles (GAAP).

§ 1980.403 Citizenship of borrowers.

Loans to individuals will be made or guaranteed only to those who are citizens of the United States or reside in the United States after being legally admitted to permanent residence. At least 51 percent of the outstanding interest in any corporation or organization-type applicant must be owned by those who are either citizens of the United States or reside in the United States after being legally admitted for permanent residence.

§ 1980.404 [Reserved]

§ 1980.405 Rural areas. (Revised 12-23-02, SPECIAL PN.)

The business financed with a B&I loan must be located in a rural area. Loans to borrowers with facilities located in both rural and non-rural areas will be limited to the amount necessary to finance the facility located in the eligible rural area. Cooperatives that are headquartered in a non-rural area may be eligible for a B&I loan if the loan is used for a project or venture that is located in a rural area. Rural areas are any areas other than a city or town that has a population of greater than 50,000 inhabitants, the urbanized area contiguous and adjacent to such a city or town, as defined by the U.S. Bureau of the Census, and which exclude certain populations pursuant to 7 U.S.C. 1991(a) (13) (H) and (I). For the purpose of this section:
(Revised 07-11-22, SPECIAL PN.)

(a) a city or town that has a population of greater than 50,000 inhabitants; and

(b) the urbanized area contiguous and adjacent to such a city or town, as defined by the U.S. Bureau of the Census using the latest decennial census of the United States.

§§ 1980.406 - 1980.410 [Reserved]

§ 1980.411 Loan purposes.

(a) Private entrepreneurs. Loans may be for improving, developing or financing business, industry and employment and improving the economic and environmental climate, including pollution abatement and control, of rural areas and may include but is not limited to:

(1) Business and industrial acquisitions, construction, conversion, enlargement, repair, modernization or development cost.

(2) Purchasing and development of land, easements, rights-of-way, buildings, facilities, leases or materials.

(3) Purchasing of equipment, leasehold improvements, machinery or supplies.

(4) Pollution control and abatement, including those in connection with farming and ranching operations.

(5) Transportation services incidental to industrial development.

(6) Startup costs and working capital.

(7) The financing of housing development sites located in open country or cities, towns, or villages with populations not in excess of those eligible for Rural Development rural housing loans, provided the community demonstrates a need for additional housing to prevent a loss of jobs in the area, or to house families moving to the area as a result of new employment opportunities.

(8) Loans, other than for working capital or debt refinancing, for meat processing facilities and integrated meat and poultry operations. Loans may not be guaranteed for agricultural production as defined in §1980.412(e); however, applicants who are in the business of processing, marketing or packaging of agricultural products, as well as agricultural production, may be eligible for loan assistance for that portion of the business other than agricultural production provided the agricultural production aspect is separate from the rest of the business; i.e., the production aspects are handled through separate legal business entities or through maintenance of the accounting system in such a manner as to clearly identify the use of and future accounting of the loan proceeds and operation of the business.

(9) Interest (including interest on interim financing) during the period before the first principal payment becomes due or the facility becomes income producing, whichever occurs first.
(Renumbered 11-8-88, SPECIAL PN)

(10) Feasibility studies. (Renumbered 11-8-88, SPECIAL PN)

(11) Debt refinancing. Lenders and Rural Development must provide as part of their loan analysis the reasons for refinancing and the file must be documented accordingly. Refinancing debts may be allowed in connection with viable projects when it is determined by the lender and Rural Development that it is necessary to create new or save existing jobs. Rural Development will consider any lender's exposure as it relates to this item and may adjust the guarantee percentage accordingly. Refinancing in accordance with this paragraph may be insured or guaranteed only when: (Revised 7-5-89, PN 112)

(i) It is necessary to spread substantial debt payment over a longer period of time, thereby improving the business' cash flow and working capital position consistent with the useful life of the asset being refinanced, or

(ii) For payment of short-term debt when required in situations customarily financed over long periods of time (e.g., financing the purchase of real estate, machinery or equipment with short-term debt or cash expenditures, when lenders would not extend reasonable longer terms to the business), or

(iii) It is necessary to place a permanent loan subsequent to an interim loan for financing the construction of the project, or

(iv) It does not refinance subordinated owner debt, or (Added 07-26-06, PN 400.)

(v) (Except where the amount to be refinanced is owed directly to the Federal government or is Federally guaranteed) the amount to be refinanced by the Agency is a secondary part (less than 50 percent) of the overall loan requested. (Added 07-26-06, PN 400.)

(12) Reasonable fees and charges only as specifically listed below and disclosed on Form RD 449-1, "Application for Loan and Guarantee," or on an addendum to the application at the time the request is submitted to Rural Development for processing. Authorized fees include fees for services rendered by professionals generally licensed by individual States or accreditation associations, such as engineers, architects, lawyers, accountants, and appraisers. The amount of the fee will be what is reasonable and customary in the community or region where the project is located. For example, architects and engineers customarily charge fees based on a percentage of estimated project costs. Lawyers, accountants and appraisers customarily charge for services on an hourly basis. Any fees for professional or expert services are to be fully documented and justified on the Form RD 449-1 and are subject to Rural Development review and approval before the application is presented to the Rural Development State Loan Review Board for action. The above approved fees and charges may be funded out of loan proceeds. (Renumbered 11-8-88, SPECIAL PN)

(13) Rural Development guarantee fee. (Renumbered 11-8-88, SPECIAL PN)

(14) Acquisition of membership and/or stocks, bonds or debentures necessary to obtain a loan from Production Credit Associations, Banks for Cooperatives, Small Business Investment Companies, and other lenders, provided such acquisition is required of all their borrowers. However, a lender which requires membership fees in such organization will not use such proceeds to acquire, lease or improve property which does not benefit its members. (Renumbered 11-8-88, SPECIAL PN)

(15) Aquaculture, including conservation, development and utilization of water for aquaculture. Aquaculture means the culture or husbandry of aquatic animals or plants by private industry for commercial purposes including the culture and growing of fish by private industry for the purpose of granting or augmenting publicly-owned and regulated stock of fish. (Renumbered 11-8-88, SPECIAL PN)

(16) Energy projects. Commercially available energy projects that produce biomass fuel or biogas as an output must have completed two operating cycles at design performance levels submitted to the Agency. Projects that produce steam or electricity as an output must have met or exceeded acceptance test performance criteria submitted to the Agency and be successfully interconnected with the purchaser of the output. Performance or acceptance test requirements for all other energy projects will be determined by the Agency on a case by case basis. Financing for energy projects will only be allowed when the facility has been constructed according to plans and specifications and is producing at the quality and quantity projected in the application.

(b) Public bodies. See §1980.481 and §1980.488.

§1980.412 Ineligible loan purposes.

Loans may not be made or guaranteed if the funds are used:

(a) To pay off a creditor in excess of the value of the collateral.

(b) For distribution or payment to the owner, partners, stockholders or beneficiaries of the applicant or members of their families when such persons will retain any portion of their equity in the business.

(c) For projects in which such assistance exceeds \$1 million and when direct employment increases more than 50 employees which is calculated to or is likely to result in the transfer from one area to another of any employment or business activity provided by the operations of the applicant. This limitation will not prohibit assistance for the expansion of an existing business entity through the establishment of a new branch, affiliate or subsidiary of such entity if the expansion will not result in an increase in the unemployment in the area of original location or in any other area where such entity conducts business operations unless there is reason to believe such expansion is being established with the intention of closing down the operations of the existing business entity in the area of its original location or in any other area where it conducts such operations.

(d) For projects in which such assistance exceeds \$1 million and when direct employment increases more than 50 employees which is calculated to or likely to result in an increase in the production of goods, materials or commodities, or the availability of services or facilities in the area when there is not sufficient demand for such goods, materials, commodities, services or facilities to employ the efficient capacity of existing competitive commercial or industrial enterprises, unless such financial or other assistance will not have an adverse effect upon existing competitive enterprises in the area.

(e) For agricultural production which means the cultivation, production (growing), and harvesting, either directly or through integrated operations, of agricultural products (crops, animals, birds, and marine life, either for fiber or food for human consumption), and disposal or marketing thereof, the raising, housing, feeding (including commercial custom feedlots), breeding, hatching, control and/or management of farm and domestic animals. Exceptions to this definition are: (Revised 11-8-88, SPECIAL PN)

RD Instruction 1980-E
§1980.412 (e) (Con.)

- (1) Aquaculture as defined under eligible purposes.
- (2) Commercial nurseries primarily engaged in the production of ornamental plants and trees and other nursery products such as bulbs, florists' greens, flowers, shrubbery, flower and vegetable seeds, sod, and the growing of vegetables from seed to the transplant stage.
- (3) Forestry which includes establishments primarily engaged in the operation of timber tracts, tree farms, forest nurseries, and related activities such as reforestation.
- (4) Loans for livestock and poultry processing as identified under eligible purposes.
- (5) The growing of mushrooms or hydroponics. (Renumbered 11-8-88, SPECIAL PN)
- (f) For the transfer of ownership of a business unless the loan will keep the business from closing, prevent the loss of employment opportunities in the area, or provide expanded job opportunities.
- (g) For financing community antenna television services or facilities.
- (h) Charitable and educational institutions, churches, organizations affiliated with or sponsored by churches and fraternal organizations.
- (i) For lending and investment institutions and insurance companies.
- (j) For assistance to government employees and military personnel who are directors, officers, or have a major ownership of 20 percent or more in the business.
- (k) For any legitimate business activity when more than 10 percent of the annual gross revenue is derived from legalized gambling activity.
- (l) For any illegal business activity.
- (m) For hotels, motels, tourist homes, or convention centers.
- (n) For any tourist, recreation or amusement facility.
- (o) For any line of credit.

ADMINISTRATIVE: Par (c) and (d). The State Director will review the criteria in §1980.412 (c) and (d) and make a written determination with supporting data and reasons as to the determinations. Such review must be independent of the Department of Labor certification. The State Director will make sure the loan file contains these determinations as part of the loan analysis prior to the issuance of the Conditional Commitment for Guarantee.

§1980.413 Transactions which will not be guaranteed. (Revised 11-8-88,
SPECIAL PN)

(a) The following transactions will not be guaranteed by Rural
Development:

- (1) The guarantee of lease payments.
- (2) The guarantee of loans made by other Federal agencies. This does not preclude the guaranteeing of loans made by the Bank for Cooperatives, Federal Land Bank, or Production Credit Association.
- (3) The guarantee or making of any B&I loan(s), to any one borrower, when the total amount of the B&I loan(s) requested plus the outstanding balance of any existing B&I loan(s) is in excess of \$10 million.

(b) Guaranteeing of loans involved in tax-exempt obligations under §1980.23 of Subpart A of this part.

ADMINISTRATIVE

The State Director will consider the overall State allocations of funding authority in recommending loans for processing. Loan requests which fall within Small Business Administration (SBA) authority should continue to be referred to SBA. If the State Director decides to process SBA size loans, the loan file must be fully documented as to the reasons for such actions.

§1980.414 Fees and charges by lender and others.

[See Subpart A, §1980.22]

- (a) All fees and charges must be specifically documented and justified on the Form RD 449-1 or on an addendum to the application at the time the loan request is submitted to Rural Development for processing. Allowable fees will be those reasonably and customarily charged borrowers in similar circumstances in the ordinary course of business and are subject to Rural Development review and approval.
- (b) Packaging fees include services rendered by the lender or others in connection with preparation of the application and seeing the project through to final decision. These services may or may not be performed by an investment banker. If an investment banker

RD Instruction 1980-E
§1980.414 (b) (Con.)

provides needed assistance in addition to the packaging of the loan, additional charges may be added to the packaging fee. The maximum allowable packaging fees are 2 percent of the total principal amount of the loan up to \$1 million and on all amounts over \$1 million, an additional one-fourth percent up to a total maximum fee of \$50,000. Packaging fees, investment banker fees and any other fees and charges not specifically provided for in this section are permitted subject to Rural Development review and approval. Loan proceeds may be used to pay fees as specifically authorized under §1980.411(a) (12) and (13). Packaging fees, investment banker fees, and any other fees and charges shall not be paid from loan proceeds. (Revised 11-8-88, SPECIAL PN)

§§1980.415 - 1980.418 [Reserved]

§1980.419 Eligible lenders. [See Subpart A, §1980.13.]

ADMINISTRATIVE:

A. Par (a) of Subpart A, §1980.13 requires National Office approval for any variations.

B. Par (b)(4) of Subpart A, §1980.13, State Director submits information to National Office with recommendations.

C. With prior written approval of the Rural Development National Office, a new eligible lender may be substituted for the original lender provided the new lender agrees to assume all original loan requirements including liabilities, servicing responsibilities and acquiring legal title to the unguaranteed portion of the loan. Such approval will be granted by the National Office only when a lender discontinues lending operations or other extreme situations require a substitution of lender. If approved by the National Office, the State Director will submit to the Finance Office Form RD 1980-42, "Notice of Substitution of Lender."

§1980.420 Loan guarantee limits. (Added 11-8-88, SPECIAL PN)

The percentage of guarantee, up to the maximum allowed by this section, is a matter of negotiation between the lender and Rural Development.

(a) For loans of \$2 million or less, the maximum percentage of guarantee is 90 percent.

(b) For loans over \$2 million but not over \$5 million, the maximum percentage of guarantee is 80 percent.

(c) For loans in excess of \$5 million, the maximum percentage of guarantee is 70 percent.

(d) Lenders and borrowers will propose the percentage of guarantee. Rural Development informs lenders and borrowers in writing on Form RD 449-14 of any percentage of guarantee less than proposed by the lender and borrower, and the reasons therefore. Rural Development determines the percentage of guarantee after considering all credit factors involved, including but not limited to:

- (1) Borrower's management. The borrower's management, and when appropriate, equity capital, history of operation, marketing plan, raw material requirements, and availability of necessary supporting utilities and services;
- (2) Collateral. Collateral for the loan;
- (3) Financial condition. Financial condition of borrower or borrower's principals, if appropriate;
- (4) Lender's exposure. The lender's exposure before and after the loan, and any applicable limits on the lender's lending authority; and
- (5) Trends and conditions. Current trends and economic conditions.

§§1980.421 - 1980.422 [Reserved]

§1980.423 Interest rates.

(a) Guaranteed loans. Rates will be negotiated between the lender and the borrower. They will be either fixed or variable as long as they are legal. Interest rates will be those rates customarily charged borrowers in similar circumstances in the ordinary course of business and are subject to Rural Development review and approval. Should any part of the loan(s) be sold by the lender, Rural Development, in its analysis, will take into consideration in approving the lender's interest rate, the rate at which guaranteed loans are being sold or traded in the secondary market.

RD Instruction 1980-E
§1980.423 (a) (Con.)

(1) A variable interest rate must be a rate that is tied to a base rate published periodically in a recognized national or regional financial publication specifically agreed to by the lender and borrower. The variable interest rate may be adjusted at different intervals during the term of the loan, but the adjustments may not be more often than quarterly. The intervals between interest rate adjustments will be specified in the loan agreement. The lender must incorporate within the variable rate promissory note at loan closing, the provision for adjustment of payment installments coincident with an interest rate adjustment. This will assure that the outstanding principal balance is properly amortized within the prescribed

loan maturity to eliminate the possibility of a balloon payment at the end of the loan. (Revised)

(2) Under a Memorandum of Understanding between Rural Development and the Farm Credit Administration dated September 25, 1974, the interest rate on loans made by the Bank for Cooperatives, Federal Land Bank and Production Credit Associations may be a variable rate based on their administrative and borrowing costs.

(3) Any change in the interest rate between the date of issuance of the Form RD 449-14, "Conditional Commitment For Guarantee," and before the issuance of the Loan Note Guarantee must be approved by the State Director. Approval of such change will be shown on an amendment to Form RD 449-14.

(4) It is permissible to have one interest rate on the guaranteed portion of the loan and another interest rate on the unguaranteed portion of the loan, provided the lender and borrower agree and:

(i) The rate on the unguaranteed portion does not exceed that currently being charged on loans of similar size and purpose for borrowers under similar circumstances.

(ii) The rate on the guaranteed portion of the loan will not exceed the rate on the unguaranteed portion.

(5) When multi-rates are used, the lender will provide Rural Development with the overall effective interest rate for the entire loan.

(6) The borrower, lender and holder (if any) may collectively effect a permanent reduction in the interest rate on their B&I guaranteed loan at any time during the life of the loan upon written agreement by these parties. Rural Development must be notified by the lender, in writing, within 10 calendar days of the change. If the guaranteed portion has been repurchased by Rural Development, then Rural Development is a holder and must affirm or reject interest rate change proposals. When Rural Development is a holder, it will concur in such interest rate change only when it is demonstrated to Rural Development that the change is a more viable alternative than initiating or proceeding with liquidation of the loan or continuing with the loan in its present state and that the Government's financial interests are not adversely affected. Factors which will be considered in making such determination will include whether the proposed interest rate will

be below the Government's cost of borrowing money, whether continuing with the loan would realistically promote or enhance rural development and employment in rural areas, whether the monetary recovery would be increased by proceeding immediately to liquidation, if applicable, or allowing the borrower to continue at a reduced interest rate, and whether an in-depth financial analysis by the lender reasonably indicates that the business would be successful at a lower interest rate and reasonably indicates that the borrower could make the reduced payment and pay off amounts in arrears, if any. The Rural Development file will reflect the documentation of the interest rate change decision.

(i) Fixed rates cannot be changed to variable rates to reduce the interest rate to the borrower unless the variable rate has a ceiling which is less than the original fixed rate.

(ii) Variable rates can be changed to reduce fixed rates. In a final loss settlement, when qualifying rate changes were made with the required written agreements and notification, the interest will be calculated for the periods the given rates were in effect, except that interest claimed on a loan which originated at a variable rate can never exceed the amount which would have been eligible for claim had the variable rate remained in force. The lesser cost to the Government will always prevail. The lender must maintain records which adequately document the accrued interest claimed.

(iii) The lender is responsible for the legal documentation of interest changes by an allonge attached to the promissory note(s) or any other legally effective amendment of the rate(s); however, no new note(s) may be issued.

(7) No increases in interest rates will be permitted under the B&I loan guarantee except the normal fluctuations in approved variable interest rate loans.

(b) Insured loans.

(1) Loans for other than those in paragraph (b) (2) of this section will bear interest at a rate prescribed by Rural Development, and will be announced periodically. The interest rate for insured loans will be the rate in effect at the time the loan is approved or at the time the loan is closed, whichever rate is lower.

(2) Loans to public bodies, nonprofit associations and Indian Tribes used to finance community facilities will bear interest at the rate prescribed in RD Instruction 440.1, Exhibit B (available in any Rural Development office).

ADMINISTRATIVE: Par (a) (6) and (a) (7). (Added 4-26-85, SPECIAL PN.)

The Director will notify the Finance Office of any interest rate reduction by using Form RD 1980-47, "Guaranteed Loan Borrower Adjustments." The State Director will make corrections to the Rural Community Facility Tracking System (RCFTS) reflecting the interest rate change. The Rural Development loan file, as well as the attachments to the copy of the promissory note in the file, will be documented by the State Director to reflect any change in the interest rate.

§1980.424 Terms of loan repayment.

(a) Principal and interest on the loan will be due and payable as provided in the promissory note except, any interest accrued as the result of the borrower's default on the guaranteed loan(s) over and above that which would have accrued at the normal note rate on the guaranteed loan(s) will not be guaranteed by Rural Development. The lender will structure repayments as established in the loan agreement between the lender and borrower. Ordinarily, such installments will be scheduled for payment as agreed upon by the lender and applicant but on terms that reasonably assure repayment of the loan. However, the first installment to include a repayment of principal may be scheduled for payment after the project is operable and has begun to generate income, but such installment will be due and payable within three years from the date of the promissory note and at least annually thereafter. Interest will be due at least annually from the date of the note. Ordinarily, monthly payments will be expected, except for seasonal-type businesses.

(b) The maximum time allowable for final maturity for a Rural Development guaranteed B&I loan will be limited to thirty (30) years for land, buildings and permanent fixtures; the usable life of the machinery and equipment purchased with loan funds, but not to exceed fifteen (15) years; and seven (7) years for the working capital portion of the loan. The term for a loan that is being refinanced may be based on the collateral the lender will take to secure the loan.

(c) The maximum time allowable for final maturity of a Rural Development insured loan for community facilities will not exceed forty (40) years.

(d) Rural Development will not guarantee any loan in which the promissory note or any other document provides for the payment of interest upon interest.

ADMINISTRATIVE:

It is permissible for lenders to structure the borrower's financial proposal under the multi-note option as provided for in paragraph III A.2. of Form RD 449-35, "Lender's Agreement," in the following ways:

A. To treat the entire financial package of the borrower as one loan (i.e., loan purposes may include one or any combination of working capital, machinery and equipment or real estate) provided:

1. The loan is amortized to provide repayment of the working capital portion within the 7 years, the machinery and equipment portion within useful life or 15 years, whichever is less, and real estate portion within 30 years.

2. One note represents the unguaranteed portion of the loan. It is permissible to issue as many as 10 notes on the guaranteed portion of the loan.

3. A Form RD 449-34, "Loan Note Guarantee," is attached to all notes, including the unguaranteed note.
 4. One interest rate (either variable or fixed) is used for the entire loan or one interest rate is used on the guaranteed portion and a different interest rate is used on the unguaranteed portion, subject to the requirements and conditions found in §1980.423 of this subpart.
 5. One of each of the following Forms: Form RD 449-14, Form RD 1940-3, "Request for Obligation of Funds - Guaranteed Loans," Form RD 449-35, and Form RD 1980-19, "Guaranteed Loan Closing Report," is used. (Revised 02-28-91, SPECIAL PN.)
- B. To treat the financial package of the borrower as separate loans that are processed as a single application provided:
1. A separate loan is made for each purpose (i.e., working capital, machinery and equipment or real estate). As an example, a working capital loan could be structured as follows:
 - One note for \$XXXX at X% interest due in 7 years representing the unguaranteed portion of the loan, and
 - Up to 10 notes for \$XXXX at X% interest due in 7 years representing the guaranteed portions of the loan.
 2. A Form RD 449-34 is attached to all notes, including the unguaranteed note.
 3. A different interest rate may be used on the guaranteed and unguaranteed portions of the loan, subject to the requirements and conditions found in §1980.423 of this subpart.
 4. Separate Forms RD 449-14, 1940-3, 449-35, and 1980-19 are required for each loan. If you have two loans, one for working capital and another for real estate, then a set of these forms will be required for each loan. (Revised 02-28-91, SPECIAL PN.)
- C. Form RD 449-36, "Assignment Guarantee Agreement," will never be used when the multi-note option is utilized.
- D. Par. (b). The State Director will assure that the loan officer reviewing the application fully evaluates the useful life of the collateral offered for the loan when determining maturities for the loan. Loan requests for the maximum maturities could result in collateral obsolescence prior to full repayment of the indebtedness. The loan file must be documented to support the maturity granted for the loan.

§1980.425 Availability of credit from other sources.

(a) Inability to obtain credit elsewhere is not a requirement for guaranteed assistance under this subpart.

(b) To be eligible for an insured loan under this subpart, the borrower must be unable to obtain the required credit from private or cooperative sources at reasonable rates and terms, taking into consideration prevailing private and cooperative rates and terms in the community in or near the borrower's location(s) for loans for similar purposes and period of time. The borrower's inability to obtain such credit elsewhere will be determined in accordance with Subpart A of Part 1942 of this chapter.

§§1980.426 - 1980.431 [Reserved]

§1980.432 Environmental review requirements. [See subpart A, §1980.40 and 7 CFR part 1970.] (Revised 04-01-16, SPECIAL PN.)

ADMINISTRATIVE:

Loans made under this part must be in compliance with the environmental review requirements in accordance with 7 CFR part 1970. (Revised 04-01-16, SPECIAL PN.)

§1980.433 Flood or mudslide hazard area precautions. (See Subpart A, Part 1980.42.)

ADMINISTRATIVE:

The State Director is responsible for determining if a project is located in a special flood or mudslide hazard area. Refer to Subpart B of Part 1806 of this chapter [RD Instruction 426.2.].

§1980.434 Equal opportunity and nondiscrimination requirements. [See Subpart A §1980.41.]

ADMINISTRATIVE:

The State Director will assure that equal opportunity and nondiscrimination requirements are met. If there is indication of noncompliance with these requirements, such facts will be reported by the Compliance Reviewing Officer or Rural Development official in writing to the Administrator, ATTN: Equal Opportunity Officer.

§§ 1980.435 - 1980.440 [Reserved]

§ 1980.441 Borrower equity requirements. (Revised 07-26-06, PN 400.)

(a) A minimum of 10 percent tangible balance sheet equity will be required for existing businesses at loan closing. A minimum of 20 percent tangible balance sheet equity will be required for new businesses at loan closing. For energy projects, the minimum tangible balance sheet equity requirement range will be between 25 percent and 40 percent. Criteria for considering the minimum equity required for an individual application will be based on: existing businesses with successful financial and management history vs. start-up businesses; personal/corporate guarantees offered; contractual relationships with suppliers and buyers; credit rating; and strength of the business plan/feasibility study. Where the application is a request to refinance outstanding Federal direct or guaranteed loans, without any new financing, the equity requirement may be determined using adjusted tangible net worth. An application that combines a refinancing loan or guarantee request with a new loan or guarantee request is subject to the standard, unadjusted, equity requirement except as provided in paragraphs (a) (1) or (a) (2) of this section. Increases or decreases in the equity requirements may be imposed or granted as follows:

(1) A reduction in the equity requirement for existing businesses may be permitted by the Administrator. In order for a reduction to be considered, the borrower must furnish the following:

(i) Collateralized personal and corporate guarantees, including any parent, subsidiary, or affiliated company, when feasible and legally permissible, and

(ii) Pro forma and historical financial statements that indicate the business to be financed meets or exceeds the median quartile (as identified in the Risk Management Association's Annual Statement Studies or similar publication) for the current ratio, quick ratio, debt-to-worth ratio, debt coverage ratio and working capital.

§ 1980.441(a) (1) (Con.)

(2) The approval official may require more than the minimum equity requirements provided in this paragraph if the official makes a written determination that special circumstances necessitate this course of action.

(b) The equity requirement must be met in the form of either cash or tangible earning assets contributed to the business and reflected on the balance sheet.

(c) The equity requirement must be determined using balance sheets prepared in accordance with GAAP and met upon giving effect to the entirety of the loan in the calculation, whether or not the loan itself is fully advanced, as of the date the loan is closed; a certification to this effect is required of all guaranteed lenders.

(d) The modified formula for determining whether the equity requirement is met, "adjusted tangible net worth," may be used only in cases where the guarantee requested is for a loan, the proceeds of which are to be used entirely to refinance a debt owed to the Federal government or Federally guaranteed debt. In all other situations, the equity requirement must be determined using tangible net worth.

ADMINISTRATIVE:

A. The final Loan Agreement must contain all conditions of the Conditional Commitment, including the tangible balance sheet equity requirement. Therefore, the business must meet the requirement before the lender executes the final loan documents and closes the loan. The lender must provide a certification to the Agency that tangible balance sheet equity was calculated from financial statements presented in accordance with GAAP and supported by attaching a copy of the balance sheet on which the certification is based.

B. For sole proprietorships, financial statements should be prepared using only the assets and liabilities directly attributable to the business. Additionally, personal financial statements typically list assets at market values. The business assets must be valued at the lower of cost or market value before calculating tangible balance sheet equity.

C. Related party receivables routinely are classified as non-current assets, unless they will be repaid within one year. These receivables do not represent a liquid asset convertible to cash and available for business operations because of the nature of the affiliation and the absence of pressure to repay the receivables. The Loan Specialist should determine why the receivable was incurred and that repayment ability exists. Most banks deduct any amount due from officers or partners from total equity. For example, an officer may have taken a loan from the company instead of a salary or bonus. This receivable is, in effect, an expense not recognized by the company, thus improving its profitability. As a prudent lending practice, the Agency must make the appropriate adjustment in the event the lender does not. Obtain a copy of any applicable promissory note to document collectibility.

§ 1980.442 Feasibility studies.

A feasibility study by a recognized independent consultant will be required for all loans, except as provided in this paragraph. The cost of the study will be borne by the borrower and may be paid from funds included in the loan. The loan approval official may make an exception to the requirement of a feasibility study for loans to existing businesses when the financial history of the business, the current financial condition of the business, and guarantees or other collateral offered for the loan are sufficient to protect the interest of the lender and Rural Development. Rural Development will thoroughly document the justification for the exception to the feasibility study for such businesses. An acceptable feasibility study should include but not be limited to: (Revised 08-25-93, PN 211.)

§1980.442 (Con.)

- (a) Economic feasibility. Information related to the project site, availability of trained or trainable labor; utilities, rail, air and road service to the site; and the overall economic impact of the project.
- (b) Market feasibility. Information on the sales organization and management, nature and extent of market and market area, marketing plans for sale of projected output, extent of competition and commitments from customers or brokers.
- (c) Technical feasibility. Technical feasibility reports shall be prepared by individuals who have previous experience in the design and analysis of similar facilities and/or processes as are proposed in the application. The technical feasibility reports shall address the suitability of the selected site for the intended use, including an environmental impact analysis. The report shall be based upon verifiable data and contain sufficient information and analysis so that a determination may be made on the technical feasibility of achieving the levels of income and/or production that are projected in the financial statements. The report shall also identify any constraints or limitations in these financial projections and any other facility or design related factors which might affect the success of the enterprise. The report shall also identify and estimate project operating and development costs and specify the level of accuracy of these estimates and the assumptions on which these estimates have been based. For the purpose of the technical feasibility reports, the project engineer or architect may be considered an independent party provided the principals of the firm or any individual of the firm who participates in the technical feasibility report does not have a financial interest in the project, and provided further that no other individual or firm with the expertise necessary to make such a determination is reasonably available to perform the function.
- (d) Financial feasibility. An opinion on the reliability of the financial projections and the ability of the business to achieve the financial projections and the ability of the business to achieve the projected income and cash flow. An assessment of the cost accounting system, the availability of short-term credit for seasonal business and the adequacy of raw materials and supplies.
- (e) Management feasibility. Evidence that continuity and adequacy of management has been evaluated and documented as being satisfactory.

ADMINISTRATIVE:

Rural Development loan approval officials will be selective in approving borrowers for new business ventures involved in unproven products, services, or markets. Should such businesses be considered, additional equity will usually be required. (Added 08-25-93, PN 211.)

§1980.443 Collateral, personal and corporate guarantees and other requirements.

(a) Collateral.

(1) The lender is responsible for seeing that proper and adequate collateral is obtained and maintained in existence and of record to protect the interest of the lender, the holder, and Rural Development.

(2) Collateral must be of such a nature that repayment of the loan is reasonably assured when considered with the integrity and ability of project management, soundness of the project, and applicant's prospective earnings. Collateral may include, but is not limited to the following: land, buildings, machinery, equipment, furniture, fixtures, inventory, accounts receivable, cash or special cash collateral accounts, marketable securities and cash surrender value of life insurance. Collateral may also include assignments of leases or leasehold interest, revenues, patents, and copyrights.

(3) All collateral must secure the entire loan. The lender will not take separate collateral to secure only the portion of the loan or loss not covered by the guarantee. The lender will not require compensating balances or certificates of deposit as a means of eliminating the lender's exposure on the unguaranteed portion of the loan. However, compensating balances as used in the ordinary course of business may be used.

(4) Release of collateral of a going concern is based on a complete analysis of the proposal.

(i) Release of collateral prior to payment-in-full of the Rural Development guaranteed debt must be requested by the lender and concurred with by the State Director as prescribed in §1980.469 ADMINISTRATIVE D.2 of this subpart subject to the following conditions:

(A) Collateral taken initially or subsequently may not be released prior to the payoff, in full, of the loan balance without adequate consideration for the value of that collateral. Adequate consideration may include, but is not limited to:

(1) Application of the net proceeds from the sale of the collateral to the note in inverse order of maturity. All or part of the total proceeds, if approved by the Administrator, may be applied to the payment of current or delinquent principal and interest on the note; or

(2) Use of the net proceeds from the sale of collateral to purchase collateral of equal or greater value for which the lender will obtain a first lien position; or

(3) Application of net proceeds from the sale of collateral to the borrower's business operations in such a manner that enhancement of the borrower's debt service ability can be clearly demonstrated; for example, the payoff or reamortization of the loan as the result of a large extra payment which reduces subsequent installments on the loan; or

(4) Assurance to Rural Development that the release of collateral will contribute to the project's success thereby furthering the goals of the B&I program to show why the release of collateral will contribute to the success of the borrower and repayment of the loan; and

(B) Rural Development must not be adversely affected by the release of collateral; and

(C) If the release of collateral does not involve a reduction of the Rural Development guaranteed debt equal to the net proceeds of the disposition of the collateral, then it must be determined that the remaining collateral is sufficient to provide for the recovery of the Rural Development guaranteed loan(s).

(ii) Sale of collateral of a going concern to the borrower, borrower's stockholder(s) or officer(s), the lender or lender's stockholder(s) or officer(s) must be based on an arm's-length transaction with the concurrence of Rural Development.

(b) Personal and corporate guarantees.

(1) Unconditional personal/corporate guarantees (i.e., absolute guarantees of full and punctual payment and performance by the borrower) from owners or major stockholders as determined by Rural Development and all partners of partnerships (except for limited partnerships) unless restricted by law will be required unless exempted as provided for in paragraph (b)(2) of this section. Guarantees of parent, subsidiaries, or affiliated companies and/or secured guarantees may also be required. Rural Development is not a co-guarantor with the personal or corporate guarantors. The personal and corporate guarantees are part of the collateral for the loan.

(2) An exception to the requirement for personal or corporate guarantees may be made by Rural Development when requested by the lender and if:

(i) The borrower has a satisfactory and current (not over 90 days old) credit report, proven management, evidence of the market necessary to support projections, profitable historical performance of no less than 3 years, abundant collateral to protect the lender and Rural Development, sufficient cash flow to service its debts and meets key industry standards such as those of Robert Morris Associates, Dunn and Bradstreet or the like; or

(ii) The borrower's stock is widely enough held so that no one individual can exercise control. Examples of control would include but are not limited to: holding sufficient proxies and maintaining sufficient family or special interest voting blocks; or

(iii) A borrower which has a parent, subsidiary, or affiliate which is legally restricted from guaranteeing, or if the guarantee would conflict with existing contractual obligations. Examples of existing contractual obligations include but are not limited to restrictions in loan agreements or in credit lines which may preclude guaranteeing.

(3) No guarantees are required from any partners in a limited partnership.

(4) As a general rule, stockholders of publicly traded corporations will not be required to guarantee. However, such guarantees can be required from some of the stockholders where such guarantees are determined necessary to adequately protect the interest of the Government.

(5) If the guarantee would conflict with existing contractual restrictions, the Administrator will have the authority to grant exceptions to the above restrictions upon a finding by the Administrator that such a guarantee is not necessary to adequately protect the Government's interest. Relief would only be granted as to contractual restrictions existing at the time the lender filed an application with Rural Development.

(6) Unsecured Personal guarantees, while collateral, will not be considered for purposes of adequacy of security. Personal guarantees will be secured by collateral when business collateral offered is determined by Rural Development to be insufficient or when the borrower's credit does not meet the program's normal requirements or anytime the lender deems such security should be taken.

(7) Guarantors of borrowers will:

(i) In the case of personal guarantees, provide current financial statements (not over 60 days old at time of filing), signed by the guarantors, which make a clear disclosure of community or homestead property.

(ii) In the case of corporate guarantees, provide current financial statements (not over 90 days old at the time of filing), certified by an officer of the corporation.

(iii) When applicable, provide written evidence to Rural Development of their inability to provide a guarantee because of existing contractual arrangements or legal restrictions.

(c) Other requirements.

(1) The lender will ascertain that no claim or liens of laborers, material men, contractors, subcontractors, suppliers of machinery and equipment or other parties are against the collateral of the borrower, and that no suits are pending or threatened that would adversely affect the collateral of the borrower when the security instruments are filed.

(2) Hazard insurance with a standard mortgage clause naming the lender as beneficiary will be required on every loan in an amount that is at least the lesser of the depreciated replacement value of the property being insured or the amount of the loan. Hazard insurance includes fire, windstorm, lightening, hail, business interruption, explosion, riot, civil commotion, aircraft, vehicle, marine, smoke, builder's risk, public liability, property damage, flood or mudslide or other hazard insurance that may be required to protect the collateral.

(3) Ordinarily, life insurance, which may be decreasing term insurance, is required for the principals and key employees of the borrower and will be assigned or pledged to the lender. A schedule of life insurance available for the benefit of the loan will be included as part of the application.

(4) Worker's compensation insurance is required in accordance with State law.

ADMINISTRATIVE:

A. Par (a) (2). Rural Development's credit analysis of collateral will consist of the following:

1. Little or no value will be assigned to unsecured personal or corporate guarantees.
2. A maximum of 80 percent of current market value will be given to real estate. Special purpose real estate should be assigned less value.
3. Rural Development at its option may permit a maximum of 60 percent of book value to be assigned to acceptable accounts receivable; however, all accounts over 90 days past due, contra accounts, affiliated accounts and other accounts deemed, by the Rural Development official, not to be collateral will be omitted. Calculations to determine the percentage to be applied in the analysis are to be based on the realizable value of the accounts receivable taken from a current aging of accounts receivable from the borrower's most recent financial statement.
4. A maximum of 60 percent of book value will be assigned to inventory.
5. Collateral value assigned to machinery and equipment, furniture and fixtures will be based upon its marketability, mobility, useful life and alternative uses, if any.

B. Par (b). The State Director will assure that the collateral values and personal and corporate guarantees are fully reviewed, analyzed and the loan file is documented as to the facts and reasons for decisions reached.

§1980.444 Appraisal of property serving as collateral.

(a) Appraisal reports prepared by independent qualified fee appraisers will be required on all property that will serve as collateral. In the case of loans of \$2 million or less, the State Director may modify this requirement by permitting the appraisal to be made by a qualified appraiser on the lender's staff with experience appraising the type of collateral involved. The appraisers will give their opinion regarding the current market value of the collateral and the purpose for which the appraisal will be used. The lender will be responsible for assuring that appropriate appraisals are made. (Revised 10-17-88, SPECIAL PN)

§1980.444 (Con.)

(b) The lender will be responsible for determining that appraisers have the necessary qualifications and experience to make the appraisals lender will consult with the Agency for its recommendations before having the appraisal made.

(c) The lender will determine that the fees or charges of appraisers are reasonable.

(d) Independent appraisals will be made in accordance with the accepted format of the industry and those prepared by the lender in accordance with its policy and procedures. All appraisals will become part of the application. (See §1980.451(i)(6).)

(e) If a subsequent loan request is made within 3 years from the date of the most recent borrower's appraisal report, and there is no significant change in the collateral, then the state director in his/her discretion, and if the lender agrees, may use the existing appraisal report in lieu of having a new appraisal prepared.

§1980.445 Periodic financial statements and audits. (Added 04-24-96, PN 260.)

All borrowers will be required to submit periodic financial statements to the lender. Lenders must forward copies of the financial statements and the lender's analysis of the statements to the Agency.

(a) Audited financial statements. Except as provided in paragraphs (d) and (e) of this section, all borrowers with a total principal and interest loan balance for loans under this subpart, at the end of the borrower's fiscal year, of more than \$1 million must submit annual audited financial statements. The audit must be performed in accordance with generally accepted accounting principles (GAAP). In addition, the audits are also to be performed in accordance with appropriate Office of Management and Budget (OMB) circulars and any Agency requirements specified in this subpart.

(b) Unaudited financial statements. For borrowers with a loan balance (principal plus interest at year-end) of \$1 million or less, the Agency will require annual financial statements which may be statements compiled or reviewed by an accountant qualified in accordance with the publication "Standards for Audit of Governmental Organizations, Programs, Activities and Functions," instead of audited financial statements.

(c) Internal financial statements. The Agency may require submission of financial statements prepared by the borrower at whatever frequency is determined necessary to adequately monitor the loan. Quarterly financial statements will be required on new business enterprises or Or those needing close monitoring.

(d) Minimum requirements. This section sets out minimum requirements for audited and unaudited financial statements to be submitted to the Agency. If specific circumstances warrant, the Agency may require audited financial statements or independent unaudited financial statements in excess of the minimum requirements. For example, loans that depend heavily on inventory and accounts receivable for collateral will normally be audited, regardless of the size of the loan. Nothing herein shall be considered an impediment to the lender requiring financial statements more frequently than required by the Agency or requiring audited financial statements when the Agency would accept unaudited financial statements.

(e) Public bodies and nonprofit corporations. Notwithstanding other provisions of this section, any public body or nonprofit corporation that receives a guarantee of a loan that meets the thresholds established by OMB Circular A-128 or A-133 for coverage under such circular, must provide an audit in accordance with the applicable OMB Circular A-128 or A-133 for the fiscal year of the borrower in which the Loan Note Guarantee is issued. If the loan is for development or purchases made in a previous fiscal year through interim financing, an audit, in accordance with the applicable circular, will also be provided for the fiscal year in which the development or purchases occurred. Any audit provided by a public body or nonprofit corporation in compliance with OMB Circular A-128 or A-133 will be considered adequate to meet the requirements of this section for that year.

§§1980.446 - 1980.450 [Reserved]

§1980.451 Filing and processing applications.

(a) Borrowers' and lenders' contact. Borrowers and lenders desiring assistance as provided in this subpart may file preapplications or applications with the county supervisor or district director servicing the area in which the project is to be located. In either case, the requirements of §1980.46 of subpart A must be met. The county supervisor or district director receiving the request for assistance will promptly notify the state director of the nature and facts of the request. The state director will promptly arrange an early meeting with the borrower and lender representatives to discuss assembly, preparation and processing of preapplications and applications. The state director may call upon the county supervisor and district director to assist the state director in any way necessary.

(b) Applications from cooperatives. Borrowers eligible for loans from the Bank for Cooperatives will be encouraged to obtain guaranteed loans from that source since the Bank for Cooperatives is experienced in making and servicing such loans and can provide substantial counsel to the applicant. Applications must be submitted to the Bank for Cooperatives as a test of credit elsewhere when an insured loan is being considered (See RD Instruction 2000-Q available in any Agency office for Memorandum of Understanding between the former Rural Development and Farm Credit Administration.)

(c) Borrowers eligible for Small Business Administration (SBA) assistance. All borrowers for loan guarantees eligible for SBA assistance will be advised by the Agency at the time of receipt of the preapplication of the availability of such assistance and will be encouraged to apply to that agency. (See RD Instruction 2000-P available in any Agency office for Memorandum of Understanding between SBA and the former Rural Development.)

(d) Loan priorities. Applications and preapplications received by the Agency will be considered in the order received; however, for the purpose of assigning priorities as described in paragraph (d) (3) of this section. The Agency will compare an application to other pending applications. (Revised 10-17-88, SPECIAL PN.)

(1) The Agency will cooperate fully with appropriate state agencies in guaranteeing and insuring loans in a manner which will assure maximum support of the state's strategies for development of its rural areas.

(2) When applications on hand otherwise have equal priority, the applications from a veteran will have preference. A veteran is a person who has been discharged or released from the active forces of the United States Army, Navy, Air Force, Marine Corps, or Coast Guard under conditions other than dishonorable and who served on active duty in such forces:

(i) During the period April 6, 1917, through March 31, 1921;

(ii) During the period of December 7, 1941, through December 31, 1946;

(iii) During the period of June 27, 1950, through January 31, 1955; or

(iv) For a period of more than 180 days, any part of which occurred after January 31, 1955; but on or before May 17, 1975. Discharges under conditions other than dishonorable include "clemency discharges."

(3) Priorities will be assigned to eligible applications on the basis of a point system that takes into account project location, the creation and saving of jobs, the cost at which those jobs would be created or saved, seasonal and part-time job impact, and leveraging of Agency assistance. The application and supporting information submitted with it will be used to determine an eligible proposed project's priority for available funds or guarantee authority. The priorities described in this paragraph will be used by the Agency to score projects. A copy of the calculation of the score should be placed in the file for future reference. The format found in Appendix J of this subpart (available in any Agency office) should be followed in scoring each application and a copy signed by the state director should be placed in the case file.

(Revised 08-30-89, PN 116.)

(i) Location priorities. The priority score for location will be the score for the highest-ranked category in which the project fits. If the location does not fit one of these categories, it receives no points for location. The categories, and their point scores, are:

(A) Located in a city or area under 25,000 population (10 points).

(B) Located in a city or area under 25,000 population that is an area of high unemployment as of the date of application (20 points).

(C) Located in an area of high unemployment as of the date of application, provided the borrower certifies in writing to the State Director in simple narrative or letter form that the project will employ on a permanent, full time basis (providing at its own cost such training or retraining as may be needed) persons (numbering no fewer than 25 percent of the project's employment) who are members of displaced farm families which recently derived from farming or ranching the majority of their combined incomes, but are no longer actively engaged in farming or ranching as operators or employees (35 points).

(ii) Jobs priorities. The priority score for jobs created and/or saved is the score for the highest-ranked category in which the project fits. If the project does not fit one of these categories, it receives no points for jobs. The categories, and their point scores, are:

(A) Project will contribute to the overall economic stability of the project area and generate permanent jobs beyond the entrepreneur and the entrepreneur's household (10 points).

(B) Project will contribute to the overall economic stability of the project area and will employ on a permanent, full time basis a number of persons that is significant in the context of the area's economy (20 points).

(C) Project will contribute to the overall economic stability of the project area, will employ on a permanent, full time basis a number of persons that is significant in the context of the area's economy, and will retain in that area a significant number of jobs that would otherwise be lost (35 points).

(iii) Job cost priorities. The priority score for the project's cost per job is the score for the highest-ranked category in which the project fits. First, divide the amount of the Rural Development guaranteed loan by the number of jobs created or saved. This will result in the cost per job. Count only full time jobs. Part time jobs may be reduced to a fraction of a full time job and counted. For example, a 20 hour per week job, or a job that is full time for six months per year is one half of a job. Second, determine the State's nonmetropolitan household income as described in §1980.451(d)(3)(vi). Third, divide the cost per job by the State's indexed nonmetropolitan household income. For example, if the cost per job is \$10,000 and the State's nonmetropolitan household income is \$20,000, the result will be 0.5. The categories, and their point scores, are:

(A) Loans on which the result is greater than 1.5 but less than 2.0 (5 points).

(B) Loans on which the result is from 1.0 to 1.5 (15 points).

(C) Loans on which the result is less than 1.0 (25 points).

If the result exceeds 2.0, a high cost per job in that State, no points are received for job cost.

(iv) Additional points. There shall be added to the score the points indicated for any and all of the following criteria met by the project.

(A) Rural Development guaranteed loan is less than 50 percent of project cost (5 points).

(B) Percentage of guarantee is 10 or more percentage points less than the maximum allowable for a loan of its size (5 points).

(C) Project will, in addition to any permanent full time jobs, create a significant number of part time or seasonal jobs that will provide additional income to underemployed residents of the project area without their having to give up any present part time or seasonal jobs (10 points).

(v) Administrative points. The State Director may assign up to 20 points to an application in addition to those points scored under §1980.451(d)(3)(i) through (iv). These administrative points are intended to be assigned by a State Director only in cases of unforeseen exigencies, emergencies, benefits to other Rural Development-assisted projects (including the limiting of financial risks affecting Rural Development loans and loan guarantees) or the loss of financing if Rural Development funds are not committed in a timely fashion. They may also be assigned in cases in which the project's goods or services are essential to other Federally assisted projects and activities in the area or to the successful implementation of an economic development strategy for the area that is sponsored and/or operated by an agency of the Federal or State government. An explanation of the assigning of these points by the State Director will be appended to the calculation of the project score maintained in the case file. If an application is considered in the National Office, the Administrator may also assign up to 20 points. An assignment of points by the Administrator will be by memorandum stating the Administrator's reasons, and that memorandum will be appended to the calculation of the project score maintained in the case file. In assigning priorities to applications and in selecting projects for funding, Rural Development will consider State development strategies. Funds (guarantee authority) allocated for use as prescribed in this regulation are to be considered for use by Indian tribes within the State regardless of whether State development plans include Indian reservations within the State's boundaries. It is essential that Indians residing on such reservations have equal opportunity to participate in any benefits of these programs.

(vi) Indexation. When current, annual data are not available to determine a State's nonmetropolitan household income for purposes of the calculations described in §1980.451(d)(3)(iii), indexation of census data is necessary. The State Director will use the figure for the most recent decennial census of the United States, increased by a factor representing the increase since the year of that census in the Consumer Price Index ("CPI-U"). That factor shall be furnished annually by the National Office, Rural Development.

(e) Filing preapplications and applications. Borrowers or lenders may file preapplications described in paragraph (f) of this section if they desire an expression of Rural Development interest prior to assembling the complete application and request for Loan Note Guarantee or they may present the complete application, in one package, including the material required in paragraphs (f), (i), (j) and (k) of this section.

(f) Preapplications. Applicants may file preapplications with the County, District, or State Office, including:

(1) A letter prepared by the borrower and the lender which shall include:

(i) Borrower's name, address, contact person and telephone number.

(ii) Amount of loan request.

(iii) Name of proposed lender, address, contact person, and telephone number.

(iv) Brief description of the projects, products and services provided.

(v) Type and number of employment opportunities and unemployment rate where the project will be located.

(vi) Amount of borrower's equity and guarantees offered.

(vii) Anticipated loan maturity and interest rates.

(viii) Availability of raw materials and supplies.

(ix) If a corporation, names and addresses of borrower's parent, affiliates and/or subsidiary firms and brief description of relationship, products and ownership among borrower, parent, affiliates and subsidiary firms.

(2) Form RD 449-22, "Certification of Non-Relocation and Market Capacity Information Report."

(3) Form RD 449-4, "Statement of Personal History," for a proprietor (owner), each partner, officer, director, key employee, and stockholders holding 20 percent or more interest in the borrower except for those corporations listed on a major stock exchange and for those so listed if required by Rural Development. Form RD 449-4 is not required to be submitted for elected officials and appointed officials in connection with loan applications from public bodies. Failure to report full, complete, and accurate information on the Statement of Personal History may result in Rural Development's not making or guaranteeing the loan. Whenever possible, a local,

regional, or national credit report, furnished by the lender, will be used to verify data on Form RD 449-4. (Revised 10-17-88, SPECIAL PN)

(4) A record of any pending or final regulatory or legal (civil or criminal) action against the borrower, parent, affiliate, proposed guarantors, subsidiaries, principal stockholders, officers and directors.

(5) For existing businesses, a current balance sheet, and latest profit and loss statement (not more than 60 days old) and financial statements including parent, affiliate and subsidiary firms, for at least the last 3 years or more if necessary for a thorough evaluation.

(6) A detailed projection of gross revenue, net earnings and cash flow statements for 3 years including assumptions upon which such forecasts are based.

(7) Sales projections indicating the percent of the national and local market the business expects to obtain.

(8) Intergovernmental consultation should be carried out in accordance with 7 CFR Part 3015, Subpart V, "Intergovernmental Review of Department of Agriculture Programs and Activities." See RD Instruction 1970-I, available in any Rural Development Office. (Revised 01-18-12, SPECIAL PN.)

(g) Preliminary determination by Rural Development. If preapplication information indicates the project will not meet Rural Development's minimum credit standards for a sound loan, is ineligible, does not have sufficient priority or that funds or guarantee authority are not available for the project, Rural Development will so inform the lender. The lender will be notified in writing with all reasons for the decision indicated. If it appears that the project is eligible, has sufficient priority, is economically feasible and loan guarantee authority is available, Rural Development will inform the lender and borrower in writing and request that they complete the application.

(h) Department of Labor certifications. Rural Development will submit Form RD 449-22 to the Department of Labor for the necessary certification that the proposal will not be in conflict with §1980.412(c) and (d).

(i) Content of application.

- (1) Form RD 449-1.
- (2) Form RD 449-2.
- (3) Environmental review documentation as required in accordance with 7 CFR part 1970. (Revised 04-01-16, SPECIAL PN.)
- (4) Architectural or engineering plans, if applicable.
- (5) Cost estimates and forecasts of contingency funds to cover cost increases or project changes.
- (6) Appraisal reports.

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(7) For existing businesses a pro forma balance sheet at startup and for at least 3 additional projected years, indicating the necessary startup capital, operating capital and short term credit based on financial statements for the last 3 years or more (if available); and projected cash flow and earnings statements for at least 3 years supported by a list of assumptions showing the basis for the projections. The business should submit a current balance sheet with a debt schedule of any debts to be refinanced and an income statement to the Agency, through the lender, every 90 days from the time the application is filed with the lender to the time of issuance of the Loan Note Guarantee. If debt refinancing is requested, a debt schedule is prepared (correlated to the latest balance sheets) reflecting the debts to be refinanced including the name of the creditor, the original loan amount and loan balance, date of loan, interest rate, maturity date, monthly or annual payments, payment status and collateral that secured such loans.

(8) For new businesses, a pro forma balance sheet at startup and for the next 3 years, project cash flow (monthly first year, quarterly for 2 additional years) and projected earnings statements for 3 years supported by a list of assumptions showing the basis for the projections.

(9) Any credit reports obtained by the lender or the Agency on the borrower, its principals and parent, affiliate and subsidiary firms.

(10) Form RD 400-1, "Equal Opportunity Agreement," if construction costing more than \$10,000 is involved.

(11) Copies of building permits, if applicable, and any necessary certifications and recommendations of appropriate regulatory or other agencies having jurisdiction over the project including any pollution control agency.

(12) Personal and corporate financial statements of those guarantors named in §1980.443.

(13) Loan agreements between the borrower and lender will be required. The final executed loan agreement must include Agency requirements as set forth in the Form RD 449-14 including the requirements for periodic financial statements in accordance with §1980.445 of this subpart. The loan agreement must include, but is not limited to, the following: (Revised 04-24-96, PN 260.)

(i) Prohibition against assuming liabilities or obligations of others.

(ii) Restrictions on dividend payments.

(iii) Limitation on purchase or sale of equipment and fixed assets.

(iv) Limitations on compensation of officers and owners.

(v) Minimum working capital requirements.

(vi) Maximum debt to net worth ratio.

(vii) Restrictions concerning consolidations, mergers or other circumstances.

(viii) Limitations on selling the business without concurrence of the lender and the Agency.

(ix) Repayment and amortization of the loan.

(x) List of collateral for the loan including a list of persons and/or corporations guaranteeing the loan with a schedule for providing the lender and the Agency with personal and/or corporate financial statements. (See §1980.443)

(14) A complete feasibility study when required. (See §1980.442)

(15) Any additional information required by the Agency.

(16) For companies listed on major stock exchanges and/or subject to the Securities and Exchange Commission regulations, a copy of Form 10-K, "Annual Report Pursuant to Section 13 or 15 D of the Act of 1934."

(17) Documented evidence that the project is located within or without special flood or mudslide hazard areas.

(18) Notices of compliance with the Privacy Act of 1974.

(i) If the borrower is acting in a personal capacity and not as an entrepreneur for such entities as proprietorships, partnerships, or corporations, and Rural Development solicits personal information about him/her, the individual will be provided Form RD 410-9, "Statement Required by the Privacy Act."

(ii) If Rural Development desires to obtain information concerning an individual from any source, Rural Development will provide such source with Form RD 410-10, "Privacy Act Statement to References."

(19) On any request for refinancing of existing loan(s) as authorized under §1980.411 (a) (11), the lender is required, as a minimum, to obtain the previously held collateral as security for the guaranteed loan(s). Additional collateral will be required by Rural Development when refinancing of unsecured loans is unavoidable in order to accomplish the necessary strengthening of the firm's current position. (Revised 11-8-88, SPECIAL PN)

(j) Use of forms. Rural Development numbered forms will be used where shown in both preapplications and applications. Otherwise, lenders should use their forms, real estate mortgages, security instruments and other agreements, provided such forms do not contain any provisions that are in conflict or are inconsistent with provisions of this subpart.

(k) Certificate of need. If the loan request is for health care facilities (e.g., hospitals or nursing homes), a "Certificate of Need" will be obtained by the borrower from the appropriate regulatory or other agency having jurisdiction over the project and submitted to Rural Development by the lender. If a significant part of the project's income will be from third party payors, (e.g., medicare or medicaid), the project will be designed and operated in a manner necessary to meet the requirements of the third-party payors.

ADMINISTRATIVE

A. The State Director:

1. Determines if material and information submitted is completed and signed by the appropriate party in the appropriate capacity.

2. May request the comments and recommendations of the County Supervisor and District Director. Such comments will include but are not limited to the following: community attitude toward project; a summary of comments regarding the proposal by the lender, county leaders and other interested parties; whether the project is likely to result in the need for additional community facilities such as schools, water, sewer and health care services, and if so, the community's plan for providing such facilities; availability of any required additional labor force and training plans for such force, if needed; an economic forecast of the effect on the community should the project fail, if financed.

3. Will furnish all individuals acting in a personal capacity at the time of filing a preapplication or application and two copies of Form RD 410-9. The individual will sign both copies, retaining one and providing Rural Development with the other copy which becomes a part of the loan file.

4. Will provide any source from whom Rural Development obtains information concerning an individual with two copies of Form RD 410-10. The source will sign both copies, retain one and provide Rural Development with the other copy which becomes a part of the loan file.

5. Will input the necessary data via terminal screens into the Rural Community Facility Tracking System (RCFTS). The RCFTS data structure consists of 3 sets: Applicant/Borrower (BOR), Facility (FAC), and Loan/Grant Request (LGR) sets. There are multiple screens for the BOR and LGR sets. The State Director may, if he/she so desires, prepare Form RD 2033-34, "Management System Card - Business and Industry," in accordance with RD Instruction 2033 F (Revised 6-27-90, PN 138)

6. Will forward immediately to the National Office on all projects.

(a) Form RD 449-22 (7 copies) for loans over \$1 million and when direct employment increases more than 50 employees.

(b) For insured loans where the borrower leases facilities to another, submit Form RD 449-22 for such borrower. The lessor(s) will also be required to provide Form RD 449-22. Subsequent loan requests require resubmission of Form RD 449-22.

(c) A local, national, or regional credit report and Form RD 449-4 for all loans over \$1 million or for loans, regardless of size, when the State Director believes a character evaluation check is advisable. (Revised 11-8-88, SPECIAL PN)

NOTE: Forms RD 449-22 and RD 449-4 should only be processed if a complete preapplication or application has been received.

B. Miscellaneous Administrative provisions:

1. Par (f). Preapplications are not to be accepted or processed unless a lender has agreed in writing to finance the proposal. The preapplication letter is a joint letter prepared by the borrower and lender.

2. Par (g). Upon receipt of all preapplications in excess of \$5 million, the State Director will transmit to the National Office the material required under paragraph (f) (1), (f) (4) and (f) (5) of this section together with recommendations and observations including an analysis of the quality and permanency of the employment opportunities involved in the project. The National Office will review the proposed project in relation to objectives, priorities and intent of the program and will advise the State Director. After receiving the National Office advice or for loans less than \$5 million, the State Director will inform the borrower of the decision.

3. Par (i). State Director submits a transmittal letter with recommendations on loan applications requiring National Office review. Included are:

(a) Loan file.

(b) Form RD 449-29, "Project Summary - Business Industrial Loan Division," including State Director's spread sheets, financial history and projections (use attachments to Project Summary if necessary).

(c) Proposed Form RD 449-14.

(d) Copy of Rural Development State Loan Review Board Minutes.

(e) Notification of required financial and other reports, their frequency, due dates and fiscal yearend.

4. Par (i) (9), Credit reports.

(a) The National Office has a contract to provide credit reports for preapplications, applications, and in instances after the loan(s) is made, where a credit report is needed.

(b) States should first try to have the lender provide such a report because credit reports are the responsibility of the lender.

(c) Any state needing a credit report should telephone the National Office, Director, B&I, and give the name of the business and the city and State location. The report will be mailed to the State the same day, if possible.

5. File documentation. Applications will be organized in a loan file in accordance with RD Instruction 2033-A (available in any Rural Development office.) An 8-position folder with tabs will be utilized. The State Director may supplement the Position Guides to include specific legal requirements within their State. If the lender prepares a complete application package, it may accompany the docket provided the docket is organized in a binder, indexed and tabbed. Feasibility studies should be kept separate. It is the responsibility of Rural Development employees who work on applications or servicing actions to add to the correspondence section of the loan file (also known as the running record) a written report of any field visits, meetings, telephone conversations and memorandums covering decisions or reasons for Rural Development actions on the cases. Particular attention must be given to this requirement on cases that become delinquent or problems in order that Rural Development's position will be defensible in the event of an adverse action.

6. Par (i) (13), Audit agreements and requirements. Rural Development urges the use of a written agreement between the lender and borrower to assure that there is no misunderstanding concerning Rural Development audit requirements.

7. Par (i), Forms and documents found in loan docket. The following table is a guide to forms and documents used in completing an application and loan docket. The filing position within the 8 position folder is shown on the right. Some of these items may not be applicable for a particular loan. However, a complete loan docket may need to include items in addition to the following:

Description of Record or Form # and Title		Filing Position
AD-425	Contractor's Affirmative Action Plan For Equal Employment Opportunity	1
RD 400-1	Equal Opportunity Agreement	6
RD 400-3	Notice to Contractors and Applicants	6
RD 400-4	Assurance Agreement	3

RD 400-6	Compliance Statement	6
RD 410-8	Applicant Reference Letter	3
RD 410-9	Statement Required by the Privacy Act	3
RD 410-10	Privacy Act Statement to References	3
RD 424-12	Inspection Report	6
RD 1940-3	Request for Obligation of Funds - Guaranteed Loans	2
RD 1970-1	Environmental Checklist for Categorical Exclusions (Revised 04-01-16, SPECIAL PN.)	3

RD Instruction 1980-E
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	Description of Record or Form # and Title	Filing Position
	Environmental Reports	3
	Environmental Assessments	3
	Environmental Impact Statements	3
RD 440-57	Acknowledgement of Obligated Funds/ Check Request	2
RD 449-1	Application for Loan and Guarantee	3
RD 449-2	Statement of Collateral	5
RD 449-4	Statement of Personal History	3
RD 449-14	Condition Commitment for Guarantee	2
RD 449-22	Certification of Non-relocation and Market and Capacity Information Report	3
RD 449-29	Project Summary - Business Industrial Loan Division	3
RD 449-34	Loan Note Guarantee	2
RD 449-35	Lender's Agreement	2
RD 449-36	Assignment Guarantee Agreement	2
RD 1980-19	Guaranteed Loan Closing Report	2
	Annual Audit Report	1
	Borrower Financial Statements	3
	Chattel Security Instruments	1
	Report - Exhibit B, RD Instruction 2015 - C	1
	Borrower's Certification of Indebtedness	1
	Lender's Loan Agreement	2
	Promissory Notes	2

RD Instruction 1980-E
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Description of Record or Form # and Title	Filing Position
Bond (specimen) Bond Ordinances, Bond Transcripts or Similar Items	2
Running Case Record	3
Market Analysis Information (feasibility study)	3
Borrower's and Lender's Preapplication Letters	3
Lender's Evaluation and Recommendations	3
Cost Estimates and Forecast for Contingency Funds	6
Dunn and Bradstreet Reports	3
Corporate or Personal Financial Statements of Guarantors	3
S.E.C. 10-K Report	3
Pro-forma Balance Sheet	3
Current Profit and Loss Statements	3
Projection of Gross Revenues and Net Earnings	3
Cash Flow Statements, 3 Years with Assumptions	3
Appraisal Reports	8
Documentation for Considering Refinancing	3
Financial Statements for Last 3 years	3
Complete Debt Schedule	3
Interim Financial Statements	3
Aging and Turnover of Receivables and Inventory	3
Credit Reports	3
Records of any Pending or Final Regulatory Litigation	3
Comments on any State Development Strategies	3

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Description of Record or Form # and Title	Filing Position
State Review Board Minutes	3
Certificate of Need (Health Care Facilities)	3
Correspondence (excluding closing instruments)	4
Department of Labor Certification	4
Mortgagee Title Insurance Policy	5
Title Opinions	5
By-Laws, Resolutions, or Regulations and Amendments	5
Articles of Incorporation, By-laws and Regulations or Charter	5
Lender Security Agreements and Financing Statements	5
Lender Mortgages and Notes	5
Advice of Office of General Counsel from Review of Docket	5
Partnership Agreements	5
Other Documents used in Loan Closing	5
Schedule of Stock Ownership	5
Franchise Agreement	5
Construction Contracts and Compliance Statements	6
Lender's Approval of Plans and Specifications	6

RD Instruction 1980-E
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Description of Record or Form # and Title	Filing Position
Engineer's Certification of Satisfactory Completion in Accordance with Plans and Specifications	6
Lender's Audit of Expenditures and Project Costs	6
Evidence of Concurrence and compliance with Construction Requirements of State, County, and Municipal Government (including building permits)	6
Lender's Closing Certification	6
Lender's Loan Servicing Plan	6
Loan Closing Opinion of Lender's Legal Counsel	6

§1980.452 Rural Development evaluation of application.

Rural Development will evaluate the application and make a determination whether the borrower is eligible, the proposed loan is for an eligible purpose and that there is reasonable assurance of repayment ability, sufficient collateral and sufficient equity and the proposed loan complies with all applicable statutes and regulations. If Rural Development determines it is unable to guarantee the loan, the lender will be informed in writing. Such notification will include the reasons for denial of the guarantee. If Rural Development is able to guarantee the loan, it will provide the lender and the borrower with Form RD 449-14 listing all requirements for such guarantees. Rural Development will include in the requirements of the Conditional Commitment for Guarantee a full description of the approved use of guaranteed loan funds as reflected in the Form RD 449-1. The Conditional Commitment for Guarantee may not be issued on any loan until the State Director has been notified by the National Officer that the Statements of Personal History(s) have been processed and cleared. Rural Development State Directors are the only persons authorized to execute Form RD 449-14.

ADMINISTRATIVE:

State Director evaluates the application and considers:

- A. Rural area determinations. (See §1980.405 of this subpart).
- B. Community impact of the proposal which includes:
 1. Number of businesses and industries in the town or city.

2. Employment impact upon the community.
3. Availability of skilled and unskilled labor and permanency of employment opportunities.
4. Vocational and educational facilities to provide skilled labor, if applicable.
5. Policies of applicant regarding unemployment, lay-offs, wage scales, etc.

C. If debt refinancing is requested, consider in accordance with § 1980.411 (a) (11) of this subpart and: (Revised 11-8-88, SPECIAL PN)

1. A complete review will be made to determine whether it is essential to restructure the company's debts on a schedule that will allow the business to operate successfully rather than merely guaranteeing an unsound loan.

- (a) Obtain a borrower's complete debt schedule. Schedule should agree with borrower's latest balance sheet.

- (b) Determine from lender if the borrower's present loan(s) is on the lender's regulatory examiner's report and if so determine the loan classification.

- (c) Analyze lender's liability ledger on the borrower, individual customer credit file, installment Loan Ledger Card or Computer printouts and other credit reports.

- (d) The percentage of guarantee should be adjusted to assure that the lender does not bring its previously existing unguaranteed exposure under the guarantee.

- (e) Any special servicing requirements should be identified and included in the Conditional Commitment for Guarantee.

D. Applications will be analyzed by a Rural Development State Loan Review Board before execution of Form RD 449-14. When analyzing the B&I loan request, the State Loan Review Board will specifically address the issue of the guarantee percentage to be approved. Consideration of reducing the maximum guarantee to less than 90 percent is appropriate when the loan has sufficient strength to warrant further participation by the private sector or refinancing of existing lender debts to the borrower is involved. Ordinarily, B&I loan guarantees should be structured so that the lender bears a significant portion of the risk of loss from a

default. "Significant" means equal to or greater than 20 percent of the loss stemming from default. All review board meetings will be fully documented, including the review and decision concerning the guarantee percentage, and will be signed by those Rural Development employees serving on the board. A copy of such documentation will be retained in the loan file. There will be a National Office Executive Loan (NOEL) Committee evaluation and recommendation for all B&I Direct Loan making and servicing actions, which are in excess of delegated authorities given to Rural Development field offices. The core of the NOEL Committee will be composed of the Administrator, as the chairperson, Deputy Administrator for Business Programs, and Deputy Administrator for Cooperative Services. Other members of the NOEL may be designated, in writing, by the Administrator as he/she determines to be appropriate. All recommended actions presented to the NOEL Committee will be in written form with an oral presentation based on an objective analysis conducted by a National Office loan specialist. All general exceptions being considered by the Administrator will be reviewed by the NOEL Committee to determine consistency with applicable regulations; and the reasons will be documented prior to the granting of a general exception by the Administrator. An Informational Memorandum outlining the reasons for the general exceptions; recommendation of the State Director and the NOEL Committee; and reasons for granting the general exception, if inconsistent with recommendations of the State Director and NOEL Committee, will be provided to the Under Secretary and to the Office of the General Counsel (OGC). The Administrator will address any concerns raised by either the Under Secretary or the OGC prior to issuing the exception. If no response is received within 48 hours (2 Business days), the Administrator may issue the exception. (Revised 07-25-01, PN 334.)

1. Generally, the review board consists of the State Director as Chairperson, Community and Business Programs Chief or the Business and Industry Chief (Loan Specialist) and either the Community Programs Chief, Rural Housing Chief, or Farmer Programs Chief, as appropriate.

2. The State Director may wish to contact non-Rural Development sources for expertise, such as bankers or other lenders, industrial development specialists from state commissions, academicians, certified public accountants, tax attorneys, successful business and professional lenders, management consultants and officials from other Federal agencies. Outside resource consultants may be reimbursed only for their travel costs (transportation and subsistence). (See RD Instruction 2036-A which is available in any Rural Development Office).

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3. The Rural Housing Loan Chief will be a member of the State Loan Review Board if a site development loan (see § 1980.411 (a) (7) of this subpart) is being considered. The Community and Business Programs Chief (Loan Specialist) will be a member if a loan for facilities of the type financed under the provisions of Subpart A of Part 1942 of this chapter is being considered. The Farmer Programs Chief will be a member of the board if a project, the success of which is dependent on the production of agricultural products, is being considered. If the proposed project covers more than one program area, all the chiefs for those programs involved will be members of the board. If the approval of an application for a B&I loan may result in benefiting or hindering other USDA programs, the review board will determine whether the making of such loan or guarantee is likely to result in embarrassment for Rural Development as a result of a possible conflict of interest whereby other parties may accuse the agency of giving loan preference to housing borrowers (in the case of site development) or producers (in the case of agricultural processing plants) or other USDA programs.

4. The State Director may request the Community Development Managers and/or Rural Development Managers to attend the review board meeting whenever it is determined they may have special knowledge of the proposed loan which may affect the board's decision.

5. Prior to submission of a B&I guaranteed loan(s) request to the National Office for loan processing review and prior to loan approval, the appropriate loan processing official must visit the project site and discuss the loan proposal with the lender and borrower. In the event there are multiple project sites the official should visit a representative sample of project sites to develop deeper understanding of the project operation. For businesses without a developed project site a visit is not necessary; however, a visit with the lender and borrower is still required. The findings of the visit should be documented in the loan docket submitted to the National Office.

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6. The State Director will prepare an original and two copies of Form RD 1940-3 for each loan to be obligated. Also, for each initial loan, Form RD 1980-50, "Add, Delete, or Change Guaranteed Loan Borrower Information," will be prepared. The State Director will sign the original and one copy and conform the second copy. Form RD 1940-3 will not be mailed to the Finance Office. Notice of approval to lender will be accomplished by providing or sending the lender the signed copy of Form RD 1940-3 and Form RD 449-14 six working days from the date funds are reserved, unless an exception is granted by the National Office. The State Director or designee will record the actual date of lender notification on the original of the Form RD 1940-3 and retain the original of the form as a permanent part of the Rural Development case file. The State Director may retain the remaining conformed copy of Form RD 1940-3. The State Director or designee will use the State Office terminal to request reservation/obligation of funds. Use of the telephone for the reservation/obligation of funds is restricted to those instances when the State Office terminal is inoperative. Form RD 1980_50 will be prepared and distributed for initial loans only. (Revised 08-29-19, PN 527.)

a. Immediately after contacting the Finance Office, the requesting official will furnish the requesting office's security identification code. Failure to furnish the security code will result in rejection of the request for reservation of authority. After the security code is furnished, all pertinent information contained on Form RD 1940-3 will be furnished to the Finance Office. Upon receipt of the telephone request for reservation of authority, the Finance Office will record all information necessary to process the request for reservation in addition to the date and time of the request. (Revised 02-28-91, SPECIAL PN)

b. The individual making the telephone request will record the date and time of the telephone request and place his/her signature in section 35 of Form RD 1940-3. (Revised 02-28-91, SPECIAL PN)

c. The Finance Office will terminally process telephone reservation requests. Those requests for reservations received before 2:30 p.m. Central Time, to the extent possible, will be processed on the date received; however, there may be instances in which the reservation will be processed on the next working day.

d. Each working day the Finance Office will notify the State Office by telephone of all projects for which authority was reserved during the previous night's processing cycle and the date of obligation. If authority cannot be reserved for a project, the Finance Office will notify the State Office that authority is not available within the State allocation. The obligation date will be the date of the request for reservation of authority which is being processed in the Finance Office. The Finance Office will mail to the State Director Form RD 440-57, "Acknowledgment of Obligated Funds/Check Request," prepared in duplicate, confirming the reservation of authority with the obligation date inserted as required by item No. 9 on the FMI for Form RD 440-57. Immediately after notification by telephone of the reservation of authority, the State Director will call the Legislative Affairs and Public Information Staff in the National Office as required by RD Instruction 2015-C (available in any Rural Development office). (Revised 08-29-19, PN 527.)

e. See RD Instruction 2015-C (available in any Rural Development office) for notification procedures.

7. State Director notifies the lender and borrower if he/she will not issue the Form RD 449-14.

§1980.453 Review of requirements.

(a) Immediately after reviewing the conditions and requirements in Form RD 449-14, the lender and applicant should complete and sign the "Acceptance of Conditions" and return a copy to the Rural Development State Director. If certain conditions cannot be met, the lender and borrower may propose alternate conditions to Rural Development.

(b) If the lender indicates in the "Acceptance of Conditions" that it desires to obtain a Loan Note Guarantee and subsequently decides at any time after receiving a conditional commitment that it no longer wants a Loan Note Guarantee, the lender will immediately advise the Rural Development State Director.

ADMINISTRATIVE:

A. The State Director will negotiate with the lender and proposed borrower any changes made to the initially issued or proposed Form RD 449-14. For loans requiring National Office concurrence, a copy of Form RD 449-14 and any amendments thereto will be included when the loan file is submitted to the National Office for review. When the National Office

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recommends modifications or additions to Form RD 449-14, the State Director will further negotiate these recommendations with the lender and proposed borrower. If, as a result of these further negotiations, the lender, proposed borrower or State Director presents alternate conditions which would result in a change in the scope of the proposed project and if the loan exceeds the State Director's loan approval authority, the State Director will submit these conditions by memorandum to the National Office for consideration with a copy of the revised Form RD 449-14 and any amendments thereto. If the loan is within the State Director's loan approval authority, the State Director may approve such changes. (Revised 02-05-92, PN 181.)

B. On loan applications within the State Director's loan approval authority, the State Director will submit to the National Office, Business and Industry Division, within 30 days after the Form RD 449-14 has been accepted:

1. A copy of Form RD 449-29.
2. A copy of Form RD 449-14 as accepted by the lender and borrower.
3. A copy of Rural Development State Loan Review Board Minutes.
4. Notification of required financial and other reports, their frequency, due dates and fiscal year-end.
5. A copy of the proposed loan agreement between the lender and the borrower.
6. When debt refinancing is involved, a copy of the justification for the refinancing.
7. The cover memorandum should indicate whether the Form RD 449-34 has been issued. If the Loan Note Guarantee has been issued, enclose a copy of the Lender Certification required by §1980.60(a) of Subpart A of this part, and, if not, a proposed date for issuance of the Form RD 449-34.

§1980.454 Conditions precedent to issuance of the Loan Note Guarantee.

In addition to compliance with the requirements of §1980.60 of Subpart A, compliance with the following provisions is required prior to issuance of the Loan Note Guarantee.

(a) Transfer of lenders. The state director may approve a substitution of a new eligible lender in place of a former lender who holds an outstanding Conditional Commitment for Guarantee (where the Loan Note Guarantee has not yet been issued and the loan is within the state director's loan approval authority) provided there are no changes in the borrower's ownership or control, loan purposes, scope of project and loan conditions in the Form RD 449-14 and the loan agreement remains the same. To effect such a substitution, the former lender will provide the Agency with a letter stating the reasons it no longer desires to be a lender for the project. For loans in excess of the state director's loan approval authority, National office concurrence is required. The state director will submit a recommendation concerning the transfer of lenders along with the lender's letter stating the reasons it no longer desires to be a lender for the project. The substituted lender will execute a new Part "B" of Form RD 449-1. If approved by the Agency, the state director will issue a letter or amendment to the original Form RD 449-14 reflecting the new lender and the new lender will acknowledge acceptance of the letter or amendment in writing.

(Revised 02-05-92, PN 181.)

(b) Substitution of borrowers. The Agency will not issue a Loan Note Guarantee to the lender who is in receipt of a Form RD 449-14 with an obligation in a previous fiscal year if the originally approved borrower (including changes in legal entity) or owners are changed. The only exception to this provision prohibiting a change in the legal entity's form of ownership is when the originally approved borrower or owner is replaced with substantially the same individuals with substantially the same interests, as originally approved and identified in the Form RD 449-1, item 15. All requests for exceptions must be approved by the National office.

(c) Changes in terms and conditions in Form RD 449-14. It is the intent of the Agency that once the Form RD 449-14 is issued and accepted by the lender, the commitment is not to be modified as to the scope of the project, overall facility concept, project purpose, use of proceeds or terms and conditions. Should changes be requested by the lender, the state director will negotiate with the lender and proposed

borrower any proposed changes to the originally accepted Form RD 449-14. If, as a result of these negotiations, the lender, proposed borrower or state director presents alternate conditions which would result in a change in the scope of the project and the loan exceeds the state director's loan approval authority, the state director will submit these changes in the conditions by memorandum to the National office for consideration with a copy of the revised Form RD 449-14 and any amendments thereto. Changes to the conditional commitment may be approved by the state director for loans within their loan approval authority. (Revised 02-05-92, PN 181.)

(d) Additional requirements for B&I guaranteed loans. All B&I borrowers and lenders, as applicable, must comply with Appendix D, paragraphs I(A) and (B); II(A) through II(A) (2) (g) (1); II(B) and (C); III(A), (B), (C), (D), and (E).

(e) Preguarantee review. Coincident with, or immediately after loan closing, the lender will contact the Agency and provide those documents and certifications required by §§1980.60 and 1980.61 of Subpart A. Only when the B&I or C&BP chief or loan specialist, as required by paragraph B. (Administrative) of this section, is satisfied that all conditions for the guarantee have been met, will the Loan Note Guarantee be executed. (Revised 02-05-92, PN 181.)

(f) Loan closing. When the loan closing plans are established, the lender will notify the Agency.

(g) Closing of working capital loans. The state director will not issue a Loan Note Guarantee for a working capital loan prior to the completion of all proposed construction for the project. Working capital loan funds will not be used to pay short-term notes.

ADMINISTRATIVE:

A. The State director reviews:

1. [Reserved]

2. Plans for inspections made on construction projects. These should be coordinated with the lender and borrower. Form RD 424-12, "Inspection Reports," may be used by the state engineer or architect who will make an inspection of the projects which involve substantial construction. The inspection shall be completed prior to the issuance of the Loan Note Guarantee to assure all construction is complete. The state loan specialist or chief may also participate in the inspections.

3. Cost overruns, if any, and how they will be met. State Directors may approve cost overruns for projects in any amount or percentage within their loan approval authority not to exceed 10 percent in loan amounts between \$1 million and \$10 million.

4. Basic credit requirements of all loans.

B. In all cases, the Program Chief or the B&I Loan Specialist will conduct a preguarantee review before issuance of the Loan Note Guarantee to assure that all requirements of the application, Conditional Commitment for Guarantee and Loan Agreement have been met including the required certifications using language specified by the regulations, and will provide such verification in the loan file, including arrangements for annual audit reports. In the conduct of this review, all requirements of §1980.60 (a) of Subpart A of this part will be reviewed and special attention should be paid to reviewing current financial statements of the borrower to assure that no adverse change has taken place. The District Director may participate in the review.

C. The State Director or any other Rural Development personnel shall not sign any documents other than those specifically provided for in Subparts A or E of this part. No certificates shall be signed except the "Certificate of Incumbency and Signature" as set forth in Appendix B of this subpart.

D. Par (a) Transfer of Lender. The State Director will analyze all requests for substituted lenders including the servicing capability, eligibility and experience of the new lender before the request is approved. If approved, notify the Finance Office of the change using Form RD 1980-42. Do not deobligate and reobligate the loan if the Form RD 449-14 was issued in a previous fiscal year.

E. Par (b) Substitution of borrowers. The State Director will review any request for exceptions to substitution of borrowers and forward such requests with a memorandum of facts and recommendation to the National Office for a decision. The National Office will not approve any request where the legal entity is changed, such as from a corporation to a partnership, etc., or if the ownership changes more than 20 percent.

F. Par (c) Changes in terms and conditions in Form RD 449-14. The State Director will review any requests for changes to Form RD 449-14. Only those changes which do not materially affect the project, its capacity, employment, original projections or credit factors may be approved. Changes in legal entities or where tax considerations are the reason for change will not be approved when modifying any loan guarantee or conditions of guarantee. State Directors may approve these changes in terms and conditions if the loan is within the State Director's loan approval authority and the change will not result in a major change in the scope of the project. Changes in terms and conditions for loans in excess of the State Director's loan approval authority, must be submitted to the National Office with a memorandum of facts and recommendations for review and concurrence. In order to identify the number and types of action taken, the following procedures are to be followed when requests of this type are approved by Rural Development.

(Revised 02-05-92, PN 181.)

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1. Start with the number 1 when the first modification is approved and enter this number in the upper right hand corner of the Letter of Concurrence and on the related "Modification or Administration Action" sheet.
2. Next to the modified wording on the work copy of the Conditional Commitment for Guarantee and the Term Loan Agreement or any form which has been modified, pencil in a short cross reference to the modification and identify the number given it.
3. File the copies of the "Modification or Administrative Action" sheet and related Letters of Concurrence numerically in the docket directly on top of the affected original documents of conditions.
4. The order of recordkeeping should include any requests which were declined by the National Office.

§§1980.455 - 1980.460 [Reserved]

§1980.461 Issuance of Lender's Agreement, Loan Note Guarantee, and Assignment Guarantee Agreement. [See §1980.61 of Subpart A, of this part]

ADMINISTRATIVE:

- A. Par (a) of Subpart A, §1980.61. The original Form RD 449-35 will be retained in the Rural Development loan file.
- B. Par (b) (1) of Subpart A, §1980.61. Copies of all issued Loan Note Guarantees will be kept in the Rural Development loan file.
- C. Par (b) (2) of Subpart A, §1980.61. The State Director will approve all substitutions of Loan Note Guarantee or Contracts of Guarantee.
- D. It is imperative that the original loan covered by a Contract of Guarantee is current.
- E. The registered holder will transmit to the State Director:
 1. Request for substitution together with the original Contract of Guarantee.
 2. Copies of notes with lender's identification numbers. (All requirements of the Lender's Agreement will be complied with before any new notes are issued.)
 3. Certification that the loan is current and in good standing.
 4. Certification of outstanding principal amount of the loan.
 5. Executed Lender's Agreement. (Rural Development provides form to lender).
 6. Executed Form RD 1980-19. (See §1980.21 of Subpart A of this part for calculation of fee due).
 7. Payment for appropriate guarantee fee.

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F. State Director will:

1. Review all the requirements of paragraph E of this section.
2. Verify the submitted request and if in order, send the guarantee fee and Form RD 1980-19 to Finance Office with a notation of the date the new Loan Note guarantee will be issued. (Note: The substitution of a Loan Note Guarantee for the Contract of Guarantee is not to be considered as a new loan for recordkeeping purposes).
3. Complete the Loan Note Guarantee (appropriate number for attachment to each note), date and sign the instrument. The following statement will be entered at the top of the form: "This Loan Note Guarantee is issued in substitution of Contract of Guarantee dated _____. " The State Director will transfer from the Contract of Guarantee all information pertaining to the Loan Note Guarantee.
4. Execute Lender's Agreement.
5. Cancel the original Contract of Guarantee.
6. Transmit to the lender the original Loan Note Guarantee and a copy of executed Lender's Agreement and retain in the loan file copies of the Loan Note Guarantee with attached original cancelled Contract of Guarantee, a copy of Form RD 1980-19 and the original Lender's Agreement.

All applicable provisions of this subpart and Subpart A of this part apply to the loan when the Loan Note Guarantee is signed.

G. Alternate Procedure: If the Registered Holder does not want to deliver the original contract of Guarantee with his/her request for substitution, the State Director will accept a copy of the Contract of Guarantee and proceed as above. However, the Loan Note Guarantee will be delivered only upon receipt of the original Contract of Guarantee.

H. Par (b) (3) of Subpart A, § 1980.61. For reporting purposes where multi-notes are issued, the loan to the borrower will be counted as one loan regardless of the number of notes issued.

I. Par (b) (4) of Subpart A, § 1980.61. The State Director will notify the Finance Office of the transaction.

J. Par (d) of Subpart A, § 1980.61. A copy of Form RD 449-36 will be kept and a copy of executed Lender's Agreement retained in loan file along with copies of the Loan Note Guarantee with attached original cancelled Contract of Guarantee, copy of Guarantee Fee Report and the original Lender's Agreement.

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K. Par (e) of Subpart A, § 1980.61. State Director signs all Forms RD 449-13, "Denial Letter."

L. Par (g) of Subpart A, §1980.61. The State Director will:
(Revised 10-28-03, SPECIAL PN.)

1. Review Form RD 1980-19 for completeness.
2. Deposit the guarantee fee in accordance with procedures prescribed in RD Instruction 1951-B.
3. Ascertain that originals or copies, as appropriate, are retained in the Rural Development Loan file.

§§ 1980.462 - 1980.468 [Reserved]

§ 1980.469 Loan servicing.

The lender is responsible for loan servicing and for notifying the Rural Development of any violations in the Lender's Loan Agreement. (See Paragraph X of Form RD 449-35).

(a) All B&I guaranteed loans in the lender's portfolio will be classified by the lender as soon as it is notified by the State Office to do so and again whenever there is a change in the loan which would impact on the original classification. The State Director will notify the lender of this requirement for all existing loan guarantees, when new Loan Note Guarantees are issued to a lender and/or when the State Office becomes aware of a condition that would affect the classification and justification of the classification will be sent to the State Office. The loans will be classified according to the following criteria:

(1) Substandard Classifications - Those loans which are inadequately protected by the current sound worth and Paying capacity of the obligor or of the collateral pledged, if any. Loans in this category must have a well defined weakness or weaknesses that jeopardize the payment in full of the debt. If the deficiencies are not corrected, there is a distinct possibility that the lender and Rural Development will sustain some loss.

(2) Doubtful Classification - Those loans which have all the weaknesses inherent in those classified Substandard with the added characteristics that the weaknesses make collection or liquidation in full, based on currently known facts, conditions and values, highly questionable and improbable.

(3) Loss Classifications - Those loans which are considered uncollectible and of such little value that their continuance as bankable loans is not warranted. Even though partial recovery may be effected in the future, it is not practical or desirable to defer writing off these basically worthless loans.

(b) There is a close relationship between classifications; and no classifications category should be viewed as more important than the other. The uncollectibility aspect of Doubtful and Loss classifications are of obvious importance; however, the function of the Substandard classification is to indicate those loans that are unduly risky which may result in future claims against the B&I guarantee.

(c) Substandard, Doubtful and Loss are adverse classifications. There are other classifications for loans which are not adversely classified but which require the attention and followup of the lenders and Agency. These classifications are:

(1) Special Mention Classification - Those loans which do not presently expose the lender and Agency to a sufficient degree of risk to warrant a Substandard classification but do possess credit deficiencies deserving the lender's close attention. Failure to correct these deficiencies could result in greater credit risk in the future. This classification would include loans that the lender is unable to supervise properly because of a lack of expertise, an inadequate loan agreement, the condition of or lack of control over the collateral, failure to obtain proper documentation or any other deviations from Prudent lending practices. Adverse trends in the borrower's operation or an imbalanced position in the balance sheet which has not reached a point that jeopardizes the repayment of the loan should be assigned to this designation. Loans in which actual, not potential, weaknesses are evident and significant should be considered for a Substandard classification.

(2) Seasoned Loan Classification. A loan which:

(i) Has a remaining principal guaranteed loan balance of two thirds or less of the original aggregate of all existing B&I guaranteed loans made to that business.

(ii) Is in compliance with all loan conditions and B&I regulations.

(iii) Has been current on the B&I guaranteed loan(s) payments for 24 consecutive months.

(iv) Is secured by collateral which is determined to be adequate to ensure there will be no loss on the guaranteed loan.

(3) Current Non-problem Classification - Those loans that are current and are in compliance with all loan conditions and B&I regulations but do not meet all the criteria for Seasoned Loan classification. All loans not classified as Seasoned or Current Non-problem will be reported on the quarterly status report with documentation of the details of the reason(s) for the assigned classification. (Revised 05-17-95, PN 245.)

ADMINISTRATIVE:

Refer to Appendix G of this subpart (available in any State or District Office) for advice on how to interact with the lender on liquidations and property management.

A. While the lender has the primary responsibility for loan servicing and protecting the collateral, the State Director is responsible for seeing that servicing as required by the Lender's Agreement and regulation is properly accomplished. Loan servicing is intended to be a preventive rather than a curative action. Prompt followup on delinquent accounts and early recognition of potential problems and pursuing a solution to them are keys to resolving many problem loan cases.

B. Paragraph II of the Lender's Agreement.

1. The Loan Note Guarantee is unenforceable by the lender to the extent any loss is occasioned by violation of usury laws, use of loan funds for unauthorized purposes, negligent servicing, or failure to obtain the required security regardless of the time at which Agency acquires knowledge of the foregoing. As used herein, the phrase "use of loan funds for unauthorized purposes" refers to the situation in which the lender in fact agrees with the borrower that loan funds are to be so used and the phrase "unauthorized purposes" means any purpose not listed by the Lender in the completed application as approved by the Agency.

2. With respect to the negligent servicing and use of loan funds for unauthorized purposes, the Loan Note Guarantee is unenforceable by the lender to the extent any loss is occasioned by negligent servicing and use of loan funds for unauthorized purposes regardless of the time the Agency acquires knowledge of the negligent servicing or use of loan funds for unauthorized purposes by the lender. Only the amount of the loss caused by negligent servicing or use of loan funds for unauthorized purposes can be withheld from the final loss claim submitted by the lender. The dollar amount withheld from the final loss claim must be ascertainable. In order to determine the final loss amount, the guaranteed loan collateral and any collateral of the guarantor(s) must be liquidated and settled or a settlement with the guarantor(s) reached. In the event there is reason to suspect the lender of negligent servicing or use of loan funds for unauthorized purposes during the life of the loan, the lender should be notified

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in writing that (a) the acts of negligent servicing and/or use of loan funds for unauthorized purposes will cause the guarantee to be unenforceable by the lender to the extent these acts cause a loss; (b) any decision not to honor any part of the guarantee is not possible until the loan has been liquidated and a loss established; (c) if any loss occurs Rural Development will consider whether negligent acts of the lender caused a loss after the liquidation is complete; and (d) at the time Rural Development determines a loss has occurred as the result of negligent servicing the lender may appeal any adverse decision.

3. When facts or circumstances indicate that criminal violation may have been committed by an applicant, a borrower, or third party purchaser, the State Director will refer the case to the appropriate Regional Inspector General for Investigations, Office of the Inspector General (OIG), USDA, in accordance with RD Instruction 2010-B (available at any Rural Development Office) for criminal investigation. Any questions as to whether a matter should be referred will be resolved through consultation with OIG for Investigations and the State Director and confirmed in writing. In order to assure protection of the financial and other interest of the Government, a duplicate of the notification will be sent to the Office of General Counsel (OGC). After OIG has accepted any matter for investigation, Rural Development staff must coordinate with OIG in advance regarding routine servicing actions on existing loans. A borrower or lender can be sued even though criminal fraud is present. If Rural Development has good reason to believe that, for example, a borrower or a lender made a false statement to obtain a loan or guarantee, or a lender submitted a loss claim which was false or fraudulent, it should promptly call the matter to the attention of OGC--even if no payment of the loss claim has occurred yet. (This would include those situations in which a borrower lied to the lender in order to get the loan, the lender believed the borrower and made the loan--which was guaranteed by Rural Development--and then the lender presented a loss claim to Rural Development for payment after the borrower defaulted on the loan.) Sometimes it might be necessary to ask OIG to do an investigation to establish all the aspects of the fraud. If at all possible, this should be done prior to referral to OGC.

4. There are two methods the government could use to seek relief for the fraud. One of the ways the Government could seek redress for the fraud is to sue under the False Claims Act (31 U.S.C. Sections 3729-3731). If fraud is proven to have occurred, the False Claims Act provides for the recovery of double damages and a \$2,000 penalty (and the costs of one civil suit) for each act involving,

for example: (a) knowingly submitting to a Government employee a false or fraudulent claim for payment or approval, (b) knowingly making or using a false record or statement to get a false or fraudulent claim paid or approved, or (c) conspiring to defraud the United States by getting a false or fraudulent claim allowed or paid. Suit under the False Claims Act must be filed within six years from the date of the commission of the act (e.g., presentation of the claim to the Agency for payment). The double damage feature ought to be a good incentive to convince OIG to undertake any necessary investigations to help establish the fraud.

5. In order to decide whether to file suit, the Department of Justice will need to know such things as: What was the amount of the loan or the loss paid to the lender or holder? How much did the scheme cost the Government? What is the difference in money between what the Government paid out and what it should have paid out? Does the borrower or lender have enough assets to make it worth suing? If the Agency can answer these questions before referral to OGC--either on its own or by using OIG--then OGC can refer the matter that much more quickly to the Justice Department.

6. There is also a way to bring suit for civil fraud by alleging that "common law" fraud occurred. This would just involve proving that a borrower or a lender falsely represented by their words or actions, a matter of fact either by alleging something in a false or misleading manner or by concealing something that should have been disclosed; and the Agency was deceived by this conduct, and relied on it to its detriment. Under "common law" fraud, only single damages could be recovered, and there would be no \$2,000 penalty assessed. The action would generally have to be brought within three years from the date of the discovery of the fraud.

7. Neither the False Claims Act nor the right to bring a "common law" action for fraud precludes the Government from just suing to recover the money wrongfully or mistakenly paid by its employees. If the Justice Department decides not to pursue a civil frauds claim under the False Claims Act or "common law", it will return the matter to OGC. Depending on what stage the proceedings were in when the matter was first referred, the Agency could then continue to negotiate with the lender or OGC could re-refer the case to Justice for any contract-based actions, including fraud or misrepresentation based on the terms of the guarantee.

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C. The State Director will assure that:

1. [Reserved]

2. A timetable for routine site, borrower and lender visitations by Agency personnel is established before the Loan Note Guarantee is issued. As a guide, visits to newly established borrowers with the lender represented should be scheduled monthly. Visits to established, nonproblem borrowers must be made at least annually except for seasoned loans which will be visited at least biennially. Special attention problem accounts should be visited as frequently as the need demands. If possible, these visitations should be coordinated with the lender's visits.

3. During or in preparation for field visits, the following functions are to be performed:

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- (a) Current financial information is obtained in advance and analyzed for trends.
- (b) Any issues revealed or problems not resolved from the last visitation are included in the agenda.
- (c) Collateral is observed and its condition, maintenance, protection and utilization by the borrower appears to be satisfactory.
- (d) A report of the visit is made on Form RD 449-39, "Field Visit Review (Business and Industrial Loans)," or otherwise documented and included in the loan file. The report should include an opinion of the borrower's status based upon observations made during the visit.
- (e) Any instructions or directions to the lender should be confirmed by letter.

4. The Program Chief or Loan Specialist will conduct an annual meeting with each lender or its agent with whom a Loan Note Guarantee(s) or Contract of Guarantee(s) is outstanding. This cannot be redelegated. These meetings may be scheduled at the time Rural Development makes periodic field inspections to the borrower's Place of business. At the meeting, a review will be made of the lender's performance in loan servicing, including enforcement of conditions and covenants in the loan agreements. The observations and results of the meeting will be documented. Form RD 449-39 may be used for this purpose. Servicing exceptions on the part of the lender which are noted by Rural Development will be confirmed by letter to the lender.

5. The lender performs an adequate analysis of borrower financial statements for Rural Development. Rural Development in turn will evaluate the lender's analysis and follow up with the lender on servicing action(s) required or negative observations not detected through the lender's analysis. The financial statement analysis of the lender, the financial statement and a memorandum reflecting Rural Development's analysis, including a comparison to Previous and Projected performance of the borrower, will be forwarded to the National Office, Attention: Business and Industry Division, only for the following loans:

- (a) All loans within the first Year of loan closing.
- (b) Loans over one year old as determined by the State Director or a National Office assigned loan reviewer who is participating in a field review. In event of a disagreement between the State Director and an assigned loan reviewer as to which loans should be included, the assigned loan reviewer's decision will take precedence.
- (c) All problem and delinquent loans.
- (d) Loans that the State Director would like reviewed by the National Office.

6. Meetings are arranged between the lender, borrower and Rural Development to resolve any problems of late payment, etc.

D. State Director Authorities.

1. The State Director may delegate authority for the conduct of all functions listed in Section 1980.469 Administrative B., except item C. 4. in Administrative B.

2. The State Director may approve B&I guaranteed loan servicing actions. as authorized in separate written approval authorities issued in accordance with Subpart A of Part 1901 of this chapter.

3. Servicing actions on loans which exceed the State Director's loan approval authority are to be referred together with the State Director's recommendations to the Director, business and Industry Division, for Prior review and concurrence.

§1980.470 Defaults by borrower. [See §1980.63 of Subpart A, of this part]

ADMINISTRATIVE:

Refer to Appendix G of RD Instruction 1980-E (available in any Rural Development Office) for advice on how to interact with the lender on liquidations and property management.

A. In case of any monetary or significant non-monetary default under the loan agreement, the lender is responsible for arranging a meeting with the State Director, or its designee, and borrower to resolve the Problem. A memorandum of the meeting, individuals who attend, a summary of the problem and proposed solution will be prepared by the Rural Development representative and retained in the loan file. When the State Director receives a notice of default on a loan, he/she will immediately notify the National Office in writing of the details and will subsequently report the problem loan to the National Office on the quarterly status report. The State Director will notify the lender and borrower of any decision reached by Rural Development.

B. In considering servicing options, some of which are identified in paragraph X. A of Form RD 449-35, the prospects for providing a permanent cure without adversely affecting the risks of the Rural Development and the lender must become the paramount objective. Within the State Director's authority, temporary curative actions such as payment deferments, moratoriums on payments or collateral subordination, if approved, must strengthen the loan and be in the best interests of the lender and Rural Development. Some of these actions may require concurrence of the holder(s). A deferral, rescheduling, reamortization or moratorium is limited by the period of time authorized by this subpart for the purpose for which the loan(s) is made or the remaining useful life of the collateral securing the loan. For example, if the promissory note on a working capital loan is scheduled to mature in 2 years the loan could be rescheduled for 7 years or the remaining life of the collateral whichever is the lesser of the two.

§1980.470 ADMIN. (Con.)

C. Subsequent loan guarantee requests will be processed in accordance with provisions of §1980.473 of this subpart.

D. If the loan was closed with the multi-note option, the lender may need to possess all notes to take some servicing actions. In these situations when Rural Development is holder of some of the notes, the State Director may endorse the notes back to the lender after the State Director has sought the advice and guidance of OGC, provided a proper receipt is received from the lender which defines the reason for the transfer. Under no circumstances will Rural Development endorse the original Form RD 449-34, to the lender.

E. The State Director's authority to approve servicing actions is defined in §1980.469, Administrative D.2.

F. Consultant services may be recommended by the State Director to assist Rural Development and the lender in determining which servicing action is appropriate. Requests for consultant services should be made by the State Director and addressed to the Administrator, Attn: Business and Industry Division. A full explanation of the loan history, an evaluation and scope of the proposed study and the need should be included in the request.

G. When the National Office determines it is necessary on individual cases, due to some special servicing requirements, it may, at its option, assume the servicing responsibility on individual cases.

H. The State Director will report all delinquent and problem loans quarterly to the Director, Business and Industry Division, by the 10th day of January, April, July, and October. This report will be submitted on Form RD 1980-59, "Quarterly Delinquent/Problem Loan Report," in duplicate. (Revised 12-05-90, PN 149.)

I. The State Director will notify the Finance Office by memorandum of any change in payment terms such as remortizations or interest rate adjustments and effective dates of any changes resulting from servicing actions.

§1980.471 Liquidation. (see §1980.64 of Subpart A of this part)

Refer to Appendix G of this subpart (available in any Rural Development Office) for advice on how to interact with the lender on liquidations and property management.

(a) Collateral acquired by the lender can only be released after a complete review of the proposal.

(1) There may be instances when the lender acquires the collateral of a business where the cost of liquidation exceeds the potential recovery value of the collection. Whenever this occurs the lender with the concurrence of Rural Development can abandon the collateral in lieu of liquidation.

(2) Sale of acquired collateral to the former borrower, former borrower's stockholder(s) or officer(s), the lender or lender's stockholder(s) or officer(s) must be based on an arm's length transaction with the concurrence of Rural Development.

ADMINISTRATIVE:

A. The State Director determines which Rural Development personnel will attend meetings with the lender.

B. Introduction to Paragraph XI and Paragraph XI B of the Lender's Agreement. Rural Development will exercise the option to liquidate only when there is reason to believe the lender is not likely to initiate liquidation efforts that will result in maximum recovery. When there is reason to believe the lender will not initiate efforts that will maximize recovery through liquidation, the State Director will forward the lender's liquidation plan, if available with appropriate recommendations, along with the State Director's exceptions to the lender's plan, if any, to the Director, Business and Industry Division, for evaluation and approval or rejection of the State Director's recommendation regarding liquidation. Only when compromise can not be reached between Rural Development and the lender on the best means of liquidation will Rural Development consider conducting the liquidation. The State Director has no authority to exercise the option to liquidate without National Office approval. When Rural Development liquidates, reasonable liquidation expenses will be assessed against the proceeds derived from the sale of the collateral. In such instances the State Director will send to the Finance Office Form RD 1980-45, "Notice of Liquidation Responsibility."

§1980.471 ADMIN. (Con.)

C. State Directors are authorized to approve lender liquidation plans as authorized on separate written approval authorities issued in accordance with Subpart A of Part 1901 of this chapter. Within delegated authorities, the State Director may approve a written partial liquidation plan submitted by the lender covering collateral that must be immediately protected or cared for in order to preserve or maintain its value. Approval of the partial liquidation plan must be in the best interest of the government. The approved partial liquidation plan is only good for those actions necessary to immediately preserve and protect the collateral and must be followed by a complete liquidation plan prepared by the lender in accordance with the requirements of paragraph XII A of the Lender's Agreement.

D. Paragraph XI D. State Directors are responsible for review and acceptance of accounting reports as submitted by lenders and for submission of such reports to lenders when Rural Development is conducting liquidation, after they have been submitted with the State's recommendations to the Director, Business and Industry Division for prior review.

E. Paragraph XI E 2. State Directors are authorized to approve final reports of loss from the lender in separate written approval authorities issued in accordance with Subpart A of Part 1901 of this chapter. The

State Director will submit to the Finance Office for payment any loss claims of the lender on Form RD 449-30, "Loan Note Guarantee Report of Loss." The Finance Office forwards loss payment checks to the State director for delivery to lender. When a loss claim is involved on a particular loan guarantee, ordinarily one "Estimated Loss Report" will be authorized. Only one final "Report of Loss" will be authorized. A final Form RD 449-30 must be filed with the Finance Office at the completion of all liquidations. Finance Office will use this form to close out the account.

F. Paragraph XI E 3. Final loss payments will be made within the 60 days required but only after a review by Rural Development to assure that all collateral for the loan has been properly accounted for and liquidation expenses are reasonable and within approved limits. State Directors are responsible to see that such reviews are accomplished by the State within 30 days and final loss claims in excess of the State Director's approval authority are forwarded to be accepted or otherwise resolved by the Director, Business and Industry Division within the 60-day period. Any estimated loss payments made to the lender must be taken into consideration when paying a final loss on the Rural Development guaranteed loan. The estimated loss payment must be treated as a deduction from the principal amount of the loan and interest cannot be accrued on the principal amount of the loan that is equal to the estimated loss payment. Community and Business Program Chiefs (C&BP), Business and Industry Chiefs or Loan Specialists will conduct such reviews. The State Director may request National Office assistance in the conduct of any review. All reviews for final loss claim in excess of the State Director's approval authority (See Subpart A of Part 1901 of this Chapter) will be submitted to the National Office, Business and Industry Division, for concurrence prior to the State Director's approval of the claim. Close scrutiny of liquidation proceeds and their application in accordance with lien priorities is required. Before final loss payments are approved and to assist in the required review, the C&BP Chief, B&I Chief or Loan Specialist will prepare a narrative history of the guarantee transaction which will serve as the summary of occurrence which led to failure of the borrower and actions taken to maximize loan recovery. The original of this report will be filed in the loan case file. A copy of this report together with the review of the final loss claim will be included in the material sent to the Director, B&I Division, for review prior to approval of final loss payments.

\$1980.472 Protective advances. [See \$1980.65 Subpart A of this Part]

ADMINISTRATIVE:

Refer to Appendix G of this subpart (available in any Rural Development Office) for advice on how to interact with the lender on liquidations and property management.

A. Protective advances will not be made in lieu of additional loans, in particular, working capital loans. Protective advances are advances made by the lender for the purpose of preserving and protecting the

collateral where the debtor has failed to and will not or cannot meet its obligations. Ordinarily, protective advances are made when liquidation is contemplated or in process. A precise rule of when a protective advance should be made is impossible to state. A common, but by no means the only, period when protective advances might be needed is during liquidation. At this point, the borrower and success of the project are no longer of paramount importance, but preserving collateral for maximum recovery is of vital importance. Elements which should always be considered include how close the project is to liquidation or default, how much control the borrower will have over the funds, what danger is there that collateral may be destroyed and whether there will be a good chance of saving the collateral later if a protective advance in contemplation of liquidation is made immediately. A protective advance must be an indebtedness of the borrower.

B. The State Director must approve, in writing, all protective advances on loans within his/her loan approval authority which exceed a total cumulative advance of \$500 to the same borrower. Protective advances must be reasonable when associated with the value of collateral being preserved.

C. When considering protective advances, sound judgment must be exercised in determining that the additional funds advanced will actually preserve collateral interests and recovery is actually enhanced by making the advance.

§1980.473 Additional loans or advances. (Refer to paragraph XIII of Form RD 449-35)

ADMINISTRATIVE:

Only the State director shall approve within his/her loan approval authority additional nonguaranteed loans or advances prior to or subsequent to the issuance of the Loan Note Guarantee. The State Director shall determine that there will be no adverse changes in the borrower's financial situation and that such loan or advance is not likely to adversely affect the collateral or the guaranteed loan.

§1980.474 [Reserved]

§1980.475 Bankruptcy.

(a) It is the lender's responsibility to protect the guaranteed loan debt and all the collateral securing it in bankruptcy Proceedings. These responsibilities include but are not limited to the following:

§1980.475 (a) (Con.)

- (1) The lender will file a proof of claim where necessary and all the necessary papers and pleadings concerning the case.
 - (2) The lender will attend and, where necessary, participate in meetings of the creditors and all court proceedings.
 - (3) The lender, whose collateral is subject to being used by the trustee in bankruptcy, will immediately seek adequate protection of the collateral.
 - (4) Where appropriate, the lender should seek involuntary conversion of a pending Chapter 11 case to a liquidating proceeding under Chapter 7 or under Section 1123 (b) (4) or seek dismissal of the proceedings.
 - (5) When permitted by the Bankruptcy Code, the lender will request modification of any plan of reorganization whenever it appears that additional recoveries are likely. (Revised 1-13-89, SPECIAL PN)
 - (6) Rural Development will be kept adequately and regularly informed in writing of all aspects of the proceedings. (Renumbered 1-13-89, SPECIAL PN)
- (b) In a Chapter 11 reorganization, if an independent appraisal of collateral is necessary in Rural Development's opinion, Rural Development and the lender will share such appraisal fee equally. (Revised 1-13-89, SPECIAL PN)
- (c) Expenses on Chapter 11 reorganization, liquidating Chapter 11 or Chapter 7 (unless the lender is directly handling the liquidation) cases are not to be deducted from the collateral proceeds.
- (d) Estimated Loss Payments. See paragraph XVI of Form RD 449-35. (Added 1-13-89, SPECIAL PN)

ADMINISTRATIVE:

Refer to Appendix G of this subpart (available in any Rural Development Office) for advice on how to interact with the lender on liquidation and property management.

A. It is the responsibility of the State Program Chief to see that Rural Development is being fully informed by the lender on all bankruptcy cases.

B. All bankruptcy cases should be reported immediately to the National Office by utilizing and completing a problem/delinquent status report. The status report will be completed on Form RD 1980-59 in duplicate. The Regional Attorney must be informed promptly of the proceedings. (Revised 12-05-90, PN 149.)

C. Chapter 11 pertains to a reorganization of a business contemplating an ongoing business rather than a termination and dissolution of the business where legal protection is afforded to the business as defined under Chapter 11 of the Bankruptcy Code. Consequently, expenses incurred by the lender in a Chapter 11 reorganization can never be liquidation expenses unless the proceeding becomes a Liquidating 11. If the proceeding should become a Liquidating 11, reasonable and customary liquidation expenses may be deducted from proceeds of collateral provided the lender is doing the actual liquidation of the collateral as provided in the Lender's Agreement. Chapter 7 pertains to a liquidation of the borrower's assets. If, and when, liquidation of the borrower's assets under Chapter 7 is conducted by the bankruptcy trustee, then the lender cannot claim expenses. (Revised 1-13-89, SPECIAL PN)

D. The State Director may approve the repurchase of the unpaid guaranteed portion of the loan from the holder(s) to reduce interest accruals during Chapter 7 proceedings or after a Chapter 11 proceeding becomes a liquidation proceeding. On loans in bankruptcy, any loss payment must be halted in accordance with the Lender's Agreement and carry the approval of the State Director. (Revised 1-13-89, SPECIAL PN)

E. The State Director must approve in advance and in writing the lender's estimated liquidation expenses on loans in liquidation bankruptcy. These expenses must be reasonable and customary and not in-house expenses of the lender.

F. The lender is responsible for advising Rural Development of the completion of the Chapter 11 reorganization plan; however, the Rural Development servicing office will monitor the lender's files to ensure timely notification of servicing actions. (Added 1-13-89, SPECIAL PN)

G. If an estimated loss claim is paid during the operation of the reorganization plan, and the borrower repays in full the remaining balance of the loan set forth in the plan without an additional loss sustained by the by the lender, a Final Report of Loss is not necessary. The Finance Office will close out the estimated loss account as a Final Loss at the time notification of payment in full. (Added 1-13-89, SPECIAL PN)

§1980.475 ADMIN. (Con.)

H. If the bankruptcy court attempts to direct that loss payments will be applied to that account other than the unsecured principal first and then to unsecured interest, the lender is responsible for notifying the Rural Development servicing office immediately. The Rural Development servicing office will then obtain advice from OGC on what actions Rural Development should take. (Added 1-13-89, SPECIAL PN)

I. Protective Advances - Authorized Protective Advances may be included with the estimated loss payment associated with the Chapter 11 reorganization provided they were incurred in connection with liquidation of the account prior to the borrower filing bankruptcy. (Added 1-13-89, SPECIAL PN)

J. Adequate Protection - The bankruptcy court can order protection of the collateral while the borrower is in a reorganization bankruptcy. The lender whose collateral is subject to being used by the trustee in bankruptcy should immediately seek adequate protection of the collateral, including petitioning for a super priority. (Added 1-13-89, SPECIAL PN)

§1980.476 Transfer and assumptions

(a) All transfers and assumptions will be approved in writing by Rural Development. Such transfers and assumptions will be to an eligible applicant.

(b) Transfers and assumptions will be considered without regard to §1980.451 (d) of this subpart.

(c) The borrower will submit to Rural Development Form RD 449-4 for the required character evaluation prior to the execution of the Assumption Agreement.

(d) Available transfer and assumption options to eligible borrowers include the following:

(1) The total indebtedness may be transferred to another borrower on the same terms.

(2) The total indebtedness may be transferred to another borrower on different terms not to exceed those terms for which an initial loan can be made.

(3) Less than the total indebtedness may be transferred to another borrower on the same terms.

(4) Less than the total indebtedness may be transferred to another borrower on different terms.

RD Instruction 1980-E
§1980.476 (Con.)

(e) In any transfer and assumption case, the transferor, including any guarantor(s), may be released from liability by the lender with Rural Development written concurrence only when the value of the collateral being transferred is at least equal to the amount of the loan or part of the loan being assumed. If the transfer is for less than the entire debt: (Revised 8-9-89, PN 115)

(1) Rural Development must determine that the transferor and any guarantors have no reasonable debt-paying ability considering their assets and income at the time of transfer.

(2) The Rural Development County Committee must certify that the transferor has cooperated in good faith, used due diligence to maintain the collateral against loss, and has otherwise fulfilled all of the regulations of this subpart to the best of borrower's ability.

(f) Any proceeds received from the sale of secured property before a transfer and assumption will be credited on the transferor's guaranteed loan debt in inverse order of maturity before the transfer and assumption transaction is closed.

(g) When the transferee makes any cash downpayment in connection with the transfer and assumption:

(1) The lender will employ an independent appraiser, subject to concurrence of both the transferor and transferee, to make an appraisal to determine the fair market value of all the collateral securing the loan. Such appraisal report fee and any other costs related thereto will be paid by the transferor and the transferee as they mutually agree.

(2) The market value of the secured Property being acquired by the transferee, plus any additional security the transferee proposes to give to secure the debt, will be adequate to secure the balance of the total guaranteed loan owed, plus any prior liens. If any cash downpayment is made, it may be paid directly to the transferor as payment for equity in the project provided:

(i) The lender recommends and Rural Development approves the cash downpayment be released to the transferor. The lender and Rural Development may require that an amount be retained for an established period of time in escrow as a reserve account as security for use against any future default on the loan. Any interest accruing on such an escrow account may be paid periodically to the transferor.

(ii) Any payments that are to be made by the transferee to the transferor in respect to the downpayment do not suspend the transferee's obligation to continue to meet the guaranteed loan payments as they come due under the terms of the assumption.

(iii) The transferor will agree not to take any actions against the transferee in connection with such transfer in the future without first obtaining the written approval of Rural Development and the lender.

(iv) The lender determines that there is repayment ability for the guaranteed debt assumed and any other indebtedness of the transferee.

(h) The lender will make, in all cases, a complete credit analysis to determine viability of the project, subject to Rural Development review and approval, including any requirement for deposits in an escrow account as security to meet its determined equity requirements for the project.

(i) The lender will issue a statement to Rural Development that the transaction can be properly transferred and the conveyance instruments will be filed, registered, or recorded as appropriate and legally permissible.

(j) Rural Development will not guarantee any additional loans to provide equity funds for a transfer and assumption.

(k) The assumption will be made on the lender's form of assumption agreement.

(l) The assumption agreement will contain the Rural Development case number of the transferor and transferee.

(m) Loan terms cannot be changed by the Assumption Agreement unless previously approved in writing by Rural Development, with the concurrence of any holder(s) and concurrence of the transferor (including guarantors) if they have not been released from personal liability. Any new loan terms cannot exceed those authorized in this subpart. The lender's request will be supported by:

(1) An explanation of the reasons for the proposed change in the loan terms.

(2) Certification that the lien position securing the guaranteed loan will be maintained or improved, proper hazard insurance will be continued in effect and all applicable Truth in Lending requirements will be met.

(n) In the case of a transfer and assumption, it is the lender's responsibility to see that all such transfers and assumptions will be noted on all originals of the Loan Note Guarantee(s). The lender will provide Rural Development a copy of the transfer and assumption agreement. Notice must be given by the lender to Rural Development before any borrower or guarantor is released from liability.

(o) The holder(s), if any, need not be consulted on a transfer and assumption case unless there is a change in loan terms.

(p) If a loss should occur upon consummation of a complete transfer of assets and assumption for less than the full amount of the debt and the transferor-debtor (including personal guarantor) is released from personal liability, as provided in paragraph (e) of this section, the lender, if it holds the guaranteed portion, may file an estimated "report of Loss" on Form RD 449-10 to recover its pro rata share of the actual loss at that time. In completing Form RD 440-30, the amount of the debt assumed will be entered on line 24 as Net Collateral (Recovery). Approved

protective advances and accrued interest thereon made during the arrangement of a transfer and assumption, if not assumed by the transferee, will be entered on Form 449-30, lines 13 and 14.

ADMINISTRATIVE:

Refer to Appendix G of this subpart (available in any Rural Development Office) for advice on how to interact with the lender on liquidations and property management.

A. The State Director may approve all transfer and assumption provisions if the guaranteed loan debt balance is within his/her individual loan approval authority including:

1. Consent in writing to the release of the transferor and guarantors from liability.
2. Any changes in loan terms.

NOTE: The assumption will be reviewed as if it were a new loan. The Loan Note Guarantee(s) will be endorsed in the space provided on the form(s).

B. A copy of the Assumption Agreement will be retained in the Rural Development file. The State Director may notify the Finance Office of all approved transfer and assumption cases on Form RD 1980-7, "Notice of Transfer and Assumption of a Guaranteed Loan," and submit Form RD 1980-50 for all new borrowers and Form RD 1980-51, "Add, Change, or Delete Guaranteed Loan Record," in order that Finance records may be adjusted accordingly.

C. Any transfer and assumption of less than the total indebtedness must be submitted to the Director, Business and Industry Division, for review and concurrence.

D. If the guaranteed loan debt balance is in excess of the State Director's loan approval authority, the State Director will forward the file, together with his/her recommendations, to the National Office for approval, ATTN: Business and Industry Division.

§§1980.477 - 1980.480 [Reserved]

§1980.481 Insured loans.

Applications from private parties for whom Rural Development and such borrowers agree that a guarantee lender is not available and from public bodies shall be processed as insured loans in accordance with the applicable provisions of this subpart and Subpart A of Part 1942 of this chapter, including the credit elsewhere requirement, except as provided in §1980.488 of this subpart which provides for the guarantee of taxable bond issues of public bodies. Loans to public bodies will be used only to finance:

RD Instruction 1980-E
§1980.481 (Con.)

- (a) Community facilities as defined in §1980.402 of this subpart, and
- (b) Constructing and equipping industrial plants for lease to private businesses (not including loans for operating such businesses) when the requested loan is not available under Subpart A of Part 1942 of this chapter.

ADMINISTRATIVE:

- A. Without specific written delegated authority, all insured loans require National Office concurrence prior to approval.
- B. Applications from private parties for insured loans will not be encouraged.
- C. Loan closings on insured loans will be in accordance with this subpart, the Regional Attorney and applicable provisions of Subpart A of Part 1942 of this chapter.

§§1980.482 - 1980.487 [Reserved]

§1980.488 Guaranteed industrial development bond issues.

- (a) Loans to public bodies will be guaranteed only in connection with the issuance of any class or series of industrial development bonds (as defined in section 103 (c) (2) of the Internal Revenue Code of 1954, as amended (IRC)), the interest on which is included in gross income under IRC. No part of the loan guaranteed by Rural Development may extend to any class or series of industrial development bonds the interest on which is excludable from gross income under section 103 (a) (1) of such Code. Before the execution of any Loan Note Guarantee, the lender will furnish Rural Development evidence regarding interest on bonds being taxable for Federal income tax purposes. Such evidence may be in the form of an unqualified opinion of a recognized bond counsel or a ruling from the Internal Revenue service. Guaranteed loans to public bodies can only be used for constructing and equipping industrial plants for lease to private businesses engaged in industrial manufacturing and does not provide funds for debt refinancing, working capital and other miscellaneous fees, charges or services. The lessee will have to provide necessary capital and sufficient financial strength to provide for a sound project.
- (b) If Rural Development and the applicant agree that a guaranteed lender is not available, the application may be considered for an insured loan under the provisions of §1980.481 of this subpart.

ADMINISTRATIVE:

The lender is responsible for notifying the Rural Development of the taxability of the proposed bond issue.

§1980.489 [Reserved]

§1980.490 Business and Industry Buydown loans. (Added 06-01-94, PN 225.)

(a) Introduction. This section contains regulations for the Business and Industry Buydown (BIB) loan program. The purpose of this program is to provide loan guarantees with reduced interest rates to the borrowers, under the authority of Public Law 103-50. All provisions of Subparts A and E of this part apply to BIB loans except as provided in this section. All forms used in connection with a BIB loan will be those used with other B&I loans, except as provided in this section.

(b) Location of applicants. Businesses eligible for BIB loans shall be located within the area covered by the Presidential disaster declaration related to Hurricanes Andrew or Iniki or Typhoon Omar.

(c) Interest rate.

(1) If the interest rate charged by the lender (note rate) on a BIB loan is a variable rate in accordance with §1980.423 of this subpart, the base rate must be the prime rate as published in the Wall Street Journal and the note rate must not exceed the prime rate as published in the Wall Street Journal by more than 100 basis points. If the note rate is fixed, it must not exceed by more than 100 basis points the prime rate as published in the Wall Street Journal on the day the Loan Note Guarantee is issued.

(2) The note rate for a BIB loan must be the same for the entire loan, including both the guaranteed and unguaranteed portion.

(d) Interest rate buydown.

(1) To be eligible for a BIB loan, the business must provide evidence and the lender and Rural Development must determine that, at least for the first year of the loan, the business will not have adequate cash flow to meet all of its financial obligations including the required payments on the proposed loan at the note rate, but that it can meet all obligations if the interest rate is reduced by 100 basis points.

(2) During the first year after a Loan Note Guarantee is issued for a BIB loan, Rural Development will pay one percentage point of interest on the loan directly to the lender, thereby reducing the interest due from the borrower by this amount. This interest payment shall be applied to both the guaranteed and unguaranteed portion of the loan pro ratably according to Rural Development regulation.

(3) Interest payments by Rural Development may continue in subsequent years if the borrower's cash flow is insufficient to pay all obligations including the required payments on the proposed loan at the note rate. On or about each yearly anniversary of the promissory note the lender may submit a request to Rural Development for continued interest payments, along with current profit and loss and cash flow statements and cash flow projections to show that the continued payments are needed for another year. Rural Development will promptly review the material submitted, determine whether the continued interest payments by Rural Development are needed to provide for sufficient cash flow in the coming year, and notify the lender in writing of the determination. Once interest payments by Rural Development are terminated because the borrower's cash flow is determined to be sufficient to pay the note rate, such payments will not be made in subsequent years even if the cash flow decreases.

(4) This section does not authorize interest payments by Rural Development on B&I loans other than those approved under this section. To be eligible for interest payments by Rural Development, the loan must be designated as a BIB loan when approved and funded from funds authorized by Public Law 103-50.

(e) Duration of BIB loan program. No BIB loan will be obligated after September 30, 1994.

(f) Administrative procedures.

(1) A lender that wants a B&I application considered under BIB authorities should so indicate by notation on Form RD 449-1 or by letter submitted with the Form RD 449-1.

(2) Rural Development will identify a loan as a BIB loan by notation in the top margin of Form RD 449-29 and by the "type of assistance" code listed on Form RD 1940-3, in accordance with the Forms Manual Insert.

(3) Rural Development will set out the interest buydown provisions in accordance with this section in the Conditional Commitment for Guarantee. When the Loan Note Guarantee is issued, the lender and Rural Development will execute Form RD 1980-48, "Business and Industry Interest Rate Buydown Agreement."

(4) The lender will request the interest payment from Rural Development by submitting Form RD 1980-23, "Request for Business and Industry Interest Buydown Payment," to the Rural Development servicing office. Each request must cover exactly 1 year and be filed within 30 days after the anniversary date of the promissory note, except when interest buydown is terminated between anniversary dates. The Rural Development servicing office will review each request for consistency with Rural Development regulations and the Form RD 1980-48 and, if the claim is valid, will approve it and forward it to the Finance Office for issuance of the payment to the lender.

(g) Termination of interest buydown. When Rural Development purchases a portion of a loan, interest buydown will cease on the entire loan. Interest buydown will also cease upon termination of the Loan Note Guarantee or assumption/transfer of the loan. In the event of any action that causes the interest buydown to terminate, the lender will submit a claim on Form RD 1980-23 for interest buydown payments through the date of termination.

(h) Loan purposes.

(1) Refinancing. Section 1980.452 ADMINISTRATIVE C 1 (d) of this subpart does not apply to BIB loans if refinancing is needed as a direct consequence of the disaster. In such cases, the lender may be allowed to bring previously unguaranteed exposure under the guarantee. No loan will be refinanced unless the current market value of the collateral is at least equal to the amount of the loan to be refinanced plus any new loan amount.

(2) Agriculture. Section 1980.412 (e) of this subpart does not apply to BIB loans. BIB loans may be guaranteed for agriculture production, which means the cultivation, production (growing), and harvesting, either directly or through integrated operations, of agricultural products (crops, animals, birds, and marine life, either for fiber or food for human consumption), and disposal or marketing thereof, the raising, housing, feeding (including commercial custom feedlots), breeding, hatching, control and/or management of farm or domestic animals.

(3) Other eligible businesses. Eligible types of businesses also include:

(i) Commercial nurseries primarily engaged in the production of ornamental plants and trees and other nursery products such as bulbs, florists' greens, flowers, shrubbery, flower and vegetable seeds, sod, and the growing of vegetables from seed to the transplant stage.

(ii) Forestry which includes establishments primarily engaged in the operation of timber tracts, tree farms, forest nurseries, and related activities such as reforestation.

(iii) The growing of mushrooms or hydroponics.

(4) Recreation and tourism. Loans may be guaranteed for tourist or recreation facilities except for hotels, motels, bed and breakfasts, race tracks, gambling, or golf courses.

(5) Meat processing facilities. The provisions of §1980.411 (a) (8) of this subpart will not apply to BIB loans. Loans, including working capital or debt refinancing, may be guaranteed for businesses engaged in meat or poultry processing.

(i) Small Business Administration. Section 1980.451 (c) of this subpart will not apply to BIB loans. Applicants eligible for Small Business Administration assistance will be advised of the availability of that assistance.

(j) Loan guarantee limits. Notwithstanding the provisions of §1980.420 of this subpart, the guarantee percentage on any BIB loan will not exceed 80 percent.

(k) Credit quality analysis. In analyzing the credit quality of a proposed loan to a business that has lost assets to a natural disaster, primary emphasis will be placed on the operating history of the business, rather than its current financial condition. If the business has a sound, profitable and successful history prior to the disaster and there are reasonable projections to ensure it can operate successfully in the future, the proposed loan may be approved even if disaster losses have caused somewhat less equity and/or collateral than would normally be expected for a B&I loan guarantee. If the business appears to have had an unprofitable operation or inadequate cash flow prior to the disaster, the proposed loan guarantee will not be approved.

(l) Equity requirements. The equity requirements of §1980.441 of this subpart do not apply to BIB loans.

(m) Collateral. Section 1980.443 ADMINISTRATIVE A 2, 3, and 4 of this subpart will not apply to BIB loans. Collateral may be considered at its current market value without discount. Work-in-process inventory may be valued at the estimated market value of the finished product. All costs of producing the finished product must be included in the cash flow analysis.

(n) Conditional approval. A Form RD 449-14 may be issued prior to receipt of specific items needed to complete an application package provided:

- (1) The lender and/or borrower demonstrates to the Government's satisfaction that it has a need for a prompt indication of the availability of the proposed loan guarantee and the conditions under which a guarantee are available;
- (2) The specific items missing from the application package will take considerable time to obtain;
- (3) The lender requests a commitment prior to providing the items;
- (4) The attachment to Form RD 449-14 clearly states that the commitment is conditioned on satisfactory completion of the missing item(s) and a guarantee will not be issued unless all conditions of these regulations are met; and
- (5) No Form RD 449-14 will be issued prior to the obligation date established with the Finance Office.

(o) Financial statements. All requirements of §1980.451 (i) (13) of this subpart will apply except that for BIB loans minimum annual financial statements will be required as follows:

- (1) For nonagricultural borrowers with a B&I indebtedness of \$500,000 or less, an annual compilation by an independent certified public accountant or by an independent public accountant licensed and certified on or before December 31, 1970.
- (2) For nonagricultural borrowers with a B&I indebtedness of \$500,001 through \$1 million an annual review by an independent certified public accountant or by an independent public accountant licensed and certified on or before December 31, 1970.
- (3) For nonagricultural borrowers with a B&I indebtedness of more than \$1 million, an annual audited financial statement by an independent certified public accountant or by an independent public accountant licensed and certified on or before December 31, 1970.
- (4) All agricultural loans will require annual financial statements per §1980.113 of Subpart B of this part.

(p) Agriculture loans. The following additional provisions apply to BIB loan guarantees for businesses engaged in agriculture production:

(1) General policy. This portion of this section contains the regulations for making BIB loans to farmers for agricultural purposes. BIB loans made for agricultural purposes are subject to the provisions in subparts A and E of this part except as specified. In addition, certain sections of Subpart B of this part referenced in this section are applicable subject to the limitations outlined in this section. Several key loan processing and loan servicing requirements stipulated in Subpart B of this part do not apply to loans made to borrowers under this section.

(2) Type of guarantee. BIB loans will be processed under the Loan Note Guarantee option of §1980.101 (e) (1) of Subpart B of this part ONLY. No loan will be processed for a Contract of Guarantee (Line of Credit) under §1980.101 (e) (2) of Subpart B of this part.

(3) Farm size. Loan guarantees may be made under the BIB program without regard to the size of the farming operation.

(4) Filing and processing preapplications and applications. If the applicant has already developed material for an Rural Development Farmer Programs loan or if the financial and production information required by §1980.113 of Subpart B of this part is needed to document repayment ability or is required by the lender, §1980.113 of Subpart B of this part may apply with the following exceptions:

(i) Lines of credit will not be guaranteed.

(ii) If the application is submitted solely for a farm as defined in §1980.106 (b) of Subpart B of this part, Form RD 1980-25, "Farmer Programs Application," or Form RD 449-1, will be used as an application for assistance.

(5) Evaluation of applications. If the application is developed and processed in accordance with §1980.113 of Subpart B of this part, the provisions outlined in §1980.114 of Subpart B of this part apply with the following exceptions:

(i) Timeframe requirements for the evaluation of applications and references to the Approved Lender Program are not applicable.

(ii) County Committee reviews of applications processed under this section will not be required. If the loan approval official finds the applicant is not eligible, the applicant will be notified in writing of the reasons for disapproval and his/her rights through inclusion of the Equal Credit Opportunity Act (ECOA) statement. An opportunity will be given for an appeal as set out in Subpart B of Part 1900 of this chapter.

(iii) When applied to BIB applications, references in §1980.114 of this part to "County Office" shall normally be construed to mean "State Office." References to "County Supervisor" shall be construed to mean "Business and Industry Chief or Community and Business Programs Chief, or other appropriate Rural Development official as designated by the State Director."

(6) Terms of loan repayment.

(i) Principal and interest on the loan will be due and payable to coincide with the cash flow operating cycle of the business. Installments will be scheduled for payment as agreed upon by the lender and borrower on terms that reasonably assure repayment of the loan. The first installment to include a repayment of principal may be scheduled for payment after the project is operational and has begun to generate income. However, such installment will be due and payable within 6 years from the date of the debt instrument and at least annually thereafter. Interest will not be deferred and will be due at least annually from the date of the debt instrument. In granting a deferral of principal payment, the loan approval official must document based on pro forma financial statements and the nature of the crop that the deferral of payments is necessary.

(ii) The lender must ensure that loan repayment is scheduled to eliminate the possibility of a balloon payment at the end of the loan.

(7) Agriculture BIB loan purposes. Loans may be made only for the following purposes:

(i) Operating purposes as outlined in §1980.175 (c) (1) of Subpart B of this part except for those stipulated in paragraphs (c) (1) (iv) and (vii) of that section.

(ii) Real estate purposes as outlined in §1980.180 (c) of Subpart B of this part except for those stipulated in paragraphs (c) (1) and (4) of that section.

RD Instruction 1980-E
§1980.490 (p) (7) (Con.)

(iii) Refinancing in accordance with paragraph (h) (1) of this section and §§1980.411 (a) (11), 1980.451 (i) (19), and 1980.452 ADMINISTRATIVE C [except §1980.452 ADMINISTRATIVE C 1 (d)] of this subpart.

(8) Sodbuster and swampbuster requirements. The requirements found in 7 CFR part 1970 will apply to loans made to enterprises engaged in agricultural production. (Revised 04-01-16, SPECIAL PN.)

§§1980.491 - 1980.494 [Reserved]

§ 1980.495 RD forms and guides.

The following RD forms and guides, as applicable, are used in connection with processing B&I, D&D, and DARBE loan guarantees; they are incorporated in this subpart and made a part hereof: (Revised 10-17-89, SPECIAL PN)

(a) Form RD 449-1, "Application for Loan and Guarantee," is referred to as "Appendix A."

(b) The "Certificate of Incumbency and Signature" is referred to as "Appendix B."

(c) "Guidelines for Loan Guarantees for Alcohol Fuel Production Facilities" is referred to as "Appendix C."

(d) "Alcohol Production Facilities Planning, Performing, Development and Project Control" is referred to as "Appendix D."

(e) "Environmental Assessment Guidelines" is referred to as "Appendix E."

(f) Form RD 449-14, "Conditional Commitment for Guarantee," is referred to as "Appendix F."

(g) "Liquidation and Property Management Guide" is referred to as "Appendix G."

(h) "Suggested Format for the Opinion of the Lender's Legal Counsel" is referred to as "Appendix H."

(i) "Regulations for Loan Guarantees for Drought and Disaster Relief" and Forms RD 1980-68, "Lender's Agreement - Drought and Disaster Guaranteed Loans," 1980-69, "Loan Note Guarantee - Drought and Disaster Guaranteed Loans," and 1980-70, "Assignment Guarantee Agreement - Drought and Disaster Guaranteed Loans" are referred to as "Appendix I." (Added 01-03-89, SPECIAL PN.)

(j) "Business and Industry Application Priority Points Scoring" is referred to as "Appendix J." (Revised 08-30-89, PN 116.)

(k) "Regulations for Loan Guarantees for Disaster Assistance for Rural Business Enterprises" and Forms RD 1980-71, "Lender's Agreement - Disaster Assistance for Rural Business Enterprises Guaranteed Loans," 1980-72 "Loan Note Guarantee - Disaster Assistance for Rural Business Enterprises Guaranteed Loans," and 1980-73 "Assignment Guarantee Agreement - Disaster Assistance for Rural Business Enterprises Guaranteed Loans" are referred to as "Appendix K." (Added 10-17-89, SPECIAL PN.)

§ 1980.496 Exception authority.

The Administrator may in individual cases grant an exception to any requirement or provision of this subpart which is not inconsistent with any applicable law or opinion of the Comptroller General, provided the Administrator determines that application of the requirement or provision would adversely affect the Government's interest. Requests for exceptions must be in writing by the State Director and submitted through the Assistant Administrator, Community and Business Programs. Requests must be supported with documentation to explain the adverse effect on the Government's interest, propose alternative courses of action, and show how the adverse effect will be eliminated or minimized if the exception is granted. All general exceptions being considered by the Administrator will be reviewed by the NOEL Committee to determine consistency with applicable regulations, and the reasons will be documented prior to the granting of a general exception by the Administrator. An Informational Memorandum outlining the reasons for the general exceptions; recommendation of the State Director and the NOEL Committee; and reasons for granting the general exception, if inconsistent with recommendations with recommendations of the State Director and NOEL Committee, will be provided to the Under Secretary and to the Office of the General Counsel (OGC). The Administrator will address any concerns raised by either the Under Secretary or the OGC prior to issuing the exception. If no response is received within 48 hours (2 Business days), the Administrator may issue the exception. (Revised 07-25-01, PN 334)

§ 1980.497 General administrative.

Refer to Appendix G of this subpart (available in any RD Office) for advice on how to interact with the OGC on liquidations and property management.

(a) Office of the General Counsel (OGC). In performing the RBS functions with regard to B&I, D&D, and DARBE loans, the advice and assistance of OGC may be sought and followed on any legal matter. However, it is the responsibility of the lender to ascertain that all requirements for making, securing and servicing the loan are duly met. If RBS has any questions concerning the lender's resolution of these matters, OGC should be consulted. Assistance of OGC will be requested on all loans specified herein and all liquidations and workouts. (Revised 10-17-89, SPECIAL PN)

(b) Contact with OGC. Initial informal contact with OGC should be made as soon as possible. RD State Directors should use the following format in formally requesting legal assistance on workouts.

(1) Origination: All written requests must come from the State Director.

(2) Method: Request should be made by referral memorandum to the Regional Attorney setting forth a brief statement of the facts, the reason assistance is requested, the extent of legal assistance sought, the date when Rural Development's response to the lender's liquidation plan (if any) is due, and:

(i) Projected losses on collateral: e.g., projected losses on collateral are expected to be significant.

(ii) Unusual or complex nature of primary collateral: e.g., multi-state foreclosures or foreclosures of leases or general intangibles.

(iii) Presence of other major creditors or of senior creditors: e.g., guaranteed loan collateral may be subject to a prior lien or other creditors may have rights in other assets of borrower, such as inventory and accounts receivable.

(iv) Litigation: e.g., bankruptcy, other foreclosure suits.

(3) Materials to submit: Referral memorandums will be accompanied by a copy of lender's liquidation plan together with a copy of Rural Development's planned response and principal loan papers, conditional commitment for guarantee, guarantee documents and any comments from the National Office. If lender refuses to prepare a plan, the State Director should so state. DO NOT SEND DOCKETS unless specifically requested by OGC.

(c) Reviews prior to issuance of the loan note guarantee. After the conditional commitment for guarantee has been issued and proposed with closing documents prepared by the lender and forwarded to Rural Development with the lender's legal counsel's opinion in the suggested format of Appendix H of this subpart, but prior to issuing the loan note guarantee, the State Director will forward the loan docket to the

§1980.497 (c) (Con.)

Regional Attorney for review. After an administrative review, the State Director will include with the docket a letter with recommendations and indicating any special items, documents or problems that need to be addressed specifically which may have a significant impact upon the loan or may be contrary to the regulation. The docket will be assembled for OGC review in accordance with §1980.451 Administrative B 5 of this Subpart and indexed and tabbed.

(d) Please submit the following for OGC review. Copies of:

- (1) Letter from Rural Development National Office authorizing loan guarantee containing conditions (if applicable);
- (2) Form RD 449-14, including any amendments;
- (3) Loan Agreement;
- (4) Promissory Notes;
- (5) Security documents - Real Estate Mortgage, Security Agreement, Financing Statements, and Leases (if applicable);
- (6) Personal or corporation guarantees with related security documents;
- (7) Proposed Form RD 449-35.
- (8) Proposed Form RD 449-34.
- (9) Proposed Form RD 449-36, if any;
- (10) Proposed Lender's Certification (§1980.60 of Subpart A of this part); and
- (11) Opinion of Lender's Counsel in form prescribed by OGC.

(e) Do not submit for OGC review feasibility studies, title information, or the original application unless specifically requested to do so.

(f) OGC Advice.

The Regional Attorney will review the docket and furnish advice to Rural Development on whether it may issue the LOAN NOTE GUARANTEE AFTER THE LOAN IS CLOSED. SUCH ADVICE IS FOR THE BENEFIT OF Rural Development ONLY AND DOES NOT RELIEVE THE LENDER OF ITS RESPONSIBILITIES UNDER Rural Development REGULATIONS. The Regional Attorney at his/her option may attend the loan closing.

RD Instruction 1980-E
§1980.497 (f) (Con.)

Upon receipt of the Regional Attorney's advice, the State Director will correct or cause to be corrected any noted deficiencies before issuing the Loan Note Guarantee.

(g) Delegation of authority. The State Director may delegate those administrative duties and responsibilities as authorized in the Administrative sections of this subpart, except those specifically reserved to the State Director.

§1980.498 Business and Industry Disaster Loans. (Added 10-05-92, SPECIAL PN.)

(a) Introduction. This section contains regulations for the Business and Industry Disaster (BID) loan program. The purpose of the program is to provide loan guarantees under the authority of the Dire Emergency Supplemental Appropriations Act, 1992, Public Law 102-368. These guaranteed loans cover costs arising from the consequences of natural disasters such as Hurricanes Andrew and Iniki and Typhoon Omar that occur after August 23, 1992, and receive a Presidential declaration. Also included are the costs to any producer of crops and livestock that are a consequence of at least a 40 percent loss to a crop, 25 percent loss to livestock, or damage to building structures from a microburst wind occurrence in calendar year 1992. No BID loan guarantee will be approved after September 30, 1993. All provisions of Subparts A and E of Part 1980 of this chapter apply to BID loans, except as provided in this section. All forms used in connection with a BID loan will be those used with other Business and Industry (B&I) loans, except as provided in paragraph (m) of this section. (Revised 08-03-93, SPECIAL PN.)

(b) Location of applicants.

(1) Section 1980.405 of this subpart, "Rural area determinations," will not apply to BID loans. BID loans may be made in rural and nonrural areas.

(2) Eligible borrowers' businesses must be located within the area covered by the Presidential declaration except for those with qualifying losses from microburst wind in accordance with paragraph (a) of this section.

(c) Loan purposes. Loans may be guaranteed for the purposes listed in §1980.411 of this subpart, "Loan purposes," except as follows:

(1) Relationship to disaster. The purpose of any BID loan must be to cover costs that are a direct consequence of a natural disaster or microburst of wind in accordance with paragraph (a) of this section. The amount of the loan must not be greater than the amount needed as determined by the Rural Development Administration (RDA) to cure problems caused

§1980.498 (c) (1) (Con.)

by the natural disaster so that the business is reestablished on a successful basis. Facilities which were damaged or destroyed by the natural disaster may be repaired or replaced by modern facilities as necessary to ensure success. Replacement by modern facilities will not be made solely for the purpose of enlarging the business or increasing its production capacity. No loan for a change of purpose of the business will be guaranteed. Eligible refinancing or working capital loans should not exceed the amount needed to overcome the financial distress caused by the disaster. Losses that were adequately paid by insurance or by loans or grants from other sources will not be covered by BID loans. BID loans may be used to supplement insurance payments and/or assistance from other sources when the insurance coverage or other assistance is not sufficient.

(2) Refinancing. Section 1980.452 ADMINISTRATIVE C 1 (d) of this subpart does not apply to BID loans. If refinancing is needed as a direct consequence of the disaster, the lender may be allowed to bring previously unguaranteed exposure under the guarantee. No loan will be refinanced unless the current market value of the collateral is at least equal to the amount of the loan to be refinanced plus any new loan amount.

(3) Agriculture. Section 1980.412 (e) of this subpart does not apply to BID loans. BID loans may be guaranteed for agriculture production, which means the cultivation, production (growing), and harvesting, either directly or through integrated operations, of agricultural products (crops, animals, birds, and marine life, either for fiber or food for human consumption), and disposal or marketing thereof, the raising, housing, feeding (including commercial custom feedlots), breeding, hatching, control and/or management of farm or domestic animals.

(4) Other eligible businesses. Eligible types of businesses also include:

(i) Commercial nurseries primarily engaged in the production of ornamental plants and trees and other nursery products such as bulbs, florists' greens, flowers, shrubbery, flower and vegetable seeds, sod, and the growing of vegetables from seed to the transplant stage.

(ii) Forestry which includes establishments primarily engaged in the operation of timber tracts, tree farms, forest nurseries, and related activities such as reforestation.

(iii) The growing of mushrooms or hydroponics.

- (5) Recreation and tourism. Loans may be guaranteed for tourist or recreation facilities except for hotels, motels, bed and breakfasts, race tracks, gambling, or golf courses.
- (6) Meat processing facilities. The provisions of §1980.411 (a) (8) of this subpart will not apply to BID loans. Loans, including working capital or debt refinancing, may be guaranteed for businesses engaged in meat or poultry processing.
- (d) Federal Emergency Management Agency (FEMA). BID loans may be approved only to the extent that the assistance is not available from FEMA. The case file will be documented to show that FEMA assistance was not available or that FEMA assistance is not adequate to cover the costs as a consequence of the natural disaster.
- (e) Small Business Administration. Section 1980.451 of this subpart will not apply to BID loans. Applicants eligible for Small Business Administration assistance will be advised of the availability of that assistance.
- (f) Loan guarantee limits. Notwithstanding the provisions of §1980.420 of this subpart, the guarantee percentage on any BID loan will not exceed 80 percent.
- (g) Credit quality analysis. In analyzing the credit quality of a proposed loan to a business that has lost assets to a natural disaster, primary emphasis will be placed on the operating history of the business, rather than its current financial condition. If the business has a sound, profitable and successful history prior to the disaster and there are reasonable projections to ensure it can operate successfully in the future, the proposed loan may be approved even if disaster losses have caused somewhat less equity and/or collateral than would normally be expected for a B&I guarantee. If the business appears to have had an unprofitable operation or inadequate cash flow prior to the disaster, the proposed loan guarantee will not be approved.
- (h) Equity requirements. The equity requirements of §1980.441 of this subpart do not apply to BID loans.
- (i) Feasibility studies. Feasibility studies as required by §1980.442 of this subpart will not be required for BID loans if the business has a successful financial history that supports future plans and projections that indicate a successful operation with adequate repayment ability.

(j) Collateral. Section 1980.443 ADMINISTRATIVE A 2, 3, and 4 of this subpart will not apply to BID loans. Collateral may be considered at its current market value without discount. Work-in-process inventory may be valued at the estimated market value of the finished product. All costs of producing the finished product must be included in the cash flow analysis.

(k) Conditional approval. A Form RD 449-14, "Conditional Commitment for Guarantee," may be issued prior to receipt of specific items needed to complete an application package provided:

- (1) The lender and/or borrower demonstrates to the Government's satisfaction that it has a need for a prompt indication of the availability of the proposed loan guarantee and the conditions under which a guarantee are available;
- (2) The specific items missing from the application package will take considerable time to obtain;
- (3) The lender requests a commitment prior to providing the items;
- (4) The attachment to Form RD 449-14 clearly states that the commitment is conditioned on satisfactory completion of the missing item(s) and a guarantee will not be issued unless all conditions of these regulations are met; and
- (5) No Form RD 449-14 will be issued prior to the obligation date established with the Finance Office.

(l) Financial statements. All requirements of §1980.451 (i)(13) of this subpart will apply except that it is modified for BID loans to require minimum annual financial statements as follows:

- (1) For nonagricultural borrowers with a B&I indebtedness of \$500,000 or less, an annual compilation by an independent certified public accountant or by an independent public accountant licensed and certified on or before December 31, 1970.
- (2) For nonagricultural borrowers with a B&I indebtedness of \$500,001 through \$1,000,000, an annual review by an independent certified public accountant or by an independent public accountant licensed and certified on or before December 31, 1970.

(3) For nonagricultural borrowers with a B&I indebtedness of more than \$1 million, an annual audited financial statement by an independent certified public accountant or by an independent public accountant licensed and certified on or before December 31, 1970.

(4) All agricultural loans will require annual financial statements per §1980.113 of Subpart B of Part 1980 of this chapter. (Revised 07-26-93, SPECIAL PN.)

(m) Agriculture loans. The following additional provisions apply to BID loan guarantees for businesses engaged in agriculture production:

(1) General policy. This portion of this section contains the regulations for making BID loans to farmers for agricultural purposes. BID loans made for agricultural purposes are subject to the provisions in Subparts A and E of Part 1980 of this chapter except as specified. In addition, certain sections of Subpart B of Part 1980 of this chapter referenced in this section are applicable subject to the limitations outlined in this section. BID loans made for agricultural purposes are made under the Business and Industry authority of Section 310B of the Consolidated Farm and Rural Development Act of 1972, as amended. In this regard, several key loan processing and loan servicing requirements stipulated in Subpart B of Part 1980 of this chapter do not apply to loans made to borrowers under this section. Only the material cross_referenced to Subpart B of Part 1980 of this chapter is to be utilized in lieu of or in addition to the requirements contained in Subpart E of Part 1980 of this chapter in processing loans under this section.

(2) Type of guarantee. See §1980.101 (e)(1) of Subpart B of Part 1980 of this chapter. BID loans will be processed under the Loan Note Guarantee option ONLY. No loan will be processed for a Contract of Guarantee (Line of Credit) under this section.

(3) Abbreviations and definitions.

(i) The abbreviations and definitions found in §1980.106 of Subpart B of Part 1980 of this chapter will apply to loans made under this section except for "family farm," "related by blood or marriage," and "subsequent loans." (Revised 09-30-93, SPECIAL PN.)

(ii) Loan guarantees may be made under the BID program without regard to the size of the farming operation.

(4) Loan eligibility requirements. In addition to the requirements set forth in this subpart, the requirements in §1980.175 (b) of Subpart B of Part 1980 of this chapter regarding controlled substances are applicable.

(5) Filing and processing preapplications and applications. If the applicant has already developed material for an Rural Development Farmer Programs loan or if the financial and production information required by §1980.113 of Subpart B of Part 1980 of this chapter is needed to document repayment ability or is required by the lender, §1980.113 of Subpart B of Part 1980 of this chapter may apply with the following exceptions: (Revised 07-21-93, SPECIAL PN.)

(i) Lines of credit will not be guaranteed.

(ii) Timeframes for applicant/lender notification in §1980.113 of Subpart B of Part 1980 of this chapter do not apply.

(iii) If the application is submitted solely for a farm as defined in §1980.106 (b) of Subpart B of Part 1980 of this chapter, Form RD 410-1, "Application for Rural Development Services," or Form RD 449-1, "Application for Loan and Guarantee," will be used as an application for assistance. (Revised 09-30-93, SPECIAL PN.)

(6) Evaluation of applications. If the application is developed and processed in accordance with §1980.113 of Subpart B of Part 1980 of this chapter, the provisions outlined in §1980.114 of Subpart B of Part 1980 of this chapter applies with the following exceptions: (Revised 07-21-93, SPECIAL PN.)

(i) Timeframe requirements for the evaluation of applications and references to the Approved Lender Program are not applicable.

(ii) County Committee reviews of applications processed under this section will not be required. If the loan approval official finds the applicant is not eligible, the applicant will be notified in writing of the reasons for disapproval and the opportunity given for an appeal as set out in Subpart B of Part 1900 of this chapter.

(7) Terms of loan repayment.

(i) Principal and interest on the loan will be due and payable to coincide with the cash flow operating cycle of the business. Installments will be scheduled for payment as agreed upon by the lender and borrower on terms that reasonably assure repayment of the loan. The first installment to include a repayment of principal may be scheduled for payment after the project is operable and has begun to generate income. However, such installment will be due and payable within 6 years from the date of the debt instrument and at least annually thereafter. All accrued interest will be due at least annually from the date of the debt instrument. In no case will interest be deferred. In granting a deferral of principal payment, the loan approval official must document based on pro forma financial statements and the nature of the crop that the deferral of payments is necessary.

(ii) The lender must ensure that loan repayment is scheduled to eliminate the possibility of a balloon payment at the end of the loan.

(8) BID agriculture loan purposes. Loans may be made only for the following purposes: (Revised 07-21-93, SPECIAL PN.)

(i) Operating purposes as outlined in §1980.175 (c) (1) of Subpart B of Part 1980 of this chapter except for those stipulated in paragraphs (c) (1) (iv) and (vii) of that section.

(ii) Real estate purposes as outlined in §1980.180 (c) of Subpart B of Part 1980 of this chapter except for those stipulated in paragraphs (c) (1) and (4) of that section.

(iii) Refinancing in accordance with paragraphs (c) (1) and (c) (2) of this section and §§1980.411 (a) (11), 1980.451 (i) (19), and 1980.452 ADMINISTRATIVE C [except §1980.452 ADMINISTRATIVE C 1 (d)] of this subpart. (Added 07-21-93, SPECIAL PN.)

(9) Sodbuster and swampbuster requirements. The requirements found in 7 CFR part 1970 will apply to loans made to enterprises engaged in agricultural production. (Revised 04-01-16, SPECIAL PN.)

§1980.499 [Reserved]

§1980.500 OMB control number.

The collection of information requirements contained in this rule have been approved by the Office of Management and Budget and have been assigned OMB control number 0575-0029.

Attachments: Appendices C, D, E, G, H, I, J, and K.

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GUIDELINES FOR LOAN GUARANTEES FOR ALCOHOL FUEL PRODUCTION FACILITIES

(1) Alcohol production facility. An alcohol production facility is a facility in which alcohol, suitable for use by itself or in combination with ether substances as a substitute for petroleum or petrochemical feedstocks and not suitable for beverage purposes, is manufactured from biomass.

(2) The alcohol production facility includes all facilities necessary for the production and storage of alcohol and the processing of the by-products of alcohol production. The intent is to limit the alcohol and by-products processing facilities to those facilities which are necessary to yield marketable products and necessary for the financial success of the project. Further refinements, such as gasoline blending or the construction of facilities which use the alcohol or by-products in another manufacturing process, are not considered part of the alcohol production facility.

(3) Application will be reviewed by both B&I personnel and the State Office engineer and forwarded to the National Office if approval is recommended.

(4) The applicant should have a startup tangible book equity of 20-25 percent. Appraisal surplus and subordinated debt are not eligible equity items.

(5) Loan maturity maximums will be as follows:

Real estate = 15 - 20 years

Machinery & Equipment = 10 years or less depending on the estimated life of the equipment involved

Working capital = 3 years (It is assumed that the additional equity required for these projects will provide much of the working capital needs.)

(6) Farmers Home Administration will ordinarily only finance new facilities and will not get involved in the refinancing of existing ones.

(7) Priority consideration will be given to the use of the primary fuel other than petroleum or natural gas.

(8) A positive energy balance must be indicated and supported by appropriate data; i.e., the energy content of the alcohol produced at the alcohol production facility must be greater than the energy used to produce the alcohol and by-products.

(9) Plant location, in relation to feedstocks, primary fuel and markets for products and by-products, will be an important consideration.

(10) Debt refinancing will only be considered in modest amounts and only when necessary to provide a satisfactory lien position.

(11) Feasibility studies are very important and required and will be prepared by competent and knowledgeable independent parties.

(12) Participating lenders must either have expertise or the availability of expertise in this field.

(13) The proposed operating managers must have experience in this or a related field.

(14) Alcohol Fuel Production Facilities are eligible for assistance under the Drought and Disaster (D&D) Guaranteed Loan and Disaster Assistance for Rural Business Enterprises (DARBE) programs described in this subpart, and especially in Appendix I and Appendix K. Any such loan must meet the requirements for D&D and DARBE loans.

ALCOHOL PRODUCTION FACILITIES

PLANNING, PERFORMING DEVELOPMENT AND PROJECT CONTROL

- (I) Design Policy. The borrower shall ensure or cause to be ensured that:
- (A). All project facilities are designed utilizing accepted engineering practices and are conformed to applicable Federal, State and local codes and requirements.
 - (B). Proven equipment and processes are employed in all project facilities unless an exception is granted by the Administrator or designee of the Farmers Home Administration (Rural Development) ("Administrator") in accordance with paragraph (B) (2) hereof and pilot equipment or processes are used instead.
 - (1). Equipment and processes shall be considered "proven" if they have been successfully employed in other commercial facilities.
 - (2). Equipment and processes shall be considered pilot if they have not been used in a commercial operation but have been operated on a scale such that all design and material problems have been identified and resolved and operations maintained to demonstrate that the equipment and process may be successfully applied to the proposed commercial operation. Pilot equipment and processes may be considered for use in the project subject to the following:
 - (a). The plans, specifications, and operational data for the applicable facilities are reviewed by the Administrator or designee and lender. If, in the opinion of Rural Development, the proposed processes or equipment are insufficiently developed to assure reliable and successful operation of the project, proven processes and equipment will be utilized.
 - (b). If pilot processes or equipment are used, the Administrator or designee will also require that:
 - (i) Reasonable provision is made in the project for conversion to proven equipment or processes; and
 - (ii) The borrower agrees to convert to proven equipment or processes if conversion is necessary to protect the interest of the Government in the project. A reserve account for this conversion may be required. This account will not be an eligible loan purpose.
 - (C). Facility and equipment design incorporates cost-effective primary fuel systems, energy recovery systems and conservation measures to the maximum extent that this is feasible and consistent with paragraphs (I) (A) and (B) of this Appendix.

(II) Technical Services

- (A). The borrower is responsible for selecting engineering consultants with suitable experience, training and professional competence in the design and construction of the project to assure that the completed project will operate at the prescribed levels of performance. In discharging its responsibility the borrower will obtain or cause to be obtained:
- (1). Full engineering services for design and construction inspection for all project facilities. Resident inspection by qualified persons will be required.
 - (2). Agreements for engineering or design/build services which describe the project facilities in terms of the parameters critical to the successful operation of the project. The parameters shall include input quantities, conversion efficiency, rate of production and fuel consumption and product quality under normal operating conditions. The design parameters will be mutually agreed upon by the borrower, lender, the State Director and the project engineer, and may not be modified without the written concurrence of each of these parties. These agreements for engineering or design/build services will require, or the borrower will otherwise obtain, assurance satisfactory to the State Director that:
 - (a) The project engineer will maintain adequate insurance to protect the borrower, lender and the Government from incurring expenses resulting from errors and omissions of the engineer in performance of engineering services.
 - (b) The project engineer will certify that only proven equipment and processes will be utilized in the proposed development. The State Director may request evidence of successful operations of such proven equipment and process. If proven equipment or processes are not used in the project, the project engineer will identify these items and provide the information necessary for acceptance by the Administrator, borrower and lender in accordance with paragraph (I) (B) (2) of this Appendix.
 - (c) If used equipment or existing facilities are incorporated into the project, they must be inspected by the project engineer or by another qualified engineer of the borrower. This engineer will prepare a report describing the proposed facilities or equipment and will comment on their suitability for use in the project. The report will also identify the modifications necessary for successful integration into the project. A cost estimate will also be included comparing new equipment and facilities to the proposed existing facilities or used equipment. Consideration

must be given to the relative energy requirements of used and new facilities and their relative operation and maintenance costs.

- (d) The project engineer or qualified individuals representing the manufacturer of principal equipment (or the designer/builder if the contractor has designed the plant) will visit the plant site at reasonable intervals for a period of one year after substantial completion of the project. Such personnel will be experienced in the proper operation and maintenance of applicable plant components. A report will be presented to the borrower within two weeks of each site visit advising the borrower of operation and maintenance deficiencies. A copy of each report will be forwarded to the State Director and lender by the borrower.
- (e) The project engineer will prepare or supervise the preparation of a record drawing of all facilities. One copy will be submitted to the lender and the borrower.
- (f) The project engineer or another group acceptable to the State Director and lender will prepare an operation and maintenance manual and assist the borrower in the startup of the project. The operation and maintenance manual will describe the specific operation and maintenance procedures which must be performed for the project to operate at its rated capacity and efficiency and outline product testing, quality control, plant safety and emergency shut-down procedures.
- (g) The project engineer will assist the borrower in determining acceptability of materials, equipment and construction during the construction period, review shop drawings, payment estimates and change orders, and assist in determining substantial completion of the project and final completion of individual contracts.
 - (1) The project is substantially complete when:
 - (i) Construction is sufficiently completed in accordance with plans and specifications so that the project may be used for its intended purpose, and;
 - (ii) The project is producing products of the quantity and quality and at the conversion and energy efficiencies proposed in the completed application submitted by the lender and borrower and approved by the Rural Development.

- (2) The State Director must concur that the project is substantially complete. The following evidence, in form and substance satisfactory to the State Director and lender, must be submitted prior to such concurrence:
 - (i) A certificate from the project engineer stating that all facilities are substantially complete. Engineers who design specialized equipment or processes must also certify that construction/ fabrication is acceptable in accordance with plans and specifications previously approved by them. The certification of the project engineer must be based upon a project startup procedure where the complete project operates continuously to reach steady-state operating conditions. During this period contractors and engineers will identify and correct problems in operations, malfunctions in equipment, failure in materials and defects in workmanship. After this pre-startup, the certifying engineers will monitor project operations for a continuous period of at least 72 hours or 3 consecutive batch runs as appropriate to assure that all equipment is operating satisfactorily at rated capacity and efficiency.
 - (ii) Copies of system operation and performance data obtained during project start-up.
 - (iii) Exceptions to substantial completion and a list of nonsubstantial items which must be completed prior to release of any contractor's retainage.
- (3) If the project is not producing products of the required quantity or quality at the prescribed conversion efficiencies, even though the project is otherwise physically complete in accordance with paragraph (1) (i) of this subparagraph, the project engineer will prepare a report identifying the corrective actions including an estimate of costs and additional time necessary to meet established performance criteria.
- (4) The project must be certified to be substantially complete by an independent engineer if any portion of the project has been designed or constructed by the borrower or the project engineer has participated in any portion of the construction.

- (B) Modification of plans and specifications will not be made without the written authorization of the project engineer.
- (C) The Administrator, State Director or their representative's acceptance or concurrence in feasibility studies, preliminary engineering reports, plans, specifications, contract documents and payment estimates will not be construed as a representation of the adequacy of same, reliability of cost estimates or quality of construction, nor will such acceptance or concurrence be deemed a waiver of any of the Government's rights or remedies against any person or party. Reviews and construction inspections by the Administrator, State Director or their representatives are solely for the benefit of the Government and do not relieve the lender or borrower of their obligation to conduct project reviews and inspections.

(III) Project Construction

- (A) Borrower will not award contracts for the construction of any project facilities unless and until:
 - (1) The borrower obtains applicable construction permits, right-of-ways, licenses and approvals of Federal, State and local authorities for the construction of such facilities.
 - (2) The State Director concurs in applicable plans, specifications and contract documents. Standard contract documents prescribed for use in Federally assisted projects may be used as a guide for determining the minimum standards for contract acceptability. These standard documents are contained in Guide 18 and 19 of Subpart A of Part 1942 of this Chapter (available in any Rural Development office).
- (B) The borrower has the responsibility, without recourse to the Government, for the settlement and satisfaction of all contractual and administrative issues arising out of procurements. This includes, but is not limited to, disputes, claims, protests of awards, or other matters of a contractual nature. Matters concerning violation of laws are to be referred to such local, State, or Federal authority as may have proper jurisdiction.
- (C) The borrower's attorney will review executed contract documents including applicable performance and payment bonds and provide a certificate to the borrower and lender that they have been properly executed and that the persons executing these documents have been properly authorized to do so.

(D) In all contracts for construction or facility improvement awarded in excess of \$100,000, the borrower will require bonds and a bank letter of credit or cash deposit in escrow, assuring performance and payment of 100 percent of the contract cost. The surety will normally be in the form of performance and payment bonds. Such assurance shall remain in full force and effect through any warranty period. Companies providing performance and payment bonds must hold a certificate of authority as an acceptable security on Federal bonds and eligible for listing in Treasury circular 510 as amended and be legally doing business in the state the project is located.

(E) Project Changes

Any change in the project which may affect collateral, its ultimate financial viability or compliance with the conditional commitment must have prior approval of the lender and Rural Development.

(1) Construction contracts will require that change orders receive prior approval from the lender when such changes:

- (a) increase or decrease contract price
- (b) materially modify contract provisions
- (c) increase or decrease time of completion
- (d) affect project performance

(2) All change orders will be recorded on a chronologically numbered contract change order as they occur. Change orders will not be included in payment estimates until approved by the borrower, project engineer, the lender and concurred in by Rural Development.

(F) Warranty

(1) All major equipment must be guaranteed by the manufacturer to be free from defects in workmanship and materials for a period of one year after start-up of equipment.

(2) Equipment purchased by a construction contractor or design builder and all other work shall be further warranted to be free from defect in material and workmanship by the contractor or the design builder for a period of one year after substantial completion of the contract.

(3) Applicable provisions to this effect shall be included in equipment purchase orders or construction contracts.

(G) Lease Agreements

Where the right of use or control of any property or equipment not owned by the borrower is essential to the successful operation of the project during the life of the loan, such right will be evidenced by written agreements or contracts between the owner(s) of the property or equipment and the borrower. Lease agreements shall not contain provisions for restricted use of the site or facility, forfeiture or similar cancellation clauses and shall provide for the right to transfer and lease without restriction. Such lease contracts or agreements shall be approved by the lender and Rural Development.

(IV) Project Control

- (A) Lender will adopt project control procedures to assure that loan funds are applied for costs or expenses properly attributable to the project ("Eligible Project Costs") as proposed in the completed application submitted by the lender and borrower and approved by the Rural Development. A project monitoring account ("Project Monitoring Account") will be developed by lender for this purpose and concurred in by the State Director. This account will be divided into sufficient budget categories to permit adequate control of expenditures and identification of potential budget overruns.
- (B) The first advance ("First Advance") of loan funds to the borrower will not commence from the Project Monitoring Account prior to lender's receipt of evidence that:
- (1) The borrower has made adequate provisions for compliance with measures established by Rural Development to mitigate adverse historical and environmental impacts.
 - (2) Applicable engineering, design/build, construction management, inspection and plant start-up service agreements have been obtained and accepted by the State Director and lender.
 - (3) The project engineer has prepared a detailed cost estimate and construction schedule for all facilities related to the project. This estimate must indicate that the project can be completed with the funds available as shown on the Form RD 449-1, "Application for Loan and Guarantee." A reasonable contingency amount will be included in the estimate. This contingency shall be at least 20 percent of the estimated project costs for which firm bids have

not been received plus 5 percent of project costs for which firm bids have been received. Construction interest and inspection costs will be based upon a reasonable contingency for unforeseen delays in project completion. The estimate shall include a listing with associated costs of any proposed leasing arrangements for property or equipment that is essential to the successful operation of the project.
(Revised 6-27-84 PN 934.)

- (4) All funds necessary for construction of project facilities will be available when needed.
 - (5) The borrower has retained a project manager with sufficient experience and training to supervise project construction and engineering services on behalf of the borrower..
- (C) After the first advance, future advances may be made from the Project Monitoring Account, in accordance with prudent lender practice, for all Eligible Project Costs established in the Project Monitoring Account, provided these payments are made in accordance with the terms of applicable contracts and are approved by the borrower and, when applicable, recommended by the project engineer.
- (D) Payments for Eligible Project Costs incurred by the borrower prior to satisfaction of the conditions precedent to the first advance shall be made with borrower's funds or other nonguaranteed loan funds only. These payments, however, may be reimbursed through the Project Monitoring Account as authorized by the State Director after compliance with Paragraph (IV) (B) hereof. The lender will not advance and the borrower will not be entitled to loan funds for reimbursement if such costs or expenses incurred by the borrower prior to the first advance, or at anytime thereafter, were for costs or expenses other than Eligible Project Costs. Costs and expenses accruing from but not limited to, interest charges imposed by construction, equipment, material or service contracts, penalty payments, damage claims, awards or settlements are not Eligible Project Costs unless specifically approved by the State Director.
- (E) The lender will monitor the progress of construction and undertake the reviews and project inspections necessary to reasonably assure that funds are paid for Eligible Project Costs and that problems in project development are expeditiously reported to the State Director.

- (F) The lender will prepare a monthly report showing the expenditures made from each budget category of the Project Monitoring Account. This report will include a review of construction progress including proposed and approved contract change orders and, to the extent possible, identify problems or delays in construction or other matters which might affect successful startup of project. This report may be based upon information received from the project engineer and borrower and/or independent observations of the lender. The report will be initialed by the borrower and project engineer and submitted to the State Director.

- (G) Transfer of loan funds between established or new categories of the Project Monitoring Account or any change in the total amount of funds committed to the project will be reported by the lender to the State Director as these changes occur.

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ENVIRONMENTAL ASSESSMENT GUIDELINES

In completing an assessment, it is important to understand the comprehensive nature of the impacts which must be analyzed. Consideration must be given to all potential impacts associated with the construction of the project and its operation and maintenance. The attainment of the project's major objectives often induces or supports changes in population densities, land uses, community services, transportation systems and resource consumption. The impacts of these activities must also be assessed.

The environmental reviewer should consult with appropriate experts from Federal, State and local agencies, universities and other organizations or groups whose views could be helpful in the assessment of potential impacts. In so doing, each discussion which is utilized in reaching a conclusion with respect to the degree of an impact should be summarized in the assessment as accurately as possible and include the name, title, phone number, and organization of the individual contacted, plus the date of contact. Related correspondence should be attached to the assessment.

The Farmers Home Administration assessment should be prepared in the following format; it should address the listed items and questions and contain as attachments the indicated descriptive materials, as well as the environmental information submitted by the applicant.

These assessment guidelines have been designed to cover the wide variety of impacts which may be encountered. Consequently, not every issue or potential impact raised in these guidelines may be relevant to each project. The purpose of the format is to give the preparer an understanding of a standard range of impacts, environmental factors and issues which may be encountered. In preparing an assessment, each topic heading identified by a roman numeral and each environmental factor listed under topic heading IV, such as air quality for example, must be addressed.

The amount of analysis and material that must be provided will depend upon the type and size of the project, the environment in which it is located and the range and complexity of the potential impacts. The amount of analysis and detail provided, therefore, must be commensurate with the magnitude of the expected impact. The analysis of each environmental factor (i.e., water quality) must be taken to the point that a conclusion can be reached and supported concerning the degree of the expected impact with respect to that factor.

(I) Project Description and Need

Identify the name, project number, location, and specific elements of the project along with their sizes, and, when applicable, their design capacities. Indicate the purpose of the project, Rural Development's position regarding the need for it, and the extent or area of land to be considered as the project site.

(II) Primary Beneficiaries and Related Activities

Identify any existing businesses or major developments that will benefit from the project and those which will expand or locate in the area because of the project. Specify by name, product, service, and operations involved.

Identify any related activities which are defined as interdependent parts of an Rural Development action. Such undertakings are considered interdependent parts whenever they either make possible or support the Rural Development action or are themselves induced or supported by the Rural Development action or another related activity. These activities may have been completed in the very recent past and are now operational or they may reasonably be expected to be accomplished in the near future. Related activities may or may not be Federally permitted or assisted. When they are, identify the involved Federal agency(s).

In completing the remainder of the assessment, it must be remembered that the impacts to be addressed are those which stem from the project, the primary beneficiaries, and the related activities.

(III) Description of Project Area

Describe the project site and its present use. Describe the surrounding land uses; indicate the directions and distances involved. The extent of the surrounding land to be considered depends on the extent of the impacts of the project, its related activities, and the primary beneficiaries. Unique or sensitive areas must be pointed out. These include residential, schools, hospitals, recreational, historical sites, beaches, lakes, rivers, parks, floodplains, wetlands, dunes, estuaries, barrier islands, natural landmarks, unstable soils, steep slopes, aquifer recharge areas, important farmlands and forestlands, prime rangelands, endangered species habitats, or other delicate or rare ecosystems.

Attach adequate location maps of the project area, as well as (1) a U.S. Geological Survey "15 minute" ("7 1/2 minute" if available) topographic map which clearly delineates the area and the location of the project elements, (2) the Department of Housing and Urban Development's floodplain map(s) for the project area, (3) site photos, (4) if completed, a standard soil survey for the project and, (5) if available, an aerial photograph of the site. When necessary for descriptive purposes or environmental analysis, include land use maps or other graphic information. All graphic materials shall be of high quality resolution.

(IV) Environmental Impact

(1) Air Quality - Discuss, in terms of the amounts and types of emissions to be produced, all aspects of the project including beneficiaries' operations and known indirect effects (such as increased motor vehicle traffic) which will affect air quality. Indicate the existing air quality in the area. Indicate if topographical or meteorological conditions hinder or affect the

dispersals of air emissions. Evaluate the impact on air quality given the types and amounts of projected emissions, the existing air quality, and topographical and meteorological conditions. Discuss the project's consistency with the State's air quality implementation plan for the area, the classification of the air quality control region within which the project is located, and the status of compliance with air quality standards within that region. Cite any contacts with appropriate experts and agencies which must issue necessary permits.

(2) Water Quality - Discuss, in terms of amounts and types of effluents all aspects of the project, including primary beneficiaries' operations and known indirect effects which will affect water quality. Indicate the existing water quality of surface and/or underground water to be affected. Evaluate the impacts of the project on this existing water quality. Indicate if an aquifer recharge area is to be adversely affected. If the project lies within or will affect a sole source aquifer recharge area as designated by the Environmental Protection Agency (EPA), contact the appropriate EPA regional office to determine if its review is necessary. If it is, attach the results of its review.

Indicate the source and available supply of raw water and the extent to which the additional demand will affect the raw water supply. Describe the wastewater treatment system(s) to be used and indicate their capacity and their adequacy in terms of the degree of treatment provided. Discuss the characteristics and uses of the receiving waters for any sources of discharge. If the treatment systems are or will be inadequate or overloaded, describe the steps being taken for necessary improvements and their completion dates. Compare such dates to the completion date of the Rural Development project. Analyze the impacts on the receiving water during any estimated period of inadequate treatment.

Discuss the project's consistency with the water quality planning for the area, such as EPA's Section 208 areawide waste treatment management plan. Describe how surface runoff is to be handled and the effect of erosion on streams.

Evaluate the extent to which the project may create shortages for or otherwise adversely affect the withdrawal capabilities of other present users of the raw water supply, particularly in terms of possible human health, safety, or welfare problems.

For projects utilizing a groundwater supply, evaluate the potential for the project to exceed the safe pumping rate for the aquifer to the extent that it would (1) adversely affect the pumping capability of present users, (2) increase the likelihood of brackish or saltwater intrusion, thereby decreasing water quality, or (3) substantially increase surface subsidence risks.

For projects utilizing a surface water supply, evaluate the potential for the project to (1) reduce flows below the minimum required for the protection of fish and wildlife or (2) reduce water quality standards below those established for the stream classification at the point of withdrawal or the adjacent downstream section.

Cite contacts with appropriate experts and agencies that must issue necessary permits.

(3) Solid Waste Management - Indicate all aspects of the project, including primary beneficiaries' operations, and known indirect effects which will necessitate the disposal of solid wastes. Indicate the kinds and expected quantities of solid wastes involved and the disposal techniques to be used. Evaluate the adequacy of these techniques especially in relationship to air and water quality. Indicate if recycling or resource recovery programs are or will be used. Cite any contacts with appropriate experts and agencies that must issue necessary permits.

(4) Land Use - Given the description of land uses as previously indicated, evaluate (a) the effect of changing the land use of the project site and (b) how this change in land use will affect the surrounding land uses and those within the project's area of environmental impact. Particularly address the potential impacts to the unique or sensitive areas discussed under Section III, Description of Project Area. Also address any changes in land use which may result from demand for feedstock for the plant's operation. Describe the existing land use plan and zoning restrictions for the project area. Evaluate the consistency of the project and its impacts with these plans.

(5) Transportation - Describe available facilities such as highways and rail. Discuss whether the project will result in an increase in motor vehicle traffic and the existing roads' ability to safely accommodate this increase. Indicate if additional traffic control devices are to be installed. Describe new traffic patterns which will arise because of the project. Discuss how these new traffic patterns will affect the land uses described above, especially residential, hospitals, schools, and recreational. Describe the consistency of the project's transportation impacts with the transportation plans for the area and any air quality control plans. Cite any contact with appropriate experts.

(6) Natural Environment - Indicate all aspects of the project, including construction, beneficiaries' operations, and known indirect effects which will affect the natural environment including wildlife, their habitats, and unique natural features. Cite contacts with appropriate experts. If an area listed on the National Registry of Natural Landmarks may be affected, consult with the Department of Interior and document these consultations and any agreements reached regarding avoidance or mitigation of potential adverse impacts.

(7) Human Population - Indicate the number of people to be relocated and arrangements being made for this relocation. Discuss how impacts resulting from the project such as changes in land use, transportation changes, air emissions, noise, odor, etc., will affect nearby residents and their lifestyles or users of the project area and surrounding areas. Cite contacts with appropriate experts.

(8) Construction - Indicate the potential effects of construction of the project on air quality, water quality, noise levels, solid waste disposal, soil erosion and siltation. Describe the measures that will be employed to limit adverse effects. Give particular consideration to erosion, stream siltation, and clearing operations.

(9) Energy Impacts - Indicate the project's and its primary beneficiaries' effects on the area's existing energy supplies. This discussion should address not only the direct energy utilization, but any major indirect utilization resulting from the siting of the project. Describe the availability of these supplies to the project site. Discuss whether the project will utilize a large share of the remaining capacity of an energy supply or will create a shortage of such supply. Discuss any steps to be taken to conserve energy.

(10) Discuss any of the following areas which may be relevant: noise, vibrations, safety, seismic conditions, fire prone locations, radiation, and aesthetic considerations. Cite any discussions with appropriate experts.

(V) Coastal Zone Management Act

Indicate if the project is within or will impact a coastal area defined as such by the state's approved Coastal Zone Management Program. If so, consult with the State agency responsible for the Program to determine the project's consistency with it. The results of this coordination shall be included in the assessment and considered in completing the environmental impact determination and environmental findings.

(VI) Compliance with Advisory Council on Historic Preservation's Regulations

In this section, the environmental reviewer shall detail the steps taken to comply with the above regulations as specified in Subpart F of Part 1901 of this Chapter. First, indicate that the National Register of Historic Places, including its monthly supplements, has been reviewed and whether there are any listed properties located within the area to be affected by the project. Second, indicate the steps taken such as historical/archaeological surveys to determine if there are any properties eligible for listing located within the affected area. Summarize the results of the consultation with the State Historic Preservation Officer (SHPO) and attach appropriate documentation of the SHPO's views. Discuss the views of any other experts contacted. Based upon the above review process and the views of the SHPO, state whether or not an eligible or listed property will be affected.

If there will be an effect, discuss all of the steps and protective measures taken to complete the Advisory Council's regulations. Describe the affected property and the nature of the effect. Attach to the assessment the results of the coordination process with the Advisory Council on Historic Preservation.

(VII) Compliance with the Wild and Scenic Rivers Act

Indicate whether the project will affect a river or portion of it which is either included in the National Wild and Scenic Rivers System or designated for potential addition to the System. This analysis shall be conducted through discussions with the appropriate regional office of the National Park Service or the Forest Service when its lands are involved, as well as the appropriate State agencies having implementation authorities. A summary of discussions held or any required formal coordination shall be included in the assessment.

(VIII) Compliance with the Endangered Species Act.

Indicate whether the project will either (1) affect a listed endangered or threatened species or critical habitat or (2) adversely affect a proposed critical habitat for an endangered or threatened species or jeopardize the continued existence of a proposed endangered or threatened species. This analysis shall be conducted in consultation with the Fish and Wildlife Service and the National Marine Fisheries Service, when appropriate.

The results of any required coordination shall be included in the assessment along with any completed biological opinion and mitigation measures to be required for the project. These factors shall be considered in completing the environmental impact determination.

(IX) Compliance with Executive Order 11988, Floodplain Management, and Executive Order 11990, Protection of Wetlands.

Indicate whether the project is either located within a 100-year floodplain (500-year floodplain for a critical action) or a wetland or will impact a floodplain or wetland. If so, determine if there is a practicable alternative project or location. If there is no such alternative, determine whether all practicable mitigation measures are included in the project and document as an attachment these determinations and the steps taken to inform the public, locate alternatives, and mitigate potential adverse impacts. See the U.S. Water Resources Council's Floodplain Management Guidelines for more specific guidance.

(X) State Environmental Policy Act

Indicate if the proposed project is subject to a State environmental policy act or similar regulation. Summarize the results of compliance with these requirements and attach available documentation.

(XI) Consultation Requirements

Attach the comments of any State or local agency received through the implementation of Executive Order 12372, Intergovernmental Review of Federal Programs.

(XII). Environmental Analysis of Participating Federal Agency

Indicate if another federal agency is participating in the project either through the provision of additional funds, a companion project, or a permit review authority. Summarize the results of the involved agency's environmental impact analysis and attach available documentation.

(XIII). Reaction to Project

Discuss any negative comments or public views raised about the project and the consideration given to these comments. Indicate whether a public hearing or public information meeting has been held either by the applicant or Rural Development to include a summary of the results and any objections raised. Indicate any other examples of the community's awareness of the project, such as newspaper articles or public notifications.

(XIV). Cumulative Impacts

Summarize the cumulative impacts of this project and the related activities. Give particular attention to land use changes and air and water quality impacts. Summarize the results of the environmental impact analysis done for any of these related activities and/or your discussion with the sponsoring agencies. Attach available documentation of the analysis.

(XV). Adverse Impact

Summarize the potential adverse impacts of the proposal as pointed out in the above analysis.

(XVI). Alternatives

Discuss the feasibility of alternatives to the project and their environmental impacts. These alternatives should include (a) alternative location, (b) alternative designs, (c) alternative projects having similar benefits, and (d) no project.

(XVII). Mitigation Measures

Describe any measures which will be taken or required by Rural Development to avoid or mitigate the identified adverse impacts. Such measures shall be included as special requirements or provisions to the offer of financial assistance.

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LIQUIDATION AND PROPERTY MANAGEMENT GUIDE

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Liquidation and Property Management Guide

I Purpose

(a) The Liquidation and Property Management Guide is designed to help Farmers Home Administration (Rural Development) personnel better understand the Rural Development regulations and procedures when faced with liquidations.

(b) While the lenders have the primary responsibility for the liquidation of the loans and protecting the collateral property in liquidation, Rural Development's responsibility is assuring that the lenders fully comply with the Rural Development regulations.

(c) Because not all lenders are experienced in handling a liquidation on a Rural Development guaranteed loan, Rural Development personnel must closely follow the liquidation of the loans. The primary concern is no longer rural development but maximizing the recovery on the loan in the minimum amount of time.

(d) This Guide is intended to assist the Rural Development official responsible for the guarantee in making decisions during the course of liquidation of Business and Industrial (B&I) loans. The guide contains basic, practical information in handling liquidation cases. Additionally, it is an outline to address the general issues normally encountered in B&I liquidations and is not intended to address every circumstance that may occur in liquidations.

II Lenders in General

(a) There is a reluctance on the part of lenders to make loans secured by industrial property because the specialized use limitations makes it poor collateral for a loan. The B&I loan guarantees are secured by such collateral and the borrowers are located in rural areas.

(b) When the borrower is not successful in its operations and the collateral must be foreclosed, there is usually a limited list of prospective purchasers willing to venture into business in a rural area. Consequently, limited prospective purchasers, specialized collateral, and the fact that the collateral is located in a rural area makes it difficult to sell.

(c) While collateral should not be the consideration in judging the quality of a loan, some real credit factors in judging a loan are the quality of the borrower and its management and market. It is important that proper and adequate collateral be required when making the loan. Collateral is accepted on a loan only for the purpose of securing the loan amount in case of liquidation.

(d) Because not all lenders are experienced in handling liquidation of varied business loans, the lender's liquidation capabilities should be analyzed. The more experienced the lender, the fewer problems one will normally have in liquidation. The inexperienced lender must be closely guided and the liquidation of the loan closely followed. The primary concern is no longer rural development, but maximizing the recovery on the loan in the least amount of time.

(e) One of the primary functions of B&I is the monitoring of the lender's servicing and liquidation activities in order to assure that servicing, as required by Form RD 449-35, "Lender's Agreement," and Rural Development regulations, is carried out in such a manner that the best interests of the Government are served. However, the lender should not be told how to function with the borrower. The lender makes recommendations and Rural Development evaluates the request(s) and the lender's recommendations. The lender has total responsibility for servicing the loan.

(f) Prompt action by the lender is essential once the decision has been made by the lender and concurred with by Rural Development to liquidate the collateral. Liquidation is a business operation and should be handled as such.

(g) The importance of maintaining a good relationship with the lender during the life of the loan is of great importance because once liquidation starts Rural Development will likely receive better cooperation during the liquidation.

(h) Any contacts with the borrower should also be on a friendly basis. Less than 15 percent of the borrowers ever reach a liquidation status. Keep in mind that the borrowers that have failed have given it their best effort, lost their investment, and may find it hard to earn a living in the community.

(i) Most of these failed borrowers as well as the lenders are honest and want to cooperate and assist in closing out the case. Rural Development officials should expect this attitude and should not take a negative stance with the involved parties. Rural Development personnel can help by being reasonable and cooperating fully with these parties while keeping in mind that their main function is protecting the government's interest.

III Involving the Office of General Counsel (OGC).

(a) The Regional Attorney must become involved on all workout and liquidation loans. The GENERAL ADMINISTRATIVE section requires OGC involvement. From experience, the Regional Attorneys have been most cooperative and willing to review such cases. However, do not expect the Regional Attorneys to make the administrative decisions that are necessary on these loans.

(b) In order to assist the Regional Attorney in the review of a liquidation case, a memorandum addressed to the Regional Attorney should be prepared by the State Director giving a narrative history of the loan

along with a full explanation of the facts and setting forth clearly and concisely what the Regional Attorney is being requested to review. If the Regional Attorney is properly informed of all the facts, a correct and expeditious reply will be obtained. Otherwise, correspondence and telephone calls may continue between the involved parties to obtain the necessary information; thereby, causing delays in the liquidation which could increase Rural Development's loss on the loan.

(c) The memorandum to the Regional Attorney should address the following along with sufficient facts and evidence to sustain Rural Development's position:

- (1) Each issue should be fully addressed.
- (2) Reasons for each decision reached.
- (3) Support each reason by citing to the appropriate regulation.
- (4) Supply the necessary facts and evidence that relate to each decision.
- (5) Explain any facts or evidence which would tend to undermine the decision or position.
- (6) The action recommended by Rural Development and why Rural Development wants to take this action. Where several alternatives suggest themselves, explain why Rural Development prefers one alternative to another.

(d) When involved in liquidation, lenders turn to their lawyers for advice and assistance. Rural Development should turn to OGC. Do not get into a situation where wrong information has been given to the lender and based on this information, certain decisions have been made which must be reversed. Involve the Regional Attorney at the beginning of any liquidation case and seek legal advice during the course of liquidation on issues that cannot be resolved as administrative decisions.

(e) All servicing actions in connection with liquidations that are sent to the National Office for review which involve legal issues must have the Regional Attorney's comments as part of the submitted material.

(f) The OGC opinions and memoranda will never be given to persons outside the Agency. Nor will non-Rural Development personnel be allowed to see or discuss these opinions. The use of OGC does not relieve Rural Development personnel of their administrative responsibility to assure compliance with the Rural Development regulations. OGC renders advice, any decision is, in the last analysis, Rural Development's.

IV When to Liquidate and the Action Necessary to Properly Classify a Loan as Being in Liquidation

(a) It is time to consider liquidation when the lender has exhausted all reasonable alternatives to collect the debt and efforts short of liquidation having been made to resolve the problem are unsuccessful. The lender and Rural Development should agree that the borrower cannot or will not repay the debt or conclude that it is no longer reasonable to assume that the borrower can succeed.

(b) There are certain other actions that could cause the lender and Rural Development to place a loan in liquidation. These actions may arise when the lender's and/or Rural Development's interest in the collateral securing the debt is in jeopardy. Examples of such action may be prior lienholders of the collateral securing the Rural Development guaranteed debt taking foreclosure action against the respective borrower; bankruptcy actions; abandonment of the collateral by the borrower; and default on the loan agreement and/or other conditions.

(c) Rural Development does not consider a loan in liquidation until the loan has been accelerated and demand has been made by the lender for payment of the loan balance in full plus any accrued interest and expenses. All obligors must be included in this action. Otherwise, improper notification could delay liquidation and result in serious legal consequences which could cause potential additional losses to Rural Development. Liquidation status can be changed by subsequent events, e.g., Chapter 11 reorganization in which event the loan is no longer being liquidated.

(d) After receiving the demand letter the borrower knows that the lender means business and unless payment is made in full as instructed, liquidation of the collateral will take place. This is not to say that the lender should not work with the borrower to resolve the issue. However, unless meaningful proposals are presented, Rural Development expects liquidation to proceed as soon as practicable.

(e) If the borrower files under Chapter 11 bankruptcy reorganization, before or after liquidation begins, there is no liquidation of the borrower in effect and therefore, the letter is not required to file a liquidation plan. Once the lender is in the position to liquidate the collateral, a liquidation plan is required by the lender.

V Phasedown of Borrower's Operation

(a) In some B&I loan guarantee cases the lender may be able to employ a technique known as operational phasedown rather than put the borrower in liquidation. Operational phasedown is getting the borrower out of its operation with a full payoff on the guaranteed loan plus expenses through a plan agreed upon by all interested parties.

(b) Before submitting such a plan, the lender must fully understand the borrower's operations, have reliable current financial information and the full cooperation of the borrower and all creditors.

(c) If accounts receivable and inventory are part of the collateral, the accounts receivable can be collected and the inventory sold through the borrower's customers. If the customer base has been lost, it may be that the supplier would be willing to take back the inventory at a discounted price.

(d) If money is owed to the supplier on the inventory that is returned to the supplier, the supplier would very likely pay the debt owed by the borrower, to itself instead of paying the lender. Another alternative would be not to permit the lender to return the merchandise but instead sell the collateral for the best offer, to a disinterested party. The object, of course, is to maximize the return on the sale of the assets.

(e) The phasedown plan may include continued operations of the borrower for a period of time in order to move the inventory and/or complete work in process to finished goods.

(f) Be sure that the borrower's principals' compensation (salary, bonus, withdrawals, etc.) during this time does not increase. Consideration should be given to decreasing the principals' compensation based on any extenuating circumstances that may be encountered during the phasedown of the operation.

(g) In the process of continued operations, the plan may call for the borrower to begin selling portions of the business, machinery, equipment, and reduce the payroll.

(h) After the sale of all assets, the borrower will make a settlement with the creditors as called for in the phasedown plan.

(i) If payment in full is not expected and it is advantageous for the lender and Rural Development to involve the borrower in the liquidation of the collateral, consider the option, "Private Sale of the Collateral by the Borrower" explained later in this appendix.

VI Do's and Don't's in Liquidation

(a) Listed below are a few basic reminders for Rural Development officials confronted with liquidations:

(1) Do's

(i) Keep Rural Development's interests paramount. Throughout the liquidation process, never lose sight of the fact that the loan officer's primary responsibility is to protect Rural Development's interests.

(ii) Encourage the lender to take strong steps to prevent the theft, surreptitious sale, or disposal of machinery and equipment. Such expenditures as are necessary in this area possibly may be imputed to protective advances or liquidation expenses.

(iii) Act promptly to make sure the lender obtains a complete inventory of all machinery and equipment and makes sure that all items are tagged and identified.

(iv) Insist upon a complete accounting from the lender of the disposal of all items listed in this inventory and such collateral as accounts receivable, recoveries from guarantors etc.

(v) Remember that an operating business is always more attractive to prospective buyers than one which has ceased operations. Make sure that the lender makes every possible effort to help find a buyer for a business before its doors are officially closed.

(vi) Make sure the lender is prepared to assist the borrower to identify possible buyers of specialized (e.g., electronic) equipment. In many instances, trade associations can help identify potential buyers.

(vii) Be aware of State and local laws pertaining to liquidations. What are the attitudes of the local courts toward liquidation?

(viii) If property used as loan collateral is to be sold at auction, make sure that someone from Rural Development attends.

(ix) Ask the lender to provide a list of all collateral (especially machinery and equipment) on hand at the time the liquidation plan is submitted. This list will often differ somewhat from earlier lists, due to maintenance and replacement of some items. However, it is important to have a complete, written list of all items in existence at the time of liquidation.

(x) Prepare a written memorandum to explain what Rural Development would do differently if it had the opportunity to do the project again. The experience and the memorandum will be useful in servicing other cases.

(2) Don't's

(i) Don't release the liquidation appraisal to the borrower, prospective bidders, or anyone else. Note any action by the lender in this regard as it may be negligent servicing. (Failure to protect the collateral during foreclosure)

(ii) Don't release information about the amount of the protective bid. Note any action by the lender in this regard as it may also be negligent servicing. (Failure to protect the collateral during foreclosure.)

(iii) Don't be reluctant to call the Regional Attorney and National Office for advice.

(iv) Don't take for granted the lender's evaluation of the collateral when the lender is negotiating a private sale. An independent appraisal will usually be required by the regulations.

(v) Don't allow the lender to schedule a liquidation sale for a time when it would be difficult for prospective buyers to attend. Weekends may be the best time for liquidation sales, in certain industries.

(vi) Don't hesitate to notify OGC and the National Office if there is any indication that the lender is not fulfilling its contract (Lender's Agreement and other regulations) with Rural Development. Let it be known to the lender and the National Office when suspecting this is the case. Don't wait.

(vii) Don't forget to keep a thorough record of everything that happens in connection with a liquidation. Remember auditors reviewing the loan file several years hence won't know why Rural Development took certain actions unless a detailed written record of the events as they happened is kept.

(viii) Don't make decisions for the lender regarding actions which are the responsibility of the lender. Rural Development's role is one of concurrence. The lender should be amenable to Rural Development's concerns because the goal of both parties is to maximize recovery.

VII Liquidation Plan

(a) As soon as the lender, with Rural Development concurrence, has made the decision to liquidate the loan, the lender should begin preparing the liquidation plan. Within delegated authorities the State Director may approve a written partial liquidation plan submitted by the lender covering collateral that must be immediately protected or cared for in order to preserve or maintain its value. Approval of the partial liquidation plan must be in the best interest of the Government. The approved partial liquidation plan is only good for those actions necessary to immediately preserve and protect the collateral and must be followed promptly by a complete liquidation plan prepared by the lender in accordance with the requirements of paragraph XI A of Form RD 449-35. The lender has 30 days in which

to submit the liquidation plan as set forth in the Form RD 449-35, Section XI, Liquidations. A guide as to what should be covered in the liquidation plan is shown in paragraph VII (b) of this Appendix. Bear in mind that liquidations vary from area to area and case to case. This guide should not be construed to cover all the material that may be necessary to fit a particular liquidation case.

(b) It is strongly recommended that a visit be made to the lender at the time liquidation is considered to discuss the liquidation of the loan. Paragraph XI of the lender's Agreement requires a meeting between the lender and Rural Development. Ordinarily, a discussion of the structure of the lender's tentative plan of liquidation will help the lender to prepare a complete liquidation plan for submission to Rural Development. If the lender submits a complete liquidation plan, Rural Development response time to the liquidation plan can be expedited; thus speeding the liquidation of the loan.

(c) Additionally, at the time of the meeting, the lender's questions should be answered in order for the lender to fully understand what is expected of the lender during the liquidation. At the same time, the Rural Development loan officer gains valuable knowledge regarding the case.

(d) During the meeting with the lender, §1980.64(c) should be discussed with the lender. This provision of the Rural Development Regulation allows the lender a settlement option under the loan note guarantee. The provision states "If a lender acquires title to property either through voluntary conveyance or foreclosure proceeding, Rural Development may elect to permit the lender the option to calculate the final loss settlement using the net proceeds received at the time of ultimate disposition of such property." This option would allow the lender to sell the property after bidding it in at foreclosure before a Final Report of Loss is submitted. The lender must submit its written request for this option to Rural Development, and Rural Development must agree, prior to the lender submitting any request for an estimated loan payment."

(e) If the lender submits a written request to Rural Development asking Rural Development to delay calculation of final loss until the lender finally disposes of the collateral out of its inventory, pursuant to the §1980.64(c) option above Rural Development, at its option, may accede to the request. Any loss paid by Rural Development would be based on the sales price obtained at the time the lender sold the collateral out of its inventory. (Paragraph XI. E. of the Lender's Agreement) Loss occasioned by accruing interest will be covered to the extent of the guarantee to the date of final settlement when the liquidation is conducted by the lender provided it proceeds expeditiously with the liquidation plan approved by Rural Development. (Paragraph XI F. of the Lender's Agreement).

(f) The final loss could not be paid until all of the collateral, including any guarantees (§1980.443 (b)), if applicable, was liquidated or settled.

(g) If the lender does not wish to extend the time for the loss claim to the point of ultimate disposition of the collateral (except for personal and corporate guarantees). any loss covered under the guarantee would be based on the collateral's value at the time the lender obtained title through the foreclosure method or a voluntary conveyance of the collateral by the borrower.

(h) No final loss can be paid until any personal and/or corporate guarantees have been liquidated or settled.

(i) At the time of the meeting, an estimated date for submission of the complete liquidation plan should be agreed upon between Rural Development and the lender. Hopefully submission of the liquidation plan can be expedited by the lender as a result of the meeting since the lender is now aware of its responsibilities. It is likely that the lender could have the complete liquidation plan (exception - appraisal) to Rural Development within 10 days.

(j) Priority should be given to the liquidation plan when received by Rural Development. Rural Development should respond to the liquidation plan as quickly as possible. Remember, for each day's reduction in the liquidation of the loan, Rural Development's potential loss exposure is reduced. Rural Development expects liquidation of the loan to maximize collections in the minimum amount of time.

(k) The liquidation plan must be in writing and (Paragraph XI of the Lender's Agreement) should include, but not be limited to:

(1) Loan position on the collateral held by the lender.

(2) Such proof as Rural Development requires to establish ownership of the guaranteed loan promissory note(s) and related security instruments. Also, a copy of the payment ledger should be included which should reflect the current loan balance and accrued interest to date and the method or basis of computing the interest.

(3) A full and complete listing of all collateral including any personal and/or corporate guarantees and current financial information on the guarantors.

(4) A copy of the demand letter sent to the borrower accelerating the loan balance. The lender should give the borrower the minimum time allowable to pay the balance in full on the loan. The chances of the borrower paying the loan in full are practically nil and any additional time over and above what is required by the respective State laws would not be in the best interests of the lender or Rural Development.

(5) Copies of the borrower's latest available financial statements.

(6) The recommended plan of action on the best liquidation methods and the justification for such action.

- (7) Recommended action on acquiring and disposing of all collateral.
- (8) Recommended action to be taken on the guarantor(s) of the loan.
- (9) Necessary steps for preservation of the collateral.
- (10) A list of the estimated liquidation expenses expected to be incurred and the justification for each expense. Each expense item should specify what it covers and the estimated amount. It should be emphasized that attorney's services are to be concerned with those issues in liquidation proceedings with a strictly legal nature. In-house administrative expenses incurred by the lender such as travel to and from the borrower's business, telephone calls, typing and internal secretarial services, related bank personnel salaries and wages, accounting and all other miscellaneous expenses are not reimbursable liquidation expenses. (Paragraph XII. I. of the Lender's Agreement)
- (11) Establishment of a schedule to periodically report to Rural Development on the progress of liquidation.
- (12) Protective advance amounts that may be necessary and the justification for the protective advance. Protective advances can only be claimed on the Final Report of Loss. (Paragraph XI E. 6 of the Lender's Agreement.)
- (13) Protective bid amounts on the collateral to be sold and a breakdown of how the amount(s) were determined (if collateral is scheduled to be sold at public auction).
- (14) If a voluntary conveyance of the collateral is considered, the lender, with Rural Development's concurrence, must determine the amount to be credited to the guaranteed debt. It is necessary to determine the amount to be credited to the guaranteed debt because any deficiency between the guaranteed debt and the amount credited to that debt is a liability of the guarantor(s) which must be settled before establishing any final loss.
- (15) Legal opinions, if necessary, to justify recommended liquidation methods, acquisition and preservation of the collateral.
- (16) Appraisal of the collateral. If the current principal balance, including accrued interest, is less than \$200,000, the lender should provide an estimate of the current market and potential liquidation value of the collateral. If the current principal loan balance, including accrued interest, is in excess of \$200,000, the lender will obtain an independent appraisal as required by the regulations on all collateral which should reflect the current market value and the potential liquidation value. The appraisal report is very important and is utilized to determine the current market liquidation

value, the appropriate liquidation action and, if necessary, to determine a proper protective bid price for a public auction sale. The fee for the appraisal is shared equally between the lender and Rural Development. (Paragraph XI. A. 4 of the Lender's Agreement.)

VIII Reviewing the Lender's Liquidation Plan

(a) After receiving the liquidation plan from the lender, Rural Development must carefully review the plan and all records. Rural Development should review the following items and take appropriate action, if necessary, to protect Rural Development's interests:

(1) Begin the review at the loan disbursement date:

(i) Was the loan disbursement proper and in accordance with Form RD 449-14, "Conditional Commitment for Guarantee" and/or 449-1, "Application for Loan and Guarantee?"

(ii) Were the conditions of the conditional commitment met?

(iii) What is the collateral position and the type of collateral, including guarantors? Were the agreed upon lien priorities obtained?

(iv) Was the loan properly closed? Were the loan disbursements proper? Can the lender confirm that they were?

(2) From closing of the loan to date, was the lender's servicing satisfactory?

(i) Were proper visits made by the lender to the borrower's place of business?

(ii) Was the loan agreement complied with by all parties?

(iii) Did the lender make routine checks of the collateral and properly account for same?

(iv) Review all correspondence in the file for any servicing actions that took place which could affect the loan.

(v) Were there servicing actions which were not taken which a reasonable prudent lender would have taken?

(3) If applicable, look at the guarantor's financial statement at loan closing and compare to the current financial statement obtained at liquidation. Were all assets listed at loan closing accounted for on the financial statement given at liquidation? If not accounted for, what happened to the assets? Was any transfer of assets made to avoid legal attachment by the lender for the guaranteed loan?

(4) Are the lien positions and collateral properly stated as compared to loan closing documents and the conditional commitment? Review the legal documents and UCC filings for proper documentation (lien position) of the collateral and all legal matters. Check with the Regional Attorney if you have questions on perfection of security interests.

(5) Compare the current appraisals to appraisals made at the time of loan closing. Do amounts correspond? If not, obtain a satisfactory explanation from the lender for any large differences.

(6) Does the liquidation plan submitted by the lender properly address liquidation of the collateral from start to final disposition of the collateral? Are all areas satisfactorily covered by the lender in the liquidation plan?

(b) If there are any subsequent changes in the liquidation plan originally agreed upon by the lender and Rural Development, the lender should inform Rural Development in writing of the changes. Rural Development should review the modification plan and inform the lender in writing as to its position on the proposed changes made in the liquidation plan.

(c) If for some reason Rural Development cannot concur in the liquidation plan, negotiations should take place between the lender and Rural Development to resolve the disagreement. The lender will ordinarily conduct the liquidation; however, should Rural Development opt to conduct the liquidation, Rural Development will proceed as follows:

(1) The lender will transfer to Rural Development all rights and interests necessary to allow Rural Development to liquidate the loan. (Paragraph XIX. 8. 1 of the Lender's Agreement.) In this event, the lender will not be paid for any loss until after the collateral is liquidated and the final loss is determined by Rural Development. (Paragraph XI. E.5. and E.2. of the Lender's Agreement.)

(2) Rural Development will attempt to obtain the maximum amount of proceeds from liquidation. (Paragraph XI. B.2. of the Lender's Agreement.)

(3) Options available to Rural Development include any one or combination of the usual commercial methods of liquidation. (Paragraph XI. B.3. of the Lender's Agreement.)

(4) Rural Development will proceed as expeditiously as possible when acceleration of the indebtedness is necessary, including giving any notices and taking any other legal actions required by the security instruments. A copy of the acceleration notice will be sent to the lender. (Paragraph XI. C. of the Lender's Agreement.)

(5) Rural Development will account for all funds during liquidation (Paragraph XII. E.5 of the Lender's Agreement) and provide periodic reports to the lender. (Paragraph XI. D of the Lender's Agreement.)

(6) Rural Development will provide an accounting and Form RD 449-30, "Report of Loss" to the lender and will pay the lender in accordance with the Form RD 449-34, "Loan Note Guarantee."

(7) Reasonable liquidation expenses will be allowed Rural Development in its liquidation. (Paragraph XI. I. of the Lender's Agreement.)

(d) Rural Development will not, unless unusual circumstances prevail, conduct the liquidation of the loan. Before any decisions are reached as to whether Rural Development should handle the liquidation, the concurrence of the National Office must be obtained.

(e) If the guaranteed portion of the loan is being held in the secondary market and the holder has made no request for either Rural Development or the lender to repurchase, and the loan is in liquidation, the lender should repurchase the guaranteed portion of the loan to adequately service the loan. The lender will not repurchase from the holder(s) for arbitrage purposes or other purposes to further its own financial gain. Any repurchase will only be made after the lender obtains Rural Development's written approval. If the lender does not repurchase the guaranteed portion from the holder(s), Rural Development will purchase such guaranteed portions. (Paragraph 10 of the Loan Note Guarantee.)

(f) The lender must establish reasonable control of the collateral in any liquidation case. This is true even if voluntary liquidation by the borrower is considered. The only difference would be the type of control initiated by the lender. The lender will be expected to account for all collateral; therefore, the controls necessary to perform in this fashion are left to the lender. The lender should initiate control to determine the collateral on hand, location, and keep track of any sale of collateral. Protection against pilferage would be expected of a reasonable and prudent lender.

IX Risk Factors Associated with Rural Development Guaranteed Loans.

(a) Guaranteed loans in liquidation contain certain built-in risks to Rural Development. These risks create potentially greater loss exposure than are normally prevalent when lenders handle unguaranteed loan liquidations in their portfolio. The increased risk factors are:

- (1) Time restraints.
- (2) Interest accruals.
- (3) Dependency upon the lender to handle the liquidation.
- (4) Deterioration of the collateral.
- (5) Additional expenses.

(b) As stated in paragraph VII of this Appendix, the lender must submit a proper liquidation plan to Rural Development within 30 days after the lender and Rural Development agree that liquidation is proper and necessary. Rural Development has 30 days to respond to the liquidation plan. In some cases, 60 days or more elapse before any real action is taken by the lender on the liquidation of the loan. During this 60-day period, insurance, taxes and other expenses may accrue. Additionally, the collateral securing the loan may be deteriorating.

(c) During this 60-day period, the lender continues to accrue interest within the terms of the Loan Note Guarantee at the promissory note rate. This is permissible under the Rural Development regulations. (Paragraph XI. F. of the Lender's Agreement.)

(d) If the lender has an attractive interest rate and holds the guaranteed loan portion, the lender may not pursue the liquidation of the loan as vigorously as an unguaranteed loan in its own portfolio especially if the lender has pressing problems on one or more of its other loans. Any delay in liquidating the collateral increases Rural Development's loss exposure; therefore, it is important that the lender move as quickly as reasonably possible to liquidate the collateral. Rural Development personnel short on time should show preference on any liquidation case as opposed to loan making or servicing of non-problem cases and keep the liquidation of the loan expeditiously moving to a conclusion. The following is an illustration reflecting potential expenses caused by Rural Development requirements that the lender might avoid if it was handling the loan and the loan was unguaranteed:

(f) Example: A \$1,500,000 original Rural Development 90 percent guaranteed loan held by the lender reduced to a balance of \$1,200,000 at a 15 percent interest rate at the time of liquidation. Additional risk factors to Rural Development as explained above reflect:

\$30,000	Interest at 15 percent per annum on \$1,200,000 for 60 days (30 days for lender to submit a liquidation plan and 30 days for Rural Development to respond).
\$ 1,667	Insurance for two months based on a \$10,000 annual insurance premium.
\$ 5,000	Taxes for two months on real estate collateral based on a \$30,000 annual tax bill.
\$12,000	Heat, electricity, water and guard services for two months assuming that the borrower walked away from the property.

unknown	Collateral deterioration and/or possible loss of ideal market conditions in selling the collateral if there is any delay in liquidation.
\$48,667	Total
_____ x 90%_	Rural Development Guarantee
\$43,800	Rural Development's loss exposure for the 60-day period.

(g) Based on this illustration, Rural Development's additional risk exposure is \$730 daily for the 60 day period allowable under the Rural Development regulations for the lender to submit a liquidation plan and for Rural Development to address the plan. Any additional delay by either the lender and/or Rural Development further increases the loss exposure.

(h) Although \$43,800 may not seem to be a large exposure on Rural Development's part, consider the number of loans in liquidation nationwide.

(i) As one can see, any delays in actual days lost by not vigorously pursuing the end result of liquidation exposes Rural Development to tremendous losses.

(j) Hope and belief that there will be a future economic change that would enhance recovery on the debt almost always results in a diminished recovery on the guaranteed loan due to accumulating interest, costs of maintaining the property and deteriorating collateral. The lender is not in the real estate market and; therefore, a quick and expeditious liquidation is the manner in which to proceed.

(k) Another procedure to utilize in order to possibly reduce Rural Development loss exposure if the lender is holding the guaranteed portion of the loan, would be to pay an estimated loss to the lender. If Government interest rates on long term borrowing are less than the current interest rate on the Rural Development guaranteed loan, the net savings by paying the estimated loss would be the difference between the cost of money to the Government and the guaranteed promissory note rate. However, before paying any estimated loss, be sure that the lender will continue to expeditiously liquidate the loan and that the lender has performed satisfactorily to date on the closing and servicing of the loan. Otherwise, if a claim against the lender for negligent servicing or use of loan funds for unauthorized purposes arose and Rural Development was holding the guaranteed portion of the loan, the lender may refuse to honor such a claim, making legal action necessary by Rural Development to claim the rightful amount due to Rural Development for the lender's improprieties. The Government would have to initiate legal action to obtain the amount due Rural Development and the burden of proof would rest on the Government in a claim of negligent servicing and/or unauthorized use of loan funds.

(l) Liquidation expenses and protective advance amounts requested by the lender should be closely reviewed to determine, before actual approval by Rural Development, that the expenses are necessary to properly conduct the liquidation of the loan. Examples of abuse by lenders as cited by the Office of Inspector General (OIG) of liquidations approved by Rural Development include inappropriate attorney fees, inhouse expenses, lender fees, care and maintenance of the collateral property.

(m) Just because a lender recommends an expense item, Rural Development should not grant automatic approval to such expense. Obtain the necessary facts and be satisfied that the expenses are necessary and reasonable. By giving close attention to all expenses, Rural Development's loss exposure could possibly be further reduced.

X Collateral Evaluation In Liquidation

(a) Accounts Receivable

(1) Accounts receivable are the easiest to convert to cash in liquidation in that the only effort required is to notify the borrower's debtors that the receivables are collateral to the loan and payments should be made to the lender. Since this type of collateral is easily converted to cash without further efforts by the borrower, it can be used by the borrower to keep operations going during periods of financial difficulty. Therefore, when liquidation occurs, more often than not, the accounts receivable have been partially collected by the borrower, thereby, dissipating the collateral on the guaranteed loan. Also, when the borrower is experiencing financial difficulties, the quality of goods manufactured could deteriorate, thereby, creating claims by the borrower's debtors when collection is pursued by the lender.

(2) If the lender properly secures the accounts receivable and has included in the Security Agreement the right to inform the borrower's debtors in writing in any acceleration of the debt, this is the action that should be taken. The lender, to protect itself, should if possible, obtain the authorized borrower's signature(s) on any notice to the borrower's debtors requesting payment be made directly to the lender. If the lender quickly takes action once the decision to liquidate the loan has been made, there is a better chance to maximize the recovery on this type of collateral.

(b) Inventory

(1) Inventory is more difficult to move and convert into cash in a liquidation than accounts receivable. A buyer must be found for the inventory collateral before it can be converted to cash.

Normally, in a manufacturing business, the inventory is in three stages; raw materials, work in process, and finished goods. The raw materials and finished goods normally have value in liquidation, whereas, work in process may have little value.

(2) If the borrower is experiencing financial difficulties, the quality of goods produced could deteriorate and the demand for this collateral may diminish. Additionally, the borrower may be utilizing the collateral to continue operations without replacement during periods of financial difficulty, thereby, diminishing the collateral value or the amount of collateral on hand. A prudent lender should take action as quickly as possible to gain control of this type of collateral.

(3) Once the lender has the inventory in its possession, arrangements should be made to secure the collateral and tag it for identification purposes. A reasonable prudent lender understands that adequate insurance coverage is necessary on the inventory collateral.

(c) Machinery, Equipment and Parts

(1) Machinery, equipment and parts take a good deal of effort and time to liquidate. Much of this type of collateral is of a specialized nature which may make locating an interested party difficult. Also, if the collateral is of a specialized nature, the demand and value of such collateral is greatly diminished.

(2) The prudent lender, upon gaining control of the collateral, should take steps to preserve and account for all such collateral. Preservation and control would include such items as:

- (i) Storing and tagging of all collateral.
- (ii) Moving exposed equipment under shelter.
- (iii) Protecting the collateral from theft or damage.
- (iv) Protective maintenance such as greasing, oiling, etc.
- (v) Adequate insurance coverage.
- (vi) A listing of all machinery and equipment.

(3) If there is any question of ownership when the lender is listing the collateral, a prudent lender would indicate the problem on the listing. The completed list of collateral made by the lender and submitted to Rural Development should be compared to the list of collateral taken at loan closing to determine whether all the collateral has been accounted for and under the control of the lender. The lender is responsible for accounting for the collateral.

(d) Rolling Stock

Rolling stock type of collateral consists of automobiles, trucks, tractors, etc. The rolling stock, if used on the State highways, must be titled in the appropriate State and a lien placed against each vehicle in order to perfect a valid lien on the respective collateral. This type of collateral, provided it is in good condition, is normally in demand in any liquidation. The collateral is easy to move and secure, and value is easily determined as various publications are available for this purpose. Deciding whether a valid lien was perfected may be more difficult. If there is any doubt, the Regional Attorney should be contacted.

(2) The lender should act quickly in any liquidation to gain control of rolling stock as it can easily disappear from the borrower's place of business and can be difficult to locate.

(3) Adequate legal title cannot be obtained by another party on this type of equipment if a proper lien was recorded against the property by the lender until the lien position on the respective vehicle has been released by the secured party.

(e) Real Estate

(1) Real estate is normally the most difficult to liquidate. It usually takes longer to sell and is expensive to hold until liquidated. Prospective buyers of the property in question are limited. Arriving at a fair sale price is difficult in most cases. The lender must obtain appraisals on this type of collateral as well as machinery and equipment, rolling stock and other hard collateral as set forth in Paragraph XI A 4 of Form RD 449-35:

"If the outstanding principal B&I loan balance, including accrued interest, is less than \$200,000; the lender will obtain an estimate of the market and potential liquidation value of the collateral. On B&I loan balances in excess of \$200,000 the lender will obtain an independent appraisal report on all collateral securing the loan, which will reflect the current market value and potential liquidation value. The appraisal report is for the purpose of permitting the lender and Rural Development to determine the appropriate liquidation actions. Any independent appraiser's fee will be shared equally by Rural Development and the lender."

(2) The appraisal reports are very important and are utilized to determine the current market and liquidation values, the appropriate liquidation action and if necessary, to determine a proper protective bid amount for a public auction sale.

(3) In order to pay for Rural Development's portion of the appraisal, complete Form 1980-46, "Report of Liquidation Expense," and forward this report to the Finance Center for payment. Do not include the cost of the appraisal in any report of loss claims.

XI Appraisal Reports

- (a) An acceptable appraisal should include:
- (1) The appraiser's transmittal letter which should state:
 - (i) Collateral being appraised.
 - (ii) Location of the collateral.
 - (iii) Explanation of condition (excellent, good, satisfactory, etc.) should be used in describing the collateral.
 - (iv) A definition of the current market and liquidation values.
 - (v) Date the appraisal was completed.
 - (vi) Different approaches used in determining the value of the collateral. In appraising the machinery and equipment, very seldom is the income approach used, whereas in appraising real estate, all three approaches are utilized; i.e., cost, income and market.
 - (vii) Methods used to determine the value of the collateral should be defined.
 - (viii) Purpose of the appraisal. In liquidation cases, it is to establish market and liquidation values.
 - (2) Certification from the appraiser that he/she:
 - (i) Has no interest in the property.
 - (ii) Personally inspected the property.
 - (iii) Report is accurate and correct to the best of his/her knowledge.
 - (iv) Appraisal was made in accordance with the standard of practices and within the code of ethics of the various appraiser's organizations.
 - (3) Qualifications of the appraiser:
 - (i) Background
 - (ii) Experience
 - (iii) Names of companies that appraisals have been made for

- (iv) Education
- (v) Certificates, licenses, etc.

(4) Description of the collateral:

- (i) Condition
- (ii) Fair market value
- (iii) Liquidation value
- (iv) Photographs of the collateral

(b) It is important to obtain a value on each piece of collateral as it may be decided to sell each piece separately rather than as a bulk sale arrangement.

(c) In addition to the aforementioned information which would normally be in a machinery and equipment liquidation appraisal a real estate appraisal should contain the following information:

- (1) Income approach to the real estate.
- (2) Comparables of property similar to the property being appraised. Make sure comparables used are local and not out of the trading area.
- (3) Values reflected in the cost, income and market approach.

(d) The appraisal is made for the benefit of the lender and Rural Development and should not be discussed with any other individuals. A prudent lender should treat the appraisal as confidential. The Rural Development official must always be the final judge of the value of the collateral based on the known facts. If the Rural Development official disagrees with the appraisal, the reason for disagreement must be fully documented. In a situation such as this, the National Office should be consulted for the necessary, action to take. In some cases more than one appraisal may be necessary, such as, cases with specialized machinery and equipment.

XII Different Options Open in Liquidation

The options open to the lender in liquidating a loan are:

(a) Sale of the business as an on-going operation, provided this method can be legally utilized

- (1) In order to utilize this option, a cooperative borrower who can legally convey fee simple title to the collateral is essential.

(2) Normally, this option comes into being before the lender actually places the borrower in liquidation; however, it can be an option to sell the collateral after acceleration of the loan balance. This option is similar to a private sale of the collateral by the borrower except all parties are interested in trying to locate a purchaser.

(3) This type of sale normally brings the maximum dollars for the collateral and is normally advantageous for both the borrower and the purchaser (buyer). The advantages and disadvantages to such a sale include:

(i) Advantages

- (A) Maximizes collections on the loan.
- (B) Buyer obtains an operating entity; the business is in place with no moving expenses.
- (C) Several parties including the borrower are interested in locating prospects.
- (D) No liquidation costs.
- (E) Save legal expenses.
- (F) No piecemeal sale of collateral necessary.

(ii) Disadvantages

- (A) Rural Development may be called upon to finance the purchase over a period of years, possibly extending terms and changing other terms in order to obtain a purchaser. Such a purchase may require a new guaranteed loan.
- (B) In some cases, the borrower wishes to remain discreet in locating prospects for the business. Interested purchasers may never receive notice that the business is for sale.
- (C) Borrower may attempt to continue to extract a living from the operations and discourage any prospects.
- (D) Borrower may want a higher sales price than is realistic for the collateral.
- (E) Borrower may not put "best foot forward" in preparing the business for sale.
- (F) Once a purchaser is located and the sale ready for liquidation, borrower could withdraw from the transaction.

(4) In any sale of this type, the corporate/personal guarantor(s) liability on the loan should be adequately addressed and resolved.

(5) In order to maximize collections on the loan, the lender cannot always make a cash settlement when selling an on-going business. However, a cash settlement has some real advantages. A cash settlement is a sure transaction and one in which a loan can be cleared without any further obligation by Rural Development. This permits the lender and Rural Development to rid themselves of a bad situation and move on to other concerns. In other words, it rids the lender and Rural Development of a problem.

(6) However, never be too anxious to settle a bad loan just to avoid a problem. Remember, Rural Development regulations state that the lender must maximize the return on the collateral. It is the Rural Development official's responsibility to see that the lender fulfills its obligation.

(7) A cash settlement offer is always preferred to a long-term transaction. A cash settlement offer is usually less than the sales price that could be obtained on a financing arrangement. It is necessary to calculate the immediate return of a cash sale as opposed to x financing interest costs. Additionally, consider the additional incidental expenses of holding on to the property for a longer period of time if the cash offer is not accepted.

(8) If an extended financing arrangement is considered, be sure the collateral is adequate to support the loan. Strive to sufficiently support the loan balance with collateral and additional personal/corporate guarantees and, when possible, secure the guarantee with collateral.

(9) When considering long-term financing, it may be possible to build into any proposal flexible conditions such as a net earnings recapture clause and certain sales ratios whereby if the transferee (purchaser) performs better than expected, it is possible to capture a greater return on the sale. This technique has been used in several cases and the purchaser is usually agreeable to such arrangements.

(10) Most important, keep in mind that a saleable company is necessary to attract potential purchasers. If the borrower's operations have been such that the production has been of poor quality, the borrower has lost its sales base (customers) or the plant and equipment have been abused, the chances of selling a company such as this are poor. Face reality in situations such as this and instruct the lender to move as quickly as possible to liquidate the collateral.

(11) As a general rule any liquidation sale of the collateral property, for less than the full guaranteed debt, must be to an independent purchaser not connected in any way with the borrower or

the lender except for financing of the transaction. Only in rare circumstances would such a sale to the borrower, its principals, relatives, be approved by Rural Development. Be careful and assured that any sale of the collateral is independent of the borrower as well as the lender except for financing of the transaction and include this as one of the conditions of sale.

(12) Documentation is very important. Make sure any offer made on the property is documented in the files along with the reasons for considering or rejecting the offer. This type of documentation serves to justify an offer that is finally accepted.

(b) Transfer and assumption of the borrower's operations

(1) Transfer and assumption of the borrower's operations can be accomplished before or after the loan goes into liquidation. A transfer and assumption has certain advantages in that it may be the best means to keep an active business operating; keeps the Rural Development guarantee intact (a good selling point with the Lender) and provides an opportunity to strengthen the loan through additional collateral and/or additional guarantees.

(2) If the lender has purchased the collateral property through a foreclosure public auction sale or the borrower has conveyed title to the lender, no transfer and assumption is permitted. Also any other transactions that affect the promissory note may rule out transfer and assumption of the debt. These situations should be referred to the Regional Attorney.

(3) Section 1980.476 of Subpart E of Part 1980 of this chapter must be followed in any transfer and assumption case. The advantages and disadvantages to such a transfer include:

(i) Advantages

(A) Purchaser obtains an operating entity; business in place with no moving expenses.

(B) Opportunity to transfer a potential or existing problem loan and keep existing collateral and guarantor(s).

(C) Opportunity to strengthen the loan through additional collateral and/or additional guarantor(s) while keeping existing collateral and guarantor(s).

(D) A transfer of the loan can be made without liquidating the collateral; thus eliminating liquidation costs.

(E) May maximize collections on a loan in liquidation.

(ii) Disadvantages

(A) Transferee may request more liberal terms. If different terms are requested, there may be statutory problems with the terms. If the guarantee has been sold to a holder, this may also create problems if different terms are being considered. The Regional Attorney and National Office can furnish advice on specific transactions.

(B) No final loss or protective advance amount, if applicable can be paid to the lender, until the transferee fulfills its obligations under the transfer.

(C) May be trading one problem for another.

(D) Side transactions could take place between the transferee and the borrower without the lender's knowledge.

(E) May have an impact on the customer base.

(4) Any transfer and assumption case should be fully understood and evaluated before concurring with the lender. The Rural Development official should treat any transfer and assumption as if Rural Development was evaluating a new loan obtaining proper documentation on the new management team, financial reports, projections, pro formas (if applicable) and assurances of adequate collateral.

(c) Leases and purchase money contracts

(1) Once the lender has purchased the collateral property through a foreclosure public auction sale or the borrower has conveyed title to the lender and the lender wishes to have the collateral begin generating income to be applied to the guaranteed debt without transferring title, the only options open to the lender would be leasing the collateral property or a purchase money contract.

(2) Generally, leasing the collateral or utilizing a purchase money contract is not in the best interest of Rural Development. There may be times when such an arrangement is advantageous and if such a situation arises, the guaranteed lender must make a written request for continuation of the Rural Development guarantee.

(3) The only real advantage of a lease or purchase money contract is the availability of a servicing tool for an improved recovery on the potential loan loss when faced with a low cash sale probability.

(4) When considering such a proposal, make the terms and conditions fit Rural Development's interests. Fully understand the proposal before committing Rural Development to any such arrangement. Otherwise, Rural Development could be agreeing to long term contracts which may cause additional problems. The object is to liquidate collateral as soon as practical, not to create long standing relationships

(5) Before concurring in any lease arrangement or a purchase money contract, involve the Regional OGC to review all legal documents and comply with the Regional Attorney's legal advice on these issues.

(d) Private sale of the collateral by the borrower

This method of liquidation is similar to a sale of the business as an on-going concern except, in this case, the lender is directly guiding the borrower in the sale of the collateral.

(1) This option permits the borrower to dispose of the collateral and liquidate the loan under the lender's guidance and expertise. Generally liquidation by the borrower is not advantageous to Rural Development as liquidation could be prolonged due to the borrower wanting more than the collateral is worth. Also, in a liquidation of this type, the borrower must be of unquestionable integrity.

(2) Liquidation by the borrower would be advantageous when certain collateral is involved in which the borrower's expertise and knowledge is needed to obtain the best price for the collateral. For example, if inventory was taken as collateral, the borrower may be able to utilize its customer base to move the inventory; thus, obtaining top dollar for this type of collateral.

(3) The advantages and disadvantages of this type of liquidation include:

(i) Advantages

(A) No liquidation costs.

(B) Saves legal expenses.

(C) Possibility of realizing greater proceeds on collateral sales, especially accounts receivable, inventory, and assets of some value that needs the borrower's knowledge to maximize collections.

(ii) Disadvantages

(A) Title to the collateral remains with the borrower.

(B) Borrower may attempt to extract a living from the operations, extending the time of liquidation.

(C) Borrower may attempt to obtain a higher sale price than is reasonable for the collateral to create funds over and above the loan balance for personal use.

(D) Lender does not have control of the liquidation.

(E) Borrower is first to touch collateral sale proceeds.

(F) Any delays by the borrower in paying off the loan balance increases Rural Development's obligations due to interest accruals.

(G) Borrower may sell only the good saleable collateral leaving the less desirable collateral which eventually may have to be sold by the lender.

(e) Voluntary conveyance of the collateral

(1) This option permits the borrower to deed title of the collateral immediately to the lender. It is voluntary to both parties (lender and borrower). If this action is considered, the lender must be sure that the borrower can convey clear title.

(2) The lender should consider such action when there would be long delays to obtain clear title to the collateral property. It is always desirable to cut delays in the liquidation process whenever possible; however, the proposal should be fully understood before acceptance by Rural Development.

(3) Most voluntary conveyances of clear title means a cancellation of the full debt. This action would automatically cancel any guarantor's liability on the debt.

(4) A voluntary conveyance of the collateral can be accomplished at a set amount of less than the full amount of the debt. To accomplish this objective, an arrangement must be made whereby the parties agree to a fixed amount for which the collateral property would be conveyed to the lender. Be careful when handling such an arrangement and involve the Regional Attorney before acceptance of such a plan. Careful documentation of the file demonstrating the commercial reasonableness of the decision is necessary.

(5) When looking to the guarantor(s) for collection on the loan deficiency balance, the guarantor(s) and the lender with Rural Development's consent should agree to a value to be credited on the promissory note and the lender should attempt to have the guarantor(s) execute a continued liability agreement to the effect that the guarantor(s) remain liable for the loan balance before the voluntary conveyance.

(6) The advantages and disadvantages to such an option include:

(i) Advantages

(A) Lowers liquidation costs.

(B) Saves legal expenses.

- (C) Lender has control of liquidation.
- (D) Speeds up liquidation.
- (E) Eliminates any redemption rights the borrower holds.

(ii) Disadvantages

- (A) Private sale could involve a conflict of interest.
- (B) Possibility of losing legal rights to collect any loan deficiency amounts from the personal/corporate guarantor(s) unless handled properly. Usually the personal guarantor will also be a principal of the business and the lender and Rural Development will have to agree not to pursue the guarantor in order to get them to agree to a voluntary conveyance.
- (C) Lose right to any potential transfer and assumption of the loan.
- (D) Lender may lose incentive to sell the collateral if holding only the unguaranteed portion of the loan, or if holding the full loan and the lender has a good interest rate on the loan.

(7) Anytime a voluntary conveyance of title takes place or the lender acquires title to any real property through other means, the title to the property should be recorded at the proper locations.

(f) Foreclosure by public auction sale

(1) A public auction foreclosure is necessary when the lender has an uncooperative borrower who will not convey title to the collateral and/or when there are liens against the collateral property which must be cleared in order to obtain fee simple title. The advantages and disadvantages to such a sale include:

(i) Advantages

- (A) Clears existing liens.
- (B) Ascertains the demand for the collateral and value.
- (C) Protect the lender's legal rights to proceed against guarantor(s), if necessary, for any loan deficiency.
- (D) Easier to prevent a defense by the guarantor(s) on the loan deficiency amount when proceeding legally against guarantor(s).

- (E) Could speed up liquidation of the collateral.
- (F) Quick cash for the collateral.
- (ii) Disadvantages
 - (A) Increases liquidation costs, including legal expenses.
 - (B) Protective advances may be necessary.
 - (C) Loss of option for any transfer and assumption of the loan.
 - (D) Lender may have to bid on the collateral at a price up to a negotiated protective bid price and arrange a private sale.
 - (E) Auction sale possibly would not realize maximum value of the collateral as opposed to other methods of collateral disposition.
 - (F) Normally requires quick and immediate decisions on sale.

XIII Protective Bids

(a) In establishing a protective bid amount, the lender should work closely with Rural Development in arriving at a proper protective bid amount. There must be a current appraisal available which reflects both the fair market value and the potential liquidation value of the collateral. In order to fully understand these values and their purpose, a definition of each is given below:

(1) Fair market value is the price a willing buyer would be justified in paying and a willing seller would be warranted in accepting if each is (1) well informed or well advised; (2) motivated by reactions of typical users; (3) free from undue stimulus; (4) financially capable of ownership and/or use; and (5) allowed a reasonable time period in which to test the market.

(2) Forced sale liquidation values (public auction sales) is defined as a price which the collateral will bring if exposed for immediate sale on the open market, both buyers and sellers having knowledge of the uses and purposes to which the collateral is capable of being used, the seller being compelled to sell and the buyer being willing but not compelled to buy.

(b) The sound market appraisal and liquidation values of all collateral must be established in order to determine the amount of the protective bid.

(c) Before the protective bid amount is established, the Rural Development official must agree with the appraised values. If the Rural Development official or the lender disagrees with the amounts in the appraisal, those concerns should be noted and the amounts adjusted accordingly with concurrence of both parties. The Rural Development official must document the justification for the change in the values.

(d) The protective bid amount is made by the lender (with Rural Development prior concurrence) at a foreclosure sale to protect the lender's and Rural Development's interests. The reason for the protective bid is to insure that the collateral is not sold at unrealistically low values to other bidders. The protective bid should be high enough to protect the lender's and Rural Development's interests; however, the protective bid amount should be reasonable.

(e) In normal situations, the lender should not be interested in purchasing the collateral at the sale but merely enters a protective bid amount, if necessary, to protect the collateral and to insure that a reasonable selling price has been established.

(f) If the collateral appraised liquidation value is in excess of the amount owed on the loan plus expenses incurred, the protective bid amount should not exceed the aggregate of these amounts. The lender should never bid more than is owed on the loan.

(g) Should the collateral appraised liquidation value reflect that sales proceeds would cover only the cost of the sale and/or pay off senior lien positions in front of the lien covering the guaranteed loan balance, normally a protective bid amount would not be established.

(h) Protective bid amounts established must be reasonable and equitable. Otherwise, the lender could run into legal problems should the protective bid amount be the successful bid price. For example, the lender could have legal problems when attempting to establish a deficiency judgment.

(i) The protective bid amount established should assure an adequate and equitable return on the collateral, protect the lender and Rural Development's interests and press other interested parties into making higher bids for the collateral at the foreclosure sale.

(j) Protective bid amounts should be reasonable and equitable for an amount when added to the various expenses of sale and other considerations and should not exceed the liquidation appraisal values.

(k) Special considerations to be taken into account in establishing the protective bid amount are:

(1) Expenses of resale. (Increased real estate taxes, commissions, recording costs, etc.)

(2) Interest accrual on the loan.

- (3) Length of time necessary for the resale of the collateral.
 - (4) Collateral deterioration.
 - (5) Maintenance of collateral.
 - (6) Guard services.
 - (7) Seasonability of collateral.
 - (8) Prior liens, taxes.
 - (9) Utilities.
 - (10) Storage costs.
 - (11) Moving expenses.
 - (12) Weatherization.
- (1) A hypothetical example of a protective bid amount is shown below:

(1) The appraised liquidation value of the collateral to be sold is \$1,000,000 and total debt owed on the loan including interest is \$1,600,000. It is estimated that the collateral is in good condition and could be sold within a six-month time frame if the lender bid the property in at the foreclosure sale. One guard would be needed to protect the collateral until sold. Some utility costs would be involved. There are no prior liens or taxes due and it is not necessary to consider the seasonability of the collateral. The protective bid amount would be \$885,000 as shown below:

Protective Bid Amount	\$885,000
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Consideration given for:

a. 6% commission - resale	53,000
b. Interest accruals for 6 mos. @ 10%	44,250
c. Guard service for 6 mos. @ \$120 weekly	2,880
d. Utility costs for 6 mos.	2,220
e. Miscellaneous costs - (Advertising, Atty, fees, etc.)	12,650

APPRAISED LIQUIDATION VALUE	\$1,000,000
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(2) If the highest bid was \$900,000 placed at the liquidation sale, a prudent lender should permit the respective bidder to purchase the property.

(m) The lender who decides upon a foreclosure public auction sale of the collateral must know and fully understand the legal aspects of any superior lien(s) on the collateral as the lender is responsible for payment in full on such liens when selling the collateral unless the property is sold subject to such lien(s). If there are any junior liens the proceeds will be available to pay such liens only to the extent of funds remaining after paying expenses and prior liens.

(n) A final payoff amount in writing as of the day of the sale should be obtained from the superior lienholder. The junior lienholder (lender), to protect its position, could purchase the mortgage for the unpaid balance and have the respective lender assign all of its rights and interests in the mortgage on a non recourse basis. The promissory note should not be marked paid as this would destroy the superior lien position.

(o) The lender should be bidding on the collateral along with all other bidders up to the maximum of the protective bid amount. If the protective bid amount entered by the lender is the highest bid entered, the lender would purchase the collateral. If other bids entered are higher than the lender's protective bid amounts, the person entering the highest bid would purchase the property subject to a confirmation period if a confirmation period was established in the terms of the sale. A confirmation period is normally a good practice as it gives the lender the opportunity to determine all factors and confer with Rural Development on the sale.

(p) If the lender acquired the collateral and it was agreed by the lender and Rural Development in the liquidation plan that this practice would be acceptable to all parties, the Rural Development guarantee would continue in effect and any loss occasioned by accruing interest will be covered to the extent of the guarantee to the date of final settlement provided the lender proceeds expeditiously with the liquidation plan approved by Rural Development.

XIV Method of Disposition of Acquired Collateral by the Lender if the Rural Development final loss claim is not to be paid until the lender disposes of the collateral.

(a) When the lender acquires title to the collateral through a voluntary basis or foreclosure means and the Rural Development final loss claim is not paid until final disposition, the lender should proceed as quickly as possible to develop a plan to see that the collateral is fully protected and a program to dispose of the collateral is commenced.

(b) Any collateral accepted by the lender on a voluntary basis or through foreclosure means must be titled in only the lender's name. Rural Development should never be named as owner or co-owner of the collateral. Rural Development's position is that of a guarantor.

(c) The first step the lender should take after acquiring the collateral is to see that the collateral is protected from deterioration (weather, vandalism). Hazard insurance in an amount necessary to cover the fair market value of the collateral should be maintained by a prudent lender.

(d) The lender should prepare a plan on the best method of sale, keeping in mind any prospective purchasers and send the plan to Rural Development for its review and comments. Rural Development should approve the plan in writing if it concurs with the lender. Otherwise, address the objections to the plan and put the lender on notice of your disapproval.

(e) It may be that the lender addressed such a plan of action when submitting the liquidation plan. If this is the case and the method of sale as addressed in the liquidation plan is still feasible, no further action on the lender's part is necessary. If some modification to the plan is necessary the lender and the Rural Development official should discuss the modification(s) and work together to attempt to assure that the modified liquidation plan is in the best interests of Rural Development and the lender.

(f) Methods and options open to the lender in considering a plan of action to sell the collateral property include:

(1) Direct sale by the lender

(i) Some questions that come to mind should be: (A) should the collateral be sold piecemeal or in bulk?; (B) is the collateral stored at a convenient and safe area?; (C) will the collateral be maintained during the lender's possession?; and (D) should the collateral be improved and "window dressed" in order to obtain a greater value for the collateral? These questions should not be the only ones to consider but are listed to provide some insight in the areas that must be considered when the lender is preparing to sell the collateral.

(ii) Rural Development should be satisfied that the lender's plan of sale is realistic, sound, and maximizes the return on the collateral.

(2) Commercial Broker

(i) In dealing with a commercial broker, the lender should engage an experienced salesman who is knowledgeable about the product or industry for sale. The contract should be on a short-term basis of preferably no more than 120 days. The contract can always be renewed if it is considered worthwhile to do so.

(ii) The commercial broker engaged should have knowledge of the product the lender is selling, the value of such collateral and prospective purchasers throughout the country. Some commercial brokers have computer listings of prospects that may be interested in a particular type of property. The broker would list the property, mail notices to possible buyers and advertise in the respective trade journals and various publications.

(iii) Most important is the engaging of an experienced and knowledgeable broker. If the broker is inexperienced or unsure of himself/herself, he/she is less likely to aggressively seek a prospective purchaser. If the broker finds a prospect, the prospect being experienced and knowledgeable in the type of property for sale, would have a distinct advantage over the inexperienced broker.

(iv) If the property for sale is a general type of commercial building which could be beneficial to several different types of industries, the broker engaged does not need the expertise necessary as in selling larger or more complex property. The lender in those cases, could engage a less experienced commercial broker with multiple listing arrangements.

(v) Also, if possible, when engaging a commercial broker, the prudent lender should have an agreement with the broker to the effect that should the lender locate a purchaser for the property, no sales commission would be paid to the broker. The lender may want to consider continuing its efforts to locate a buyer for the property even though the collateral is in the broker's hands.

(vi) If the lender has engaged the proper commercial broker and the commercial broker cannot locate any serious prospects within a reasonable period of time, the only other approach is a public auction of the property if the collateral has value. This is probably the least desirable method to use in liquidating the collateral.

(3) Public auction sale

(i) This option could be selected first if it is obvious that it will maximize recovery; however, normally the net proceeds from the sale of collateral by means of a public auction will not be as great as the recovery realized by the other methods of sale previously mentioned; therefore, after exhausting all other options to sell the collateral and if the lender has been unable to successfully complete a sale, a public auction sale should be strongly considered. The sale should be carefully planned and well organized. Consideration should be given to engaging a professional auctioneer experienced in selling the type of property that will be listed.

(ii) The fee for a professional auctioneer may be high when compared to the cost of engaging a broker to sell the property or having the lender conduct the sale. However, experience has shown that in engaging a professional auctioneer, the loan official obtains expert services and advice usually resulting in a higher return on the collateral sold.

(iii) A professional auctioneer makes an evaluation of the property for sale, determines the market area and the prospects most likely to be interested in the collateral. Additionally, the auctioneer has knowledge of advertising methods and knows which advertising medium will give the maximum exposure for the dollars spent.

(iv) A real estate auction under the guidance of a professional auctioneer normally attracts more potential buyers because of proper advertising and therefore, usually produces a better price for the property. A professional auctioneer may recover more than its fees charged netting to the lender on the guaranteed loan a larger return than would have been obtained using other methods. In addition, by engaging the professional auctioneer, the lender is more likely to sell the collateral.

(v) The lender, in utilizing a public auction should determine a minimum sale price for the collateral. The amount determined by the lender should carry Rural Development prior concurrence. The minimum amount acceptable can be included in the advertisements or the auctioneer can announce the minimum sale price on the day of the sale. If the lender does not wish to proceed in this manner, the public auction could be held with the lender retaining the approval rights of any sale. Normally, the lender retains a 5-7 day confirmation period on any sale to review the highest bid and consults with Rural Development on whether to accept the bid.

(vi) If the collateral being auctioned consisted of real property and machinery and equipment, consideration should be given to holding the public auction sale in different stages; first to sell the real property; secondly, to sell the machinery; thirdly, to sell in a bulk sale. The lender should determine which arrangement brings the greatest return and if the price meets the lender's and Rural Development approval, the property should be sold.

(vii) When deciding whether to accept the highest bid offer keep in mind that a professional auctioneer has covered the market for the collateral to be sold and informed all interested prospects of the sale. In a case such as this, if it can be said that the public auction was the best and most effective method of determining the true market value of the collateral, the highest bid should probably be accepted and the file documented accordingly. Before turning down the offer, consider the expenses that may continue on the property while being held in the lender's possession along with the length of time the lender may have to hold on to the property before another interested party can be found.

(4) Abandonment of the collateral

(i) The primary purpose of collateral is to afford a net return on the loan funds not repaid in cases of liquidation. However, there will be times when Rural Development will be faced with situations when converting the collateral to cash would result in a loss.

(ii) Situations when this type of action could exist are:

(A) Senior lien claims held by other parties against the guaranteed loan collateral and the senior lien claims are more than the collateral value.

(B) Collateral on the loan has deteriorated to the point where the net sale value (after expenses) of the collateral would not produce any funds that could be applied to the outstanding debt.

(C) Specialized collateral which has little or no value or demand for the collateral taking into consideration the expenses of the sale.

(iii) Anytime there is a case when the conversion of collateral to cash can reasonably be expected to result in a negative net recovery amount, abandonment of the collateral should be strongly considered. However, the lender should rarely find itself in this position. Abandonment of the collateral is a judgment factor and before any decision is made to abandon the collateral make sure the facts are known and document both the facts and the reasons for the decision in the file.

(iv) When considering the action of abandoning the collateral, it must be determined what effect this would have on the pursuing of collection on the guarantor(s) and proceed accordingly.

XV Guarantors

(a) The following considerations should be carefully reviewed before a determination is made whether to release or settle the guarantor(s) liability on any B&I loans:

(1) Age and health of the guarantor(s).

(2) Potential income.

(3) Inheritance prospects.

(4) The possibility that assets have been concealed or improperly transferred by the guarantor(s).

- (5) The availability of assets or income which may be realized.
- (6) Any compromise must be reasonable when compared with what could be recovered if enforced collection Procedures were followed.
- (7) Effect of other guarantor(s) on the loan. May need consent of other guarantor(s) on loan if one guarantor is released.
- (8) Cash consideration or other collateral in exchange for the guarantee.

(b) When releasing a guarantor from liability on a B&I loan, adequate consideration must be received. This concept encompasses some new benefit to Rural Development either in the form of money, additional security or some other benefit to the goals and objectives of Rural Development. When the question of consideration arises in this context, contact the National Office.

XVI Compromise Settlement - Any compromise which involves a forgiveness of the debt must be approved by the Administrator.

- (a) There are situations when compromise of the remaining debt may be in the best interest of everyone concerned. A compromise settlement normally will not take place until all the collateral has been sold and a deficiency loan balance remains.
- (b) A compromise settlement would be considered when attempting to settle with any guarantor(s) on the loan when the deficiency balance of the loan is larger than the financial ability of the guarantor(s) to pay the remaining loan debt.
- (c) Before consideration is given to compromising the debt the lender should have a current financial statement on any guarantor(s). The financial statement(s) must reflect all assets and the lender and Rural Development should be reasonably satisfied all assets are properly reflected.
- (d) If the Rural Development official cannot put full faith in the financial material received or wishes additional documentation to support the financial condition of the guarantor(s), a deposition could be taken from the guarantor(s). The lender can request such action on any guarantee(s) before compromising or settling a claim against the guarantor(s).
- (e) As stated earlier, the current personal financial statement(s) should be compared to the financial statement(s) taken at loan closing to determine if all assets are accounted for. Rural Development expects a full disclosure of all assets before considering any compromise settlement. After reviewing all assets and determining values, a reasonable settlement amount should be set as to the amount the lender and Rural Development feel is fair and adequate under the circumstances. If Rural Development, with the Administrator's approval, can concur in an amount presented by the lender, then the

lender can proceed to effect the compromise with the guarantor. Rural Development should not become involved with the guarantor in any negotiations. It is the lender's job to take all necessary steps. Rural Development is a guarantor for the loan, not the servicer.

(f) Another instance when Rural Development would consider a compromise settlement is in a situation when Rural Development may have a claim against the lender for negligent servicing of the loan. However, before considering compromising a settlement in such cases, review the case with the Regional Attorney to determine what Rural Development's chances are of collecting the debt in full from the lender through the legal process. If there is some doubt that the case can be successfully collected through the legal process, a compromise settlement could be the answer. If fraud or misrepresentation is involved, the case must be sent to the Regional Attorney so that the Regional Attorney can decide whether the case must be referred to the Department of Justice.

(g) Before considering a compromise settlement, all the facts must be known. Ascertain what amount may be collected through the legal process and take into consideration legal costs and time when arriving at a fair compromise settlement.

XVII Liquidation Expenses

(a) When submitting a liquidation plan, the lender must include as part of the plan, an estimate of the liquidation expenses that are expected to be incurred during the course of liquidation. (Paragraph XI. I of the Lender's Agreement). If the expenses to be incurred are not in-house and are reasonable and customary when compared to the anticipated recovery value of the collateral property to be sold, the expenses can be approved by Rural Development when approving the liquidation plan subject to the liquidation expenses being deducted from the gross proceeds from the sale of the collateral.

(b) If after the submission of the liquidation plan, circumstances arise which may dictate a revision of liquidation costs, the lender must obtain Rural Development's written concurrence prior to proceeding with any proposed changes. In-house expenses of the lender such as routine travel costs, accounting expenses or employee's time in handling the liquidation will not be allowed.

(c) Attorney's fees are approved liquidation expenses provided the fees are reasonable and cover legal issues pertaining to the liquidation that could not be properly handled by the lender and its house-counsel or retainer. This should not be construed to mean that when liquidation occurs, the lender engages the services of an attorney to handle the liquidation of the loan. The preparation of the liquidation plan and the liquidation of the loan is the lender's responsibility.

(d) Attorney's fees and/or expenses incurred by the lender while the borrower is in a Chapter 11 reorganization would not be deductible from collateral proceeds as liquidation expenses. A reorganization is not a liquidation. Paragraph IX C 5 of Form RD 449-35 requires the lender to protect the collateral in bankruptcy, receivership and insolvency. Expenses incurred by the lender in these situations are not recoverable by the lender under the loan guarantee.

(e) If a trustee is appointed by the bankruptcy court to sell the collateral under a Chapter 11 liquidation or Chapter 7, the trustee rather than the lender in this instance, is responsible for liquidating the collateral. Most expenses will be the trustee's expenses and will be approved by the court. Normally, even though the loan will then be in liquidation, there will be no liquidation expenses of the lender. If you have questions, contact your Regional Attorney or the National Office.

(f) Pursuit of personal/corporate guarantors who are not the borrower on the loan while the borrower is in Chapter 11 reorganization or the Chapter 7 proceeding is a matter outside the bankruptcy. The automatic stay imposed by the Bankruptcy Code does not apply to proceedings against persons who are not in the bankruptcy proceedings. Reasonable expenses incurred in pursuit of these guarantors (even though the borrower is in bankruptcy) would be allowable provided there was sufficient collateral sold or collections made on the guarantee which would at a minimum cover the expenses.

(g) The lender at Rural Development's request will provide complete records, acceptable to Rural Development, listing of all expenses before payment of a final loss or closing out the loan guarantee. (Paragraph XI. E.3 of the Lender's Agreement)

XVIII Protective Advances

(a) Protective advances generally cannot be authorized unless the borrower is in liquidation. Any advances must constitute an indebtedness of the borrower to the lender and be secured by the security instrument(s). Rural Development's written authorization is required on all protective advances which exceed a total cumulative advance of \$500 to the same borrower. (Paragraph XII of the Lender's Agreement.)

(b) Protective advances include, but are not limited to, advances made for taxes, annual assessments, ground rent, hazard or flood insurance premiums affecting the collateral and other expenses necessary to preserve or protect the security. (Paragraph XII of the Lender's Agreement.)

(c) Protective advances are not generally authorized while the borrower is in a Chapter 11 reorganization. A reorganization is not a liquidation. The bankruptcy court can order protection of the collateral while the

borrower is under Chapter 11 Protection and the lender, whose collateral is subject to being used by the trustee in bankruptcy, should immediately seek adequate protection of the collateral.

(d) When classifying liquidation expenses and protective advances, keep in mind that liquidation expenses do not accrue interest, whereas protective advance amounts do accrue interest at the promissory note rate. Therefore, it is to Rural Development's advantage that whenever possible, any amount authorized by Rural Development during liquidation be classified as liquidation expense. For example, hazard insurance premiums may be a liquidation expense rather than a protective advance if hazard insurance is necessary while the loan is in liquidation. Payment of the hazard insurance premium could also be a protective advance if it is necessary to protect the security of the guaranteed loan. Thus, an item such as payment of hazard insurance, in certain circumstances, could be treated two different ways if it occurred during liquidation.

XIX Bankruptcies

(a) In bankruptcies, there are two separate proceedings; liquidation and reorganization under the bankruptcy court's protection. It is the lender's responsibility to protect the guaranteed loan debt and all collateral securing the loan in bankruptcy proceedings. (Paragraph IX. C.5 of the Lender's Agreement) Section 1980.475 of Subpart E of Part 1980 of this chapter sets forth certain responsibilities of the lender. These responsibilities include, but are not limited to, the following:

(1) The lender will file a proof of claim where necessary and all the necessary papers and pleadings concerning the case.

(2) The lender will attend and where necessary participate in meetings of the creditors and all court proceedings.

(3) The lender, whose collateral is subject to being used by the bankruptcy estate, will immediately seek adequate protection of the collateral. Adequate protection of the collateral, depending on interpretation, may take several forms. In a bankruptcy, the trustee is authorized to sell, lease or use the collateral if the borrower's business is in operation. The only collateral the trustee cannot utilize is cash collateral unless the secured creditor grants permission or the bankruptcy court authorizes the use of such after giving a proper hearing and notice.

(i) Cash collateral means cash, negotiable instruments, documents of title, securities, deposit accounts, or other cash equivalents, such as accounts receivable.

(ii) Concerning machinery, equipment and real estate, adequate protection can be interpreted differently under Chapter 11 reorganization. The bankruptcy trustee could dispose of certain collateral and grant to the secured party a replacement lien on some other collateral which may or may not have the same value. For example, the lender may hold a first lien on a good saleable piece of real estate and could find replacement of this particular parcel of property with a second or possibly a third lien on another parcel of land that the lender may find undesirable for adequate protection. There are no guarantees to the lender when the borrower is in Chapter 11 reorganization that the collateral will be protected to the lender's satisfaction. The lender should be fully aware of what is taking place with the collateral and resist any adverse changes that may be made in the collateral securing the Rural Development guaranteed loan.

(4) Where appropriate, the lender should seek involuntary conversion of a pending Chapter 11 case to a liquidating proceeding under Chapter 7 or under Section 1123 (b) (4) or seek dismissal of the proceedings. A Chapter 11 case can be converted into a liquidating Chapter 11 or Chapter 7 upon the request of the lender if the lender can show cause and it is in the best interest of all creditors. Cause may be:

(i) Continuing losses and very little likelihood that the borrower can successfully reorganize;

(ii) Borrower's failure to submit a plan to the bankruptcy court within the prescribed time set by the court;

(iii) Unreasonable delays by the borrower detrimental to creditors;

(iv) Inability on the borrower's part to submit a sound reorganization plan; or

(v) Bankruptcy court decision denying the proposed reorganization plan and failure on the borrower's part to gain additional time from the bankruptcy court to submit an amended plan.

(5) Rural Development will be kept adequately and regularly informed in writing of all aspects of the proceedings.

(b) In a Chapter 11 reorganization, if an independent appraisal is necessary in Rural Development's opinion, Rural Development and the lender will share such appraisal fee equally.

(c) Lender expenses on Chapter 11 reorganization cases are not to be deducted from the collateral proceeds because a reorganization is not considered liquidation. All expenses incurred (except a collateral

appraisal) by the lender while the borrower is in reorganization are the responsibility of the lender and are not deductible from collateral proceeds or covered under the Rural Development guarantee. Attorney fees incurred by the lender, without exception, cannot be approved. Reasonable and customary liquidation expenses may be deducted from the collateral proceeds in liquidation cases under Chapter 7 or Section 1123 (b) (4), Liquidations, provided the lender is doing the actual liquidation of the collateral and presents adequate written justification for each expense and secures Rural Development's written concurrence prior to incurring the expense.

(d) If a trustee is appointed by the bankruptcy court to sell the collateral under a Chapter 11 liquidation or Chapter 7, the trustee rather than the lender in this instance, is responsible for liquidating the collateral. Normally, any expenses incurred by the lender during this period are not considered liquidation expenses and cannot be deducted from collateral proceeds. The lender is not engaged in the actual liquidation but is performing in a manner considered to be normal servicing of the loan under the circumstances.

(e) If the property is abandoned by the trustee and the lender is actually engaged in actual liquidation, reasonable liquidation expenses would be recoverable from liquidation proceeds with prior written concurrence for each expense from Rural Development before the expense is incurred.

(f) It is the responsibility of the State Program Chief to see that Rural Development is being fully informed by the lender in all bankruptcy cases.

(g) All bankruptcy cases should be reported immediately to the National Office by utilizing and completing a problem/delinquent status report. The Regional Attorney must be promptly informed of the proceedings.

(h) Even if the loan is not in default the State Director may approve the repurchase of the unpaid guaranteed portion of the loan from the holder(s) to reduce interest accruals during Chapter 7 proceedings or after a Chapter 11 proceeding becomes a liquidation proceeding. (Paragraph 10.C. of the Loan Note Guarantee). On loans in bankruptcy, any loss payment must be handled in accordance with the Lender's Agreement and carry the approval of the State Director.

XX Negligent Servicing

(a) Negligent servicing is defined in the Lender's Agreement "as the failure to perform those services which a reasonably prudent lender would perform in servicing its own portfolio of loans that are not guaranteed. The term includes not only the concept of a failure to act but also not acting in a timely manner or action contrary to the manner in which a reasonably prudent lender would act up to the time of loan maturity or until a final loss is paid."

(b) If a lender fails to act responsibly as stated above, the guarantee is unenforceable by the lender to the extent any loss is occasioned by negligent servicing. As a practical matter, in many cases it is hard to prove negligent servicing actually caused a loss. A connection must be made between the lender's act or failure to act and the loss amount to be established. The loss amount must be ascertainable.

(c) When such a case arises, obtain all the facts and submit these facts in writing to the Regional OGC for a legal opinion. Do not notify the lender of any negligent act until such time as the Regional OGC legally clears such actions.

(d) Legally Rural Development cannot withdraw the guarantee for negligent servicing. The response to the lender in negligent servicing cases, when no loss has been established, should merely put the lender on notice that the act(s) of negligent servicing will cause the guarantee to be unenforceable to the extent the act(s) causes a loss.

(e) When the lender holds the guaranteed portion of the loan and Rural Development refuses to reimburse the lender for the portion of the guarantee because of negligent servicing, while the lender must institute suit, Rural Development will have the burden of proof regarding the loss occasioned by negligent servicing. Also, if Rural Development repurchased the guaranteed portion and the lender refuses to reimburse Rural Development for the amount designated as negligent servicing, Rural Development bears the burden of proof in court.

(f) An amount of loss must be ascertainable in negligent servicing cases. If this cannot be accomplished, a legal case against the lender would not be handled by the U.S. Attorney. A negotiated settlement would be a practical course to take in these situations.

XXI Fraud or Misrepresentation

(a) The guarantee constitutes an obligation supported by the full faith and credit of the United States and is incontestable except for fraud or misrepresentation of which the lender has actual knowledge at the time it became such lender or which the lender participates in or condones.

(b) Fraud is established by showing that an individual (lender/borrower) made a material representation, and such representation was false, that the individual knew it was false when the individual made it and it was made with the intention that the individual would benefit from such misrepresentation and another party would act in reliance on such information and suffer damages.

(c) Misrepresentation is generally any material statement of alleged fact which is untrue, or partly untrue, or which is so stated as to lead to false conclusions. For example, a false description of the condition of property on an insurance application which would lead to the wrong premium being charged, is clearly a misrepresentation.

(d) Nondisclosure can amount to misrepresentation or fraud if a transaction is based on the existence of a particular fact and one party fails to tell the other that the circumstances have changed with regard to that particular fact.

(e) If the borrower makes fraudulent representation to the lender to induce the lender/Rural Development to provide a loan or other benefits, which the lender/Rural Development relied upon to its detriment, the loan note guarantee would still be enforceable by the lender as long as the lender had no knowledge or participated in the misrepresentations. When such an act occurs and Rural Development becomes knowledgeable of such act, the Regional Attorney must be immediately notified of all such facts for a determination of action to be taken by Rural Development.

(f) If the lender made fraudulent representations, the loan note guarantee would be contestable for the full amount of the loan in most cases. However, Rural Development must:

(1) Prove that the lender made or participated in making a false representation.

(2) Prove that the lender had knowledge or belief that the representation was false, or that the lender had an insufficient basis to make the representation.

(3) Prove that the lender intended to induce the Government to act or refrain from action in reliance on the misrepresentation.

(4) Prove justifiable reliance by the Government on the misrepresentation.

(5) Prove that such reliance caused damage to the Government.

(g) If Rural Development becomes aware of fraud or misrepresentation by the lender, the Regional Attorney must be notified immediately of all the facts for a determination of the action to be taken by Rural Development.

(h) If for some reason Rural Development strongly suspects the lender may have committed fraud or misrepresentation, it may be necessary to request OIG to do an investigation to determine the facts. If possible, this action should take place prior to referral of the case to OGC.

(i) If the guaranteed portion of the loan has been sold in the secondary market and the holder makes a demand on Rural Development to purchase the guaranteed portion of the loan under the conditions set forth in paragraphs x C. and D of Form RD 449-35, Rural Development has a legal responsibility to repurchase the guaranteed portion of the loan except for fraud or misrepresentation of which the holder has actual knowledge at the time it became the holder. (Paragraph 3 of the Loan Note Guarantee)

XXII Final Report of Loss

(a) Before approval by Rural Development any final loss report, the lender must account for all funds during the period of liquidation, disposition of the collateral, all costs incurred and any other information necessary for the successful completion of liquidation.

(b) Rural Development, upon receipt of the final accounting and the report of loss, may review and determine the final loss. (Paragraph XI. E.3 of the Lender's Agreement). If Rural Development has any questions regarding the amounts set forth in the final report of loss, the matter should be investigated. The lender should make its records available and otherwise assist Rural Development in making the investigation. If Rural Development finds any discrepancies, Rural Development will contact the lender as soon as possible for any necessary corrections.

(c) Documentation should accompany the report of loss to support the figures shown on the final loss report. Areas of special concern include:

(1) The lender should document and show that all of the collateral has been accounted for, properly liquidated, liquidation proceeds properly accounted for and applied correctly on the loan. The State Office must be satisfied that the lender has accomplished this in the manner set forth in Form RD 449-35 and that the lender maximized the collections in conducting the liquidation.

(2) The lender should show a breakdown on any protective advance amount as to the payee, purpose of the expenditure, date paid, evidence supporting the amount expended was proper and data showing the bill was paid.

(3) Liquidation expenses must be accounted for by the lender in the same manner as protective advance amounts. The lender should show a breakdown of the liquidation expenses as to the payee, purpose of the expenditure, date paid, evidence supporting the amount expended was proper and data showing the bill was paid. Rural Development should review all liquidation expenses to determine if the expenses were proper, reasonable and claimed in accordance with the approval given by Rural Development.

(4) Accrued interest owed to the lender should be supported by attachments as to how the amount was accrued by the lender. A copy of the promissory note and ledger should also be attached. As part of the review of the final loss claim, the State Director should be assured that the lender has not accrued interest on the amount of the loan that is equal to the estimated loss payment. The State Office is responsible for the accuracy of the interest calculations on the final report of loss before submission to the Finance Office.

(d) If the interest on the loan was a variable interest rate tied to a published standard, the interest charged by the lender should be supported by documentation of when the changes in the interest rate became effective.

Rural Development should review this to see that the lender complied with the rise and fall of the changes in the selected base rate and the changes, if any, were made no more often than quarterly.

(e) The maximum loss that can be paid by Rural Development on any loan guarantee will never exceed the original amount guaranteed plus any accrued interest times the percentage of guarantee. For example, a \$1,000,000, 90 percent guaranteed loan with \$100,000 accrued interest on the loan and there is no collateral to liquidate and no payments were made on the loan, the maximum loss would be 900,000 principal and \$90,000 accrued interest.

(f) In the example cited, if there were protective advance amounts, these amounts could not be authorized or paid by Rural Development since the maximum amount was reached. Rarely would a situation occur as stated as normally payments have been made on the loan before liquidation takes place and there is collateral to be sold in liquidation cases.

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Suggested Format for the Opinion
of the Lender's Legal Counsel

(LEGAL OPINION TO BE RETYPED ON LENDER'S COUNSEL'S LETTERHEAD)

To: (Name of Lender)

I/we have acted as counsel to (Lender) in connection with a \$ (amount) (type) loan by the (Lender) (hereinafter "the Lender") to (Borrower) (hereinafter "Borrower"), the terms of which loan are set forth in a certain Loan Agreement (hereinafter "the Loan Agreement") executed by the Lender and Borrower on (date).

In connection with this loan, I/we have examined:

1. The corporate records of Borrower, including its Articles of Incorporation, By-Laws and Resolutions of its Board of Directors.
2. The Loan Agreement between the Lender and Borrower.
3. The Security Agreement executed by Borrower on (date).
4. The Guaranty (where applicable) executed on (date) by (personal guarantors).
5. Financing Statements executed by Borrower and the Lender.
6. Real Estate Mortgages dated (date) and executed by Borrower in favor of the Lender.
7. Real Estate Mortgages dated (date) and/or other security documents dated (date) executed by (personal guarantors) in favor of the Bank.
8. The appropriate title and/or lien searches relating to Borrower's property.
9. The pledge of stock and instruments related thereto.
10. Such other materials, including relevant provisions of the laws of this state as I/we have deemed pertinent as a basis for rendering the opinion hereafter set forth.

IN SOME CIRCUMSTANCES

11. Lease(s) between Borrower and (lessor's name) for the rental of (property being rented), (if real property, give the address of the premises; if machinery equipment, etc., give brief, precise description of property for a (length of lease) term commencing on (date).

Based on the foregoing examinations, I am/we are of the opinion and advise you that:

1. Borrower is a duly organized corporation in good standing under the laws of the Commonwealth/State of (State) .
2. Borrower has the necessary corporate power to authorize and has taken the necessary corporate action to authorize the Loan Agreement and to execute and deliver the Note, Security Agreement, Financing Statement, and Mortgage. Said instruments hereinafter collectively referred to as the "Loan Instruments."
3. The Loan Instruments were all duly authorized, executed, and delivered and constitute the valid and legally binding obligation of the Borrower and collectively create a valid (first) lien upon or valid security interest in favor of the Lender, in the security covered thereby, and are enforceable in accordance with their terms, except to the extent that the enforceability (but not the validity) thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors' rights.
4. The execution and delivery of the Loan Instruments and compliance with the Provisions thereof under the circumstances contemplated thereby did not, do not and will not in any material respect conflict with, constitute default under, or contravene any contract or agreement or other instrument to which the Borrower is a Party or any existing law, regulation, court order, or consent decree or device to which the Borrower is subject.
5. All applicable Federal, State and local tax returns and reports as required have been duly filed by Borrower and all Federal, State and local taxes, assessments and other governmental charges imposed upon Borrower or its respective assets, which are due and payable, have been paid.
6. The Guaranty has been duly executed by the Guarantors and is a legal, valid and binding joint and several obligations of the Guarantors, enforceable in accordance with its terms, except to the extent that the enforceability (but not the validity) thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors' rights.
7. All necessary consents, approvals, or authorizations of any governmental agency or regulatory authority or of stockholders which are necessary have been obtained. The improvements and the use of the property comply in all respects with all Federal, State, and local laws applicable thereto.
8. (In cases involving subordinate or other than first lien position) That the mortgage/deed of trust on Borrower's real estate and (fixtures, e.g. machinery and equipment) and the security interest on (type of collateral,

17. The Lender's lien has been duly noted on all motor vehicle titles, stock certificates or other instruments where such notations are required for proper perfection of security interests therein.

18. That a valid pledge of the outstanding and unissued stock and/or shares of Borrower has been obtained and the Lender has a validly perfected and enforceable security interest in the shares/stock of Borrower, except to the extent the enforceability thereof may be limited by laws of bankruptcy, insolvency, or other laws generally affecting creditors rights.

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INSTRUCTIONS FOR LOAN GUARANTEES FOR DROUGHT AND DISASTER RELIEF

A. In general. Drought and Disaster (D&D) guaranteed loans are authorized by §331 ("Disaster Assistance for Rural Business Enterprises") of the Disaster Assistance Act of 1988, which provides for guarantees of up to 90 percent of the unpaid principal amount of qualifying loans. Interest and protective advances are not covered by the guarantee. Drought and Disaster Guaranteed loans may be either to assist in alleviating financial distress caused to rural business entities, directly or indirectly, by drought, hail, excessive moisture, or related conditions occurring in 1988, or to assist such entities that refinance or restructure debt as a result of losses incurred, directly or indirectly, because of such natural disasters. Where used in this appendix, the term "natural disaster(s)" refers only to drought, hail, excessive moisture, and related conditions occurring in 1988. All provisions of Subparts A and E of Part 1980 of this chapter apply to D&D loans, except as provided in this appendix. All forms used in connection with a D&D loan will be those used in connection with a B&I guaranteed loan, except for the following three forms that are incorporated in this Appendix I of this Subpart E, made a part hereof, and appear in the Federal Register following the body of this appendix as Exhibits A, B, and C in the following order:

- (1) Form RD 1980-68, "Lender's Agreement - Drought and Disaster Guaranteed Loans," will be used instead of Form RD 449-35, "Lender's Agreement."
- (2) Form RD 1980-69, "Loan Note Guarantee - Drought and Disaster Guaranteed Loans," will be used instead of Form RD 449-34, "Loan Note Guarantee."
- (3) Form RD 1980-70, "Assignment Guarantee Agreement - Drought and Disaster Guaranteed Loans," will be used instead of Form RD 449-36, "Assignment Guarantee Agreement."

B. Loan purposes. Except for §§1980.411(a)(11), 1980.412, and paragraph C., below, loan proceeds may be used for purposes described in §1980.411(a) if such use of loan proceeds will assist in alleviating financial distress caused, directly or indirectly, by drought, hail, excessive moisture, or related conditions which occurred in 1988. In lieu of the debt refinancing requirements in §1980.411(a)(11), the following refinancing requirements apply to D&D loans. Loan proceeds to be used for refinancing must be used solely for refinancing or restructuring of debts as a result of losses incurred, directly or indirectly, as a result of drought, hail, excessive moisture, or related conditions occurring in 1988, and such refinancing or restructuring of debt(s) must be essential for the borrower to meet its financial obligations in a timely fashion. In addition, D&D loan proceeds may be used for hotels, motels, tourist or recreation facilities which meet the eligibility requirements for D&D guaranteed loans. (Revised 6-28-89, PN 111.)

(1-3-89) SPECIAL PN

C. Ineligible loan purposes. See §1980.412. Except for hotels, motels, tourist and recreation facilities mentioned in paragraph B of this appendix, purposes listed as ineligible B&I loan purposes are ineligible D&D loan purposes. In addition, D&D guaranteed loans may not be used for: (Revised 6-28-89, PN 111)

- (1) Business expansion, acquisition of real estate, machinery, equipment, inventory, other goods or services, or for any other purpose unless related directly to the financial distress or loss that is the basis for the D&D loan.
- (2) Any eligible agricultural production purpose if annual tillage of the soil is involved.
- (3) Refinancing or restructuring debt(s) which are or were in payment default more than 60 consecutive days during the 12 months preceding the date of the adverse financial effect of the natural disaster of 1988 upon the borrower.

D. Transactions which will not be guaranteed. In addition to transactions listed in §1980.413, Rural Development will not guarantee:

- (1) D&D guaranteed loan(s) to any borrower if the total cumulative principal amount of D&D guaranteed loan(s) to that borrower would exceed \$500,000, or
- (2) Any D&D guaranteed loan if the completed application is not received by Rural Development on or before September 30, 1991.

E. Borrower equity requirements. See §1980.441. In lieu of the borrower equity requirements in §1980.441, paragraphs (a) and (b), the following applies to D&D loans. Tangible balance sheet equity must be positive when the Loan Note Guarantee is issued. Equity must be such that, when considered with other credit factors, repayment of the loan and the continued success of the business operation are reasonably assured. Requirements of §1980.441(c) apply to D&D guaranteed loans.

F. Filing and processing preapplications and applications. See §1980.451. All requirements of §1980.451 remain in effect. But, in addition to the information required as part of a preapplication under §1980.451(f), and unless previously submitted, as a part of an application under §1980.451(i), evidence is required which demonstrates:

- (1) The causal relationship between a 1988 natural disaster and the financial distress or loss upon which the preapplication or application is based; and,

(2) That the amount of the loan requested is not greater than the amount necessary for curing the problems caused by the natural disaster. Financial distress or loss shall be determined on the basis of a comparison of financial data for comparable periods of time and need not necessarily be based on data at the year's end. Evidence submitted may include, but is not limited to, the following:

(a) Evidence of financial loss or distress (including loss or distress caused by business interruption) resulting from physical damage caused by natural disaster, or

(b) Evidence that the financial loss and/or distress of the business is the direct or indirect result of loss of sales, business interruption, loss of markets, shortage of raw materials, or decline in patronage or customers caused by a natural disaster. It must be shown that business operations were damaged as a result of such natural disaster.

G. Loan guarantee limit. See §1980.20 of Subpart A. The maximum loss covered by the Loan Note Guarantee, Form RD 1980-69, can never exceed the percentage of guarantee multiplied by the unpaid principal amount of the loan as evidenced by the note(s) or by assumption agreement(s). Interest, capitalized interest, and protective advances are not covered by the guarantee of a D&D loan.

H. Percentage of guarantee. See §1980.420. The maximum percentage of guarantee on a D&D loan is 90 percent of the unpaid principal.

I. Lender's existing unguaranteed exposure. The provisions of §1980.452 ADMINISTRATIVE C. 1(d) do not apply.

J. No direct or "insured" loans. §§1980.423(b), 1980.488(b), 1980.481, 1980.411(b), and other provisions of this subpart dealing with "insured" or direct loans do not apply to D&D loans. All D&D loans are Rural Development guaranteed loans. Rural Development has no authority to make D&D loans directly to borrowers.

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Appendix I, Exhibit A in PDF ONLY.

Appendix I, Exhibit B in PDF ONLY.

Appendix I, Exhibit C in PDF ONLY.

BUSINESS AND INDUSTRY
APPLICATION PRIORITY POINTS SCORING

Name _____ Date: _____
State _____

List the maximum points the applicant is eligible for under each category.

Jobs created _____ Jobs saved _____ Total jobs _____
Loan amount \$ _____, _____, _____ Index factor _____
State income \$ _____, _____ Indexed State income \$ _____, _____
National unemployment _____.% Area unemployment _____.%

1. Location:

- A. Located in city or area under 25,000. (10 points) _____
- B. Located in city or area under 25,000 population which is a high unemployment area. (20 points) _____
- C. Located in a high unemployment area and the borrower has certified that at least 25 percent of its employees will be displaced farmers. (35 points) _____

2. Jobs:

- A. Project will contribute to the overall economic stability of the area and generate employment beyond entrepreneur's household. (10 points) _____
- B. Project will contribute to the overall economic stability of the area and provide significant employment in the area. (20 points) _____
- C. Project will contribute to the overall economic stability of the area, provide significant full-time employment in the area, and retain a significant number of jobs in the area. (35 points) _____

3. Job cost: [See RD Instruction 1980-E. §1980.451 (d) (3) (iii), for calculation instructions]

- A. Job cost score greater than 1.5 but less than 2.0. (5 points) _____
- B. Job cost score from 1.0 to 1.5. (15 points) _____
- C. Job cost score less than 1.0. (25 points) _____

4. Additional points: [Give points for each criteria met]
- A. Loan is less than 50 percent of project cost.
(5 points) _____
 - B. Percentage of guarantee is 10 or more percentage
points less than the maximum allowable. (5 points) _____
 - C. Project will create a significant number of part-
time or seasonal jobs in addition to permanent
full-time jobs. (10 points) _____
5. State Director's administrative points: (May be up to
20 points but documentation must support the number
given)
- _____
- _____
- _____
- _____
- Total points _____

Is applicant eligible for veteran preference? _____

Date served: _____ to _____

State Director

THE FOLLOWING TO BE COMPLETED BY THE NATIONAL OFFICE ON
APPLICATIONS SUBMITTED TO THE NATIONAL OFFICE:

Administrator's administrative points: (May be up to
20 points but documentation must support the number
given)

Total points _____

REGULATIONS FOR LOAN GUARANTEES FOR DISASTER ASSISTANCE
FOR RURAL BUSINESS ENTERPRISES

A. In General. Disaster Assistance for Rural Business Enterprises (DARBE) guaranteed loans are authorized by §401 of the Disaster Assistance Act of 1989, which provides for guarantees of up to 90 percent of the unpaid principal and interest amount of qualifying loans, or \$2,500,000 whichever is less, to any one borrower. DARBE guaranteed loans may be either to assist in alleviating financial distress caused to rural business entities, directly or indirectly, by drought, freeze, storm, excessive moisture, earthquake or related conditions occurring in 1988 or 1989, or to assist such entities that refinance or restructure debt as a result of losses incurred, directly or indirectly, because of such natural disasters. Where used in this appendix, the term "natural disaster(s)" refers only to drought, freeze, storm, excessive moisture, earthquake and related conditions occurring in 1988 or 1989. All provisions of Subparts A and E of Part 1980 of this chapter apply to DARBE loans, except as provided in this appendix. All forms used in connection with a DARBE loan will be those used in connection with a Business and Industrial (B&I) guaranteed loan, except for the following three forms that are incorporated in this Appendix K of this Subpart E, made a part hereof, and appear in the Federal Register following the body of this appendix as exhibits A, B, and C in the following order: (Revised 5-9-90, PN 133)

(1) Form RD 1980-71, "Lender's Agreement - Disaster Assistance for Rural Business Enterprise Guaranteed Loans," will be used instead of Form RD 449-35, "Lender's Agreement."

(2) Form RD 1980-72, "Loan Note Guarantee - Disaster Assistance for Rural Business Enterprise Guaranteed Loans," will be used instead of Form RD 449-34, "Loan Note Guarantee."

(3) Form RD 1980-73, "Assignment Guarantee Agreement - Disaster Assistance for Rural Business Enterprise Guaranteed Loans," will be used instead of Form RD 449-36, "Assignment Guarantee Agreement."

B. Loan purposes. Loan proceeds may be used for purposes described in §1980.411(a), except in lieu of the debt refinancing requirements in §1980.411(a)(11), the following refinancing requirements apply to DARBE loans. Loan proceeds to be used for refinancing must be used solely for refinancing or restructuring of debts as a result of losses incurred, directly or indirectly, as a result of drought, freeze, storm, excessive moisture, earthquake or related conditions occurring in 1988 or 1989, and such refinancing or restructuring of debt(s) must be essential for the borrower to meet its financial obligations in a timely fashion. DARBE loan proceeds may be used for hotels, motels, tourist, or recreation facilities which meet the eligibility requirements of DARBE guaranteed loans in addition to the eligible loan purposes as stated in RD Instruction 1980-E. In addition, DARBE loan proceeds may be used for business enterprises engaged in agricultural production (Production agriculture) which means the

cultivation, production (growing), and harvesting, either directly or through integrated operations, of agricultural products (crops, animals, birds, and marine life, either for fibers or food for human consumption), and disposal or marketing thereof, the raising, housing, feeding (including commercial custom feedlots), breeding, hatching, control and/or management of farm and domestic animals. Other eligible uses of loan proceeds under agricultural production include; (Revised 5-9-90, PN 133)

- (1) Commercial nurseries primarily engaged in the production of ornamental plants and trees and other nursery products such as bulbs, florists' greens, flowers, shrubbery, flower and vegetable seeds, sod, and the growing of vegetables from seed to the transplant stage.
- (2) Forestry which includes establishments primarily engaged in the operation of timber tracts, tree farms, forest nurseries, and related activities such as reforestation.
- (3) Loans for livestock and poultry processing as identified under eligible purposes.
- (4) The growing of mushrooms or hydroponics.

In addition, those business enterprises which qualify for assistance as agricultural production must be ineligible entities for Rural Development farmer program loans because the entity exceeds the definition of a family-size farm as defined by RD Instruction 1941-A, §1941.4 (d).

C. Ineligible loan purposes. RD Instruction 1980-E, §1980.412 are ineligible purposes for DARBE guaranteed loans except for hotels, motels, tourist, recreation facilities and agricultural production (production agriculture) as defined in §1980.412(e), DARBE guaranteed loans may not be used for:

- (1) Business expansion, acquisition of real estate, machinery, equipment, inventory, other goods or services, or for any other purpose unless related directly to the financial distress or loss that is the basis for the DARBE guaranteed loan.
- (2) Alleviating financial distress of entities engaged in agricultural production that are eligible for other Rural Development-type farm loan programs.

D. Transactions which will not be guaranteed. In addition to transactions listed in RD Instruction 1980-E, §1980.413, except for §1980.413(a)(3). Rural Development will not make DARBE guaranteed loans if the completed application is not received by Rural Development on or before September 30, 1991, nor will Rural Development make subsequent DARBE guarantee loans.

E. Borrower equity requirements. See RD Instruction 1980-E, §1980.441. In lieu of the borrower equity requirements in §1980.441, paragraphs (a) and (b), the following applies to DARBE loans. Tangible balance sheet equity must be positive when the Loan Note Guarantee is issued. Equity must be such that, when considered with other credit factors, repayment of the loan and the continued success of the business operation are reasonably assured. Requirements of §1980.441(c) apply to DARBE guaranteed loans.

F. Filing and processing preapplications and applications. See RD Instruction 1980-E, §1980.451. All requirements of §1980.451 remain in effect. In addition to the information required as part of a preapplication under §1980.451(f), and unless previously submitted as a part of an application under §1980.451(i) evidence is required which demonstrates to Rural Development's satisfaction:

- (1) The causal relationship between a 1988 or 1989 natural disaster and the financial distress or loss upon which the preapplication or application is based; and,
- (2) That the amount of the loan requested is not greater than the amount necessary for curing the problems caused by the natural disaster. Financial distress or loss shall be determined on the basis of a comparison of financial data for comparable periods of time and need not necessarily be based on data at the year's end. Evidence submitted may include, but is not limited to, the following:
 - (a) Evidence of financial loss or distress (including loss or distress caused by business interruption) resulting from physical damage caused by natural disaster, or
 - (b) Evidence that the financial loss and/or distress of the business is the direct or indirect result of loss of sales, business interruption, loss of markets, shortage of raw materials, or decline in patronage or customers caused by a natural disaster. It must be shown that business operations were damaged as a result of such natural disaster.
- (3) Evidence of compliance with Sodbuster and Swampbuster requirements as referenced in paragraph K below.

G. Loan guarantee limit. The total principal amount of DARBE guaranteed loans to any one borrower cannot exceed \$10,000,000. The maximum loss covered by Form RD 1980-72, "Loan Note Guarantee DARBE," issued on any one borrower can never exceed the percentage of guarantee multiplied by the unpaid principal and accrued interest on the loan as evidenced by the note(s) or by assumption agreement(s), and protective advances, or \$2,500,000, whichever is the lesser amount. (Revised 1-3-90, SPECIAL PN)

H. Percentage of guarantee. The provisions of RD Instruction 1980-E, §1980.420 will not apply to DARBE. For loans in excess of \$2,000,000 the percentage of guarantee will be calculated so that the guaranteed portion of the principal amount of the loan cannot exceed \$2,000,000. For loans of \$2,000,000 or less the maximum percentage of guarantee will be 90 percent. For example, a loan of \$10,000,000 would not exceed a 20 percent guarantee; a \$5,000,000 loan would not exceed a 40 percent guarantee, etc. (Revised 1-3-90, SPECIAL PN)

I. Lender's existing unguaranteed exposure. The provisions of §1980.452 ADMINISTRATIVE C. 1(d) do not apply.

J. No direct or insured loans. RD Instruction 1980-E, §§1980.423(b), 1980.488(b), 1980.481, 1980.411(b), and other provisions of this subpart dealing with insured or direct loans do not apply to DARBE loans. All DARBE loans are Rural Development guaranteed loans. Rural Development has no authority to make DARBE loans directly to borrowers.

K. Sodbuster and Swampbuster requirements. The provisions of 7 CFR part 1970 will apply to loans made to rural business enterprises engaged in agricultural production. (Revised 04-01-16, SPECIAL PN.)