**PART 4287 - SERVICING**

**Subpart B - Servicing Business and Industry Guaranteed Loans**

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**Subpart B - Servicing Business and Industry Guaranteed Loans**

**§ 4287.101 Introduction.**

**(a) As of October 1, 2020, this subpart is specifically applicable to and only contains regulations for servicing Business and Industry (B&I) Loans guaranteed by the Agency prior to October 1, 2020 and Business and Industry loans under the authority of the Coronavirus Aid, Relief, and Economic Security Act (CARES Act) (Pub. L. 116-136) to provide B&I guarantees for loans needed as a result of the Coronavirus Disease 2019 (COVID-19) pandemic for working capital loan purposes to support business operations and facilities in rural areas (B&I CARES Act Program Loans). Other than B&I CARES Act Program Loans and B&I loans guaranteed by the Agency prior to October 1, 2020, this subpart is no longer used for servicing B&I loans guaranteed by the Agency. Requirements for B&I loans guaranteed by the Agency after October 1, 2020 (other than B&I CARES Act Loans) may be found at 7 CFR part 5001.**

**(b) The lender is responsible for servicing the entire loan and must remain mortgagee and secured party of record, notwithstanding the fact that another party may hold a portion of the loan.**

**(c) Whether specifically stated or not, whenever Agency approval is required, it must be in writing. Copies of all forms and regulations referenced in this subpart may be obtained from any Agency office and from the USDA Rural Development Web site at http://www.rd.usda.gov/publications. Whenever a form is designated in this subpart, that designation includes predecessor and successor forms, if applicable, as specified by the Agency.** *Any portion of this Instruction appearing in italicized type is considered by the Agency to be administrative procedure and has not been published as part of the regulation in the Federal Register.*

**§ 4287.102 Definitions and abbreviations.**

**The definitions and abbreviations contained in § 4279.2 of this chapter apply to this subpart.**

**§ 4287.103 Exception authority.**

**Section 4279.15 of this chapter applies to this subpart.**

**§§ 4287.104 - 4287.105 [Reserved]**

**§ 4287.106 Appeals.**

**Section 4279.16 of this chapter applies to this subpart.**

**§ 4287.107 Routine servicing.**

**The lender is responsible for servicing the entire loan and for taking all servicing actions that a reasonably prudent lender would perform in servicing its own portfolio of loans that are not guaranteed. The lender may contract for services but is ultimately responsible for underwriting, loan origination, loan servicing, and compliance with all Agency regulations. Form RD 4279-4, "Lender's Agreement," is the contractual agreement between the lender and the Agency that sets forth some of the lender's loan servicing responsibilities. These responsibilities include, but are not limited to, periodic borrower visits, the collection of payments, obtaining compliance with the covenants and provisions in the loan agreement, obtaining and analyzing financial statements, ensuring payment of taxes and insurance premiums, maintaining liens on collateral, keeping an inventory accounting of all collateral items, and reconciling the inventory of all collateral sold during loan servicing, including liquidation.** *The State Director has the primary responsibility for ensuring that the lender is servicing the loan in a prudent manner as required by the Lender's Agreement and the regulations governing the program and that the lender and borrower are abiding by the terms of the loan documents. Loan servicing is intended to be preventive rather than curative. Prompt follow-up on delinquent accounts and early recognition of and pursuing a solution to potential problems are keys to resolving many problem accounts. The lender should be immediately notified in writing when the Agency suspects noncompliance with the legal instruments governing the loan. In the event the State Office becomes aware of lender noncompliance with any provision of the loan agreement, Lender's Agreement, Loan Note Guarantee, or other similar document, the lender is to be notified in writing of the Full Faith and Credit provisions as they relate to the enforceability of the Loan Note Guarantee, with a copy of the letter to be included in the case file. The Regional OIG should be contacted when fraud or misrepresentation is suspected. All servicing actions that are submitted to the National Office must be sent in the format set forth in Appendix A of this subpart.*

*(a)* **Lender reports and annual renewal fee. The lender must report the outstanding principal and interest balance and the current loan classification on each guaranteed loan semiannually (at June 30 and December 31), using either the USDA Lender Interactive Network Connection (LINC) system** *(see Appendix F for guidance on the LINC system)* **or Form RD 1980-41, "Guaranteed Loan Status Report." The lender must transmit the annual renewal fee to the Agency in accordance with § 4279.120(b) of this chapter calculated based on the December 31 semiannual status report.** *Copies of semiannual reports should be filed in the case file.*

**(b) Loan classification. The lender must provide the loan classification or rating under its regulatory standards as of loan closing, using either the LINC system or Form 1980-19, "Guaranteed Loan Closing Report." When the lender changes the loan**

**classification in the future, the lender must notify the Agency within 30 days, in writing, of any change in the loan classification.** *The Agency is required to classify all loans within the guaranteed loan portfolio (see Appendix G for loan classification guidance). When the lender uses a different classification system, the Agency must convert the lender's classification to a corresponding GLS classification for entry into GLS. Loan classifications may change during the term of a loan. If the Agency feels a change in classification may be warranted, or disagrees with the lender's classification, the Agency should conduct its own analysis of the loan and discuss concerns with the lender. The Agency's opinion of the appropriate loan classification must be entered into GLS within 30 days of receipt of the lender's classification. The integrity of the data in GLS is vitally important, and every effort should be made to maintain GLS in a current status.*

(c) **Agency and lender conference. At the Agency's request, the lender must consult with the Agency to ascertain how the guaranteed loan is being serviced and that the conditions and covenants of the loan agreement are being enforced.** *The Agency will hold conferences with the lender at least annually. An Agency and lender conference may be a face-to-face visit or held via teleconference and must be documented on Form RD 4279-15, "Field Visit Review Report." The Agency, at a minimum, should remind the lender of its servicing responsibilities under the Lender's Agreement during the conference, review the lender's latest financial analysis, and check the loan classification. It is suggested that the application of loan payments also be reviewed. The Agency should:*

*(1) Coordinate the conference with the lender.*

*(2) Prepare for the conference by reviewing the previous field visit reports.*

*(3) During the conference, discuss with the lender the borrower's performance and financial reporting, and review the lender's analysis of the reports.*

*(4) Determine the economic impact of the program by verifying jobs created and saved and documenting the number of employees broken down by full time and part time jobs.*

**(d) Borrower financial reports. The lender must obtain, analyze, and forward to the Agency the borrower's and any guarantor's annual financial statements required by the loan agreement within 120 days of the end of the borrower's fiscal year. States, local government, Indian Tribes, institution of higher education, and nonprofit organization borrowers who meet the Federal awards expended threshold established in 2 CFR part 200, subpart F, "Audit Requirements" during their fiscal year must submit an audit conducted in accordance with 2 CFR 200, subpart F. When the borrower's audit is conducted in accordance with 2 CFR 200, subpart F, audits must be submitted no**

**later than nine months after the end of the borrower's fiscal year or 30 days after the borrower's receipt of the auditor's report, whichever is earlier. The lender must analyze these financial statements and provide the Agency with a written summary of the lender's analysis, ratio analysis, and conclusions, which, at a minimum, must include trends, strengths, weaknesses, extraordinary transactions, violations of loan covenants and covenant waivers proposed by the lender, any routine servicing actions performed, and other indications of the financial condition of the borrower. Spreadsheets of the financial statements must also be included. Following the Agency's review of the lender's financial analysis, the Agency will provide a written report of any concerns to the lender. Any concerns based upon the Agency's review must be addressed by the lender. If the lender makes a reasonable attempt to obtain financial statements but is unable to obtain the borrower's cooperation, the failure to obtain financial statements will not impair the validity of the Loan Note Guarantee.** *See Appendix G for credit evaluation guidance on the lender's analysis of borrower financial statements. For reporting requirements for public bodies, nonprofit corporations, and Indian Tribes see § 4279.71 of subpart A of part 4279.*

**(e) Protection of Agency interests. If the Agency determines that the lender is not in compliance with its servicing responsibilities, the Agency reserves the right to take any action the Agency determines necessary to protect the Agency's interests with respect to the loan. If the Agency exercises this right, the lender must cooperate with the Agency to rectify the situation. In determining any loss, the Agency will assess against the lender any cost to the Agency associated with such action.**

*(f) GLS. State Offices should place increased emphasis on maintaining the GLS in a current status for all guaranteed loans, which includes reporting all nondelinquent problem loans into GLS. The State Office should institute a verification mechanism to ensure that the information entered into GLS is accurate and up to date. It is important that the Agency properly monitor guaranteed lenders and the guaranteed loan portfolio to minimize potential losses to the Government. The National Office will compare nondelinquent problem loans serviced by the State Office and the numbers reported in the GLS.*

*(g) Borrower visits. For all loans, including those made prior to August 2, 2016, all borrowers, especially problem and delinquent borrowers, should be visited as frequently as necessary, but regularly scheduled borrower visits by the Agency are not required. It is the lender's responsibility to conduct borrower visits, and the Agency may accompany the lender on these visits. All field visits must be documented on Form RD 4279-15, "Field Visit Review Report." The Agency should:*

*(1) Coordinate the visit with the lender.*

*(2) Prepare for the visit by reviewing the case file, including previous field visit reports.*

*(3) Before the visit, discuss with the lender the borrower's performance and financial reporting, and review the lender's most recent analysis of the borrower.*

*(4) Determine the economic impact of the program by spot checking the number of jobs and documenting the number of employees broken down by full time and part time jobs.*

*(5) Check the condition of the business premises and the equipment and observe how the borrower is maintaining and utilizing the collateral.*

*(6) Check for potential hazardous contamination.*

*(7) Document any adverse findings or concerns in written correspondence with the lender.*

**§§ 4287.108 - 4287.111 [Reserved]**

**§ 4287.112 Interest rate changes.**

**(a) The borrower, lender, and holder (if any) may collectively initiate a permanent or temporary reduction in the interest rate of the guaranteed loan at any time during the life of the loan upon written agreement among these parties. The lender must obtain prior Agency concurrence and provide a copy of the modification agreement to the Agency. If any of the guaranteed portion has been purchased by the Agency, the Agency (as a holder) will affirm or reject interest rate change proposals in writing.**

**(b) No increases in interest rates will be permitted, except the normal fluctuations in approved variable interest rates, unless a temporary interest rate reduction occurred or to change from a variable rate to a fixed rate. Variable rates can be changed to a fixed rate at the request of the borrower, lender, agreement of the holder, if any, and with the Agency's prior written concurrence. After the rate change, the rate must meet the requirements of 7 CFR 4279.125.**

**(c) The interest rate, after adjustments, must comply with the interest rate requirements set forth in § 4279.125 of this chapter.**

**(d) The lender is responsible for the legal documentation of interest-rate changes by an endorsement or any other legally effective amendment to the promissory note; however, no new notes shall be issued. The lender must provide copies of all legal documents to the Agency.**

*(e) The State Office must notify the office of the DCFO of any interest-rate change by using Form RD 1980-47, "Guaranteed Loan Borrower Adjustments," make corrections to GLS reflecting the change, and document*

*the loan file to reflect the change. A system must be established to monitor receipt from the lender of interest-rate changes and the effective date of change on all guaranteed loans, especially where the Agency is the holder.*

## § 4287.113 Release of collateral.

**(a) Within the parameters of paragraph (c) of this section, lenders may, over the life of the loan, release collateral (other than personal and corporate guarantees) without Agency concurrence if the proceeds generated are used to pay down debt in order of lien priority, reduce the guaranteed loan or to acquire replacement collateral. Working assets, such as accounts receivable, inventory, and work-in-progress that are routinely depleted or sold and proceeds used for the normal course of business operations may be used in and released for routine business purposes without prior concurrence of the Agency as long as the loan is not in monetary default or liquidation.**

**(b) If a release of collateral does not meet the requirements of paragraph (a) of this section, the lender must complete a written evaluation to justify the release and obtain written Agency concurrence in advance of the release.**

**(c) Collateral must remain sufficient to provide for adequate collateral coverage for the outstanding guaranteed loan(s). For a release of collateral request when the Borrower is not in monetary default or liquidation, the lender must support all releases of chattel collateral with a value exceeding $250,000 and real estate collateral with a value exceeding $500,000 with a current appraisal on the collateral being released and otherwise meets the requirements of §4279.144 of this chapter. All other release of collateral requests must meet the appraisal requirements of §4279.144 of this chapter. The cost of this appraisal will not be paid for by the Agency. The Agency may, at its discretion, require an appraisal of the remaining collateral in cases where it has been determined that the Agency may be adversely affected by the release of collateral. The sale or release of the collateral must be based on an arm's length transaction, and there must be adequate consideration for the release of collateral. Such consideration may include, but is not limited to:**

**(1) Application of the net proceeds from the sale of collateral to the borrower's debts in order of their lien priority against the sold collateral;**

**(2) Use of the net proceeds from the sale of collateral to purchase other collateral of equal or greater value for which the lender will obtain as security for the benefit of the guaranteed loan with a lien position equal or superior to the position previously held;**

**(3) Application of the net proceeds from the sale of collateral to the borrower's business operation in such a manner that a significant improvement to the borrower's debt service ability will be clearly demonstrated. The lender's written request must detail how the borrower's debt service ability will be improved; or**

**(4) Assurance that the release of collateral is essential for the success of the business, thereby furthering the goals of the program. Such assurance must be supported by written documentation from the lender acceptable to the Agency.**

*(d) When considering loan servicing actions for guaranteed loans involving subordinations or the release of collateral, the State Office must:*

*(1) Review the regulatory requirements that are set forth in the regulations that are pertinent to the servicing action being considered;*

*(2) Obtain current (not more than 90 days old) financial statements on the borrower and guarantors;*

*(3) Obtain a current independent appraisal, in accordance with § 4279.144 of subpart B of part 4279, for any affected collateral that exceeds $250,000 in value;*

*(4) Consider whether the guaranteed loan will be adequately secured upon completion of the servicing action; and*

*(5) Ensure the borrowers' and guarantors' obligations and ability to repay the guaranteed loan before the servicing action remains unchanged after the completion of the servicing action. This may be verified by receipt of the lender's analysis and current financial statements of the borrower and guarantors.*

*(e) The Agency should take the following into consideration:*

*(1) The lender's interest - The Agency may have just a lender's interest in the collateral. This is when the Agency has an outstanding guaranteed loan that has not been sold or that has been sold but the Agency has not repurchased any holder's interest.*

*(2) The Agency's interest - To the extent the Agency repurchases all or part of the guaranteed portion of the loan from the holder(s) or the lender, the Agency owns an interest in the loan. This is covered by a Comptroller General opinion, which states that Government officers are not authorized to modify the terms of a contract by a supplemental or substitute agreement if such modification is prejudicial to the interest of the U.S., nor to give away the money, property, or any claim of the Government. Therefore, the Agency will not modify its interest in the loan, including modifying loan covenants, releasing personal or corporate guarantees or other collateral, or subordinating its lien position*

*without receiving new consideration that will adequately secure the loan. Consideration that will adequately secure the loan encompasses some new benefit to the Agency either in the form of money, additional security, or some other benefit to the goals and objectives of the Agency.*

*(3) Combination Interest - The Agency may have both an owner's and lender's interest in the collateral. This could arise when the Agency has repurchased a holder's interest in an outstanding guaranteed loan. The Agency must consider the request of the lender without regard to the Agency's owner interest. If the Agency's lender and owner interests are in conflict, forward the request to the National Office Program Processing Division for review and consideration using Appendix A of this subpart.*

**§§ 4287.114 - 4287.122 [Reserved]**

**§ 4287.123 Subordination of lien position.**

**A subordination of the lender's lien position must be requested in writing by the lender and concurred with in writing by the Agency in advance of the subordination. The lender's subordination proposal must include a financial analysis of the servicing action and be fully supported by current financial statements of the borrower and guarantors that are less than 90 days old.**

**(a) The subordination of lien position must enhance the borrower's business** *(increases sales, net profit, or otherwise improves cash flow and repayment ability)* **and not adversely affect the potential for collection of the B&I loan through repayment or liquidation.**

**(b) The lien to which the guaranteed loan is subordinated is for a fixed dollar limit and for a fixed term after which the guaranteed loan lien priority will be restored.**

**(c) Collateral must remain sufficient to provide for adequate collateral coverage. The Agency may require a current independent appraisal in accordance with § 4279.144 of this chapter.**

**(d) Lien priorities must remain for the portion of the collateral that was not subordinated.**

**(e) A subordination to a line of credit cannot exceed 1 year. The term of the line of credit cannot be extended.**

*(f) A subordination is considered a servicing action requiring the appropriate environmental review by the Agency in accordance with 7 CFR part 1970, "Environmental Policies and Procedures."*

*(g) In the event of default, the lender's lien position and the Agency's subordination of collateral may continue beyond the maturity date of the note. The Agency may require the use of borrowing based certificates and cross-default provisions when subordinating collateral to an operating line of credit.*

*(h) When considering a subordination of lien position, refer to administrative guidance in § 4287.113(d) and (e).*

**§ 4287.124 Alterations of loan instruments.**

**The lender must neither alter nor approve any alterations or modifications of any loan instrument without the prior written approval of the Agency.** *The State Office may, if necessary, consult with the Regional OGC and the National Office Program Processing Division for additional guidance.*

**§§ 4287.125 - 4287.132 [Reserved]**

**§ 4287.133 Sale of corporate stock.**

**Any sale or transfer of corporate stock must be approved by the Agency in writing and must be to an eligible individual or entity in accordance with §§ 4279.108(a) and 4279.108(b) of this chapter. In the event a portion of the borrower's stock is sold or transferred, the Agency may require personal or corporate guarantees from those then owning a 20 percent or more interest in the borrower in accordance with § 4279.132 of this chapter.**

**§ 4287.134 Transfer and assumption.**

**The lender may request a transfer and assumption of a guaranteed loan in situations where the total indebtedness, or less than the total indebtedness, is transferred to another eligible borrower on the same or different terms. A transfer and assumption of the borrower's operation can be accomplished before or after the loan goes into liquidation. However, if the collateral has been purchased through foreclosure or the borrower has conveyed title to the lender, no transfer and assumption is permitted. Additionally, no transfer and assumption is permitted when the Agency has repurchased 100 percent of the guaranteed portion of the loan.**

**(a) Documentation of request.**

**All transfers and assumptions must be approved in writing by the Agency and must be to an eligible borrower. The lender must provide credit reports for each individual or entity owning 20 percent or more interest in the transferee, along with such other documentation as the Agency may request to determine eligibility. In accordance with § 4279.132 of this chapter, the Agency will require personal and/or corporate guarantee(s) from all owners that have a 20 percent or more ownership interest in the transferee. When warranted by an Agency assessment of potential financial risk, the Agency may also require guarantees of parent, subsidiaries, or affiliated companies (owning less**

**than a 20 percent interest in the borrower) and may require security for any guarantee.** *Although a transfer and assumption is normally considered loan servicing, it should be processed in the same manner as a new loan.* **The new borrower must sign Form RD 4279-1, "Application for Loan Guarantee," and any guarantors of the guaranteed loan must sign Form RD 4279-14, "Unconditional Guarantee."** *Borrowers and co-borrowers do not execute Form RD 4279-14; only personal and corporate guarantors are required execute the guarantor form.*

**(b) Terms.**
**Loan terms may be changed with the concurrence of the Agency, all holders, and the transferor (including guarantors) if the transferor has not been or will not be released from liability. Any new loan terms must be within the terms authorized by § 4279.126 of this chapter.**

**(c) Release of liability.**
**The transferor, including any guarantor, may be released from liability only with prior Agency written concurrence and only when the fair market value of the collateral being transferred is at least equal to the amount of the loan being assumed and is supported by a current appraisal and a current financial statement of the transferee. The Agency will not pay for the appraisal. If the transfer is for less than the debt, for a release of liability, the lender must demonstrate to the Agency that the transferor and guarantors have no reasonable debt-paying ability considering their assets and income in the foreseeable future.**

**(d) Proceeds.**
**The lender must credit any proceeds received from the sale of collateral before a transfer and assumption to the transferor's guaranteed loan debt in order of lien priority before the transfer and assumption is closed.**

**(e) Additional loans.**
**Loans to provide additional funds in connection with a transfer and assumption must be considered a new loan application, which requires submission of a complete Agency application in accordance with § 4279.161(b) of this chapter.**

**(f) Credit quality.**
**The lender will provide a credit analysis of the proposal that addresses <u>capacity</u> (sufficient cash flow to service the debt), <u>capital</u> (net worth), <u>collateral</u> (assets to secure the debt), <u>conditions</u> (of the borrower, industry trends, and the overall economy), and <u>character</u> (integrity of the transferee management) in accordance with § 4279.131 of this chapter.**

**(g) Appraisals.**
**If the proposed transfer and assumption is for the full amount of the Agency guaranteed loan, the Agency will not require an appraisal, unless a guarantor is being released from liability in accordance with paragraph (c) of this section. If the proposed transfer and assumption is for less than the full amount of the Agency guaranteed loan, the Agency will require an appraisal on all of the collateral being**

**transferred, and the amount of the assumption must not be less than this appraised value. The lender is responsible for obtaining this appraisal, which must conform to the requirements of § 4279.144 of this chapter. The Agency will not pay the appraisal fee or any other costs associated with this transfer.**

**(h) Documents.**
**Prior to Agency approval, the lender must provide the Agency a written legal opinion that the transaction can be properly and legally transferred and assurance that the conveyance instruments will be appropriately filed, registered, and recorded.**

**(1) The lender must not issue any new promissory notes. The assumption must be completed in accordance with applicable law and must contain the Agency case number of the transferor and transferee. The lender must provide the Agency with a copy of the transfer and assumption agreement. The lender must ensure that all transfers and assumptions are noted on all original Loan Note Guarantees.**

**(2) A new loan agreement, consistent in principle with the original loan agreement, must be executed to establish the terms and conditions of the loan being assumed. An assumption agreement can be used to establish the loan covenants.**

**(3) Upon execution of the transfer and assumption, the lender must provide the Agency with a written legal opinion that the transfer and assumption is completed, valid, and enforceable, and certification that the transfer and assumption is consistent with the conditions outlined in the Agency's conditions of approval for the transfer and complies with all Agency regulations.**

**(i) Loss/repurchase resulting from transfer.**

**(1) Any resulting loss must be processed in accordance with § 4287.158.**

**(2) If a holder owns any of the guaranteed portion, such portion must be repurchased by the lender or the Agency in accordance with § 4279.78 of this chapter.**

**(j) Related party.**
**If the transferor and transferee are affiliated or related parties, any transfer and assumption must be for the full amount of the debt.**

**(k) Cash downpayment.**
**The lender may allow the transferee to make cash downpayments directly to the transferor provided:**

**(1) The transfer and assumption is made for the total indebtedness;**

**(2) The lender recommends that the cash be released, and the Agency concurs prior to the transaction being completed. The lender may require that an amount be retained for a defined period of time as a reserve against future defaults. Interest on such account may be paid periodically to the transferor or transferee as agreed;**

**(3) The lender determines that the transferee has the repayment ability to meet the obligations of the assumed guaranteed loan, as well as any other indebtedness; and**

**(4) Any payments by the transferee to the transferor will not suspend the transferee's obligations to continue to meet the guaranteed loan payments as they come due under the terms of the assumption.**

**(l) Annual renewal fees***.*

**The lender must pay any annual renewal fee published in the Federal Register and then in effect at the time the loan is closed for the duration of the Loan Note Guarantee. Annual renewal fees are due for the entire year even if the Loan Note Guarantee is terminated before the end of the year.** *The annual renewal fee does not apply to loans obligated before October 3, 2005; therefore, a transfer and assumption of a loan obligated before October 3, 2005, would not carry an annual renewal fee. However, a transfer and assumption of a loan obligated October 3, 2005, or after, continues to carry the annual renewal fee.*

*(m) Bankruptcy.*

*The lender is responsible for protecting the guaranteed loan and all collateral securing the loan in bankruptcy proceedings. The court does not have any jurisdiction to require a lender to accept another debtor or to transfer a loan to another entity. In such a case, contact your Regional OGC immediately.*

*(n) Approval.*

*The Agency will handle a transfer and assumption as a new loan, which must be approved within the approval official's delegated loan approval authority. If there will be a loss or if the guaranteed loan balance is in excess of the State Director's delegated loan approval authority, the request must be submitted to the National Office Program Processing Division for review and concurrence. The Agency will approve the transfer and assumption by providing a letter to the lender outlining the conditions of approval and continuance of the Loan Note Guarantee subject to any new conditions. The signed Form RD 1980-7, "Notification of Transfer and Assumption of a Guaranteed Loan," should be transmitted to the office of the DCFO if the field office chooses not to process the transfer and assumption in GLS themselves or if assistance is required. A copy of the assumption agreement must be placed in the case file.*

*(o) Environmental.*

*Transfers and assumptions are considered servicing actions requiring the appropriate environmental review by the Agency in accordance with 7 CFR part 1970, "Environmental Policies and Procedures."*

**§ 4287.135 Substitution of lender.**

**After the issuance of a Loan Note Guarantee, the lender is prohibited from selling or transferring the entire loan without the prior written approval of the Agency. Because the Loan Note Guarantee is associated with a specific promissory note and cannot be transferred to a new promissory note, the lender must transfer the original promissory note to the new lender, who must agree to its current loan terms, including the interest rate, secondary market holder (if any), collateral, loan agreement terms, and guarantors.**

**The new lender must also obtain the original Loan Note Guarantee, original personal and corporate guarantee(s), and the loan payment history from the transferor lender. If the new lender wishes to modify the loan terms after acquisition, the new lender must submit a request to the Agency.**

**(a) The Agency may approve the substitution of a new lender if:**

**(1) The proposed substitute lender:**

**(i) Is an eligible lender in accordance with § 4279.29 of this chapter and is approved as such;**

**(ii) Is able to service the loan in accordance with the original loan documents; and**

**(iii) Agrees in writing to acquire title to the unguaranteed portion of the loan held by the original lender and assumes all original loan requirements, including liabilities and servicing responsibilities.**

**(2) The substitution of the lender is requested in writing by the borrower, the proposed substitute lender, and the original lender of record, if still in existence.**

**(b) The Agency will not pay any loss or share in any costs (e.g., appraisal fees and environmental assessments) with a new lender unless a relationship is established through a substitution of lender in accordance with paragraph (a) of this section. This includes situations where a lender is merged with or acquired by another lender and situations where the lender has failed and been taken over by a regulatory agency such as the Federal Deposit Insurance Corporation (FDIC) and the loan is subsequently sold to another lender.**

**(c) Where the lender has failed and been taken over by the FDIC and the loan is liquidated by the FDIC rather than being sold to another lender, the Agency will pay losses and share in costs as if the FDIC were an approved substitute lender.** *In cases where the lender has failed and been taken over by the FDIC and the FDIC subsequently sells or transfers the loan, a request from the borrower regarding the substitution of lender is not required. Further, in this case, prior written authorization by the Agency on the sale or transfer of the loan may not be possible to obtain as the FDIC is authorized to sell or transfer loans* *to maximize recovery. However, in accordance with this section, a substitution of lender must be executed prior to any losses or shared costs being paid by the Agency.*

**(d) In cases where there is a substitution of the lender, the Agency and the new lender must execute a new Form RD 4279-4, "Lender's Agreement," unless a valid Lender's Agreement already exists with the new lender.** *The State Office should contact the new lender to obtain the new Lender's Agreement, tax identification number, and discuss program requirements, including the annual renewal fee and servicing responsibilities.*

*(e) The Regional OGC may be requested to review the proposed substitution documents to ascertain whether the documents will comply with legal requirements. State Directors may approve a substitution of lender for loans where the outstanding loan balance is within their delegated loan servicing authority.*

*(f) GLS should be updated to reflect the change, and the office of the DCFO should be notified using Form RD 1980-42, "Notice of Substitution of Lender," or some form of written notification. This includes cases where a lender is acquired by another institution.*

## § 4287.136 Lender failure.

**(a) Uninsured lender.**

**The lender or insuring agency cannot arbitrarily change the Lender's Agreement and related documents on the guaranteed loan, and the Agency will make the successor to the failed institution aware of the statutory and regulatory requirements. If the acquiring institution is not an eligible lender as set forth in § 4279.29 of this chapter, the Loan Note Guarantee will not be enforceable, and the institution must promptly apply to become an eligible lender. The failure of the uninsured lender to become an eligible lender will result in the Loan Note Guarantee being unenforceable. A new lender approved by the Agency will be afforded the benefits of the Loan Note Guarantee in the sharing of any loss and eligible expenses subject to the limits that are set forth in the regulations governing the program.** *When an uninsured lender with an Agency guaranteed loan fails, the State Office must notify both the National Office Program Processing Division and the Regional Attorney, in writing, at once. The Agency will likely be dealing with a bankruptcy situation where the receiver will control any B&I guaranteed loan and sell it as part of the liquidation process. These are lengthy, complicated affairs, and the Agency needs to keep track of the B&I guaranteed loan and monitor the bankruptcy progress.*

**(b) Insured lender.**

**The FDIC and the Agency have entered into an Inter-Agency Agreement and all parties are to abide by this Agreement or successor document(s). This document sets forth the duties and responsibilities of each Agency when an institution fails. The lender must take such action that a reasonably prudent lender would take if it did not have a Loan Note**

**Guarantee to protect the lender and Agency's mutual interest.** *When an insured lender fails, its assets, including its loans, are normally taken over by an insuring agency such as the FDIC. B&I guaranteed loans are usually acquired by either the insuring agency or a private institution.*

*(1) Initial action. As soon as the Agency becomes aware that a lender has failed, the Agency should contact the FDIC office (if there is one) or the State agency servicing the lender's area at once. The Agency should brief the FDIC or State agency on the requirements contained in the Lender's Agreement as well as any other Agency regulations that apply. The Regional Attorney should be contacted for legal advice, including determining the time period established by applicable law in which a proof of claim can be filed.*

*(2) Recovery by the Agency. When the Agency has repurchased the guaranteed portion of the loan, the lender has failed, and the Agency suspects that the guarantee is unenforceable due to negligent servicing, unauthorized use of loan funds, fraud, or misrepresentation by the lender:*

*(i) Involve the National Office Program Processing Division and Regional Attorney as soon as it is suspected that the Loan Note Guarantee may be unenforceable.*

*(ii) Determine and document the exact amount of loss paid by the Agency as a result of negligent servicing.*

*(iii) Locate the name and address of the insurance company covering the failed institution and its officers for errors and omissions. The Agency loan officer should contact the Regional Attorney to structure a demand letter for payment of the loss associated with the negligence.*

*(iv) If the financial institution has been taken over by a Federal or State regulatory agency, the Agency should request settlement of the loss from the assets of the failed institution by filing a timely proof of claim.*

*(v) If the failed institution's operations and the Agency guaranteed loan were sold to another institution, with the concurrence of the Regional Attorney and the National Office, a timely appropriate demand for payment should be made from the new entity. A detailed analysis substantiated with any supporting documents should accompany the demand for payment within the time constraints established by law.*

*(vi) Should the demand on the successor financial institution be denied, the Agency should obtain the documented reasons in writing. The Regional Attorney should be consulted to prepare the rebuttal and request for reconsideration of payment.*

**§§ 4287.137 - 4287.144 [Reserved]**

**§ 4287.145 Default by borrower.**

**The lender's primary responsibilities in default are to act prudently and expeditiously, to work with the borrower to bring the account current or cure the default through restructuring if a realistic plan can be developed, or to accelerate the account and conduct a liquidation in a manner that will minimize any potential loss. The lender may initiate liquidation subject to submission and approval of a complete liquidation plan.** *The Agency's role is one of concurrence, assuring that servicing of the loan is realistic, and protecting the interest of the Government.*

**(a) The lender must notify the Agency when a borrower is more than 30 days past due on a payment and the delinquency cannot be cured within 30 days or when a borrower is otherwise in default of covenants in the loan agreement by promptly submitting Form RD 1980-44, "Guaranteed Loan Borrower Default Status," or processing the Default Status report in LINC. The lender must update the loan's status each month using either Form RD 1980-44 or the LINC Default Status report until such time as the loan is no longer in default. If a monetary default exceeds 60 days, the lender must meet with the Agency and, if practical, the borrower to discuss the situation.** *Although a joint conference can often be effective in resolving a problem case, in some instances, a meeting with the borrower is not practicable, such as when there is a bankruptcy or when the borrower is not cooperative. If the lender fails to initiate the conference, the Agency will contact the lender once the account is 60 days past due to discuss the lender's plans for servicing the default. The Agency will discuss the servicing options available as well as liquidation requirements. Discussions should include plans for obtaining a liquidation appraisal.*

**(b) In considering options, the prospects for providing a permanent cure without adversely affecting the risk to the Agency and the lender is the paramount objective.**

**(1) Curative actions (subject to the rights of any holder and Agency concurrence) include, but are not limited to:**

**(i) Deferment of principal and/or interest payments;**

**(ii) An additional unguaranteed temporary loan by the lender to bring the account current;**

**(iii) Reamortization of or rescheduling the payments on the loan;**

**(iv) Transfer and assumption of the loan in accordance with § 4287.134;**

**(v) Reorganization;**

**(vi) Liquidation; and**

**(vii) Changes in interest rates with the Agency's, the lender's, and any holder's approval. Any interest payments must be adjusted proportionately between the guaranteed and unguaranteed portion of the loan.**

**(2) The term of any deferment, rescheduling, reamortization, or moratorium will be limited to the lesser of the remaining useful life of the collateral or remaining limits as set forth in § 4279.126 of this chapter (excluding paragraph (c)). During a period of deferment or moratorium on the guaranteed loan, the lender's unguaranteed loan(s) and any stockholder loans must also be under deferment or moratorium. Balloon payments are permitted as a loan servicing option as long as there is a reasonable prospect for success and the remaining life of the collateral supports the action.**

**(3) In the event of a loss or a repurchase, the lender cannot claim default or penalty interest, late payment fees, or interest on interest. If the restructuring includes the capitalization of interest, interest accrued on the capitalized interest will not be covered by the guarantee. Consequently, it is not eligible for repurchase from the holder and cannot be included in the loss claim.**

*(4) This section provides options for curing loans in default, but does not prohibit their use for loans that are not in default. Section 4287.124 authorizes the lender to alter or modify loan instruments with Agency approval. When a lender requests Agency concurrence in a loan servicing action, including loan restructuring and payment deferral, and the request makes business sense and complies with the regulations, the approval official may concur in the servicing action within their delegated loan servicing authority.*

**(c) Debt write-downs for an existing borrower, where the same principals retain control of and decisionmaking authority for the business, are prohibited, except as directed or ordered under the Bankruptcy Code.**

**(d) For loans closed on or after August 2, 2016, in the event of a loss, the guarantee will not cover note interest to the lender accruing after 90 days from the most recent delinquency effective date** *as reported in item number 8 on Form RD 1980-44, "Guaranteed Loan Borrower Default Status."*

**(e) For loans closed on or after August 2, 2016, the lender or the Agency will issue an interest termination letter to the holder(s) establishing the termination date for interest accrual. The guarantee will not cover interest to any holder accruing after the greater of: 90 days from the date of the most recent delinquency effective date as reported by the lender or 30 days from the date of the interest**

**termination letter.** *The Agency must ensure the interest termination letter is issued, whether by the lender or the Agency, 60 days from the date of the most recent delinquency effective date to ensure that not more than 90 days of interest is paid. The lender should issue the interest termination letter to the holder(s) and provide the Agency with a copy. In the event the lender cannot or will not issue the letter, the Agency will issue the letter to the holder(s) and provide the lender with a copy (see Appendix H of this subpart for a sample letter). The Agency should confirm current holder contact information with the lender and ensure that information in GLS is accurate.*

**(f) For repurchases of guaranteed loans, refer to § 4279.78 of this chapter.**

*(g) Any fully justified rescheduled, deferred, or reamortized loan that meets the revised performance agreed to by the lender and the Agency will no longer be classified as delinquent but should be considered a problem loan for a reasonable period of time and watched closely. The State Office must notify the DCFO, in writing, of any changes in payment terms (interest-rate adjustment and reamortizations) as well as the effective dates of such changes.*

*(h) All problem loans that are in excess of the State's delegated loan servicing authority, all delinquent loans, and any loans in bankruptcy must be reported to the National Office on a quarterly basis using Form RD 4279-16, "Quarterly Delinquent/Problem Loan Report." See Appendix E for guidance. This report is due to the National Office Program Processing Division by the 10th day of the month following the end of the quarter.*

**§§ 4286.146 - 4287.155 [Reserved]**

**§ 4287.156 Protective advances.**

**Protective advances are advances made by the lender for the purpose of preserving and protecting the collateral where the debtor has failed to, will not, or cannot meet its obligations. Lenders must exercise sound judgment in determining that the protective advance preserves collateral and recovery is actually enhanced by making the advance. Lenders cannot make protective advances in lieu of additional loans. A protective advance claim will be paid only at the time of the final report of loss payment.** *Legal/attorney fees are not protective advances.*

**(a) The maximum loss to be paid by the Agency will never exceed the original loan amount plus accrued interest times the percentage of guarantee regardless of any protective advances made.**

**(b) In the event of a final loss, protective advances will accrue interest at the note rate and will be guaranteed at the same percentage of guarantee as provided for in the Loan Note Guarantee. The guarantee**

**will not cover interest on the protective advance accruing after 90 days from the most recent delinquency effective date.**

**(c) Protective advances must constitute an indebtedness of the borrower to the lender and be secured by the security instruments. Agency written authorization is required when the cumulative total of protective advances exceeds $200,000 or 10 percent of the aggregate outstanding balance of principal and interest, whichever is less.**

*(d) Once collateral is conveyed directly to the lender, expenses thereafter incurred with that property are liquidation expenses. The lender's liquidation expenses may only be recovered from proceeds of the disposition of primary collateral in accordance with § 4287.158(e).*

**§ 4287.157 Liquidation.**

**In the event of one or more incidents of default or third party actions that the borrower cannot or will not cure within a reasonable period of time, the lender, with Agency consent, must liquidate the loan. In accordance with § 4287.145(d), for loans closed on or after August 2, 2016, in the event of a loss, the guarantee will not cover note interest to the lender accruing after 90 days from the most recent delinquency effective date** *as reported in item number 8 on Form RD 1980-44, "Guaranteed Loan Borrower Default Status."*

**(a) Decision to liquidate.**
**A decision to liquidate must be made when the lender determines that the default cannot be cured through actions such as those contained in § 4287.145, or it has been determined that it is in the best interest of the Agency and the lender to liquidate. The decision to liquidate or continue with the borrower must be made as soon as possible when one or more of the following exist:**

**(1) A loan is 90 days behind on any scheduled payment and the lender and the borrower have not been able to cure the delinquency through actions such as those contained in § 4287.145.**

**(2) It is determined that delaying liquidation will jeopardize full recovery on the loan.**

**(3) The borrower or lender is uncooperative in resolving the problem or the Agency or lender has reason to believe the borrower is not acting in good faith, and it would improve the position of the guarantee to liquidate immediately.**

**(b) Repurchase of loan.**
**When the decision to liquidate is made, if any portion of the loan has been sold or assigned under § 4279.75 of this chapter and not already repurchased, provisions will be made for repurchase in accordance with § 4279.78 of this chapter.** *The State Office can request that the office of the DCFO stop interest accrual for accounting purposes only if the Agency buys back 100 percent of the guaranteed portion of the loan.*

**(c) Lender's liquidation plan.**

**The lender is responsible for initiating actions immediately and as necessary to assure a prompt, orderly liquidation that will provide maximum recovery. Within 30 days after a decision to liquidate, the lender must submit a written, proposed plan of liquidation to the Agency for approval. The liquidation plan must be detailed and include at least the following:**

**(1) Such proof as the Agency requires to establish the lender's ownership of the guaranteed loan promissory note and related security instruments and a copy of the payment ledger, if available, that reflects the current loan balance, accrued interest to date, and the method of computing the interest;**

**(2) A full and complete list of all collateral, including any personal and corporate guarantees;**

**(3) The recommended liquidation methods for making the maximum collection possible on the indebtedness and the justification for such methods, including recommended action for acquiring and disposing of all collateral and collecting from guarantors;**

**(4) Necessary steps for preservation of the collateral;**

**(5) Copies of the borrower's most recently available financial statements;**

**(6) Copies of each guarantor's most recently available financial statements;**

**(7) An itemized list of estimated liquidation expenses expected to be incurred along with justification for each expense;**

**(8) A schedule to periodically report to the Agency on the progress of liquidation, not to exceed every 60 days;**

**(9) Estimated protective advance amounts with justification;**

**(10) Proposed protective bid amounts on collateral to be sold at auction and a breakdown to show how the amounts were determined. A protective bid may be made by the lender, with prior Agency written approval, at a foreclosure sale to protect the lender's and the Agency's interest. The protective bid will not exceed the amount of the loan, including expenses of foreclosure, and must be based on the liquidation value considering estimated expenses for holding and reselling the property. These expenses include, but are not limited to, expenses for resale, interest accrual, length of time necessary for resale, maintenance, guard service, weatherization, and prior liens;** *If the liquidation value is not more than the sale expenses plus any liens superior to the lien of the guaranteed loan, a protective bid should not normally be made.*

**(11) If a voluntary conveyance is considered, the proposed amount to be credited to the guaranteed debt;**

**(12) Legal opinions, if needed by the lender's legal counsel; and**

**(13) An estimate of fair market and potential liquidation value of the collateral. If the value of the collateral is $250,000 or more, the lender must obtain an independent appraisal report meeting the requirements of § 4279.144 of this chapter for the collateral securing the loan, which reflects the fair market value and potential liquidation value. For collateral values under this threshold, lenders must follow their primary regulator's policies relating to appraisals and evaluations or, if the lender is not regulated, normal banking practices and generally accepted methods of determining value. The liquidation appraisal of the collateral must evaluate the impact on market value of any release of hazardous substances, petroleum products, or other environmental hazards. The independent appraiser's fee, including the cost of the environmental site assessment, will be shared equally by the Agency and the lender. In order to assure prompt action, the liquidation plan can be submitted with an estimate of collateral value, and the liquidation plan may be approved by the Agency subject to the results of the final liquidation appraisal.** *The Agency may pay for additional appraisals, as warranted. To request payment for the Agency's share of the liquidation appraisal and/or environmental assessment fee(s), the Agency will complete and sign Form RD 1980-46, "Report of Liquidation Expense," attaching a copy of the invoice(s) or receipt(s) and faxing to the Guaranteed Loan Branch (GLB) in the office of the DCFO at (314) 457-4279. Upon receipt, the DCFO will make payment utilizing GLS. Any questions or concerns with regard to the payment should be addressed to GLB, DCFO, by calling the main line at (314) 457-4192.*

**(d) Approval of liquidation plan.**

**The lender's liquidation plan must be approved by the Agency in writing. The lender and Agency must attempt to resolve any Agency concerns. If the liquidation plan is approved by the Agency, the lender must proceed expeditiously with liquidation and must take all legal action necessary to liquidate the loan in accordance with the approved liquidation plan. The lender must update or modify the liquidation plan when conditions warrant, including a change in value based on a liquidation appraisal. If the liquidation plan is not approved by the Agency, the lender must take such actions that a reasonably prudent lender would take without a guarantee and keep the Agency informed in writing. The lender must continue to develop a liquidation plan in accordance with this section.** *The liquidation plan may be approved within the State Director's delegated loan servicing authority. In the event the loan balance is in excess of the State*

*Director's delegated authority, the liquidation plan must be forwarded to the National Office Program Processing Division for review and concurrence, submitted in accordance with Appendix A of this subpart, along with supporting documentation. The liquidation plan may be* *modified when conditions warrant. All modifications must be approved in writing by the Agency prior to implementation.*

**(e) Acceleration.**

**The lender will proceed to accelerate the indebtedness as expeditiously as possible when acceleration is necessary, including giving any notices and taking any other legal actions required. The guaranteed loan will be considered in liquidation once the loan has been accelerated and a demand for payment has been made upon the borrower. The lender must obtain Agency concurrence prior to the acceleration of the loan if the sole basis for acceleration is a nonmonetary default. In the case of monetary default, prior approval by the Agency of the lender's acceleration is not required, although Agency concurrence must still be given not later than at the time the liquidation plan is approved. The lender will provide a copy of the acceleration notice or other acceleration document to the Agency.**

**(f) Filing an estimated loss claim.**

**When the lender owns any of the guaranteed portion of the loan, the lender must file an estimated loss claim once a decision has been made to liquidate if the liquidation is expected to exceed 90 days. The estimated loss payment will be based on the liquidation value of the collateral. For the purpose of reporting and loss claim computation, for loans closed on or after August 2, 2016, the guarantee will not cover note interest to the lender accruing after 90 days from the most recent delinquency effective date** *as reported in item number 8 on Form RD 1980-44, "Guaranteed Loan Borrower Default Status."* **The Agency will promptly process the loss claim in accordance with applicable Agency regulations as set forth in § 4287.158.**

**(g) Accounting and reports.**

**The lender must account for funds during the period of liquidation and must, in accordance with the Agency-approved liquidation plan, provide the Agency with reports on the progress of liquidation including disposition of collateral, resulting costs, and additional procedures necessary for successful completion of the liquidation.**

**(h) Transmitting payments and proceeds to the Agency.**

**When the Agency is the holder of a portion of the guaranteed loan, the lender must transmit to the Agency its pro rata share of any payments received from the borrower, liquidation, or other proceeds using Form RD 1980-43, "Lender's Guaranteed Loan Payment to Rural Development."**

**(i) Abandonment of collateral.**

**When the lender adequately documents that the cost of liquidation would exceed the potential recovery value of certain collateral and receives Agency concurrence, the lender may abandon that collateral. When the lender makes a recommendation for abandonment of collateral, it must comply with 7 CFR part 1970, "Environmental Policies and Procedures."** *Examples where abandonment may be considered include, but are not limited to:*

*(1) The cost of liquidation is increased or the value of the collateral is decreased by environmental issues;*

*(2) The collateral has deteriorated or is functionally or economically obsolete;*

*(3) There are superior liens held by other parties in excess of the value of the collateral; or*

*(4) There is little or no demand for the collateral.*

**(j) Personal or corporate guarantees.**
**The lender must take action to maximize recovery from all personal and corporate guarantees, including seeking deficiency judgments when there is a reasonable chance of future collection.**

**(k) Compromise settlement.**
**Compromise settlements must be approved by the lender and the Agency. Complete current financial information on all parties obligated for the loan must be provided. At a minimum, the compromise settlement must be equivalent to the value and timeliness of that which would be received from attempting to collect on the guarantee. The guarantor cannot be released from liability until the full amount of the compromise settlement has been received. In weighing whether the compromise settlement should be accepted, among other things, the Agency will weigh whether the comparison is more financially advantageous than collecting on the guarantee.**

*(1) Before the Agency will release a guarantor from liability, the Agency will consider each of the following factors:*

*(i) Cash, either lump sum or over a period of time, or other consideration offered by the guarantor;*

*(ii) Age and health of the guarantor;*

*(iii) Potential income of the guarantor;*

*(iv) Inheritance prospects of the guarantor;*

*(v) Availability of the guarantor's assets;*

*(vi) Possibility that the guarantor's assets have been concealed or improperly transferred; and*

*(vii) Effect of other guarantors on the loan. The lender may need the prior written consent from other guarantors before a guarantor is released.*

*(2) Once the Agency and the lender agree on a reasonable amount that is fair and adequate, the lender can initiate the settlement compromise. Releases should not be executed until all payments or other considerations have been received by the lender and the*

*Agency. Such cases involving fraud, negligent servicing, or misrepresentation must be reviewed by the Regional OGC and have the concurrence of the National Office.*

*(3) A compromise should only be accepted if it is in the best interest of the Agency. In order to avoid referral of the debt to the U.S. Treasury under the DCIA, the borrower and guarantors must repay the debt in full or agree to a repayment plan acceptable to the Agency. A repayment plan will typically be paid over a 3-year period and must be supported by financial statements and independent verifications. If the guarantor has fulfilled an Agency settlement agreement, then there is no debt to refer to DCIA. Once the repayment plan has been paid in full, the original Form RD 4279-14, "Unconditional Guarantee," must be returned with a cover letter to the guarantor. For additional DCIA guidance, see § 4287.159 and Appendix D of this subpart.*

*(4) For guaranteed loans closed after January 22, 2004, and for guaranteed loans closed after December 20, 2006, in which the guarantors executed Form RD 4279-14, "Unconditional Guarantee," if a State Office can substantiate for any reason why a borrower or guarantor who has not filed bankruptcy should not be referred for DCIA collection, the State Office should confer with their Regional OGC and request concurrence from the National Office for the Account Receivable to be written-off by the DCFO. When the sale of the promissory note is utilized in the liquidation of a guaranteed loan, the sale of the promissory note does not relieve the borrower, guarantor, or any other liable third party from their liability for any loss claim paid by the Government. For additional DCIA guidance, see section § 4287.159 and Appendix D of this subpart.*

*(5) For borrowers and guarantors that are subject to DCIA, a compromise settlement offer may be considered by the Agency after the final report of loss has been processed and during the 60 day due process period prior to referral to the Treasury Department for collection.*

**(l) Litigation.**

**In all litigation proceedings involving the borrower, the lender is responsible for protecting the rights of the lender and the Agency with respect to the loan and keeping the Agency adequately and regularly informed, in writing, of all aspects of the proceedings. If the Agency determines that the lender is not adequately protecting the rights of the lender or the Agency with respect to the loan, the Agency reserves the right to take any legal action the Agency determines necessary to protect the rights of the lender, on behalf of the lender, or the Agency with respect to the loan. If the Agency exercises this right, the lender must cooperate with the Agency. Any cost to the Agency associated with such action will be assessed against the lender.** *For example, in the case of a bankruptcy or liquidation, if the lender fails to protect its rights in a timely fashion, the Agency will solicit the advice of the Regional OGC* *and may initiate or assume the role of plaintiff in legal proceedings against the borrower.*

**§ 4287.158 Determination of loss and payment.**

**Unless the Agency anticipates a future recovery, the Agency will make a final settlement with the lender after the collateral is liquidated or after settlement and compromise of all parties has been completed. The Agency has the right to recover losses paid under the guarantee from any party that may be liable.** *State Directors are authorized to approve estimated and final reports of loss within their delegated loan servicing authority. Approval of estimated and final reports of loss that exceed the State Director's delegated loan servicing authority must be forwarded to the National Office Program Processing Division for review and concurrence in the format set forth in Appendix A of this Instruction. See Appendix B for a final loss settlement checklist.*

**(a) Report of loss form.**
**Form RD 449-30, "Loan Note Guarantee Report of Loss," will be used for reporting and calculating all estimated and final loss determinations.**

**(b) Estimated loss.**
**In accordance with the requirements of § 4287.157(f), the lender must prepare an estimated loss claim, based on liquidation appraisal value, and submit it to the Agency. When the lender is conducting the liquidation and owns any or all of the guaranteed portion of the loan, the lender must file an estimated loss claim once a decision has been made to liquidate if the liquidation will exceed 90 days. The estimated loss payment will be based on the liquidation value of the collateral.**

**(1) Such estimate will be prepared and submitted by the lender on Form RD 449-30 using the basic formula as provided on the report, except that the liquidation appraisal value will be used in lieu of the amount received from the sale of collateral. Interest accrual eligible for payment under the guarantee on the defaulted loan will be discontinued when the estimated loss is paid.**

**(2) A protective advance claim will be paid only at the time of the final report of loss payment.**

**(c) Final loss.**
**Within 30 days after liquidation of all collateral is completed (except for certain unsecured personal or corporate guarantees as provided for in this section), the lender must prepare a final report of loss and submit it to the Agency. If the lender holds all or a portion of the guaranteed loan, the Agency will not guarantee interest to the lender accruing after 90 days from the most recent delinquency effective date** *as reported in item number 8 on Form RD 1980-44, "Guaranteed Loan Borrower Default Status."* **The Agency will not guarantee interest to any holder accruing after the greater of: 90 days from the date of the most**

**recent delinquency effective date as reported by the lender or 30 days from the date of the interest termination letter.** *The Agency must ensure the interest termination letter is issued, whether by the lender or the Agency, 60 days from the date of the most recent delinquency effective date to ensure that not more than 90 days of interest is paid. The lender should issue the interest termination letter to the holder(s) and provide the Agency with a copy. In the event the lender cannot or will not issue the letter, the Agency will issue the letter to the holder(s) and provide the lender with a copy (see Appendix H of this subpart for a sample letter). The Agency should confirm current holder contact information with the lender and ensure that information in GLS is accurate.* **Before approval by the Agency of 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. Upon receipt of the final accounting and report of loss, the Agency may audit all applicable documentation to determine the final loss. The lender must make its records available and otherwise assist the Agency in making any investigation. The documentation accompanying the report of loss must support the amounts reported as losses on Form RD 449-30***, "Loan Note Guarantee Report of Loss."*

**(1) The lender must make a determination regarding the collectability of unsecured personal and corporate guarantees. If reasonably possible, the lender must promptly collect or otherwise dispose of such guarantees in accordance with § 4287.157(j) prior to completion of the final loss report. However, in the event that collection from the guarantors appears unlikely or will require a prolonged period of time, the lender must file the report of loss when all other collateral has been liquidated. Unsecured personal or corporate guarantees outstanding at the time of the submission of the final loss claim will be treated as a future recovery with the net proceeds to be shared on a pro rata basis by the lender and the Agency. Debts owed to the Agency (Federal debt) may be collected using DCIA authority. The Agency may consider a compromise settlement of Federal debt after it has processed a final report of loss and issued a 60 day due process letter. Any funds collected on Federal debt will not be shared with the lender.** *The State Office will establish a follow-up system to ensure that the lender is making reasonable collection efforts and distributing any collections properly. DCIA applies to all loans closed on or after January 22, 2004. As such, the lender must cease collection efforts, and there would be no recovery. The U.S. Treasury will collect the debt and all collections will be posted as a receivable payment in GLS minus a fee for the Treasury Department. Loansclosed prior to January 22, 2004, may have future recoveries, and loans closed on or after January 22, 2004, that are not eligible for DCIA may have future recoveries.*

**(2) The lender must document that all of the collateral has been accounted for and properly liquidated and that liquidation proceeds have been accounted for and applied correctly to the loan.**

**(3) The lender must provide receipts and a breakdown of any protective advance amount as to the payee, purpose of the expenditure, date paid, and evidence that the amount expended was proper.**

**(4) The lender must provide receipts and a breakdown of liquidation expenses as to the payee, purpose of the expenditure, date paid, and evidence that the amount expended was proper. Liquidation expenses are recoverable only from liquidation proceeds. The Agency may approve attorney/legal fees as liquidation expenses provided that the fees are reasonable, require the assistance of attorneys, and cover legal issues pertaining to the liquidation that could not be properly handled by the lender and its employees.** *The Agency should review all liquidation expenses to determine if the expenses were proper, reasonable, and in accordance with the approval given by the Agency.*

**(5) The lender must support accrued interest by documenting how the amount was accrued. If the interest rate was a variable rate, the lender must include documentation of changes in both the selected base rate and the loan rate.**

**(6) The Agency will pay loss payments within 60 days after it has reviewed the complete final loss report and accounting of the collateral.**

*(7) Should there be a circumstance where the lender cannot or will not sign a report of loss, the State Director may complete the estimated or final report of loss and submit it to the office of the DCFO without the lender's signature. Before this action can be taken, all collateral must be disposed of or accounted for; there must be no evidence of fraud, misrepresentation, or negligent servicing by the lender; and all efforts to obtain the cooperation of the lender must have been exhausted and documented.*

*(8) Appendix B of this subpart must be completed on each final report of loss and a copy placed in the loan file.*

**(d) Loss limit.**
**The amount payable by the Agency to the lender cannot exceed the limits set forth in the Loan Note Guarantee.**

**(e) Liquidation expenses.**
**The Agency will deduct liquidation expenses from the liquidation proceeds of the collateral. The lender cannot claim any liquidation expenses in excess of liquidation proceeds. Any changes to the liquidation expenses that exceed 10 percent of the amount proposed in the liquidation plan must be approved by the Agency. Reasonable attorney/legal expenses will be shared by the lender and Agency equally, including those instances where the lender has incurred such expenses from a trustee conducting the liquidation of assets. The lender cannot claim the guarantee fee or the annual renewal fee as authorized liquidation expenses, and no in-house expenses of the lender will be**

**allowed. In-house expenses include, but are not limited to, employee's salaries, staff lawyers, travel, and overhead.**

**(f) Rent.**

**The lender must apply any net rental or other income that it receives from the collateral to the guaranteed loan debt.**

**(g) Payment.**

**Once the Agency approves Form RD 449-30,** *"Loan Note Guarantee Report of Loss,"* **and supporting documents submitted by the lender:**

**(1) If the loss is greater than any estimated loss payment, the Agency will pay the additional amount owed by the Agency to the lender.**

**(2) If the loss is less than the estimated loss payment, the lender must reimburse the Agency for the overpayment plus interest at the note rate from the date of payment.**

*§ 4287.159 Debt Collection Improvement Act.*

*Refer to Appendix D for additional guidance on DCIA. The following is applicable to the B&I, Biorefinery, and the Rural Energy for America Guaranteed Loan Programs:*

*(a) On January 22, 2004, a final rule was published in the Federal Register regarding the DCIA in order to make debtors aware that the DCIA provisions are applicable to the program. RD Instruction 1951-C, section 1951.133, Offsets of Federal Payment to USDA Agency Borrowers, was amended regarding the establishment of Federal debt for the program. This section states that any amounts paid by the Agency on account of liabilities of guaranteed loan borrower(s) and/or co-borrower(s) will constitute a Federal debt owing to the Agency by the guaranteed loan borrower(s) and/or co-borrower(s). All guaranteed loans closed on or after January 22, 2004, are subject to the DCIA provisions. The Agency will refer all borrowers under the DCIA to the U.S. Treasury for collection. The date of the Agency's final loss claim payment will establish the date for determining the referral deadline to the U.S. Treasury under the DCIA.*

*(b) On November 20, 2006, a final rule was published in the Federal Register with an effective date of December 20, 2006, that addressed the concern that guarantors might successfully assert a defense that they did not know they were guaranteeing a loan. When the Agency implemented this second regulation, several Agency forms were modified and a new form was created, Form RD 4279-14, "Unconditional Guarantee." All personal/corporate guarantors that sign the Unconditional Guarantee form acknowledge that delinquent guaranteed loan debt is subject to DCIA. Therefore, any guaranteed loan closed after December 20, 2006, where the guarantor signed the Unconditional Guarantee form is governed by these requirements. As a reminder, borrowers and co-borrowers do not execute*

*Form RD 4279-14; only personal and corporate guarantors are required execute the guarantor form. When the Agency pays a loss claim, both the borrower(s) and/or co-borrower(s) and the guarantor(s) must be sent to the U.S. Treasury for offset within the 180 day time period. All eligible key members, including co-borrowers and those individuals or entities that execute Form RD 4279-14, should be entered as Key members in GLS for referral to the U.S. Treasury Department under the DCIA. Before a debt is referred to the Treasury Department, you should ensure that all eligible co-borrowers, individuals and entities are properly listed in GLS as key members. Once referred to the U.S. Treasury, the lender should cease all collection efforts. In the event that the guarantors did not sign the Unconditional Guarantee form, you should consult with OGC before referring a claim against a guarantor to the U.S. Treasury.*

*(c) When a borrower or guarantor has a pending bankruptcy as a result of the final loss, they will not be referred for the DCIA collection action unless the Agency has obtained a relief from stay. However, if a State Office can substantiate for any reason why a borrower and/or guarantor who has not filed bankruptcy should not be referred for the DCIA collection, the State Office should confer with their Regional OGC and request concurrence from the National Office for the Account Receivable to be written-off by the DCFO.*

*(d) The lender will prepare a final loss claim on Form RD 449-30, "Guaranteed Loan Report of Loss," and submit it to the State Office. After approval by the State Office, the claim will be forwarded to the DCFO for payment. The State Office will ensure that all guarantor information located in the BP Fund Request View (application) in GLS is accurate. When the DCFO pays the final loss and updates it to GLS, a DCIA Accounts Receivable will be established for the borrower and/or any guarantors subject to the DCIA.*

*(e) A 60-day "Due Process Letter" (as outlined in Appendix D) is system generated by the DCFO on or around the 15th of the month and will be sent to the borrower and each guarantor identifying their options of setting up a repayment plan or making a payment in full and notifying the debtors that the guaranteed loan balance is a Federal debt, which will be referred to the U.S. Treasury to collect the debt in accordance with statutory requirements and authorities, including Cross-Servicing and TOP. If the State/Field Office does not receive a response to the due process notification within this due process period, the debt will be referred to the U.S. Treasury for* collection. *Treasury will use all remedies available under the DCIA to collect the debt from the borrower and/or guarantors. The State/Field Office should notify the lender in writing to cease further collection efforts against the borrower and/or guarantors after the debt has been referred to the U.S. Treasury for collection. The DCIA accounts receivable and all subsequent servicing activities can be viewed by the State Office via the View Debt Offset web page in GLS.*

*(f) In order for the borrower and/or guarantor to avoid referral of the debt to the U.S. Treasury, they must agree to a repayment plan acceptable*

*to the Agency or repay the debt in full. A repayment plan generally does not exceed 3 years and must be supported by a current financial statement and independent verification. If the guarantor has fulfilled an Agency settlement agreement, then there is no debt to refer to DCIA.*

*(g) Adequate consideration must be received before a release from liability is issued. Adequate consideration includes money or additional security. For personal guarantors, § 4287.157(l) provides guidance on factors to consider when evaluating settlement offers.*

*The case file should be documented on any compromise settlements approved within the State's delegated loan servicing authority.*

*(h) The National Office must concur in the release of all borrowers and/or guarantors from liability. The borrower and/or guarantor should not be released from liability until the settlement amount is paid in full.*

(i) *The approved payment plan should be coordinated with the State/Field Office representatives and submitted to the DCFO, Mail Code FC-350, for the purpose of ensuring the debt is posted in the GLS system as a repayment plan. Collections received in the field office from the borrower or guarantors will be sent to the Wholesale Lockbox by submitting Form RD 451-2, "Schedule of Remittances," as Miscellaneous Collection Code 35. A copy of the Form RD 451-2 should be sent to the DCFO. These collections as well as any receipts from Cross-Servicing and TOP will be updated to the DCIA Account Receivable by the DCFO. The original Form RD 4279-14, "Unconditional Guarantee," should be returned to the guarantor after full satisfaction of the settlement agreement. If the borrower and/or guarantor defaults on the repayment plan, they will be referred to the U.S. Treasury.*

*(j) Generally for all loans subject to the DCIA, the Agency should not initiate the recall of Agency debt that has been referred to the U.S. Treasury.*

*(1) However, should the Agency receive a request to recall the debt, the debt can only be recalled from the U.S. Treasury under one of the following conditions:*

*(i) The debtor has filed for bankruptcy and the automatic stay is in effect;*

*(ii) The debt is not enforceable;*

*(iii) The debt is not delinquent;*

*(iv) The debt is not valid or has been paid in full;*

*(v) The creditor agency discovers that it incorrectly certified the debt;*

*(vi) The creditor agency discovers any other reason that would render its certification invalid.*

*(2) If a debt must be recalled from the U.S. Treasury, the State Office will need to provide the following:*

*(i) A cover memorandum, signed by the Program Director (or designee), addressed to the Business and Industry Division Director to the attention of the Loan Servicing Branch Chief, stating the history of the loan, reason for the recall and State Office recommendation;*

*(ii) A completed Modification or Administrative Action form;*

*(iii) Supporting information/materials including any analysis the State Office has performed and the reason for the recall.*

*(3) The National Office will review the request at the appropriate loan committee level and will notify the State Office of the decision.*

*(4) Upon approval, the State Office will forward the request to the DCFO, Program Reporting Division, Debt Collection Improvement Branch, for review and processing.*

**§§ 4287.160 - 4287.168 [Reserved]**

**§ 4287.169 Future recovery.**

**Unless notified otherwise by the Agency, after the final loss claim has been paid, the lender must use reasonable efforts to attempt collection from any party still liable on any loan that was guaranteed. Any net proceeds from that effort must be split pro rata between the lender and the Agency based on the percentage of guarantee. Any collection of Federal debt made by the United States from any liable party to the guaranteed loan will not be split with the lender.** *For loans closed prior to January 22, 2004, and for those loans not eligible for DCIA, after a loan has been liquidated and a final loss has been paid by the Agency, the lender must prorate any future funds that it recovers between the Agency and the lender based on the original percentage of guarantee. For loans closed on or after January 22, 2004, the Agency is required to refer debt owed to the Government to the U.S. Treasury for collection. The Agency will use all remedies available under DCIA to collect the debt from the borrower, guarantors, and any other liable third party. Any proceeds received from such efforts will not be shared with the lender. The Agency will notify the lender when a DCIA referral occurs, at which time the lender must cease collection efforts.*

**§ 4287.170 Bankruptcy.**

**(a) Lender's responsibilities.**

**It is the lender's responsibility to protect the guaranteed loan and all of the collateral securing it in bankruptcy proceedings, including taking actions that result in greater recoveries and not taking actions that would not likely be cost-effective. These responsibilities include, but are not limited to, the following:**

**(1) Monitoring confirmed bankruptcy plans to determine borrower compliance, and, if the borrower fails to comply, seeking a dismissal of the bankruptcy plan;**

**(2) Filing a proof of claim, where necessary, and all the necessary papers and pleadings concerning the case;**

**(3) Attending and, where necessary, participating in meetings of the creditors and all court proceedings;**

**(4) Requesting modifications of any bankruptcy plan whenever it appears that additional recoveries are likely; and**

**(5) Keeping the Agency adequately and regularly informed in writing of all aspects of the proceedings.**

**(6) The lender must submit a default status report when the borrower defaults and every 30 days until the default is resolved or a final loss claim is paid by the Agency. The default status report will be used to inform the Agency of the bankruptcy filing, the plan confirmation date, when the plan is complete, and when the borrower is not in compliance with the plan.**

**(7) With written Agency consent, the lender and Agency will equally share the cost of any independent appraisal fee to protect the guaranteed loan in any bankruptcy proceedings.**

**(b) Reports of loss during bankruptcy.**

**In bankruptcy proceedings, payment of loss claims will be made as provided in this section. Attorney/legal fees and protective advances as a result of a bankruptcy are only recoverable from liquidation proceeds.**

**(1) <u>Estimated loss payments.</u>**

**(i) If a borrower has filed for bankruptcy and all or a portion of the debt has been discharged, the lender must request an estimated loss payment of the guaranteed portion of the accrued interest and principal discharged by the court. Only one estimated loss payment is allowed during the bankruptcy. All subsequent claims of the lender during bankruptcy will be considered revisions to the initial estimated loss. A revised estimated loss payment may be processed by the Agency, at its option, in accordance with any court-approved changes in the bankruptcy plan. Once the bankruptcy plan has been completed, the lender is responsible for submitting the documentation necessary for the Agency to**

**review and adjust the estimated loss claim to reflect any actual discharge of principal and interest and to reimburse the lender for any court-ordered interest-rate reduction under the terms of the bankruptcy plan.**

**(ii) The lender must use Form RD 449-30 to request an estimated loss payment and to revise any estimated loss payments during the course of the bankruptcy plan. The estimated loss claim, as well as any revisions to this claim, must be accompanied by documentation to support the claim.**

**(iii) Upon completion of a bankruptcy plan, the lender must complete Form RD 1980-44**, *"Guaranteed Loan Borrower Default Status,"* **and forward it to the Agency.**

**(iv) Upon completion of the bankruptcy plan, the lender must provide the Agency with the documentation necessary to determine whether the estimated loss paid equals the actual loss sustained. If the actual loss sustained as a result of the bankruptcy is less than the estimated loss, the lender must reimburse the Agency for the overpayment plus interest at the note rate from the date of payment of the estimated loss. If the actual loss is greater than the estimated loss payment, the lender must submit a revised estimated loss claim in order to obtain payment of the additional amount owed by the Agency to the lender.** *State Directors should carefully determine the amount of the estimated loss payments to avoid litigation that may become necessary to recover overpayments from the lender.*

**(2) <u>Bankruptcy loss payments</u>.**

**(i) The lender must request a bankruptcy loss payment of the guaranteed portion of the accrued interest and principal discharged by the court for all bankruptcies when all or a portion of the debt has been discharged. Unless a court approves a subsequent change to the bankruptcy plan that is adverse to the lender, only one bankruptcy loss payment is allowed during the bankruptcy. Once the court has discharged all or part of the guaranteed loan and any appeal period has run, the lender must submit the documentation necessary for the Agency to review and adjust the bankruptcy loss claim to reflect any actual discharge of principal and interest.**

**(ii) The lender must use Form RD 449-30**, *"Loan Note Guarantee Report of Loss,"* **to request a bankruptcy loss payment and to revise any bankruptcy loss payments during the course of the bankruptcy. The lender must include with the bankruptcy loss claim documentation to support the claim, as well as any revisions to this claim.**

**(iii) Upon completion of a bankruptcy plan, restructure, or liquidation, the lender must either complete Form RD 1980-44,**

*"Guaranteed Loan Borrower Default Status,"* **and forward it to the Agency or enter the data directly into LINC.**

**(iv) If an estimated loss claim is paid during a bankruptcy and the borrower repays in full the remaining balance without an additional loss sustained by the lender, a final report of loss is not necessary.**

**(3) Interest rate losses as a result of bankruptcy reorganization.**

**(i) For guaranteed loans closed prior to August 2, 2016:**

**(A) Interest losses sustained during the period of the bankruptcy plan will be processed in accordance with paragraph (b)(1) of this section.**

**(B) Interest losses sustained after the bankruptcy plan is confirmed will be processed annually when the lender sustains a loss as a result of a permanent interest rate reduction that extends beyond the period of the bankruptcy plan.**

**(C) If a bankruptcy loss claim is paid during the operation of the bankruptcy plan and the borrower repays in full the remaining balance without an additional loss sustained by the lender, a final report of loss is not necessary.**

**(ii) For guaranteed loans closed on or after August 2, 2016, the Agency will not compensate the lender for any difference in the interest rate specified in the Loan Note Guarantee and the rate of interest specified in the bankruptcy plan.**

**(4) Final bankruptcy loss payments. The Agency will process final bankruptcy loss payments when the loan is fully liquidated.**

**(5) Application of loss claim payments. The lender must apply estimated loss payments first to the unsecured principal of the guaranteed portion of the debt and then to the unsecured interest of the guaranteed portion of the debt. In the event a court attempts to direct the payments to be applied in a different manner, the lender must immediately notify the Agency in writing.** *The Agency will immediately obtain advice from OGC on what action to take.*

**(6) Protective advances. If approved protective advances, as authorized by § 4287.156, were incurred in connection with the initiation of liquidation action and were required to provide repairs, insurance, etc., to protect the collateral as a result of delays in the case of failure of the borrower to maintain the security prior to the borrower having filed bankruptcy, the protective advances together with accrued interest, are payable under the guarantee in the final loss claim.**

**(c) Expenses during bankruptcy proceedings.**

**(1) Under no circumstances will the guarantee cover liquidation expenses in excess of liquidation proceeds.**

**(2) Expenses, such as reasonable attorney/legal fees and the cost of appraisals incurred by the lender as a direct result of the borrower's bankruptcy filing, are considered liquidation expenses. Liquidation expenses must be reasonable, customary, and provide a demonstrated economic benefit to the lender and the Agency. Lender's in-house expenses, which are those expenses that would normally be incurred for administration of the loan, including in-house lawyers, are not covered by the guarantee. Liquidation expenses must be deducted from collateral sale proceeds. The lender and Agency will share liquidation expenses equally. To accomplish this, the lender will deduct 50 percent of the liquidation expenses from the collateral sale proceeds.**

**(3) When a bankruptcy proceeding results in a liquidation of the borrower by a bankruptcy trustee, expenses will be handled as directed by the court, and the lender cannot claim liquidation expenses for the sale of the assets.** *If a trustee is appointed by the court to sell the collateral, the trustee rather than the lender is responsible for the liquidation. Other than attorney/legal expenses, no other liquidation expenses will normally be incurred by the lender.*

**(4) If the property is abandoned by the bankruptcy trustee and any relief from the stay has been obtained, the lender will conduct the liquidation in accordance with § 4287.157.**

**(5) Proceeds received from the partial sale of collateral during bankruptcy may be used by the lender to pay reasonable costs associated with the partial sale, such as freight, labor, and sales commissions. Reasonable use of proceeds for this purpose must be documented with the final loss claim.**

**(6) Reasonable and customary liquidation expenses in bankruptcy may be deducted from liquidation proceeds of collateral.** *Chapter 11 generally 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 bankruptcy can never be liquidation expenses unless the proceeding becomes a Chapter 11 liquidation.*

*(d) Personal/corporate guarantors.*

*Pursuit of personal and corporate guarantors who are not the borrower and not in bankruptcy is a matter outside of the jurisdiction of the court. Reasonable expenses incurred in pursuit of such guarantors* *would be allowable provided there was sufficient collateral sold or collections made on the loan to cover such expenses.*

*(e) Agency monitoring.*

*State Directors are responsible for seeing that the Agency is fully informed by the lender on all bankruptcy cases and monitoring the lender's files to ensure timely action on bankruptcy cases. The Agency may approve the repurchase of the unpaid guaranteed portion of the loan from the holders to reduce interest accrual during Chapter 7 proceedings or after a Chapter 11 proceeding becomes a liquidation proceeding. State Directors must approve in advance and in writing the lender's estimated liquidation expenses on loans in liquidation bankruptcy.*

**§§ 4287.171 - 4287.179 [Reserved]**

**§ 4287.180 Termination of guarantee.**

**The Loan Note Guarantee will terminate under any of the following conditions:**

**(a) Upon full payment of the guaranteed loan;**

**(b) Upon full payment of any loss obligation; or**

(c) **Upon written notice from the lender to the Agency that the guarantee will terminate 30 days after the date of notice, provided that the lender holds all of the guaranteed portion and the Loan Note Guarantee is returned to the Agency to be canceled.** *The State Office must notify the DCFO that the Loan Note Guarantee has been terminated or the loan has been paid in full.*

**§§ 4287.181 - 4287.199 [Reserved]**

**§ 4287.200 OMB control number.**

**In accordance with the Paperwork Reduction Act of 1995, the information collection requirements contained in this rule have been submitted to the Office of Management and Budget (OMB) under OMB Control Number 0570-0069 for OMB approval.**

oOo

***APPENDIX A - MODIFICATION OR ADMINISTRATIVE ACTION FORM***

***BORROWER INFORMATION:***

***Name and address of borrower:***

| |
|---|
| |

***Number of employees:***

| |
|---|
| |

***History of the account:***

| |
|---|
| |

***LOAN INFORMATION:***

***Name and address of lender:*** *(If different from lender holding guarantee, has the lender been substituted as outlined in § 4287.135 of this subpart?)*

| |
|---|
| |

***Loan 1 - Date loan note guarantee was issued:***

| |
|---|
| |

***Loan 1 - Original amount of the loan:***

| |
|---|
| |

***Loan 1 - Interest rate:***

| |
|---|
| |

***Loan 1 - Term:***

| |
|---|
| |

***Loan 1 - Unpaid balance: As of***

| | |
|---|---|
| *Principal:* | |
| *Interest:* | |
| *Per Diem:* | |

***Loan 1 - Status:***

| *Current:* | *Delinquent:* | *Liquidation:* | *Chapter 7:* | *Chapter 11:* | *Other (specify):* |
|---|---|---|---|---|---|
| | | | | | |

***Loan 1 - Use of loan funds:***

| Purpose: | Borrower Contribution: | B&I Loan: | Other: | Total: | |
|---|---|---|---|---|---|
| Land | - | - | - | - | |
| Real Estate Improvements | - | - | | - | |
| Contingency and Reserve | - | - | - | - | |
| Machinery and Equipment | - | | - | - | |
| Working Capital | - | | - | - | |
| Refinance | - | | | - | |
| Fees and Costs | - | | - | - | |
| **Total =** | **-** | **-** | **-** | **-** | |
| Percent Contribution = | | | | | |

***Loan 1 - Market and liquidation value of collateral:***

| *Collateral:* | *Appraisal date:* | *Lien position:* | *Market value:* | *Liquidation value:* |
|---|---|---|---|---|
| *Real Estate* | | | | |
| *Depreciated Equipment* | | | | |
| *Vehicles* | | | | |
| *Excess A/R* | | | | |
| ***Total*** | | | | |

***Loan 1 - Who owns the guaranteed portion?***

| | |
|---|---|
| *Lender:* | % |
| *Agency:* | % |
| *Holder:* | % |

***Loan 1 - Has an estimated loss been paid:***

***Loan 1 - Amount paid and date:***

***FINANCIAL INFORMATION:***

***Financial Analysis:***

***Financial condition of personal guarantors:***

| | |
|---|---|
| *Guarantor:* | |
| *Dates Of Latest Financials:* | |
| *Net Worth:* | |

***Comments on collectibility:***

| |
|---|
| |

***SERVICING REQUEST:***

***Nature of request:***

| |
|---|
| |

***State Office analysis of request:***

| |
|---|
| |

***Lender recommendation:***

| |
|---|
| |

***Review comments by Regional Attorney (copy of opinion attached):***

| |
|---|
| |

***RECOMMENDATIONS:***

***State Director Recommendations:***

| |
|---|
| |

***Program Chief Recommendations:***

| |
|---|
| |

*Reviewed by:*

______________________________ __________
*State Office Loan Specialist* *Date*

______________________________ __________
*Business Programs Director* *Date*

______________________________ __________
*<State> State Director* *Date*

***National Office Recommendation:***

*Reviewed by:*

*National Office Loan Specialist* *Date*

*Branch Chief* *Date*
*Program Processing Division*

*Director* *Date*
*Program Processing Division*

***Instructions for modifications or administrative actions:***

*1. Start with number 1 when the first modification is approved and enter this number in the upper right hand corner of the Letter of Concurrence and related "Modification or Administrative Action" sheet.*

*2. Next to the modified wording on the work copy of the Conditional Commitment and the term loan agreement or any form that 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 case file directly on top of the affected original documents of conditions. Recordkeeping should include any requests that were declined by the National Office.*

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***APPENDIX B - FINAL LOSS SETTLEMENT CHECKLIST***

***GENERAL INFORMATION:***

*Date* ______________________________ *State* _____________________________

*Name of Borrower* _______________________________________________________

*Case Number* ____________________________________________________________

*Type of Project* ________________________________________________________

*Type Organization* ______________________________________________________

*Servicing Office* _______________________________________________________

*Original Loan Amount* ___________________________________________________

*Date of Loan* ___________________________________________________________

*Loan Number* ____________________________________________________________

*Repayment Period* _______________________________________________________

*Interest Rate* __________________________________________________________

*Fixed* ____________________ ** Variable* __________________________________

*Daily Accrual, 360, Actual/360, 365 or Actual/365 days* _________________

*Percent of Guarantee* ___________________________________________________

*Subsequent Loan Amount* _________________________________________________

*Date of Subsequent Loan* ________________________________________________

*Repayment Period* _______________________________________________________

*Interest Rate* __________________________________________________________

*Fixed* _____________________** Variable* __________________________________

*Daily Accrual, 360, Actual/360, 365 or Actual/365 days* _________________

*Percent of Guarantee* ___________________________________________________

*Type of Security:*

*General Obligation Bond* ________________________________________________

*Revenue Bond*______________________________________________________________

*Real Estate* ______________________________________________________________

*Machinery and Equipment* __________________________________________________

*Accounts Receivable* ______________________________________________________

*Inventory* ________________________________________________________________

*Furniture and Fixtures* ___________________________________________________

*Personal Guarantee* _______________________________________________________

*Other* ____________________________________________________________________

*Name of Lender* ___________________________________________________________

*Percent of Loan Held by Lender* ___________________________________________

*Name of Holder* ___________________________________________________________

*Percent of Loan Held by Holder* ___________________________________________

*Amount of Holder's interest repurchased by Lender* ________________________
____________________________________________________________________________

*Percent of Holder's interest repurchased by Lender* _______________________
____________________________________________________________________________

*Amount of Holder's interest repurchased by Agency* ________________________
____________________________________________________________________________

*Percent of Holder's interest repurchased by Agency* _______________________
____________________________________________________________________________

* *List below the dates and interest rate changes for variable rate loans from the date the loan was last current through the settlement date.*

| *Exact Date of Rate change* | *Interest Rate* | *Guaranteed Note* | *Unguaranteed Note* |
|---|---|---|---|
| | | | |

____________________________________________________________________________

____________________________________________________________________________
______________________________________________

____________________________________________________________________________

***II. COLLATERAL FOR THE LOAN:***

*Total Value at Loan Approval* _____________ *Date of Appraisal* ____________

** List both current market and liquidation value for the following listed below:*

*Land-Buildings* _____________________________ *Date of Appraisal* ____________

*Machinery and Equipment* _____________________________ *Date of Appraisal* ____________

*Furniture and Fixtures* _____________________________ *Date of Appraisal* ____________

*Accounts Receivable* _____________________________ *Date of Book Value* ___________

*Inventory* _____________________________ *Date of Book Value* ___________

*Other* _____________________________ *Date of Appraisal* ____________

***III. LOAN BALANCE AT LIQUIDATION:***

*Date Liquidation Plan Submitted* ___________________________________________

*Date of Liquidation Plan* ___________________________________________

*Effective Date of Liquidation* ___________________________________________

*Principal Balance at Liquidation* ___________________________________________

*Interest Balance at Liquidation* ___________________________________________

*Total Balance at Liquidation* ___________________________________________

*Daily Interest Accrual* ___________________________________________

***IV. LIQUIDATION COSTS:***

*Phase I Assessment Cost* ___________________________________________

*Phase II Assessment Cost* ___________________________________________

*Attorney/legal Fees* ___________________________________________

*Sheriff's Cost* ___________________________________________

*Taxes Due and Paid* ___________________________________________

*Auction Cost* ___________________________________________

*Broker Cost* ____________________________________________________________

*Other fees (identify below):* ________________________

________________________ ________________________

________________________

*Total Liquidation Expenses* _______________________________________________

*Appraisal Fees* ___________________________________________________________

*Protective Advances* ______________________________________________________

*Dates Protective Advances Paid* _____________________

(1)_____________________

(2)_____________________

***V. USE OF LIQUIDATION PROCEEDS:***

*Net Proceeds Applied to Guaranteed Loan* ___________________________________

*Proceeds Applied to Liquidation Expenses* __________________________________

*Other Applications (identify)* _____________________________________________

***VI. SOURCE OF LIQUIDATION PROCEEDS:***

*Sale Proceeds Received* _________________

*Land-Building* _________________

*Machinery and Equipment* _________________

*Furniture and Fixtures* _________________

*Inventory* _________________

*Other (identify)* _________________

*Collection on Personal Guarantee* _________________

***VII. DCIA:***

*DCIA Eligible (closing => 1/22/04)* *YES NO*

*If YES – questions for State Office:*

*Should this loss be eligible for DCIA?* *YES NO*

*Is the guarantor(s) eligible for DCIA => 12/20/06* *YES NO*

*1a. If yes, did guarantor sign an unconditional guarantee form?* *YES NO*

*1b. Is there a Repayment/Settlement plan?* *YES NO*
*(If YES, must submit to DCFO within 60 day due process period)*

*2. Is the delinquency code identified correctly?* *YES NO*

*3. Was there a Bankruptcy as a result of this loss?* *YES NO*

*Has the State Office identified the liable guarantors in the BP Fund Request View of the application in GLS?* *YES NO*

*Generate 1099-C (Cancellation of Debt)* *YES NO*

*Unconditional Guarantee Form* *YES NO*

*****Letter to Lender at end of 60 day due process to cease ALL collection action*****

*****Due Process letter to be sent to guarantor(s) when loss is input into GLS*****

==========================================================================

*Estimated Loss Paid Amount $____________ Basis ____________*

*Percentage of Guarantee ____________%*

*BP Annual/Late Fees:*

*Check UnPd/Pd Annual/Late fees,*
*if another type loss was previously processed* *YES $__________NO______*

*Check UnPd/Pd Annual/Late fees,*
*if a Final Loss w/no other previous type losses* *YES $__________NO______*

==========================================================================

*Final Loss Payment to Lender*
*$*_________________________________

*Total Principal Loss Amount*
*$*_________________________________

*Total Interest Loss Amount*
*$*_________________________________

***VIII. SUMMARY (circle the proper answer):***

***NOTE: All questions answered with "NO" must be explained and fully documented to support the reason for the "NO" answer.***

*1. (YES - NO - NA) Did the lender submit a liquidation plan and did the Agency approve, in writing, the lender's liquidation plan and any subsequent revision?*

*2. (YES - NO - NA) Were all liquidation expenses and protective advances approved?*

*3. (YES - NO - NA) Was a determination made that the lender did not charge for "in house" fees in connection with the liquidation?*

*4. (YES - NO - NA) Were all liquidation appraisal fees shared equally between the lender and the Agency?*

*5. (YES - NO - NA) Did the lender obtain the proper security and lien position at loan closing?*

*6. (YES - NO - NA) Did the lender maintain proper liens, insurance coverage and security instruments on security?*

*7. (YES - NO - NA) Was all collateral disposed of and proceeds accounted for and were liquidation expenses deducted from sale proceeds?*

*8. (YES - NO - NA) Has a list of all unaccounted for security been provided and has the value been taken into account for the final loss settlement amount?*

*9. (YES - NO - NA) Have lender payment records been reviewed to determine that payments were applied correctly and interest was properly accrued and posted to the borrower's account?*

*10. (YES - NO - NA) Has a determination been made whether to pursue the personal guarantee, if one was taken, and is a deficiency judgment warranted?*

*11. (YES - NO - NA) Are all guarantors (key members) listed in GLS ("BP Fund Request View" of the application)?*

*12. (YES - NO - NA) Is the borrower/co-borrower(s) or any guarantors eligible for DCIA?*
*Borrower/co-borrower(s) for loans closed on or after January 22, 2004, with no bankruptcy.*
*Guarantor(s) (key members) - that signed an unconditional guarantee on or after December 20, 2006, with no bankruptcy.*

*13. (YES - NO - NA) Did OGC provide a ruling/opinion with National Office approval as to why the borrower(s) and guarantor(s) should not be referred to Treasury for DCIA and to have the debt written off?*

*14. (YES - NO - NA) Has the lender been notified in writing to cease collection actions from the borrower(s) or guarantor(s) if it has been determined that the borrower(s) or guarantor(s) will be referred to Treasury for DCIA?*

*15. (YES - NO - NA) Have required signatures been obtained on Form RD 449-30, "Loan Note Guarantee Report of Loss"?*

*16. (YES - NO - NA) Have interest computations been verified?*

*17. (YES - NO - NA) Is there additional interest to be paid to the check date?*

*18. (YES - NO - NA) Has the OIG and the OGC been consulted, where necessary?*

*19. (YES - NO - NA) Was the loan properly closed in accordance with the Conditional Commitment and were loan funds used for authorized purposes?*

*20. (YES - NO - NA) If loan funds were not used for authorized purposes, has the unauthorized use of funds been taken into consideration?*

*21. (YES - NO - NA) If a future recovery possibility is likely, has the Agency set up a monitoring system to follow-up with the lender?*

*22. (YES - NO - NA) If the Agency has a receivable, has the lender remitted to the Agency its pro rata share of funds?*

*23. (YES - NO - NA) Has pro rata application of funds been made to the guaranteed and unguaranteed portions of the loan?*

*DATE* _________________ ______________________________________
*AGENCY APPROVAL OFFICIAL*

oOo

***APPENDIX C – LIQUIDATION AND PROPERTY MANAGEMENT GUIDE***

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*I. Purpose*

*This Liquidation and Property Management Guide is designed to help Agency personnel better understand Agency regulations and procedures when faced with liquidations. There is a liquidation plan checklist at the end of this Appendix.*

*While lenders have the primary responsibility for the liquidation of loans and the protection of collateral in liquidation, the Agency is responsible for assuring that lenders fully comply with Agency regulations. Because not all lenders are experienced in handling liquidation of an Agency guaranteed loan, Agency personnel must closely follow their liquidation actions with the primary concern to maximize recovery on the loan in the least amount of time.*

*This guide contains basic, practical information in handling liquidation cases and is an outline to address the general issues normally encountered in guaranteed loan liquidations but is not intended to address every circumstance that may occur.*

## *II. General Comments*

*Only a small percentage of borrowers ever reach a liquidation status. Keep in mind that these borrowers have invested substantial time and money into their business and may have an uncertain future. Most of these failed borrowers as well as the lenders are honest and want to cooperate and assist in closing out the case. Agency officials should expect this attitude and should not take a negative stance with the involved parties. Agency personnel can help by being reasonable and cooperating with these parties while keeping in mind that their main function is protecting the Government's interests.*

*One of the primary functions of the Agency is the monitoring of the lender's servicing and liquidation activities in order to ensure that servicing, as required by Agency 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 has total responsibility for servicing the loan and liquidating the business assets while making recommendations that the Agency then evaluates. The more experienced the lender, the fewer problems one will normally have in liquidation. The inexperienced lender may need guidance and the liquidation process more closely monitored.*

*Liquidation is a business operation and should be handled as such. Prompt action by the lender is essential once the decision has been made to liquidate the collateral and the business assets. The importance of maintaining a good relationship with the lender during the life of the loan is of great importance because once liquidation starts, the Agency will likely receive better cooperation during the liquidation. A positive relationship should also be maintained during any contact with the borrower.*

*With proper portfolio management, there should never be any surprises when it comes to borrower liquidations. Extra servicing and monitoring should have been occurring for the time leading up to the liquidation. In order to better service these "at risk" loans, it is suggested that the State Office maintain a periodically updated "Watch List." This list or report should contain all delinquent borrowers, those classified as Special Mention that may become delinquent, as well as those in bankruptcy and liquidation. All servicing actions, meetings, and conversations with the lender or borrower should be carefully documented in the case file.*

## *III. Involving OGC*

*When involved in a liquidation, lenders turn to their attorneys for advice and assistance. The Regional OGC may be involved as necessary in workouts and liquidations of guaranteed loans. These offices have been cooperative and willing to review legal issues involving such cases; however, do not expect the Regional OGC to make the administrative decisions that are necessary on these loans. Do not get into a situation where wrong information has been given to the lender and, based on this, certain decisions have been made that must be reversed. Involve the Regional OGC 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.*

*In order to assist the Regional OGC in the review of a liquidation case, a memorandum addressed to the Regional OGC should be prepared by the State Director giving a narrative history of the loan along with a full explanation of the facts. This document should set forth clearly and concisely what the Regional OGC is being requested to review. The Regional OGC will be better able to provide prompt and helpful legal assistance if it is properly informed of all the facts.*

*The memorandum to OGC must explain or provide sufficient facts and evidence to sustain the Agency's position:*

*(1) Each issue should be fully addressed;*

*(2) The reasons for each decision reached should be discussed and supported by citing the appropriate regulation;*

*(3) Supply the necessary facts and evidence that relate to each decision;*

*(4) Explain any facts or evidence that would tend to undermine the decision or position; and*

*(5) Discuss the action recommended by the Agency and why the Agency wants to take this action. Where several alternatives suggest themselves, explain why the Agency prefers one alternative to another.*

*Servicing actions for liquidations that involve legal issues and also require National Office review and concurrence must have the Regional OGC's comments as part of the submitted material.*

*OGC opinions and memoranda will never be given to persons outside the Agency nor will non-Agency personnel be allowed to see or discuss these opinions. The use of OGC does not relieve Agency personnel of their administrative responsibility to assure compliance with Agency regulations. OGC renders advice, but any decision is the Agency's.*

*IV. <u>When to Liquidate</u>*

*In the event of one or more incidents of borrower default or third party actions that the borrower cannot or will not cure or eliminate within a reasonable period of time, liquidation may be considered. If the lender concludes that liquidation is necessary, it must request the Agency's concurrence. Refer to page 57 of this Appendix for a sample letter regarding the decision to liquidate.*

*The loan can be either in technical default of a loan agreement covenant or in monetary default, or both, when the lender and Agency decide to liquidate. Before commencing with liquidation, the lender should evaluate all proposed methods of liquidation, i.e., listing collateral with a real estate agent, auctioneer, sealed bid, selling the note, as well as the costs associated with each method. The lender should also include a net recovery* *value for each liquidation option so that the Agency can properly compare and evaluate the options. In all cases, it is the lender's responsibility to conclude that liquidation is necessary, suggest a liquidation method, and obtain Agency concurrence of this decision. The lender should continue to work with the borrower to resolve the issues, but unless meaningful proposals are presented, the Agency expects liquidation to proceed as soon as practicable.*

*It is time to consider liquidation when:*

*(a) The lender determines that the borrower cannot succeed.*

*(b) The lender's and/or Agency's interest in the collateral securing the debt is in jeopardy. Examples of such action may be prior lien holders of the collateral taking foreclosure action against the borrower; bankruptcy actions; abandonment of the collateral by the borrower; and default on the loan agreement and/or other conditions.*

*The Agency does not consider a loan in liquidation until the loan has been accelerated and a demand for payment has been made upon the borrower. The lender will proceed to accelerate the indebtedness as expeditiously as possible when acceleration is necessary, including giving any notices and taking any other legal actions required. A copy of the demand letter or other acceleration document will be sent to the Agency. All obligors must be included in this action, as improper notification could delay liquidation and result in serious legal consequences. Once the lender is in the position to liquidate the collateral, a liquidation plan submitted to the Agency is required.*

*Liquidation status can be changed by subsequent events, such as a Chapter 11 bankruptcy reorganization, in which event liquidation is either ceased or directed by the court. If the borrower files for protection under bankruptcy reorganization, before or after liquidation begins, liquidation of the borrower is no longer in effect and, therefore, the lender is not required to file a liquidation plan.*

*V. Do's and Don'ts in Liquidation*

*Listed below are a few basic reminders for Agency officials confronted with liquidations:*

*(1) Do's*

*(i) Keep the Agency's interests paramount. Throughout the liquidation process, be cooperative but never lose sight of the fact that your primary responsibility is to protect the Agency's interests.*

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

*(iii) Ask the lender to provide a list of all collateral (especially machinery and equipment) on hand at the time the liquidation plan is submitted. All items should be tagged and identified if possible. 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.*

*(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 that has ceased operations. Make sure that the lender and borrower make every possible effort to help find a buyer before the business doors are officially closed.*

*(vi) Be prepared to assist the lender and borrower with identifying possible buyers of specialized equipment. In many instances, trade associations can help identify potential buyers.*

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

*(viii) If property used as loan collateral is to be sold at auction, make sure an Agency representative attends.*

*(ix) Prepare a written memorandum to the file explaining what the Agency would do differently if it had the opportunity to do the project again. The experience and the memorandum may be useful in servicing other cases.*

*(2) Don’ts*

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

*(ii) Don't be reluctant to call the Regional OGC and National Office for advice.*

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

*(iv) 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.*

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

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

*(vii) Don't hesitate to notify OGC and the National Office if there is any indication that the lender is not fulfilling its contract with the Agency. Make it known to the lender and the National Office when it is suspected this is the case.*

*(viii) Don't forget to keep a thorough record of everything that happens in connection with a liquidation process. Remember that auditors and others reviewing the loan file several years later won't know why the Agency took certain actions unless a detailed written record of the events as they happened is kept.*

*VI. Phasedown of Borrower's Operation*

*In some cases, the lender may be able to employ a technique known as operational phasedown rather than placing the borrower in liquidation. Operational phasedown is designed to get 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.*

*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. 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.*

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

*In the process of continued operations, the plan may call for the borrower to begin selling portions of the business, machinery, equipment, and reduce their payroll expenses. 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, the supplier may be willing to take back the inventory at a discounted price.*

*If money is owed to inventory suppliers, the supplier would very likely apply the value of any returned inventory toward its own account instead of paying the lender. Another alternative would be to not return the merchandise, but instead sell the collateral for the best offer to an independent entity. The object, of course, is to maximize the return on the sale of the assets.*

*If payment in full is not expected and it is advantageous for the lender and Agency to involve the borrower in the liquidation of the collateral, other options, including a private sale, should be considered. After the sale of all assets, the borrower should make a settlement agreement with all remaining creditors as called for in the phasedown plan.*

*VII. Sale of the Promissory Note without Recourse*

*One method of liquidation is the sale of the promissory note. Advantages of a promissory note sale include a reduction of liquidation costs and access to a larger pool of potential investors. The sale of the promissory note as a method of liquidation should not be considered on guaranteed loans that are current.*

*When the lender is considering the sale of the promissory note as a method of liquidation, including loans in bankruptcy, the lender must document that this method would yield the highest and best recovery in their detailed Liquidation Plan. The lender must offer the entire loan for sale, both the guaranteed and unguaranteed portions of the loan. All sales must be on a non-recourse basis, and the Loan Note Guarantee* ***will not*** *transfer.*

*Due diligence must be performed that includes an evaluation of all potential companies that perform this service to ascertain their expertise in this area. The companies should be reputable, with a track record in executing these types of transactions, and aware of the associated risks involved.*

*The Purchase and Sales Agreement must be reviewed in advance by the Regional OGC. When the sale is consummated, the lender will promptly remit to the Agency its pro-rata share, and the lender will promptly file a final report of loss claim in accordance with regulations.*

*The lender, with Agency approval, can also establish a minimum bid and reserve the right to pull the loan from the bid process if the reserve bid is not met. This option can be used concurrently with other liquidation methods.*

*This liquidation method must also follow regulatory requirements, including a current appraisal that reflects both current and liquidation values of collateral, if necessary. The State Office is authorized to approve all promissory note sale transactions within its delegated loan servicing authority. Any transaction that is in excess of its delegated loan servicing authority must be submitted to the National Office Program Processing Division using the Modification or Administrative Action form outlined in Appendix A of this subpart.*

*The sale of the promissory note does not relieve the borrower, guarantor, or any other liable third party from liability if the promissory note sale results in a loss to the Government. The Agency will reserve its rights to collect from the guarantor and any other liable third party, including remedies available under DCIA, if applicable.*

*VIII. Liquidation Plan*

*It is strongly recommended that an Agency representative visit the lender at the time a loan default is considered to discuss other available remedies, or if there are none available, to encourage an orderly liquidation of the loan. A discussion of the tentative plan of liquidation will help the* *lender to prepare a complete liquidation plan for submission to the Agency. At the same time, the Agency official gains valuable knowledge regarding the case, and the Agency's response time to the liquidation plan can be expedited.*

*As soon as the lender has made the decision to liquidate the loan, the lender should begin preparing the liquidation plan. The lender has 30 days in which to submit the liquidation plan as set forth in the regulations. A guide as to what should be covered in the lender's liquidation plan is outlined in this section. 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.*

*The regulations require the Agency to respond to the lender's proposed liquidation plan within 30 days of receipt or the lender may proceed without Agency approval (refer to page 58 of this Appendix for a sample letter regarding approval of the liquidation plan). Priority should be given to the liquidation plan when received by the Agency, and the response should be made as quickly as possible. The Agency's potential loss exposure is increased daily, thus a liquidation of the loan in the least amount of time maximizes collections.*

*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 that identified collateral and must be followed promptly by a complete liquidation plan prepared by the lender in accordance with the requirements of the regulations.*

*The liquidation plan must be in writing and should explain the current situation and the remedies suggested by the lender. RD Instruction 4287-B, § 4287.157(c), details the requirements of a liquidation plan. Information that should be provided includes but is not limited to:*

*(1) Such proof as the Agency 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 that reflects the current loan balance, accrued interest to date, and the method or basis of computing the interest.*

*(2) 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. 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 the Agency.*

*(3) The recommended plan of action on the best liquidation methods and the justification for such action, including acquisition and disposal of all collateral and actions to be taken on the guarantor(s) of the loan.*

*(4) A full and complete listing of all collateral, including the lien position held by the lender, and any necessary steps for preservation of the collateral.*

*(5) A listing of all personal and/or corporate guarantees and the most recent financial information on the guarantors.*

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

*(7) 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.*

*(8) 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.*

*(9) 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).*

*(10) If a voluntary conveyance of the collateral is considered, the lender, with the Agency's concurrence, must determine the amount that will eventually be credited to the guaranteed debt.*

*(11) Establishment of a schedule to periodically report to the Agency on the progress of liquidation.*

*(12) Legal opinions, if necessary, to justify recommended liquidation methods, acquisition, preservation of the collateral, and for DCIA.*

*(13) An estimate of fair market and potential liquidation value of the collateral. If the value of the collateral is $250,000 or more, the lender must obtain an independent appraisal report meeting the requirements of § 4279.144 of this chapter for the collateral securing the loan, which reflects the fair market value and potential liquidation value. For collateral values under this threshold, lenders must follow their primary regulator's policies relating to appraisals and evaluations or, if the lender is not regulated, normal banking practices and generally accepted methods of determining value. The liquidation appraisal of the collateral must evaluate the impact on market value of any release of hazardous substances, petroleum products, or other environmental hazards. The independent appraiser's fee, including the cost of the environmental site assessment, will be shared equally by the Agency and the lender. In order to assure prompt action, the liquidation plan can be submitted with an estimate of collateral value, and the liquidation plan may be approved by the Agency subject to the results of the final liquidation appraisal. The Agency may pay for additional appraisals as warranted.*

*The Agency employee requesting payment for the lender's share of the liquidation appraisal and/or environmental assessment fee(s) must complete a*

*Report of Liquidation Expense form and sign, attaching a copy of the invoice(s) or receipt(s), and fax to the Guaranteed Loan Branch (GLB) in the office of the DCFO at (314) 457-4279. Upon receipt of the faxed signed form and copy(s) of the invoice(s) or receipt(s), GLB, DCFO will make payment utilizing GLS. Any questions or concerns in regards to the payment should be addressed to GLB, DCFO, by calling the main line at (314) 457-4192.*

*If a lender acquires title to property either through voluntary conveyance or foreclosure proceeding, the Agency 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 allows the lender to sell the property after bidding on it in a foreclosure before a Final Report of Loss is submitted. The lender must submit its written request for this option to Agency, and Agency must agree, prior to the lender submitting any request for an estimated loss payment.*

*If the lender submits a written request to the Agency asking the Agency to delay calculation of final loss until the lender finally disposes of the collateral out of its inventory, pursuant to the option above, the Agency, at its option, may accede to the request. 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 the Agency. For loans closed on or after [**DATE OF FINAL RULE PUBLICATION**], in the event of a loss, the guarantee will not cover note interest to the lender accruing after 90 days from the most recent delinquency effective date.*

*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) then 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.*

*The final loss should not be paid until all of the collateral, including any guarantees, if applicable, is liquidated or settled.*

*IX. Reviewing the Lender's Liquidation Plan*

*After receiving the liquidation plan from the lender, the Agency must carefully review the plan and associated documents. The liquidation plan must address the borrower's current situation and remedies suggested by the lender, plus provide a reasonable plan to protect the collateral and liquidate the business assets expediently and in the best interests of the lender and the Agency. The Agency should consider the following items and take appropriate action, if necessary, to protect the Agency's interests:*

*If the guaranteed portion of the loan is being held in the secondary market and the holder has made no request for either the Agency 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 must 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 Agency's written approval. If the lender does not repurchase the guaranteed portion from the holder(s), the Agency will purchase such guaranteed portions.*

*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, its location, and keep track of any sale of collateral. Protection against pilferage would be expected of a reasonable and prudent lender.*

*If there is any question concerning an owner's cooperation or integrity, consideration should be given to the appointment of a Receiver to handle the operation of the business and sale to ensure proper accounting of all assets and funds.*

*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 should recommend a quick and expeditious liquidation of any real estate and collateral.*

*Liquidation expenses and protective advance amounts requested by the lender should be closely reviewed to determine, before actual approval by the Agency, that the expenses are necessary to properly conduct the liquidation of the loan. Examples of abuse by lenders, as cited by the OIG, of liquidations approved by the Agency include inappropriate attorney fees, in-house expenses, lender fees, and care and maintenance of the collateral property. Just because a lender recommends an expense item, the Agency 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, the Agency's loss exposure could possibly be further reduced.*

*Agency review should consider whether the liquidation plan submitted by the lender properly addresses liquidation of the collateral from start to final disposition of the collateral and that all areas of liquidation, including legal issues, are satisfactorily covered by the lender.*

*If for some reason the Agency cannot concur in the liquidation plan, a meeting should take place between the lender and the Agency to resolve the concerns and move forward in a prudent and expedient manner.*

*If there are subsequent changes in the liquidation plan to the one originally agreed to by the lender and the Agency, the lender should inform the Agency in writing of the changes. The Agency should review the modification plan and inform the lender in writing as to its position on the proposed changes made from the original liquidation plan.*

*X. Lender's Documentation review*

*After assessing the current situation and the appropriate liquidation of the borrower’s business and assets, in conjunction with the liquidation process, the Agency should perform a post-review of the loan’s documentation. This review is performed to provide insight on weaknesses that can be addressed in future applications and to protect the Agency’s interests.*

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

*(i) Was the loan disbursement proper and in accordance with the Conditional Commitment and/or the Application for Loan 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 loan closing 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 that could affect the loan.*

*(v) Were there servicing actions taken (or not taken) that a reasonably prudent lender would have taken?*

*(3) Look at the guarantor's balance sheet at loan closing and compare to the current balance sheet obtained at liquidation. Were all assets listed at loan closing accounted for on the balance sheet 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 OGC if you have questions on perfection of security interests.*

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

*In the rare instance where the Agency has concerns regarding the above questions, a meeting with the lender must be made to clarify and resolve any discoveries. Actions by the lender at loan closing or during servicing of the loan that have an adverse impact and may cause greater loss exposure to the government may result in a reduced guarantee payment and a claim against the lender for use of loan funds for an unauthorized purpose or negligent servicing.*

*XI. Risk Factors Associated with Agency Guaranteed Loans*

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

*(1) Time restraints.*

*(2) Interest accruals.*

*(3) Dependency upon the lender to handle the liquidation.*

*(4) Deterioration of the collateral.*

*(5) Additional expenses.*

*As stated in section VIII of this Appendix, the lender must submit a proper liquidation plan to the Agency within 30 days after the lender and Agency agree that liquidation is proper and necessary. The Agency 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 and the lender continues to accrue interest within the terms of the Loan Note Guarantee at the promissory note rate. For loans closed on or after [**DATE OF FINAL RULE PUBLICATION**], in the event of a loss, the guarantee will not cover note interest to the lender accruing after 90 days from the most recent delinquency effective date as reported in item number 8 on Form RD 1980-44, "Guaranteed Loan Borrower Default Status." Agency personnel must show preference on any liquidation case as opposed to loanmaking or servicing of non-problem cases and keep liquidation of the loan expeditiously moving to a conclusion.*

*If the lender has an attractive interest rate and holds the guaranteed portion, the lender may not pursue 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 the Agency's loss exposure; therefore, it is important that the lender move as quickly as reasonably possible to liquidate the collateral.*

*The following is an illustration reflecting potential expenses caused by Agency requirements that the lender might avoid if it was handling the loan and the loan was unguaranteed:*

*A $1,500,000 original Agency 90% guaranteed loan held by the lender reduced to a balance of $1,200,000 at an interest rate of 7.5% at the time of liquidation. Additional risk factors to the Agency as explained above reflect:*

*$15,000 - Interest at 7.5% per annum on $1,200,000 for 60 days (30 days for lender to submit a liquidation plan and 30 days for Agency to respond).*

*$ 1,667 - Insurance for 2 months based on a $10,000 annual insurance premium.*

*$ 5,000 - Taxes for 2 months on real estate collateral based on a $30,000 annual tax bill.*

*$12,000 - Heat, electricity, water and guard services for 2 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.*

*$33,667 Total*
*x 90% Agency Guarantee*
*$30,300 Agency's loss exposure for the 60-day period*

*Based on this illustration, the Agency's additional risk exposure is $505 daily for the 60-day period allowable under Agency regulations for the lender to submit a liquidation plan and for the Agency to address the plan. Any additional delay by either the lender and/or the Agency further increases the loss exposure. Although $30,300 may not seem to be a large exposure on the Agency's part, consider the number of loans in liquidation nationwide.*

*As one can see, any delays in actual days lost by not vigorously pursuing the end result of liquidation exposes the Agency to tremendous losses. Therefore, a quick and expeditious liquidation is the manner in which to proceed.*

*Another procedure to utilize in order to possibly reduce Agency 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 Agency 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 the Agency was holding the guaranteed portion of the loan, the lender may refuse to honor such a claim, making legal action necessary by the Agency to claim the rightful amount due to the Agency for the lender's improprieties. The*

*Government would have to initiate legal action to obtain the amount due the Agency and the burden of proof would rest on the Government in a claim of negligent servicing and/or unauthorized use of loan funds.*

*If interest accrual has not already been stopped, the lender and DCFO should be notified to stop interest accrual as of the date the estimated loss is paid. For loans closed on or after [**DATE OF FINAL RULE PUBLICATION**], in the event of a loss, the guarantee will not cover note interest to the lender accruing after 90 days from the most recent delinquency effective date.*

*XII. 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 of the loan and payments should be made to the lender. Since this type of collateral is easily converted to cash, 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 of maximizing recovery on this type of collateral.*

*(b) Inventory*

*(1) Inventory is more difficult than accounts receivable to move and convert into cash in liquidation. 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 reasonably 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 that 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. In many instances, trade associations can be a resource to identify potential machinery and equipment buyers.*

*(2) A 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) A listing of all machinery and equipment.*
*(ii) Storing and tagging of all collateral.*
*(iii) Moving exposed equipment under shelter.*
*(iv) Protecting the collateral from theft or damage.*
*(v) Protective maintenance such as greasing, oiling, etc.*
*(vi) Adequate insurance coverage.*

*(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 the Agency 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*

*(1) Rolling stock type of collateral consists of automobiles, trucks, tractors, operating equipment, etc. Vehicles and trailers, if used on 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.*

*(2) The lender should act quickly in any liquidation to gain physical 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 transferred to another party on rolling stock until the lien position on the respective vehicle has been released by the secured party. Deciding whether a valid lien was perfected may be more difficult if the rolling stock is not titled. If there is any doubt, the National Office OGC should be contacted.*

*(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 often limited, and arriving at a fair sale price is difficult in most cases. The lender must obtain an independent appraisal report on all collateral securing the loan that reflects the current market value and potential liquidation value. 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.*

*(2) There may be reluctance on the part of lenders to make loans secured by industrial property because the specialized use limitations make it poor collateral for a loan. 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 make it difficult to sell.*

*XIII. Appraisal Reports*

*The appraisal is made for the benefit of the lender and the Agency and should not be discussed with any other individuals. A prudent lender should treat the appraisal as confidential. The Agency official must always be the final judge of the value of the collateral based on the known facts. If the Agency 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. An appraisal report by a qualified independent appraiser in accordance with § 4279.144 is required on all collateral securing loans when the value of the collateral is more than $250,000.*

*(a) An acceptable appraisal should include:*

*(1) The appraiser's transmittal letter, which should state:*

*(i) The collateral being appraised and its location.*

*(ii) Explanation and description of condition (excellent, good, satisfactory, etc.) including photographs, if possible.*

*(iii) A definition of the current market and liquidation values.*

*(iv) Date the appraisal was completed.*

*(v) Different approaches used in determining the value of the collateral. In appraising 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.*

*(vi) Methods used to determine the value of the collateral should be defined.*

*(vii) 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) The 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.*

*(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 that 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.*

*XIV. <u>Environmental Requirements in Liquidation</u>*

*This guidance explains how to evaluate the economic impacts posed by contamination by hazardous substances or petroleum products when determining the liquidation value of real property.*

*The purpose of an appraisal report is to permit the lender and the Agency to determine the appropriate liquidation actions. The cost of the appraisal report will be shared equally with the lender.*

*In order to formulate a liquidation plan that maximizes recovery, the collateral must be evaluated for the presence of contamination or the release of hazardous substances or petroleum products that may adversely impact the* *market value of the collateral. An appraisal that does not consider this aspect is incomplete and possibly misleading. Because these environmental evaluations are performed in conjunction with the appraisal process, the cost of these evaluations will also be shared equally between the Agency and the lender.*

*An evaluation of the environmental condition of collateral is made by conducting environmental due diligence in conjunction with the appraisal. Environmental due diligence, in the context of a real estate transaction, is defined as the process of evaluating real estate for the presence of contamination from release of hazardous substances or petroleum products, and determining the effect, if any, the contamination has on the regulatory status or security value of the property. If contamination is present, the cost of environmental restoration activities can be estimated and used to adjust the market value of the collateral. The process of environmental due diligence is designed to reduce the uncertainty regarding the environmental condition of collateral and meet the "appropriate inquiry" and "due care" provisions in the Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. 9601, et seq.*

*The Agency considers the use of the (1) initial investigation using the Transaction Screen Questionnaire (TSQ), and (2) professional evaluation by a Phase I Environmental Site Assessment (ESA) to be the acceptable way of conducting environmental due diligence. The TSQ and ESA standards are published by the American Society of Testing and Materials (ASTM E-1528 and E-1527 respectively) as an adequate format for performing due diligence. It is not necessary to complete both steps in performing due diligence if (1) the TSQ concludes an ESA is unnecessary, or (2) an ESA is completed without using a TSQ. It is necessary only to complete the level of review required to ascertain and document economic risks posed by contamination.*

*The Agency considers ASTM standards to be an effective way to determine and document the environmental conditions of collateral and reduce the potential effect that an adverse environmental condition will pose to the market value of the property, particularly at the time of liquidation. The ASTM two-step due diligence process is further explained as follows:*

*The TSQ is the initial level of inquiry that evaluates the environmental condition of collateral and concludes whether additional evaluation is necessary. The TSQ is a series of questions that determine present or past land uses or activities that have the potential for adversely impacting the environmental conditions and market value of collateral. If the results of the TSQ are inconclusive, a Phase I Environmental Site Assessment is needed. If contamination or hazardous materials are obvious during site visit, the TSQ may be eliminated and a Phase I ESA conducted.*

*The next level of review, a Phase I ESA, may be necessary to clarify the issues raised by the TSQ. A Phase I ESA is a detailed investigation and evaluation of a property's environmental condition and involves a review of all pertinent records, a site reconnaissance of the property, interviews with current and past owners or operators of the property, and the preparation of a narrative report communicating the findings and conclusions about the environmental condition of the property. The Phase I ESA may indicate a need* *for further detailed investigation, in the form of a Phase II ESA, to determine the extent of contamination, remediation measures, and associated costs. The Agency and the lender, if further investigation is warranted, may share the cost of these additional investigations. Phase I ESAs are performed by environmental professionals. Such professionals must be trained in the fields of environmental science and engineering and have the experience necessary to perform the ESA, in accordance with the ASTM standards. The environmental professional must develop conclusions regarding the environmental status of a site and, if necessary, develop remedial options and estimate associated costs. This information is then shared with the appraiser so that a more accurate determination of market value can be made. Remediation plans proposed in ESAs need to be cleared with State or local agencies having jurisdiction over site remediation activities.*

*Lenders should contact the Program Director for further assistance in incorporating environmental due diligence into their liquidation plans. The Program Director will contact the State Environmental Coordinator for advice as needed.*

*XV. Liquidation Expenses*

*The preparation of the liquidation plan and the liquidation of the loan is the lender's responsibility. 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. 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 the Agency when approving the liquidation plan. The lender should be reminded that liquidation expenses can only be reimbursed to the lender by deduction from the gross proceeds from the sale of the collateral.*

*If after submission of the liquidation plan, circumstances arise that may dictate a revision of liquidation costs, the lender must obtain the Agency'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.*

*Attorney/legal 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 in-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. Attorney/legal fees incurred by the lender while the borrower is in a Chapter 11 reorganization would not be deducted from collateral proceeds as liquidation expenses. A reorganization is not a liquidation. Regulations require 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.*

*If a trustee is appointed by the 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, except legal fees associated with protecting the lenders rights and collateral within the bankruptcy process. If you have questions, contact your Regional OGC or the National Office Program Processing Division.*

*Pursuit of personal/corporate guarantors (who are not the borrower on the loan) while the borrower is in Chapter 11 reorganization or a 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 that would at a minimum cover the expenses.*

*The lender must provide a list of all liquidation expenses before payment of a final loss or closing out of the loan guarantee.*

*XVI. Protective Advances*

*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). The lender must obtain written Agency approval for any protective advance that will singularly or cumulatively amount to more than $200,000 or 10% of the guaranteed loan, whichever is less.*

*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.*

*Protective advances are not generally authorized while the borrower is in a Chapter 11 reorganization since a reorganization is not a liquidation. The 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.*

*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 the Agency's advantage that whenever possible, any amount authorized by the Agency 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.*

*XVII. Different Options of Liquidation*

*As a general rule, any liquidation sale of the collateral property 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, or relatives, be approved by the Agency. 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.*

*Never be too anxious to settle a bad loan just to avoid a problem. Remember, Agency regulations state that the lender must maximize the return on the collateral. It is the Agency official's responsibility to see that the lender fulfills this obligation.*

*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. In any sale of this type, the corporate/personal guarantor(s) liability on the loan should be adequately addressed and resolved, especially if the anticipated sale may be for less than the full loan balance.*

*Normally, this sale 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. In order to utilize this option, a cooperative borrower who can legally convey fee simple title to the collateral is essential. 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:*

*(1) 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) Reduced legal expenses.*

*(F) No piecemeal sale of collateral is necessary.*

*(2) Disadvantages*

*(A) The lender or Agency 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.*

*(3) 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 the Agency.*

*While a cash settlement offer is always preferred to a long-term transaction, it is usually less than the sales price that could be obtained on a financing arrangement. Consider the additional incidental expenses of holding on to the property for a longer period of time compared to the immediate return of a cash sale.*

*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 additional collateral.*

*When considering long-term financing, it may be possible to build flexible conditions into any proposal 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.*

*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.*

*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 encourage the lender to move as quickly as possible to liquidate the collateral.*

*(b) Transfer and assumption of the borrower's operations.*

*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 Agency guarantee intact (a good selling point with the lender), and provides an opportunity to strengthen the loan through additional collateral and/or additional guarantees.*

*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. Any other transactions that affect the promissory note may also rule out transfer and assumption of the debt. These situations should be referred to the Regional OGC.*
*Follow the regulations in any transfer and assumption case. RD Instruction 4287-B, § 4287.134, states the regulatory requirements of a transfer and assumption. The advantages and disadvantages to such a transfer include:*

*(1) Advantages*

*(A) A transfer of the loan can be made without liquidating the collateral; thus eliminating or reducing liquidation costs.*

*(B) The purchaser obtains an operating entity whose business is 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) May maximize collections on a loan in liquidation.*

*(2) Disadvantages*

*(A) Transferee may request more liberal terms. If different terms are requested, there may be regulatory 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 OGC 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) Without proper analysis, the Agency may be blindly trading one problem for another.*

*(D) Side transactions could take place between the transferee and the borrower without the lender's knowledge.*

*(E) An ownership change may have an impact on the customer base.*

*Any transfer and assumption case should be fully understood and evaluated before concurring with the lender. The Agency official should treat any transfer and assumption as if the Agency 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.*

*This option is only available after the lender has purchased the collateral property through a foreclosure public auction sale or the borrower has conveyed title to the lender. The lender may wish to have the collateral begin generating income to be applied to the guaranteed debt without transferring title, though generally, leasing the collateral or utilizing a purchase money contract is not in the best interest of the Agency. 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 Agency guarantee.*

*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.*

*When considering such a proposal, make the terms and conditions fit the Agency's interests. Fully understand the proposal before committing the Agency to any such arrangement. Otherwise, the Agency could be agreeing to long term contracts that may cause additional problems. The object is to liquidate collateral as soon as practical, not to create long standing relationships.*

*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 OGC'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.*

*This option permits the borrower to dispose of the collateral and liquidate the loan under the lender's guidance. 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.*

*Generally liquidation by the borrower is not advantageous to the Agency 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.*

*The advantages and disadvantages of this type of liquidation include:*

*(1) 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.*

*(2) 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 the Agency's obligations due to interest accruals.*

*(G) Borrower may sell only the good saleable collateral, leaving the less desirable collateral that eventually may have to be sold by the lender.*

*(e) Voluntary conveyance of the collateral.*

*This option permits the borrower to deed title of the collateral immediately to the lender and is voluntary to both parties (lender and borrower). If this action is considered, the lender must be certain that the borrower can convey clear title.*

*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 the Agency.*

*Most voluntary conveyances of clear title mean a cancellation of the full debt. This action would automatically cancel any guarantor's liability on* *the debt. Be careful when handling such an arrangement and involve the Regional OGC before acceptance of such a plan. Careful documentation of the file demonstrating the commercial reasonableness of the decision is necessary. If the loan is subject to DCIA, the National Office must approve the release of liability to the borrower and guarantors.*

*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.*

*When looking to the guarantor(s) for collection on the loan deficiency balance, the guarantor(s) and the lender with Agency'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. Again, the Regional OGC should provide guidance before the Agency accepts this type of conveyance.*

*The advantages and disadvantages to such an option include:*

*(1) 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.*

*(2) 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 the Agency 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.*

*(E) DCIA considerations and lack of State approval authority to release liability in DCIA cases.*

*Any time 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 immediately recorded at the proper locations.*

*(f) Foreclosure by public auction sale.*

*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 that must be cleared in order to obtain fee simple title. The lender should be familiar with state and local foreclosure laws and the timing requirements to facilitate such a sale.*

*The advantages and disadvantages to such a sale include:*

*(1) Advantages*

*(A) Clears existing liens.*

*(B) Ascertains the demand for the collateral and value.*

*(C) Protects the lender's legal rights to proceed against guarantor(s), if necessary, for any deficiency balance.*

*(D) Easier to prevent a defense by the guarantor(s) on the deficiency balance amount when proceeding legally against guarantor(s).*

*(2) 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.*

*(G) The foreclosure process can be an extremely slow, tedious process in states where real estate liens are perfected with mortgages.*

*(H) Sheriff sales are generally not well attended and may not offer the most reasonable bidding terms. Some jurisdictions will allow a private auction to take the place of the Sheriff sale, and this should be encouraged.*

*XVIII. Protective Bids*

*In establishing a protective bid amount, the lender should work closely with the Agency in arriving at a proper protective bid amount. There must be a sound and current appraisal available that reflects both the fair market value and the potential liquidation value of the collateral. 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. In order to fully understand these values and their purpose, a definition of each is given below:*

*(A) 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.*

*(B) Forced sale liquidation values (public auction sales) is defined as a price that 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.*

*Before the protective bid amount is established, the Agency official must agree with the appraised values. If the Agency 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 Agency official must document the justification for the change in the values.*

*The protective bid amount is made by the lender (with prior Agency concurrence) at a foreclosure sale to protect the lender's and Agency's interests. 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 ensure that a reasonable selling price has been established. The reason for the protective bid is to ensure that the collateral is not sold at unrealistically low values to other bidders and press other interested parties into making higher bids for the collateral at the foreclosure sale.*

*The protective bid should be high enough to protect the lender's and Agency's interests; however, the protective bid amount should 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.*

*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.*

*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.*

*Special considerations to be taken into account in establishing the protective bid amount are:*

*(1) Expenses of resale (real estate taxes, commissions, recording costs, etc.).*

*(2) Continuing interest accrual on the loan.*

*(3) Length of time necessary for the resale of the collateral.*

*(4) Collateral deterioration and maintenance plus additional protective costs.*

*(5) Seasonability of collateral and weatherization.*

*(6) Prior liens and taxes.*

*(7) Utilities.*

*(8) Storage costs.*

*(9) Moving expenses.*

*A hypothetical example of a protective bid amount is shown below:*

*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 6 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 $760,000 as shown below:*

*Consideration given for:*

*a. 6% commission at resale = $53,000*

*b. Interest accrual for 12 mos. @ 8% = $128,000*

*c. Guard service for 12 mos. @ $500 weekly = $26,000*

*d. Utility costs for 12 mos. = $8,000*

*e. Miscellaneous costs (Advertising, Attorney, fees, etc.) = $25,000*

*APPRAISED LIQUIDATION VALUE of $1,000,000*
*LESS: Cost Considerations of $240,000*
*EQUALS: Protective Bid Amount of $760,000*

*If the highest bid was $800,000 placed at the liquidation sale, a prudent lender should permit the respective bidder to purchase the property.*

*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. 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.*

*A final payoff amount in writing as of the day of the sale should be obtained from any superior lien holder. The junior lien holder (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.*

*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 the Agency on the sale.*

*If the lender acquired the collateral and it was agreed by the lender and the Agency in the liquidation plan that this practice would be acceptable to all parties, the Agency 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 Agency. For loans closed on or after August 2, 2016, in the event of a loss, the guarantee will not cover note interest to the lender accruing after 90 days from the most recent delinquency effective date.*

*XIX. <u>Method of Disposition of Collateral</u>*

*If the lender acquires title to the collateral through a voluntary basis or foreclosure means, the Agency 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 process to dispose of the collateral is commenced.*

*Any collateral accepted by the lender on a voluntary basis or through foreclosure must be titled in only the lender's name. The Agency should never be named as owner or co-owner of the collateral as the Agency's position is only that of a guarantor.*

*The first step the lender should take after acquiring the collateral is to see that the collateral is protected from deterioration (weather, vandalism, etc.). Hazard insurance in an amount necessary to cover the fair market value of the collateral should be maintained by the lender.*

*The lender should prepare a plan on the best method of sale, keeping in mind any prospective purchasers, and send the plan to the Agency for its review and comments. 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 Agency official should discuss the modification(s) and work together to attempt to assure that the modified liquidation plan is in the best interests of the Agency and the lender. The Agency 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.*

*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.*

*Some questions for consideration by the lender are: (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 need to 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.*

*The Agency should be satisfied that the lender's plan of sale is realistic, sound, and maximizes the return on the collateral.*

*(2) Commercial Broker.*

*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 and can always be renewed if it is considered worthwhile to do so.*

*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.*

*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.*

*If the property for sale is a general type of commercial building that 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.*

*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. If possible, when engaging a commercial broker, a 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.*

*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.*

*(3) Public auction sale.*

*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. 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.*

*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.*

*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.*

*The lender, in considering a public auction, should determine a minimum sale price for the collateral and should carry prior Agency 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 to consult with the Agency on whether to accept the bid.*

*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 and auctioneer should determine which arrangement brings the greatest return, and, if the price meets the lender's and Agency's approval, the property should be sold.*

*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.*

*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 the Agency will be faced with situations when converting the collateral to cash would result in a loss.*

*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 that has little or no value, or demand for the collateral is minimal and will provide limited proceeds after taking into consideration the expenses of the sale.*

*Any time 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.*

*When considering the action of abandoning the collateral, it must also be determined what effect this would have on the pursuing of collection on the guarantor(s) before proceeding.*

**Worksheet for Determining Business and Industry Guaranteed Loan Programs Maximum Bid on Real Estate Property**

_________________________
(Name of Borrower)

The holding period to be used is 365 days (12 months) or less if it can be justified by the actual State average holding period. Any State right of redemption should be considered.

1. LIQUIDATION VALUE OF PROPERTY $______________________________

Date of Appraisal __________________

The appraisal must be current (no more than 12 months) and must be in accordance with RD Instruction 4279-B, section 4279.144.

2. INCOME

a. Annual Rent _____________ x Holding Period ____________ = ______________

b. Annual Royalties ________ x Holding Period ____________ = ______________

c. Other Annual Income ___________________ x Holding Period ____________ = ______________

d. Annual% Land Appreciation _______ x Holding Period ____________ = ______________

e. Other (describe) ________ x Holding Period ____________ = ______________

TOTAL ADDITIONS = $________________

3. EXPENSES

a. Total Prior Lien Holder Indebtedness (P and I) = __________________

b. Other Acquisitions Costs (taxes presently owed, closing costs, (survey costs, administrative costs, junior liens, etc.) List:

______________________ ______________________ = ______________________

c. Annual Taxes and Assessment ___________________ x Holding Period = _____________________

d. Annual Insurance ________________________ x Holding Period = _____________________

e. Annual Estimated Protective Advances_____ x Holding Period = _____________________

f. Total Estimated Repairs to Secure and Resell = _____________________

g. Annual% Decrease In Land Value ____________________ x Holding Period = _____________________ (if applicable)

h. Total Anticipated Expenses (Auction, Commissions, Advertising, etc.) = _____________________

i. Total Interest Cost:

Liquidation Value $ _______________ x Regular OL Rate _______ x Holding Period = ____________________

j. Hazardous Waste Clean-up Costs = ___________________________________

**TOTAL DEDUCTIONS (ITEMS A THROUGH J) = ______________________**

4. BID WILL BE THE LESSER OF

| a.________ | +________ | - _________ | =___________ | +____________ | =__________ |
|---|---|---|---|---|---|
| Liquidation Value | Total Additions | Total Deductions | Net Recovery Value(NRV) If zero or negative, **Do not** bid | Only if NRV is positive add prior liens, unless is being sold subject to prior liens | NRV + Prior Liens Bid |

Or, [Agency's Guaranteed Debt + Prior Liens]

| b. __________________ | __________________ | = ___________________ |
|---|---|---|
| Unpaid Guaranteed Loan Balance on Secured Debt | Prior Liens | Total |

Review by: _________________________ ____________________
Agency Official Date

Concurrence by: _________________________ ____________________
State Program Director Date

*XX. Guarantors*

*The following considerations should be carefully reviewed before a determination is made whether to release or settle the guarantor(s) liability on any guaranteed loans:*

*(1) Potential income, including any inheritance prospects.*

*(2) The possibility that assets have been concealed or improperly transferred by the guarantor(s).*

*(3) The availability of assets or income that may be realized.*

*(4) Age and health of the guarantor(s).*

*(5) Effect of other guarantor(s) on the loan. The lender may need consent of other guarantor(s) on loan if one guarantor is released.*

*(6) Cash consideration or other collateral in exchange for the guarantee.*

*Any compromise for release of a guarantor must be reasonable when compared with what could be recovered if enforced collection procedures were followed but may be impossible due to DCIA.*

*When releasing a guarantor from liability on a guaranteed loan, adequate consideration must be received. This concept encompasses some new benefit to the Agency either in the form of money, additional security, or some other benefit to the goals and objectives of the Agency. When the question of consideration arises in the context of Agency goals and objectives, the National Office should be contacted. The National Office must approve such releases if the loan and/or guarantor are subject to DCIA.*

*XXI. Compromise Settlement*

*This section pertains to those guaranteed loans not subject to DCIA; otherwise, a compromise settlement must be part of the 60 day due process under DCIA.*

*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 an identified deficiency balance remains.*

*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.*

*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 the Agency should be reasonably satisfied all assets are properly reflected. If the Agency 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) even before compromising or settling a claim against the guarantor(s).*

*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. The Agency 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 the Agency feel is fair and adequate under the circumstances.*

*If the Agency can concur in an amount presented by the lender, the lender can proceed to effect the compromise with the guarantor. The Agency should not become involved with the guarantor in any settlement negotiations. It is the lender's job to take all necessary steps to maximize recovery. The Agency is a guarantor for the loan, not the servicer.*

*Another instance when the Agency would consider a compromise settlement is in a situation when the Agency may have a claim against the lender for negligent origination or negligent servicing of the loan. However, before considering compromising a settlement in such cases, review the case with the Regional OGC to determine what the Agency'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 OGC so that the Regional OGC can decide whether the case must be referred to the Department of Justice.*

*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.*

*XXI. Bankruptcies*

*In bankruptcies, there are two separate proceedings under the court's protection; liquidation and reorganization. It is the lender's responsibility to protect the guaranteed loan debt and all collateral securing the loan in bankruptcy proceedings. The regulations set forth certain responsibilities of the lender. These responsibilities include, but are not limited to, the following:*

*(1) Filing proof of claim, where necessary, and all the necessary papers and pleadings concerning the case.*

*(2) Attending and, where necessary, participating in meetings of the creditors and all court proceedings.*

*(3) Seeking immediate 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 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) Adequate protection can be interpreted differently under Chapter 11 reorganization concerning machinery, equipment and real estate. The bankruptcy trustee could dispose of certain collateral and grant to the secured party a replacement lien on some other collateral that 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 that could be replaced 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 Agency 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 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) Court decision denying the proposed reorganization plan and failure on the borrower's part to gain additional time from the court to submit an amended plan.*

*The Agency must be kept adequately and regularly informed in writing of all aspects of the proceedings. It is the responsibility of the State Program Director to see that the Agency is being fully informed by the lender in all bankruptcy cases. All bankruptcy cases should be reported immediately to the National Office by utilizing and completing a problem/delinquent status report. Court records are public documents and should be available to the Agency if the lender is not adequately providing such documents.*

*In a Chapter 11 reorganization, if an independent appraisal is necessary in the Agency's opinion, the Agency and the lender will share such appraisal fee equally.*

*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 deducted from collateral proceeds or covered under the Agency guarantee. Attorney/legal 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.*

*If a trustee is appointed by the 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.*

*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 the Agency before the expense is incurred.*

*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 accrual during Chapter 7 proceedings or after a Chapter 11 proceeding becomes a liquidation proceeding. On loans in bankruptcy, any loss payment must be handled in accordance with the regulations and carry the approval of the State Director.*

*XXII. Negligent Origination/Servicing*

*Negligent origination is defined in the regulation as the failure of a lender to perform those services that a reasonably prudent lender would perform in origination its own portfolio of unguaranteed loans; or the failure of the lender to perform its origination responsibilities in accordance with the origination policies and procedures in use by the lender at the time of the loan. The term includes the concepts of failure to act, not acting in a timely manner, or acting in a manner contrary to the manner in which a reasonably prudent lender would act.*

*Negligent servicing is defined in the regulations 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.*

*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 origination or negligent servicing. As a practical matter, in many cases it is hard to prove negligent origination or 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.*

*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. Refer to page 59 of this Appendix for a sample letter regarding possible negligent loan servicing.*

*Legally the Agency cannot withdraw the guarantee for negligent origination or servicing. The response to the lender in negligent origination or servicing cases, when no loss has been established, should merely put the lender on notice that the act(s) of negligent origination or servicing will cause the guarantee to be unenforceable to the extent the* *act(s) causes a loss (refer to pages 60-63 of this Appendix for a sample letter regarding a determination of negligent loan servicing).*

*When the lender holds the guaranteed portion of the loan and the Agency refuses to reimburse the lender for the portion of the guarantee because of negligent origination or servicing, the Agency will have the burden of proof regarding the loss occasioned by such negligent origination or servicing. Also, if the Agency repurchased the guaranteed portion and the lender refuses to reimburse the Agency for the amount designated as negligent origination or servicing, the Agency bears the burden of proof in court.*

*An amount of loss must be ascertainable in negligent origination or 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.*

*XXIII. Fraud or Misrepresentation*

*The guarantee constitutes an obligation supported by the full faith and credit of the U.S. 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.*

*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.*

*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 that would lead to the wrong premium being charged, is clearly a misrepresentation.*

*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.*

*If the borrower makes fraudulent representation to the lender to induce the lender/Agency to provide a loan or other benefits, which the lender/Agency 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 the Agency becomes knowledgeable of such act, the Regional OGC must be immediately notified of all such facts for a determination of action to be taken by the Agency.*

*If the lender made fraudulent representations, the Loan Note Guarantee would be contestable for the full amount of the loan in most cases. However, the Agency 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.*

*If the Agency becomes aware of fraud or misrepresentation by the lender, the Regional OGC must be notified immediately of all the facts for a determination of the action to be taken by the Agency. If for some reason the Agency 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.*

*If the guaranteed portion of the loan has been sold in the secondary market and the holder makes a demand on the Agency to purchase the guaranteed portion of the loan, the Agency will 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.*

*Generally what must be proven by the Government in cases of fraud or misrepresentation is that the fraudulent representation made by the lender was intentional and not negligent. The Government will also likely be expected to establish that the lender knew the representation was false or that the lender made the representation without having knowledge of its truth. Nondisclosure of information can amount to a false representation if a transaction is based on the existence of a particular fact and the Government is not informed that material circumstances have changed with regard to that particular fact.*

*Further, the Government would likely be expected to show that the representation concerned a material fact. This would be a representation of a fact that individually or cumulatively would have caused the Government to not issue the guarantee. Additionally, the Government would likely have to prove that the intent of the representation was to cause the Government to issue the guarantee, which the Government ultimately did.*

*These elements are provided as an illustrative (and not exhaustive) list to highlight that proving fraud or misrepresentation is very difficult. It is also important to not confuse or interchange fraud or misrepresentation with negligent servicing and the remedies related to each (denying the guarantee for fraud or misrepresentation versus reducing the guarantee for negligent servicing). If you believe the guarantee should be terminated because of fraud or misrepresentation, you should consult with your Regional*

*OGC. If the conclusion is to proceed on this ground, the lender should be notified immediately.*

*Generally what must be proven by the Government, in order to prevail in cases of negligent servicing is that the lender had a duty to take a certain action that he failed to perform or failed to adequately perform. This duty is established in the regulations by the general reference to what a reasonable lender would have done. The lender's failure to meet this standard must have caused a loss to the Government. Again, this list of what the Government must prove is illustrative and not exhaustive.*

*When there is negligent servicing, the loan guarantee is reduced by the amount of the associated loss. Therefore, there must be some way of quantifying the loss. This latter requirement is not always easy to prove. For instance, assume the lender fails to assure that the insurance premiums are paid and the policy is cancelled. If a subsequent fire causes $50,000 in damage to a building that serves as collateral, the loss could be reduced accordingly. However, what if the lender failed to timely obtain periodic reports that a reasonable lender would have obtained and that would have shown the company was not performing as expected? Calculating the amount of any resulting loss in this case could prove very difficult.*

*Keep in mind that the Agency cannot terminate the guarantee because of negligent servicing. However, the Agency can reduce a loss claim payable to the lender under the guarantee to the extent of loss caused by the lender's negligence. In some instances, this reduction may even be for the full amount of the guarantee. Again, you should consult with your Regional OGC before proceeding with a reduction of the guarantee. Once a decision to reduce the claim has been made, you should notify the lender immediately.*

*XXIV. <u>Final Report of Loss</u>*

*Before approval by the Agency of 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. Also before approval by the Agency of any final loss report, the borrower must be made aware of the DCIA provisions. Guidance regarding the DCIA provisions are contained in Appendix D of this part.*

*The Agency, upon receipt of the final accounting and report of loss, will review and determine the final loss in accordance with regulations. If the Agency 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 the Agency in making the investigation. If the Agency finds any discrepancies, the Agency will contact the lender as soon as possible for any necessary corrections.*

*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, and that liquidation proceeds were*

*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 the regulations and that the lender maximized the collections in conducting the liquidation.*

*(2) The lender should show a breakdown of any protective advance amount(s) 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. The Agency should review all liquidation expenses to determine if the expenses were proper, reasonable and claimed in accordance with the approval given by the Agency. The lender should also provide accounting of the proceeds from the sale of any collateral and indicate any payments to the lender for reimbursement of their liquidation expenses.*

*(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. If an estimated report of loss was paid previously, the accrued interest shown on the estimated report of loss should be the same amount shown on the final report of loss. Interest accrual stops on the unpaid principal balance of the loan on the payment date of the estimated report of loss if paid before the final report of loss. The State Office is responsible for the accuracy of the interest calculations on the final report of loss before submission to the DCFO.*

*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. The Agency 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.*

*The maximum loss that can be paid by the Agency on any loan guarantee will never exceed the original advanced amount guaranteed plus any accrued interest times the percentage of guarantee. For example, a $1,000,000 (principal advanced), 90% 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. In this example, if there were protective advance amounts, these amounts could not be authorized or paid by the Agency since the maximum amount was reached. Rarely would a situation occur as stated because normally payments have been made on the loan before liquidation takes place.*

***Procedures for Paying a Loss***

*This procedure will be used to process and manually pay estimated, bankruptcy, interest, and final reports of loss until software becomes available to systematically generate the payments. This applies to all losses on guaranteed loans. The loss claim, Form RD 449-30, "Loan Note Guarantee Report of Loss," (Guaranteed Loan Report of Loss form), will be* *completed and signed by the lender, approved and signed by the field office, and processed for payment by the Guaranteed Loan Branch (GLB) in the office of the DCFO. The documents to be submitted to GLB will include, but are not limited to:*

*(1) Form RD 449-30, "Loan Note Guarantee Report of Loss (Report of Loss form);"*

*(2) Cover letter with any special instructions;*

*(3) The lender's or Agency's ledgers/transcripts to account for the unpaid principal balance and accrued interest owed remaining on the loan (for loans closed on or after the effective date of this regulation or of the regulation that cross-references this section, in the event of a loss, the guarantee will not cover note interest to the lender accruing after 90 days from the most recent delinquency effective date);*

*(4) A list of protective advances and the dates advanced:*

*(a) Written Agency approval is required for any protective advance that will singularly or cumulatively amount to more than $200,000 or 10% of the guaranteed loan, whichever is less.*

*(b) Written Agency approval to pay accrued interest on the protective advances (for loans closed on or after August 2, 2016, in the event of a loss, the guarantee will not cover accrued intereston the protective advances to the lender accruing after 90 days from the most recent delinquency effective date.);*

*(5) Payment instructions to include ACH routing/account numbers (no wires or checks will be allowed);*

*(6) A copy of the promissory note (normally the first few pages indicating the basis, interest rate changes, indexes used, any other special instructions). The promissory note will also provide the name(s) of any co-borrower(s);*

*(7) A copy of Form RD 4279-14, "Unconditional Guarantee," for each guarantor; and*

*(8) A copy of the Guaranteed Final Loss Settlement Checklist, which is Appendix B of this subpart.*

*GLB will assure that the Report of Loss form is correctly completed and the loss payments are properly authorized. The Report of Loss form for estimated, bankruptcy, interest, and final losses must be signed by both the lender and an authorized RD approving official. Original signatures are required to make payment (electronic signatures are acceptable as originals).*

*Estimated, bankruptcy, interest, and final losses on the Report of Loss form that exceed the State Director's delegated loan servicing approval authority must be approved by the National Office. If applicable, a copy of* *the National Office's approval memorandum must be attached to the Report of Loss form.*

*The top of the Report of Loss form outlines which items on the form must be completed for the various types of loss claims that can be filed. This form also provides instructions on how to complete a recovery and a voluntary payment for those loans not subject to DCIA.*

*Corrections can be made to the Report of Loss form as long as the field office and lender concur with the corrections. Revised data on the forms will be entered above the incorrect data. The incorrect data will be circled. All telephone contacts with the field must be documented on the cover page prepared by GLB. Changes to claim amounts must be approved by the field office and a copy of the revised Report of Loss form will be faxed to the field office.*

***Liquidation Plan Check List***

***Lender:*** ______________________ ***Borrowers:*** ______________________

***Reviewed by:*** __________________ ***Date:*** ______________________

| ***Completed*** | ***Liquidation must include:*** | ***Comments and Proof/Supporting document provided:*** |
|---|---|---|
| *Yes:* ___<br>*No:* ___ | *(1) Lien position on the collateral held by the lender.* | |
| *Yes:* ___<br>*No:* ___ | *(2) Such proof as Agency 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 that reflects the current loan balance and accrued interest to date and the method of computing the interest.* | |
| *Yes:* ___<br>*No:* ___ | *(3) A full and complete listing of all collateral including any personal and/or corporate guarantees and current financial information on the guarantors.* | |
| *Yes:* ___<br>*No:* ___ | *(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. It is not likely that the borrower can/will pay the loan in full, and any additional time over and above what is required by the respective State laws would not be in the best interest of the lender or Agency.* | |
| *Yes:* ___<br>*No:* ___ | *(5) Copies of the borrower's latest available financial statements.* | |
| *Yes:* ___<br>*No:* ___ | *(6) The recommended plan of action on the best liquidation methods and the justification for such action.* | |

| | | |
|---|---|---|
| *Yes: ___* <br> *No: ___* | *(7) Recommended action acquiring and disposing of all collateral.* | |
| *Yes: ___* <br> *No: ___* | *(8) Recommended action to be taken on the guarantor(s) of the loan.* | |
| *Yes: ___* <br> *No: ___* | *(9) Necessary steps for preservation of the collateral.* | |
| *Yes: ___* <br> *No: ___* | *(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 the 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.* | |
| *Yes: ___* <br> *No: ___* | *(11) Establishment of a schedule to periodically report to the Agency on the progress of liquidation.* | |
| *Yes: ___* <br> *No: ___* | *(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.* | |
| *Yes: ___* <br> *No: ___* | *(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 auctions).* | |

| | | |
|---|---|---|
| *Yes:* ___<br><br>*No:* ___ | *(14) If a voluntary conveyance of the collateral is considered, the lender, with the Agency'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) that must be settled before establishing any final loss.* | |
| *Yes:* ___<br><br>*No:* ___ | *(15) Legal opinions, if necessary, to justify recommended liquidation methods, acquisition, preservation of the collateral and for DCIA (borrowers and guarantors).* | |
| *Yes:* ___<br><br>*No:* ___ | *(16) An estimate of fair market and potential liquidation value of the collateral. If the value of the collateral is $250,000 or more, the lender must obtain an independent appraisal report meeting the requirements of § 4279.144 of this chapter for the collateral securing the loan, which reflects the fair market value and potential liquidation value. For collateral values under this threshold, lenders must follow their primary regulator's policies relating to appraisals and evaluations or, if the lender is not regulated, normal banking practices and generally accepted methods of determining 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 the Agency.* | |

*Sample Letter – Decision to Liquidate*

***DATE***

***LENDER***
***ADDRESS***
***CITY, STATE ZIP***

*RE:* ***BORROWER – LOAN AMOUNT***
*Decision to Liquidate*

*Dear* ***LENDING OFFICER,***

*We have reviewed your* ***DATE*** *correspondence requesting Agency concurrence with the decision to liquidate. As the Agency understands the situation,* ***BORROWER*** *was $****AMOUNT*** *behind schedule as of* ***DATE.***

***SUMMARY NARRATIVE OF SERVICING REQUESTS ATTEMPTING TO CURE THE DELINQUENT ACCOUNT THAT LED UP TO THE DECISION TO LIQUIDATE.*** *Consequently,* ***LENDER*** *has requested Agency concurrence with the decision to liquidate the loan.*

*In accordance with 7 CFR § 4287.157, the Agency concurs with the* ***LENDER'S*** *decision to liquidate. Please submit a liquidation plan within 30 days that meets the requirements of 7 CFR § 4287.157(c). Details as to what should be included in the plan are enclosed with this letter. Please submit the liquidation plan as one complete package. We recognize that the appraisals and environmental survey (discussed below) will take additional time to acquire. Your office will need to engage an appraisal service immediately to update the collateral values and recovery estimates.*

*Your office should continue submitting Form RD 1980-44, "Guaranteed Loan Borrower Default Status," on a monthly basis until such time as the loan is no longer in default.*

*We will review your proposed plan and provide feedback as soon as possible. Please contact* ***AGENCY CONTACT*** *at* ***EMAIL ADDRESS*** *or* ***PHONE*** *if you have any questions. Thank you for your interest in the business programs of Rural Development.*

*Sincerely,*

*Business Programs Director*

*Enclosure: Liquidation Plan Outline,*
*7 CFR § 4287.157(c)*

*Sample Letter – Approval of Liquidation Plan*

***DATE***

***LENDER***
***ADDRESS***
***CITY, STATE ZIP***

*RE:* ***BORROWER – LOAN AMOUNT***
*Approval of Liquidation Plan*

*Dear* ***LENDING OFFICER,***

*This is in response to your proposed liquidation plan for* ***BORROWER.*** *The Agency has reviewed the proposed plan in accordance with 7 CFR § 4287.157(c), and we concur with your office's recommendation to liquidate subject to the following conditions being met:*

***STATE CONDITIONS***

*As the lender of record, your office should implement the approved liquidation plan expeditiously. Your office is responsible for accelerating the loan and providing a copy of the letter to the Agency. The loan is considered in liquidation from the date of the acceleration and demand for payment. Any modifications to the plan must be approved by the Agency in writing.*

*Please contact* ***AGENCY CONTACT*** *at* ***EMAIL ADDRESS*** *or* ***PHONE*** *if you have any questions.*

*Sincerely,*

*Business Programs Director*

*Sample Letter – Possible Negligent Loan Servicing*

***DATE***

*Sent via Email and 1st Class Mail*
***LENDER***
***ADDRESS***
***CITY, STATE ZIP***

*RE:* ***BORROWER – LOAN AMOUNT***
*Possible Negligent Loan Servicing*

*Dear* ***LENDING OFFICER,***

*The purpose of this letter is to advise* ***LENDER*** *that USDA Rural Development is concerned with* ***ACTION*** *in connection with the* ***BORROWER*** *loan. This* ***ACTION*** *may be considered negligent loan servicing.*

*Please advise this office of any actions taken to cure this concern.*

*This letter also serves to remind* ***LENDER*** *that the Loan Note Guarantee will be unenforceable by* ***LENDER*** *to the extent that any loss is occasioned by violation of usury laws, negligent loan servicing, or failure to obtain the required security, regardless of the time at which USDA acquires knowledge of the foregoing.*

*If you have any questions, please feel free to contact this office. Thank you for your interest in the business programs of Rural Development.*

*Sincerely,*

*Business Programs Director*

*Enclosures:* *Lender's Agreement*
*Loan Note Guarantee*

*cc: Regional Coordinator*
*Loan Servicing Branch Chief, Washington, DC*

*Sample Letter – Determination of Negligent Loan Servicing*

***DATE***

*Sent via Email and 1st Class Mail*
***LENDER***
***ADDRESS***
***CITY, STATE ZIP***

*RE:* ***BORROWER – LOAN AMOUNT***
*Determination of Negligent Loan Servicing*

*Dear* ***LENDING OFFICER,***

*The purpose of this letter is to advise* ***LENDER*** *that Rural Development has made a determination of negligent loan servicing in connection with the* ***BORROWER*** *loan. Please refer to Section IV of the enclosed Form RD 4279-4, "Lender's Agreement," executed by you on* ***DATE*** *with regard to specific routine servicing requirements.*

***EXPLAIN NEGLIGENT LOAN SERVICING ACTION(S).***

***EXPLAIN HOW THE LENDER COULD POSSIBLY CURE THE DETERMINATION OF NEGLIGENT LOAN SERVICING.***

*One of the above options must be completed and received by close of business,* ***DUE DATE,*** *in order to protect the enforceability of your Loan Note Guarantee.*

*The decision described in this letter will terminate or reduce the collectability of your Loan Note Guarantee. If you believe this decision or the facts used in this case are in error, you may pursue any or all of the following three options:*
*<u>Option 1 – Request an Informal Administrative Review</u>*

*If you have questions concerning this decision or the facts used making it and desire further explanation, you may write this office to request an informal review. There is no cost for an informal review. This written request must be received no later than 15 calendar days from the date you received this letter. You must present any new information, evidence, and possible alternatives along with your request.*

*You may also have a representative or legal counsel participate in the process at your cost. The informal review may be conducted by telephone or in person at the discretion of the Agency. Please include a daytime phone number in your request to arrange for the review. You may skip this step in the informal process and select one of the following two options. If you do, you will automatically waive your right to an informal review.*

*Option 2 – Request Mediation*

*You have the right to request mediation. The purpose of mediation is to resolve disputes through the use of a neutral mediator. A mediator will listen to all parties involved in the dispute and work with all parties to achieve a mutually agreeable resolution. If you need information on the mediation process to assist you in deciding whether to utilize Option 2, contact the State Rural Development Alternative Dispute Resolution Coordinator for business programs listed below.*

*Alternative Dispute Resolution Contact:*

***NAME***
***ADDRESS***
***CITY, STATE ZIP***

*Mediation Contact:*

***NAME***
***ADDRESS***
***CITY, STATE ZIP***

*Rural Development's policy is to pay 50 percent of the reasonable cost for mediation. If you qualify for poverty status for the particular Rural Development program, then the State Director will agree to pay for 75 percent of the mediation cost and you will have to pay the remaining 25 percent.*

*If you elect to seek mediation, your written request for this service must be sent to the Rural Development State Director listed below and must be postmarked no later than 30 days from the date of this letter. Once you request mediation, it stops the running of the 30-day period in which you may request an appeal hearing (described in Option 3) but does not waive your right to an appeal.*

*Once you have requested mediation, the Rural Development State Director will advise you of the estimated cost of mediation, the amount the Agency will contribute, and the process and procedures for this service. In States with a USDA-sponsored mediation program, you will generally be referred to such service. In States without a USDA-sponsored mediation program, you will be either directed to a mediation service, or you will be provided with the names of three mediators from which you will need to select one. Also, you may suggest a mediator subject to the Agency's approval. Once you have selected the mediator, you will be advised directly by the mediation source if they can mediate your case. Once the case has been referred to the mediator, you have 45 days to complete the mediation, unless the participants agree to an extension. If mediation does not result in resolution of the issues, you have the right to continue with a request for an appeal hearing as set forth in Option 3.*

*When mediation is concluded, you will be notified of the result and your right to request an appeal hearing, if applicable. If you request mediation prior to filing for an appeal, the number of days you will have to request an appeal will be 30 days from the date of the adverse decision minus the number* *of days you took to request mediation. Mediation does not take the place of, or limit your rights to, an appeal to the National Appeals Division (NAD); however, a NAD appeal hearing would take place only after mediation. You may skip mediation and request an appeal hearing. However, in doing so, you will automatically waive your right to an informal meeting. Once the appeal hearing begins, you also waive your right to mediation.*

*Option 3 – Request an Appeal Hearing*

*You may request an appeal hearing by NAD rather than an informal review or mediation. There is no cost for an appeal hearing. Your request for an appeal must be made no later than 30 days from the date you received this letter. You must write the Assistant Director, NAD, for your region at the following address:*

*Appeal Contact:*

***NAME***
***ADDRESS***
***CITY, STATE ZIP***

*Your request must state the reasons why you believe the decision is wrong, be personally signed by you, and include a copy of this letter. A copy of your request must also be sent to Rural Development State Director at:*

***NAME***
***ADDRESS***
***CITY, STATE ZIP***

*You, or your representative or counsel, may contact this office anytime during regular office hours to examine or copy the Agency's record relative to the adverse decision. Photocopies will be provided to you. Your representative or counsel must have your written authorization to represent you and review your file. The NAD Hearing Officer will contact you regarding a time and place for the hearing.*

*The Federal Equal Credit Opportunity Act prohibits creditors from discriminating against credit applicants based on race, color, religion, national origin, sex, marital status, age (provided that the applicant has the capacity to enter into a binding contract); because all or part of the applicant's income derives from any public assistance program; or because the applicant has in good faith exercised any right under the Consumer Credit Protection Act. The agency that administers compliance with this law concerning this creditor is the Federal Trade Commission. If a person believes he or she was denied assistance in violation of this law, they should contact the Federal Trade Commission, Washington DC 20580.*

*The Fair Housing Act prohibits discrimination in real estate related transactions, or in the terms or conditions of such a transaction, race, color, religion, sex, disability, familial status, or national origin. The Federal agency that is responsible for enforcing this law is the U.S. Department of Housing and Urban Development. If a person believes that they have been discriminated against in violation of this law, they should contact* *the U.S. Department of Housing and Urban Development, Washington, DC 20410 or call (800) 669-9777.*

*If you have any questions, please give me a call.*

*Sincerely,*

*Business Programs Director*

*Enclosures:* *Lender's Agreement*
*Loan Note Guarantee*

*cc: Regional Coordinator*
*Loan Servicing Branch Chief, Washington, DC*

oOo

***APPENDIX D – DEBT COLLECTION IMPROVEMENT ACT GUIDANCE***

***Background Information:***

*(a) On January 22, 2004, a final rule was published in the Federal Register regarding the DCIA in order to make debtors aware that the DCIA provisions are applicable to the program. RD Instruction 1951-C, section 1951.133, Offsets of Federal Payment to USDA Agency Borrowers, was amended regarding the establishment of Federal debt for the program. This section states that any amounts paid by the Agency on account of liabilities of guaranteed loan borrower(s) and/or co-borrower(s) will constitute a Federal debt owing to the Agency by the guaranteed loan borrower(s) and/or co-borrower(s). All guaranteed loans closed on or after January 22, 2004, are subject to the DCIA provisions. The Agency will refer all borrowers under the DCIA to Treasury for collection. The date of the Agency's final loss claim payment will establish the date for determining the referral deadline to the U.S. Treasury under the DCIA.*

*(b) On November 20, 2006, a final rule was published in the Federal Register with an effective date of December 20, 2006, that addressed the concern that guarantors might successfully assert a defense that they did not know they were guaranteeing a loan. When the Agency implemented this second regulation, several Agency forms were modified and a new form was created, Form RD 4279-14, "Unconditional Guarantee." All personal/corporate guarantors that sign the Unconditional Guarantee form acknowledge that delinquent guaranteed loan debt is subject to DCIA. Therefore, any guaranteed loan closed after December 20, 2006, where the guarantor signed the Unconditional Guarantee form is governed by these requirements. As a reminder, borrower and co-borrowers do not execute Form RD 4279-14; only personal and corporate guarantors are required execute the guarantor form. When the Agency pays a loss claim, both the borrower(s) and/or co-borrower(s) and the guarantor(s) must be sent to the U.S. Treasury for offset within the 180 day time period. All eligible key members, including co-borrowers and those individuals or entities that execute Form RD 4279-14, should be entered as Key members in GLS for referral to the U.S. Treasury Department under the DCIA. Before a debt is referred to the Treasury Department, you should ensure that all eligible co-borrowers, individuals and entities are properly listed in GLS as key members. Once referred to the U.S. Treasury, the lender should cease all collection efforts. In the event that the guarantors did not sign the Unconditional Guarantee form, you should consult with OGC before referring a claim against a guarantor to the U.S. Treasury.*

*(c) For guaranteed loans, all guarantors must execute Form RD 4279-14, "Unconditional Guarantee," and be aware that:*

*(1) Any amounts paid by the Agency on account of an Agency guaranteed loan borrower will constitute a Federal debt owed to the Agency by the guaranteed loan borrower. In such case, the Agency may use all remedies available to it, including offset under the DCIA to collect the debt from the borrower.*

*(2) Any amounts paid by the Agency pursuant to a claim by a guaranteed program lender will constitute a Federal debt owed to the Agency by a third-party guarantor of the loan, to the extent of the amount of the third-party guarantee. In such case, the Agency may use all remedies available to it, including offset under the DCIA to collect the debt from the third-party guarantor.*

*(3) In all instances under paragraphs (1) and (2) of this section, interest charges will be assessed in accordance with RD Instruction 1951-C, section 1951.133. Based on Federal Claims Collection (FCC) Standards, Agencies may waive interest if the Agency determines that collection of these charges is not in the best interest of the Government, and, at this time, automation and effort to charge interest would not be cost-effective due to minimal collections and volume.*

***Procedures:***

***U.S. TREASURY REFERRAL PROCEDURES IN REFERENCE TO THE DCIA***

*The lender is responsible for preparing a final loss utilizing Form RD 449-30, "Loan Note Guarantee Report of Loss," and submitting it to the Agency for review and approval. After approval, the claim is forwarded to the Guaranteed Loan Branch (GLB) located in the office of the DCFO for review, certification and payment.*

*When the office of the DCFO pays the final loss and updates the payment to GLS, a DCIA account receivable will be established for the borrower(s)/co-borrower(s) and/or any guarantor(s) determined subject to DCIA. The DCIA receivable account and all subsequent servicing activities can be viewed by the field via the "View Debt Offset" web page in GLS.*

*The accountant in DCFO conducting the review of the final loss claim and processing the claim in GLS should:*

*(a) Ensure that the final loss settlement checklist, Appendix B of this subpart, is used as a part of the review for any final loss claim received from the field prior to making payment;*

*(b) Verify via the Key Member Table as part of the "BP Fund Request View" of the application web page in GLS to ensure no guarantor is identified as being eligible for DCIA if only the borrower and/or co-borrower is referred for DCIA; and*

*(c) Request a copy of the Unconditional Guarantee form from the State Office if it is not included in the claim package for any guarantor for those loans closed on or after December 20, 2006.*

*GLS generates and mails a 60-day due process letter to the borrower and/or co-borrower, and each guarantor subject to DCIA provisions, with a copy to the servicing office advising the debtors that the guaranteed loan balance is a Federal debt, which will be referred to the U.S. Treasury to collect the debt in accordance with statutory requirements and authorities.*

*In order for the borrower/co-borrower or guarantor to avoid referral of the debt to the U.S. Treasury, they must repay the debt in full or agree to a repayment plan. All options must be approved by the National Office and submitted to DCFO within the 60-day due process period so that DCFO can update the terms of the DCIA Account Receivable in GLS.*

*In the event the State Office has questions regarding whether a guarantor is eligible for referral to the U.S. Treasury under Cross Servicing, the State Office should seek Regional OGC guidance. If no guarantor form was signed, it is highly unlikely that the guarantor can be referred to the U.S. Treasury.*

*After the 60-day due process period has expired on the balance owed, the Program Reporting Branch (PRB) in the office of the DCFO submits a file on the 15th of each month to the U.S. Treasury for all loans eligible for DCIA. At this time, the State Office must issue notification to the lender to cease all collection action against the borrower/co-borrower or guarantor.*

*If the U.S. Treasury contacts PRB for information requested by the debtors, they will contact GLB for documentation to support the debt. The designated GLB accountant will provide PRB the information requested. The documents will at a minimum include a copy of the signed Unconditional Guarantee form for each guarantor, copy of the Loan Note Guarantee for each co-borrower, and the Notice of Final Settlement Report of Loss (Report 4063).*

*All collections received in a field office from the borrower/co-borrower or guarantor will be sent to the Wholesale Lockbox utilizing a Schedule of Remittances form using miscellaneous collection code 33 (payment). A copy of the Schedule of Remittances form and a copy of the payment item should be sent to GLB via fax at (314) 457-4279. All collections as well as any receipts from the U.S. Treasury (Cross Servicing) will be processed to the DCIA account receivable established in GLS.*

*the borrower and/or co-borrower to the U.S. Treasury under Cross Servicing.*

***Frequently Asked Questions (FAQ):***

*(1) Does the final regulation published in the Federal Register dated January 22, 2004, only pertain to the borrower and/or co-borrower? How does this rule pertain to the guarantor?*

*Response: The January 22, 2004, Federal Register notice pertained to the borrower and/or co-borrower only. This regulation does not affect the guarantor(s). When the Agency pays a loss claim, the lender should be notified in writing by the Agency to cease all collection efforts. The Agency will refer*

*(2) Does the final regulation published in the Federal Register dated November 20, 2006, only pertain to the guarantor? Is this considered an amendment to the earlier final rule of January 22, 2004?*

*Response: The November 20, 2006, Federal Register pertained primarily to the guarantor. Both the borrower/co-borrower and guarantor can be referred to* *the U.S. Treasury after this final rule was published. The January 22, 2004, Federal Register and the November 20, 2006, are complementary publications regarding implementation of the DCIA.*

*(3) For guaranteed loans closed on or after January 22, 2004, but before December 20, 2006, does the January 22, 2004, final rule apply to the borrower/co-borrower and can the borrower/co-borrower be referred to the U.S. Treasury if no bankruptcy exists?*

*Response: Yes, for guaranteed loans closed on or after January 22, 2004, the borrower and/or co-borrower may be referred to the U.S. Treasury under Cross Servicing if no bankruptcy exists.*

*(4) For guaranteed loans closed on or after January 22, 2004, but before December 20, 2006, and correction amendment published in the May 15, 2007, Federal Register, does the final rule apply to the guarantor? Can the guarantor be referred to the U.S. Treasury even though the guarantor* ***did not*** *sign an Unconditional Guarantee form if no bankruptcy exists?*

*Response: The January 22, 2004, Federal Register applies to the borrower and/or co-borrower. The State Office should submit the signed guarantor form to the Regional OGC for guidance on whether the guarantor is eligible for referral to the U.S. Treasury under Cross Servicing. If no guarantor form was signed, it is highly unlikely that the guarantor can be referred to the U.S. Treasury.*

*(5) For guaranteed loans closed after January 22, 2004, but before December 20, 2006, does the January 22, 2004, final rule apply to the guarantor and can the guarantor can be referred to the U.S. Treasury if the guarantor* ***signed*** *the Unconditional Guarantee form if no bankruptcy exists?*

*Response: The January 22, 2004, Federal Register pertained only to the guaranteed loan borrower and/or co-borrower. Provide a copy of the guarantee document and consult the Regional OGC for guidance on whether the guarantor is eligible for referral to the U.S. Treasury under Cross Servicing.*

*(6) The November 20, 2006, rule indicates that if the loan was closed on or after December 20, 2006, the borrower(s)/co-borrower(s) and guarantors can be referred to the U.S. Treasury if no bankruptcy exists if the Unconditional Guarantee form was signed. What happens if the form wasn't signed by the guarantor?*

*Response: Both the borrower and/or co-borrower and the guarantor claims can be referred.*

*Letter - 60-Day Due Process Notice*

*Name:*
*Address:*

*RE: Amount of Debt Owed to Rural Development*
*Date loss incurred by Rural Development:*
*State/County:*
*Borrower/Co-borrower ID:*
*Loan number:*
*Lender:*

*As a guarantor on your debt with the above lender, the Agency has paid a loss claim to cover your defaulted debt. As a result, Rural Development now has the right to collect your defaulted debt for the amount of loss paid to the lender. The public was notified in a Federal Register notice dated January 22, 2004, entitled "Debt Collection Improvement Act-Cross Servicing" that any amounts paid by Rural Development on the liabilities of a guaranteed loan borrower and/or co-borrower will constitute a Federal debt and that Rural Development may use any remedies available to it to collect. If you do not pay your debt or take other action described below within **60** days from the date of this letter, Rural Development will submit your debt to the U.S. Department of the Treasury for collection via Cross-Servicing. We will continue to add any applicable principal, interest, penalties, and fees to your unpaid debt.*

*Once your debt is submitted to the U.S. Treasury for Cross-Servicing, they will service and collect the debt in accordance with applicable statutory requirements and authorities. Treasury may take adverse actions to enforce recovery of a delinquent debt including, but not limited to:*

*referring the debt to a private collection agency;*
*referring the debt to the Department of Justice or agency counsel for litigation;*
*reporting the debt to a credit bureau;*
*garnishing your wages; and*
*reporting of the debt to the Internal Revenue Service (IRS) as potential taxable income.*

*Once your debt is submitted to the U.S. Treasury for Cross-Servicing, it will also be included in the Treasury Offset Program (TOP). TOP reduces or withholds any eligible Federal payments by the amount of your debt. This process, known as "offset," is authorized by 31 U.S.C. Chapter 37. <u>The U.S. Treasury is not required to send you notice before your payment is offset</u>. Most Federal payments, including certain loans and income tax refunds, are eligible for offset.*

*Before we submit your debt to the U.S. Treasury, we are required to tell you that you may (1) inspect and copy our records related to your debt; (2) be* *entitled to a review if we determine that a review is required; (3) submit a request for a written repayment agreement to the Rural Development Business Programs Director at the address listed at the end of this letter; (4) repay your debt; and (5) request mediation or an appeal hearing.*

***INSPECT AND COPY RECORDS RELATED TO YOUR DEBT:*** *To discuss arrangements for inspecting and copying your records, you must contact the Rural Development Program Director in writing at the address listed at the end of this notice. This does not stop the process of referring your debt to the U.S. Treasury.*

***TO AVOID U.S. TREASURY CROSS-SERVICING****, you must do one of the following within* ***60*** *days from the date of this letter:*

***REQUEST A REVIEW IF YOU BELIEVE THE DEBT IS NOT OWED:*** *If you believe that all or part of the debt is not due or legally enforceable, you must file a written request for review no later than* ***60*** *days from the date of this letter. Your request must include evidence to support your position and should be sent in writing to the address listed at the end of this letter. We will inform you of our decision about your debt. The timely filing of a request for review will suspend the offset process until a determination is made.*

***AGREE TO A REPAYMENT PLAN:*** *If you are unable to pay your debt in full, you must contact the Rural Development Business Programs Director in writing at the address listed at the end of this letter no later than* ***60*** *days from the date of this letter, agree to a repayment plan acceptable to the Agency, and make payments required in the repayment plan.*

***REPAY YOUR DEBT:*** *To repay your debt, send a check or money order, payable to Rural Development, for the full amount of your debt, to the Rural Development Business Programs Director at the address listed at the end of this letter. Please include your account number on your payment. The payment must be received within* ***60*** *days from the date of this letter.*

***REQUEST MEDIATION OR AN APPEAL HEARING:*** *The request to use mediation may be made any time prior to a formal National Appeals Division (NAD) appeal hearing. You must pay half of the cost associated with the mediation process. A request for mediation must be in writing and sent to the following address:*

*State Director*
*U.S. DEPARTMENT OF AGRICULTURE*
*RURAL DEVELOPMENT*
*City, State Zip Code*

*You may request an appeal hearing by NAD rather than an informal review or mediation. There is no cost for an appeal hearing. Your request for an appeal must be made no later than 30 days from the date you received the attached letter and must meet the requirements for such a request outlined in 7 CFR 11.6. You must write the Area Supervisor, NAD, for your region at the following address:*

*Area Supervisor*

*U.S. DEPARTMENT OF AGRICULTURE*
*NATIONAL APPEALS DIVISION,*
*___________REGIONAL OFFICE,*
*POST OFFICE BOX _____*
*City, State Zip Code*

*A request for either the informal review or mediation will suspend the 30 day time period for filing a formal written NAD appeal. If after the informal review or mediation you still desire to appeal, you will have the balance of the 30 days to make the formal written request for a NAD appeal hearing. If you file an appeal and then request mediation, you will waive your right to a NAD appeal hearing until after the conclusion of the mediation process. You then have the right to a NAD appeal hearing within 45 days of the conclusion of the mediation.*

***BANKRUPTCY:*** *If you are currently in bankruptcy, then you are not subject to offset while the automatic stay is in effect. Please notify the Rural Development Business Programs Director in writing at the address listed at the end of this letter, and include a copy of the bankruptcy filing. If you have an attorney, please provide your attorney's name, address, and phone number, as well. If we do not know of your status in bankruptcy, we may inadvertently take collection action that could be avoided.*

***IF YOU FILE A JOINT INCOME TAX RETURN:*** *If you file a joint income tax return, you should contact the IRS before filing your return regarding the steps to take to protect the share of the income tax refund that may be payable to your spouse, if your spouse is not a delinquent debtor.*

***FALSE STATEMENTS:*** *If you make or knowingly provide any false statements, representations, or evidence, you may be liable for civil penalties under the False Claims Act (31 U.S.C. Sections 3729-3731), or criminal penalties under 18 U.S.C. Sections 286, 287, 1001, 1002, or other applicable statutes.*

*If you are a Federal employee and you make or knowingly provide any false statements, representations, or evidence, you also may be subject to disciplinary actions appropriate under 5 U.S.C. Chapter 75 and 5 CFR Part 752.*

***IF YOU ARE A FEDERAL EMPLOYEE:*** *Your current net disposable pay is subject to offset if you do not pay your debt or take other action described above. This will be approximately 60 days from the date of this letter, and continuing every pay period until your debt, including any principal, interest, penalties, and other costs, is paid in full.*

*You are entitled to the same options as described previously in this letter, except that your review, if timely requested, would be conducted by a hearing official upon USDA's determination of the debt or percentage of disposable pay to be deducted each pay period. If you wish to petition for a waiver or review to dispute the existence or amount of the debt, or the amount of the payroll deduction, you must file a written request for a review no later than 60 days from the date of this letter. The timely filing of a request for review will suspend the offset process until a determination is made. You must send evidence to support your position to the Rural Development Business*

*Programs Director at the address listed at the end of this letter. A final decision on the review (if one is requested) will be issued no later than 60 days after filing a request for review (unless extended by the review official), in accordance with 7 CFR 3.55.*

***OVERPAYMENTS:*** *Unless prohibited by law or contract, we will promptly refund any amounts paid by you or deducted from your payment for your debt that are later waived or found not owed to the United States.*

*If you have any questions regarding this letter or your rights, you should contact the Rural Development Business Programs Director in writing at the following address:*

*USDA RURAL DEVELOPMENT*
*PROGRAM TYPE*
*PROGRAM DIRECTOR*
*STATE ADDRESS*

*cc: RURAL DEVELOPMENT BUSINESS PROGRAMS DIRECTOR*
*GUARANTEED LOAN BRANCH*

*Sample Letter to the Lender to Cease Collection Efforts*

***DATE***

***LENDING OFFICER, TITLE***
***LENDER***
***STREET ADDRESS***
***CITY, STATE, ZIP***

*Dear Mr./Ms.* ***LENDING OFFICER,***

*On* ***DATE*** *USDA Rural Development issued a 60-Day Due Process Notice to* ***GUARANTOR NAME*** *as a guarantor of a loan by* ***BORROWER*** *under which our Agency made a loss payment to your institution. The letter was a notification that the loss amount is now a debt owed to the Federal government and thus reported to the U.S. Treasury for collection action under the Debt Collection Improvement Act-Cross Servicing as published in a Federal Register notice dated January 22, 2004. A copy of this letter is enclosed.*

*Commensurate with the referral of this debt to the U.S. Treasury, and in compliance with statutory requirements and authorities, our Agency is providing notification to you that your collection efforts against* ***GUARANTOR NAME*** *should cease.*

*We thank you for your support of our Rural Development programs, and any questions regarding this action should be addressed to* ***AGENCY CONTACT INFORMATION.***

*Respectfully,*

***RD PROGRAM DIRECTOR NAME***
***RD PROGRAM DIRECTOR TITLE***

*Enclosure*

*Copy:*

oOo

***APPENDIX E – QUARTERLY DELINQUENT/PROBLEM LOAN REPORT***

*The State Director is primarily responsible for administering prudent servicing practices and ensuring that the lender prudently services guaranteed loans. Reducing the number of problem and delinquent loans, as well as preventing additional problem and delinquent loans, continues to be a high priority.*

*All problem loans in excess of the State's loan servicing authority, all delinquent loans, and any loans in bankruptcy are to be reported on a quarterly basis to the National Office using Form RD 4279-16, "Quarterly Problem/Delinquent Loan Report," for each loan. The quarterly reports are due to the National Office B&I Loan Servicing Branch by the 10th day of January, April, July, and October.*

*The quarterly reports should contain sufficient documentation to provide any reader with an understanding of what has occurred to cause the default and what specific actions are being taken by the lender and/or State Office to service the account. In monitoring your servicing actions, the National Office will continue to pay particular attention to the completion of the quarterly reports submitted. The following considerations must be addressed completely for each case reported:*

1. *Basic cause of problem/delinquency and covenants in violation.*

2. *What curative action is being taken and the lender's latest action.*

3. *State Office recommendation to eliminate the problem/delinquency.*

4. *Agency's latest action and date of last contact with lender.*

*In the event the reports are incomplete or fail to provide a plan of action for eliminating the cause of each of the existing problem/delinquent loans, the reports will be returned to the State Office for correction and resubmission to the National Office.*

*Quarterly reports should be accompanied by GLSR002, "Guaranteed Problem/Delinquent Servicing Report," and GLSR030, "Direct Delinquencies Report." The results of GLSR002 are determined by the status codes that the State inputs on the criteria page. If the State does not indicate specific status codes, the report will provide the user with any loan currently having a GLS status code of 501-549. The State should also pull report GLS2001, "List of Delinquent Borrowers (Guaranteed Only)" and compare it with GLSR002.*

*The borrowers listed on report GLS2001 should be the same as the borrowers having a status code of 520-549 on report GLSR002. If these reports do not match up, the State must reconcile them by either correcting the status code in the GLS or updating the default status report showing the loan has been brought current. Report GLSR030 results are determined by the status found in the Program Loan Accounting System (PLAS). If a borrower should not be coded as delinquent in PLAS, you should work with the accountant in the*

*Fiscal and Accounting Branch in the office of the DCFO that is assigned to your State.*

*GLS is the official reporting system and absolutely must be accurate. The National Office continues to receive quarterly reports in which GLSR002 and GLSR030 are not attached. We cannot stress enough the importance of submitting these GLS reports in conjunction with the quarterly reports. These GLS reports are time sensitive, and the data cannot be recreated or replicated after the end of the quarterly reporting cycle.*

*It is important to actively service the loans in your portfolio. The importance of lender and/or borrower visits, spreading and analyzing financial statements, and monitoring lender and borrower activities cannot be overstated.*

oOo

## *APPENDIX F - USDA LINC/APPLICATION AUTHORIZATION SECURITY MANAGEMENT SYSTEM*

***Background Information:***

*USDA Rural Development has incorporated the Status Reports, Default Status Reports, and Loan Closing for guaranteed loans to an electronic system. This allows the lender to submit their monthly default and semiannual status reports electronically. The forms are submitted in real-time, saving mailing time, the possibility of lost documents, and paper generation. This system is secured and incorporates encryption technology used by many commercial banks in on-line banking applications, and there is no software to buy or install.*

*The lender user will be able to submit information in LINC and GLS any time during normal operating hours (available for use Monday through Saturday from 6am to 7pm Central Standard Time and Sunday from 8am to 4pm CST). If errors occur in the submission of information from the lender user, field office personnel must be contacted immediately to determine the error and possibly have the user resubmit information to GLS through LINC. The Agency will not be responsible for any damages incurred by the lender as a result of missing or delayed submissions of information when the problem is not with or caused by the Agency.*

*The following terms are used in the LINC and Application Authorization Security Management System:*

*Application Authorization Security Management (AASM) System. The system defining user roles for lender employees and providing a means for the Systems Administrator to assign those roles and respective access levels. This system is also used by the office of the DCFO to establish security administrators and by security administrators to establish lender/branch representatives and viewers.*

*Branch Administrator. Employee of the lender who has authorization only for a specific branch or multiple branches of the lender's ID and is responsible for adding Branch Representatives or Branch Viewers to the AASM system and ensures that all employees adhere to the requirements of electronic data submission. These employees also have access to the LINC system to input electronic data.*

*Branch Representative. Employee of the lender who has authorization only for a specific branch or multiple branches of the lender's ID in the LINC system.*

*Branch Viewer. Employee of the lender who has view-only capacity for a specific branch or multiple branches of the lender's ID in the LINC system.*

*<u>eAuthentication</u>. eAuthentication is the system used by USDA agencies to enable customers to obtain accounts that will allow them to access USDA Web applications and services via the Internet. This access includes submitting forms electronically, completing surveys online, and checking the status of USDA accounts. The security system is also used by USDA to restrict LINC access to authorized users. Users must register and be identity-proofed by a Local Registration Authority prior to access being granted.*

*<u>Lender Administrator</u>. Employee of the lender who is authorized and responsible for adding the Lender Representative/Viewer or Branch Representative/Viewer for a specific lender's ID or multiple lender IDs to the AASM system and ensures that all employees adhere to the requirements of electronic data submission. These employees also have access to the LINC system to input electronic data.*

*<u>Lender Representative</u>. Employee of the lender who has authorization for all branches of a specific lender's ID or multiple lender IDs and is responsible for inputting electronic data in the LINC system.*

*<u>Lender Viewer</u>. Employee of the lender who has view-only capacity for all branches of the lender's ID or multiple IDs in the LINC system.*

*<u>Level 1 Access</u>. A secured level of limited access to USDA Web site portals and applications that have minimal security requirements. Level 1 access is limited and in most cases does not allow one to conduct official electronic business transactions with USDA via the Internet. The Guaranteed Underwriting System requires a Level 1 access.*

*<u>Level 2 Access</u>. A secured level of access providing access to all of the portals and applications within the USDA Web site that are covered by an account with Level 2 access. This access also provides the ability to conduct official electronic business with USDA via the Internet.*

*<u>Local Registration Authority (LRA)</u>. USDA employees who are trained to act as the "trusted entity" to validate the identity of a customer seeking access to the USDA eAuthentication system. The role of the LRA can be compared to that of a Notary Public who ensures the identity of an individual conducting official business transactions.*

*<u>Security Administrator</u>. An employee of the lender who is either designated as a Lender Administrator or Branch Administrator in the AASM system.*

*<u>USDA Lender Interactive Network Connection (LINC)</u>. The portal Web site at https://usdalinc.sc.egov.usda.gov/ used by lenders to update loan data in the Agency's Guaranteed Loan System. Current LINC capabilities include loan closing and status reporting.*

***Procedures for using LINC:***

*(a) The lender must select an employee to be their Security Administrator in order to access LINC and must complete the Agreement for Electronic Transactions (example of the Agreement is included in this Appendix) to designate the Security Administrator.*

*Note: The Security Administrator can process loan closings and status reports and delegates access to the system to all other lender employees (representatives and viewers).*

*(b) The Security Administrator and all other employees who will use the system must go to the following web site to create an eAuthentication ID with Level 2 access:* ***www.eauth.usda.gov.***

*(c) In order to use the status reporting and loan closing system through LINC, the individual must personally present a valid government photo identification for Level 2 access to a USDA employee, who has been trained as an LRA. The LRA must personally verify the lender employee's identity and validate their account using a valid ID.*

*(d) The USDA employee, who is providing the lender training, will fax the Agreement to the Guaranteed Loan Branch (GLB) in the office of the DCFO at (314) 457-4279.*

*(e) When GLB receives the Agreement for Electronic Transaction, they will authorize the Security Administrator to access the status report and loan closing system. The Security Administrator will receive an e-mail that they are authorized as a Security Administrator for the lender.*

*(f) The Security Administrator is responsible for delegating access to other employees who will use the status report and loan closing system at the following web site: https://usdalinc.sc.egov.usda.gov. After accessing the LINC site, click the RBS, RUS or RHS LINC HOME (access is based on authorization given for various programs).*

*(g) The Security Administrator must add each individual to the AASM system before they will have access to input the status reports and loan closings. Any individual who will be responsible for completing the electronic transactions mentioned in this document must be eAuthenticated at Level 2 access and ID proofed by an LRA.*

*(h) The lender can also request to expand their program access using the sample letter titled, "Security Administrator Request to Expand Program Access," as shown below. The lender will need to work with their local Rural Development field office to process this request with GLB, DCFO, faxing the request to (314) 457-4279.*

*(i) The lender can receive assistance from the Rural Development Help Desk for access problems, activation of the account, and forgotten (reset) passwords by calling (800) 457-3642, at the prompt select option #2 (issues with applications), at the next prompt, select option #2 (Rural Development).*

***Procedures for accessing LINC:***

*LINC gives lenders the capability to add loan closing information, grant USDA LINC access to other lender employees, and process status/default reports. The web site URL is https://usdalinc.sc.egov.usda.gov.*

*Click on the Rural Business Service link to access Business Programs loans, the Rural Housing Service link to access Community Facility loans, and the Rural Utilities Service link to access Water and Waste Disposal Facilities loans.*

*Press the Continue push button to move to the eAuthentication Login screen.*

*Enter your Level 2 eAuthentication User ID and Password and press the Login push button. Local RD staff cannot access any password information. In cases of a forgotten password, a user must receive assistance to reset any passwords from the RD Help Desk at (800) 457-3642, and select option 2, option 2.*

*If login is successful, the called page will display. For example, if the Lender Status Report List link was selected, you would see the following:*

*"This page defaults to show all due and past due status and default reports. If no due or past due reports exist, no loans will be listed and the Validation Error "CI00801E: No entries found that meet the search criteria."*

*Received and Future status reports can also be viewed on this page by selecting the appropriate option from the Receipt Status drop down box and pressing the Submit push button.*

*To submit a due or past due report, click the applicable Effective Date link, enter the required data, and press the Submit push button. To submit a report that is not listed (an initial default report, for example), press the Add Report push button and enter the required data.*

***Status Reporting by the Lender via LINC***

*Form RD 1980-41, "Guaranteed Loan Borrower Status," (status report) has been automated and is accessible to the lender through LINC in the form of an input screen. An e-mail notice will be sent to the Security Administrator and other users designated by the lender's Security Administrator semiannually (on or before June 30 and December 31) indicating the requirement to update the status report. The status report is due within 30 days (July 31 and January 31 respectively). If the lender completes the report and marks the loan as delinquent (either behind or default), a default status report will be generated, and the lender must complete this report through LINC within 30 days. Field offices should provide guidance to the lender that the loan should not be designated as delinquent unless the loan is more than 30 days past due and cannot be cured within 30 days. This will eliminate inaccurate accounting of delinquent loans. The Guaranteed Loan Borrower Status report input screen corresponds to the fields on the status* *report. If the report is not completed in LINC within 45 days of the due date, the office of the DCFO will notify the lender by e-mail. Field offices should monitor the receipt and update of the status reports by running GLS report GLSSR01, Past Due Status Report.*

***GLS**:*

*Agency personnel can view the same Lender Status Report List screens that lenders can. To do so, select the Lender link on the GLS home page:*

*Enter the lender's ID and press the Submit push button.*

*Switch the Action drop down to Lender Status Report List and click the Lender ID link.*

*The Lender Status Report List displays. From this point forward, screen displays and functionality are identical on both the LINC and GLS web sites.*

*Note: To see all loans serviced by a particular ID, clear the Lender Branch field and press the Submit push button.*

***Agreement for Electronic Transactions:***

### *1.0 INTRODUCTION*

*This agreement between the U.S. Department of Agriculture (USDA) Rural Development (RD) and ___________________________________, hereafter known as Lender, prescribes the general procedures and policies to be followed when the USDA Lender Interactive Network Connection (LINC) is used to enter the Guaranteed Loan System (GLS) for submitting electronic data in lieu of the paper documents normally associated with conducting business with RD.*

### *2.0 PURPOSE*

*This agreement ensures that the electronic transmission of data between USDA RD and the Lender will be treated equivalently to the manual paper-based transmission of data.*

### *3.0 TERMS AND CONDITIONS*

*3.1 RD will bear the cost of making web pages available for retrieval by the Lender from GLS through LINC and receiving the systemic information transmitted to GLS through LINC. The Lender is responsible for all costs associated with retrieving information on the web pages and transmitting the systemic transactions to GLS through LINC.*

*3.2 This Agreement authorizes RD to process Loan Closings, Semiannual Reports, and Default Status Reports electronically, provided that the Lender inputs all required information. RD will not be responsible for any damages incurred by the Lender as a result of missing or delayed submissions of information when the problem is not with or caused by RD.*

*3.3 The Lender will designate a Security Administrator (SA). The SA will further be designated as Lender Administrator (having access to all branches) or a Branch Administrator (having access to a particular branch). The SA will be required to enter all identified users in the Application Authorization Security Management (AASM) system through LINC to allow users to complete electronic transactions.*

*3.4 This agreement constitutes the entire agreement between the parties. No changes in the terms and conditions of this agreement shall be effective unless approved and signed by all parties. In the event a court of competent jurisdiction negates any of the provisions of this agreement, the remainder of the agreement will remain in full force and effect.*

*3.5 In any case where there is a conflict between this agreement and applicable RD statutes or regulations, the statutes or regulations will control.*

*3.6 Individual user identification numbers and passwords may not be transferred between Lender employees, and the Lender shall ensure that such transfers do not occur.*

*3.7 Lender agrees to maintain documentation that substantiates the electronic data transmission for 6 years. Lender agrees to provide supporting documentation when requested by RD to complete the electronic transaction.*

*3.8 Information needed to add a Security Administrator for loan closing and status reporting in GLS after Level 2 (security) has been processed/approved should be faxed, e-mailed, or mailed to DCFO, Guaranteed Loan Branch (GLB) from the state/field office. The information can be found in the Lender User Manual.*

***4.0 FORCE MAJEURE***

*None of the parties in this agreement will be liable for failure to properly conduct electronic transmission of data in the event of war, accident, riot, fire, flood, epidemic, power outage, labor dispute, act of God, act of public enemy, malfunction or inappropriate design of hardware or software, or any other cause beyond such party's control. If, in RD's judgment, standard business cannot be conducted by LINC and/or GLS, RD will, at its discretion, return to paper-based transactions, as appropriate, for processing the business documents described in this agreement.*

***5.0 AGREEMENT REVIEW AND UPDATE***

*Lender will notify RD contact, identified below, in writing within 15 calendar days of any change in company name, Lender ID number, or Security Administrator. Changes will be incorporated into a new Agreement. RD will notify Lender in writing at least 60 days in advance of any change in the technical provisions of LINC and/or GLS. All notifications required under this agreement will be submitted in writing to the Security Administrator indicated below.*

***6.0 TERMINATION***

*This Agreement may be terminated by either RD or the Lender, effective 30 days after receipt of written notice by either party. Termination notice will have no affect on transactions occurring prior to the effective date of termination.*

***7.0 APPROVAL***

*The undersigned Lender and Rural Development do hereby agree to the participation requirements and other provisions of the Agreement.*

| | |
|---|---|
| *Lender Name* | *Security Administrator (Indicate Lender or Branch Administrator):* |
| *Lender ID Number:* | *Signature:* |
| *USDA Assigned Branch Number (Required for both Lender and Branch Administrators):* | *Title:* |
| *Signature:* | *eAuthentication ID:* |
| *Date:* | *Date:* |
| *Print Name:* | *e-mail address:* |
| *Title:* | *Telephone:* |
| *e-mail address:* | *Fax Number:* |
| | *Program Access: Check all that apply* |
| | *Single Family Housing* |
| | *Business Programs* |
| | *Community Facility* |
| | *Multi-Family Housing* |
| | *Water & Waste Disposal* |

***Rural Development***
***Loan Approval Official***

*Name:*_______________________________________________

*Title:*______________________________________________

*Signature:*__________________________________________

*Date:*_______________________________________________

*Telephone:*__________________________________________

***Security Administrator Request to Expand Program Access***

***Sample Letter***

*Subject:* *Request to Expand Program Access*

*To:* *State Director*
*USDA Rural Development*

*Attn:* *Program Director*
*Business Programs*
*Community Programs*
*Water and Environmental Programs*

*We are requesting an expansion/change of authority for ___________________, Security Administrator. Currently _____________________ has authority to access (Business Programs, Community Programs and Water and Waste Disposal Programs). Please add access to the following programs:*

*______ Business Programs*
*______ Community Programs*
*______ Water and Waste Disposal Programs*

*The following is the Security Administrator's information:*

*eAuthentication ID:__________________________________________________*
*Name:________________________________________________________________*
*Phone Number:________________________________________________________*
*Fax Number:__________________________________________________________*
*Lender ID:___________________________________________________________*
*Branch ID:___________________________________________________________*

*If you have any questions, please contact our office at____________________.*

*Signature: ___________________________*
*Lender Name: _________________________*
*Title: _______________________________*

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***APPENDIX G – CREDIT EVALUATION GUIDANCE***

## ***A. Lender Analysis of Borrower Financial Statements***

*The Agency must increase its efforts to obtain financial statements, review lenders' analyses, and provide follow-up to lenders on servicing deficiencies. Files should be documented to show attempts to obtain the required information. A nonexclusive list of the lender's servicing responsibilities is contained on Form RD 4279-4, "Lender's Agreement," Section IV, paragraph (c). The lender's servicing responsibilities include obtaining compliance with loan covenants and for obtaining, analyzing, and forwarding borrower and guarantor financial statements to the Agency.*

*In accordance with § 4287.107(d), the lender is responsible for providing the Agency with:*

*1. an analysis of the borrower's financial statements (including spreadsheets); and*

*2. a written trend analysis that compares the borrower's year-to-year historical financial information. The lender's analysis should also include a borrower ratio comparison to industry standards for similar size businesses. The lender's written analysis to the Agency must include the borrower's strengths, weaknesses, and extraordinary transactions, any loan agreement violations, and other indications of the financial condition of the borrower. The lender will submit the annual financial statements to the Agency, along with its spreadsheets and written analysis, within 120 days of the end of the borrower's fiscal year. Upon receipt, the servicing office should analyze the borrower's annual financial statements. A copy of the analysis will be filed in the case file.*

*It is important to note that every borrower is different. As such, recognize that economic conditions change, industry conditions are not constant, and public policy and community relations affect how lenders deal with problem loans. A review of the financial statements assists the lender and Agency in determining the appropriate action that will maximize recovery to the Agency. A reasonably prudent lender will include a number of the identified ratios and provide this information to the Agency, along with its written summary of the analysis. Promptly obtaining and reviewing financial information from the borrower can reveal financial red flags that indicate problems the borrower may be experiencing and has not disclosed.*

## ***B. Loan Classification***

*Guaranteed loans must be properly classified at inception and during the term of the loan. Properly classified loans will enable the Agency to focus oversight activities on higher risk loans and enable the State and National Offices to conduct effective portfolio management and assess the quality or risk in the portfolio.*

*Two elements are necessary to develop classification results into meaningful data: 1) clear, well-understood classification definitions and 2) uniform application of the definitions. The Agency has essentially adopted the Uniform Classification System (UCS), which provides classification definitions necessary to develop meaningful data on the quality of the loan portfolio. UCS credit classifications are assigned on the basis of risk and include the following categories: Acceptable, Special Mention, Substandard, Doubtful, and Loss. The category Seasoned is not recognized by the UCS but is an option in GLS.*

*Many lenders use variations of the UCS or entirely different systems. When a lender submits its loan classifications using a different system or code, review the differences or ask the lender to explain how its risk rating system codes correlate to the UCS descriptions used by the Agency. Lenders may assign more than one classification to different portions of a loan when portions of the loan meet different classification standards. Because GLS will accept only one classification per loan, when this occurs, the most adverse classification should be entered for the entire loan.*

*The regulations require the lender to provide the classification at loan closing. All guaranteed loans are to be classified as if they were not supported by a loan guarantee. The lender is also required to notify the Agency whenever there is a change in the loan classification (not only when a loan's classification is lowered). This will assist the Agency in portfolio management.*

*When the Agency receives a loan classification from a lender or otherwise feels a change in classification may be warranted, the Agency should conduct its own analysis of the loan. If the Agency disagrees with the lender's classification, the Agency should discuss concerns with the lender. In any event, the Agency's opinion of the appropriate loan classification should be entered into GLS within 30 days of receipt of the lender's classification. The integrity of the data in GLS is vitally important, and every effort should be made to maintain GLS in a current status.*

*The loan classification codes are maintained within GLS on the Business Programs Loan/Grant Detail screen. The screen can be found by going to the Request List, inputting the borrower's ID, and on the Action dropdown box, highlight "Maintain Loan/Grant Detail" and click on the type of assistance code. The loan classification is a dropdown box with the codes as described below. For further instructions, please review the GLS User Guide. Loans classified Substandard, Doubtful, and Loss are considered adversely classified; while Special Mention loans are not.*

*A general description and application of each classification category and credit factor is provided below.*

***Current Non-Problem*** *– GLS code 10*

*These loans are high quality. They are current and in compliance with loan conditions and the program regulations, but do not meet all of the criteria for a Seasoned classification. Loans in this classification are typically more than 1 year old with a good payment history and where the Agency has conducted its initial lender visit and found no credit concerns.*

***Seasoned*** *– GLS code 20*
*A loan that (1) is in compliance with all loan conditions and applicable program regulations; (2) the borrower has a remaining guaranteed loan principal balance of two-thirds or less of the original aggregate of all existing B&I and REAP guaranteed loans made to that business; (3) has been current on loan payments for 24 consecutive months; and (4) is secured by collateral that is determined to be adequate to ensure there will be no loss on the loan.*

***Special Mention*** *– GLS code 30*
*Loans in this category are currently protected but are potentially weak. They do not presently expose the lender and Agency to a sufficient degree of risk to warrant a Substandard classification but do possess potential weaknesses that may, if not checked or corrected, weaken the loan or inadequately protect the Agency's position at some future date. Special Mention loans therefore deserve close attention.*
*All loans, regardless of collateral, financial stability, and responsibility of the borrower, have certain risks. The credit risk may be relatively minor yet constitute identifiable risks in light of the circumstances surrounding a specific loan. Typically (but not always), there is a credit reason for the lender to request a loan guarantee. Generally, all loans to new/startup businesses will be classified as Special Mention but are not considered Substandard. Some examples of credit risk that could warrant a Special Mention classification may include:*
*Business is a startup with limited or no operating history.*
*Adverse trends in the borrower’s operation or industry.*

*Business is subject to economic or market conditions that may, in the future, affect the borrower.*

*Recent change in borrower management.*
*Lack of proper lender oversight (possibly due to lack of lender expertise), credit support, on-site appraisals or inspections, failure of the lender to act prudently, or other similar matters that could lead the reviewer to question the quality of the loan.*
*Collateral coverage is tight, the collateral is highly specialized, or the lender lacks control over the collateral.*

*Loans in which actual weaknesses, rather than potential weaknesses, are evident and significant should be considered for an adverse classification.*
***Substandard*** *– GLS code 40*
*These loans are inadequately protected by the current sound worth, repayment capacity, equity, and/or collateral pledged. Loans so classified must have a well-defined weakness or weaknesses that could jeopardize normal collection of the debt. They are characterized by the distinct possibility that the lender will sustain some loss if the deficiencies are not corrected.*
*All delinquent loans and loans where the borrower is in bankruptcy should be adversely classified, even when a loss is not likely.*
***Doubtful*** *– GLS code 50*
*Loans classified Doubtful have all the weaknesses inherent in those classified Substandard with the added characteristic that weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable.*

***__Loss__*** *– GLS code 60*
*Loans classified Loss are considered uncollectible and of such little value that their continuance as bookable loans is not warranted. This classification does not mean the loan has absolutely no recovery or salvage value, but rather it is not practical or desirable to defer writing off this basically worthless loan even though partial recovery may be affected in the future. Delaying the recognition of losses due to the remote possibility that a restructure will occur is not considered consistent with the definitions contained in the UCS or generally accepted accounting principles. Loans in liquidation where a significant loss is anticipated should be classified Loss. Unfortunately, GLS cannot accommodate split classifications where only the estimated loss amount would be classified Loss.*

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***APPENDIX H - SAMPLE LETTER - INTEREST TERMINATION DATE***

***DATE***

*Sent via Email and 1st Class Mail*

***NAME OF HOLDER***
***ADDRESS***
***CITY, STATE ZIP***

*RE: Business and Industry Guaranteed Loans, Section 9003 Bio-refinery Assistance Loans and Section 9007 Rural Energy for America Program Loans*
***BORROWER - LOAN AMOUNT***
***GLS BORROWER ID***
***GLS LOAN NUMBER***
*Interest Termination Date*

*Dear* ***HOLDER OFFICER,***

*Our records indicate that* ***NAME OF HOLDER*** *currently owns a portion of* ***BORROWER'S, NOTE DATE*** *loan guaranteed by the United State Department of Agriculture (USDA) through the Business and Industry Guaranteed Loan Program.*

*As the Agency understands the situation,* ***BORROWER*** *was $****AMOUNT*** *behind schedule as of* ***DATE.*** *In accordance with 7 CFR § 4287.145, for loans closed on or after August 2, 2016, the lender or the Agency will issue an interest termination letter to the holder(s) establishing the termination date for interest accrual. The guarantee will not cover interest to any holder accruing after the greater of: 90 days from the date of the most recent delinquency effective date as reported by the lender or 30 days from the date of the interest termination letter.*

*The purpose of this letter is to inform* ***HOLDER*** *that USDA Rural Development is terminating the interest accrual on the* ***BORROWER'S*** *loan effective as of* ***INTEREST TERMINATION DATE.*** *If* ***LENDER*** *declines to repurchase your portion of this loan upon your written demand and you subsequently demand repurchase by USDA Rural Development, you will only be paid interest through this date.*

*In accordance with 7 CFR § 4279.16, any party adversely affected by this decision may request a determination of appealability from the National Appeals Division (NAD), USDA, within 30 days from the date you received this letter. Appeals will be handled in accordance with 7 CFR, Part 11. There is no cost for an appeal hearing. You must write the Area Supervisor, NAD, for your region at the following address:*

*Area Supervisor*

*U.S. DEPARTMENT OF AGRICULTURE*

*NATIONAL APPEALS DIVISION,*

*REGIONAL OFFICE,*

*POST OFFICE BOX _____*

*City, State Zip Code*

*If you have any questions, please feel free to contact this office. Thank you for your interest in the business programs of Rural Development.*

*Sincerely,*

*Business & Cooperative Programs Director*

*Enclosures:* *Lender's Agreement*
*Loan Note Guarantee*

*cc: Regional Coordinator*
*Servicing Branch Chief, Washington, DC*

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