

**DEPARTMENT OF AGRICULTURE****Rural Utilities Service****7 CFR Part 1779****Rural Housing Service****7 CFR Part 3575****Rural Business-Cooperative Service****Rural Utilities Service****7 CFR Parts 4279 and 4280****Rural Business-Cooperative Service****Rural Housing Service****Rural Utilities Service****7 CFR Part 5001****RIN 0570-AA65****Rural Development Guaranteed Loans**

**AGENCY:** Rural Business-Cooperative Service, Rural Housing Service, Rural Utilities Service, USDA.

**ACTION:** Proposed rule.

**SUMMARY:** Rural Development, a mission area within the U.S. Department of Agriculture, is proposing a unified guaranteed loan platform for enhanced delivery of four existing Rural Development guaranteed loan programs—Community Facility; Water and Waste Disposal; Business and Industry; and Renewable Energy Systems and Energy Efficiency Improvement Projects. This proposed rule would eliminate the existing loan guarantee regulations for these four programs and consolidate them under a new, single part. In addition to consolidating these four programs, the proposed rulemaking incorporates provisions that will enable the Agency to better manage the risk associated with making and servicing guaranteed loans and that will reduce the cost of operating the guaranteed loan programs. Such provisions include incorporating specific project eligibility criteria, revisions to the requirements for lenders to participate in the programs, allowing approved lenders to become preferred lenders, and allowing guaranteed loan applications to be submitted with less documentation accompanying the application under certain conditions.

**DATES:** Comments on the proposed rule must be received on or before November 13, 2007. The comment period for the information collection under the Paperwork Reduction Act of 1995 continues through November 13, 2007.

**ADDRESSES:** You may submit comments to this rule by any of the following methods:

- *Agency Web Site:* <http://www.rurdev.usda.gov/regs>. Follow instructions for submitting comments on the Web site.
- *E-Mail:* [comments@wdc.usda.gov](mailto:comments@wdc.usda.gov). Include the RIN No. 0570-AA65 in the subject line of the message.
- *Federal eRulemaking Portal:* <http://www.regulations.gov>. Follow the instructions for submitting comments.
- *Mail:* Submit written comments via the U.S. Postal Service to the Branch Chief, Regulations and Paperwork Management Branch, U.S. Department of Agriculture, STOP 0742, 1400 Independence Avenue, SW., Washington, DC 20250-0742.
- *Hand Delivery/Courier:* Submit written comments via Federal Express Mail or other courier service requiring a street address to the Branch Chief, Regulations and Paperwork Management Branch, U.S. Department of Agriculture, 300 7th Street, SW., 7th Floor, Washington, DC 20024.

All written comments will be available for public inspection during regular work hours at the 300 7th Street, SW., 7th Floor address listed above.

**FOR FURTHER INFORMATION CONTACT:** Mr. Michael Foore, Rural Development, Business and Cooperative Programs, U.S. Department of Agriculture, 1400 Independence Avenue, SW., Stop 3201, Washington, DC 20250-3201; e-mail: [Michael.Foore@wdc.usda.gov](mailto:Michael.Foore@wdc.usda.gov); telephone (202) 690-4730.

**SUPPLEMENTARY INFORMATION:****Executive Order 12866**

This proposed rule has been reviewed under Executive Order (EO) 12866 and has been determined to be significant by the Office of Management and Budget. The EO defines a “significant regulatory action” as one that is likely to result in a rule that may: (1) Have an annual effect on the economy of \$100 million or more or adversely affect, in a material way, the economy, a sector of the economy, productivity, competition, jobs, the environment, public health or safety, or State, local, or tribal governments or communities; (2) Create a serious inconsistency or otherwise interfere with an action taken or planned by another agency; (3) Materially alter the budgetary impact of entitlements, grants, user fees, or loan programs or the rights and obligations of recipients thereof; or (4) Raise novel legal or policy issues arising out of legal mandates, the President’s priorities, or the principles set forth in this EO.

The Agency conducted a qualitative benefit cost analysis to fulfill the

requirements of Executive Order 12866. Based on the results of this qualitative analysis of the benefits and costs of the proposed rule, the Agency has concluded that the net effect of the rule will be beneficial in part due to improved underwriting.

**Unfunded Mandates Reform Act**

Title II of the Unfunded Mandates Reform Act 1995 (UMRA) of Public Law 104-4 establishes requirements for Federal agencies to assess the effects of their regulatory actions on State, local, and tribal governments and the private sector. Under section 202 of the UMRA, Rural Development generally must prepare a written statement, including a cost-benefit analysis, for proposed and final rules with “Federal mandates” that may result in expenditures to State, local, or tribal governments, in the aggregate, or to the private sector of \$100 million or more in any one year. When such a statement is needed for a rule, section 205 of UMRA generally requires Rural Development to identify and consider a reasonable number of regulatory alternatives and adopt the least costly, more cost-effective, or least burdensome alternative that achieves the objectives of the rule.

This proposed rule contains no Federal mandates (under the regulatory provisions of Title II of the UMRA) for State, local, and tribal governments or the private sector. Thus, this rule is not subject to the requirements of sections 202 and 205 of the UMRA.

**Environmental Impact Statement**

This document has been reviewed in accordance with 7 CFR part 1940, subpart G, “Environmental Program.” Rural Development has determined that this action does not constitute a major Federal action significantly affecting the quality of the human environment, and in accordance with the National Environmental Policy Act (NEPA) of 1969, 42 U.S.C. 4321 *et seq.*, an Environmental Impact Statement is not required. Loan applications will be reviewed individually to determine compliance with NEPA.

**Executive Order 12988, Civil Justice Reform**

This proposed rule has been reviewed under Executive Order 12988, Civil Justice Reform. In accordance with this rule: (1) All State and local laws and regulations that are in conflict with this rule will be preempted; (2) no retroactive effect will be given this rule; and (3) administrative proceedings in accordance with the regulations of the Department of Agriculture National Appeals Division (7 CFR part 11) must

be exhausted before bringing suit in court challenging action taken under this rule unless those regulations specifically allow bringing suit at an earlier time.

#### **Executive Order 13132, Federalism**

It has been determined, under Executive Order 13132, Federalism, that this proposed rule does not have sufficient federalism implications to warrant the preparation of a Federalism Assessment. The provisions contained in the proposed rule will not have a substantial direct effect on States or their political subdivisions or on the distribution of power and responsibilities among the various government levels.

#### **Regulatory Flexibility Act**

The Regulatory Flexibility Act (5 U.S.C. 601–602) (RFA) generally requires an agency to prepare a regulatory flexibility analysis of any rule subject to notice and comment rulemaking requirements under the Administrative Procedure Act or any other statute unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities. Small entities include small businesses, small organizations, and small governmental jurisdictions.

In compliance with the RFA, Rural Development has determined that this action will not have a significant economic impact on a substantial number of small entities. Rural Development made this determination based on the fact that this regulation only impacts those who choose to participate in the program. Small entity applicants will not be impacted to a greater extent than large entity applicants.

#### **Executive Order 12372, Intergovernmental Review of Federal Programs**

Rural Development Guaranteed Loans are subject to the Provisions of Executive Order 12372, which require intergovernmental consultation with State and local officials. Rural Development will conduct intergovernmental consultation in the manner delineated in RD Instruction 1940–J, “Intergovernmental Review of Rural Development Programs and Activities,” available in any Rural Development office, on the Internet at <http://rurdev.usda.gov.regs>, and in 7 CFR part 3015, subpart V.

#### **Executive Order 13175, Consultation and Coordination With Indian Tribal Governments**

This executive order imposes requirements on Rural Development in the development of regulatory policies that have tribal implications or preempt tribal laws. Rural Development has determined that the proposed rule does not have a substantial direct effect on one or more Indian tribe(s) or on either the relationship or the distribution of powers and responsibilities between the Federal Government and the Indian tribes. Thus, the proposed rule is not subject to the requirements of Executive Order 13175.

#### **Programs Affected**

The Catalog of Federal Domestic Assistance Program numbers assigned to this program are 10.760, Water and Waste Disposal Systems for Rural Communities; 10.766, Community Facilities Loans and Grants; 10.768, Business and Industry Loans; and 10.775, Renewable Energy Systems and Energy Efficiency Improvements Program.

#### **Paperwork Reduction Act**

In accordance with the Paperwork Reduction Act of 1995, Rural Development will seek OMB approval of the reporting and recordkeeping requirements contained in this proposed rule and hereby opens a 60-day public comment period.

*Title:* Rural Development Guarantee Loans.

*Type of Request:* New collection.

*Abstract:* Rural Development is implementing a new consolidated guaranteed loan platform. The new guaranteed loan platform would combine the following four existing guaranteed loan regulations into a consolidated rule: (1) The Community Facility Program, (2) the Water and Waste Disposal Program, (3) the Business and Industry Program, and (4) the Renewable Energy Systems and Energy Efficiency Improvements Program under Title IX, Section 9006 of the Farm Security and Rural Investment Act of 2002 (FSRIA 2002). These programs provide loan guarantees for a variety of projects intended to improve the economies of rural America.

The information required under the proposed rule is similar to much of the information currently being required under the four separate regulations. Under these four separate regulations, the current information being collected is approved under OMB control numbers 0570–0016, 0670–0018, 0572–0122, and 0575–0137. The proposed

rule, however, is requesting some new information from lenders. The two primary examples are: (1) lenders are required to supply information to the Agency in order to be approved for participation in the program and (2) more frequent reporting of loans that are in default. On the other hand, the proposed rule would not include some information previously being requested. This is most evident for the Renewable Energy Systems and Energy Efficiency Improvements guaranteed loan program, where technical reports are being required only for higher cost renewable energy systems projects because renewable energy projects of less than \$200,000 are less complex, so for such projects the technical reports only have marginal value, and the energy audit requirements from energy efficiency improvement projects are sufficient so that separate technical reports also have only marginal value. The proposed rule creates a single set of common forms that lenders can use across all four programs, thereby creating efficiencies in reporting. On net, the information being requested to support the consolidated program is estimated to reduce burden and cost to lenders and borrowers.

As noted in the previous paragraph, the information requirements contained in this proposed rule require information from lenders and borrowers. This information is vital to Rural Development to make wise decisions regarding the eligibility of projects, borrowers, and lenders in order to reduce the risk associated with making the loan guarantees, to ensure compliance with the proposed rule, to ensure that the funds obtained from the Government are used appropriately, and to effectively monitor the borrowers and lenders to protect the financial interests of the Government. In sum, this collection of information is necessary in order to implement the consolidated guaranteed loan regulation being proposed.

The following estimates are based on the average over the first three years the program is in place.

*Estimate of Burden:* Public reporting burden for this collection of information is estimated to average 2.6 hours per response.

*Respondents:* Rural developers, farmers and ranchers, rural businesses, public bodies, local governments, lenders.

*Estimated Number of Respondents:* 3,450.

*Estimated Number of Responses per Respondent:* 5.4.

*Estimated Number of Responses:* 18,472.

*Estimated Total Annual Burden (hours) on Respondents:* 48,892.

Copies of this information collection may be obtained from Cheryl Thompson, Regulations and Paperwork Management Branch, Support Services Division, U.S. Department of Agriculture, Rural Development, STOP 0742, 1400 Independence Ave., SW., Washington, DC 20250-0742 or by calling (202) 692-0043.

*Comments:* Comments are invited on: (a) Whether the proposed collection of information is necessary for the proper performance of the functions of Rural Development, including whether the information will have practical utility; (b) the accuracy of the new Rural Development estimate of the burden of the proposed collection of information, including the validity of the methodology and assumptions used; (c) ways to enhance the quality, utility, and clarity of the information to be collected; and (d) ways to minimize the burden of the collection of information on those who are to respond, including through the use of appropriate automated, electronic, mechanical, or other technological collection techniques or other forms of information technology. Comments may be sent to Cheryl Thompson, Regulations and Paperwork Management Branch, U.S. Department of Agriculture, Rural Development, STOP 0742, 1400 Independence Ave., SW., Washington, DC 20250. All responses to this proposed rule will be summarized and included in the request for OMB approval. All comments will also become a matter of public record.

### E-Government Act Compliance

Rural Development is committed to complying with the E-Government Act, to promote the use of the Internet and other information technologies to provide increased opportunities for citizen access to Government information and services, and for other purposes.

#### I. Background

Rural Development proposes a unified platform for delivery of four existing Rural Development guaranteed loan programs—Community Facility; Water and Waste Disposal; Business and Industry; and Renewable Energy Systems and Energy Efficiency Improvement Projects. These four programs are administered by Rural Housing Service (Community Facilities), Rural Utilities Services (Water and Waste Disposal), and Rural Business-Cooperative Service (Business and Industry and the Renewable Energy Systems and Energy Efficiency

Improvements Projects). Collectively, Rural Development's programs work together to assist in building and maintaining entire, sustainable rural communities.

Under the unified guaranteed loan platform, Rural Development will simplify, improve, and enhance the delivery of these four guaranteed loan programs across their service areas. The remainder of this section describes Rural Development's mission, the four current guaranteed loan programs being aligned under the new platform, why the new platform is being proposed, and how the new platform will work.

#### A. Rural Development's Mission

By statutory authority, Rural Development is the leading Federal advocate for rural America, administering a multitude of programs, ranging from housing and community facilities to infrastructure and business development. Its mission is to increase economic opportunity and improve the quality of life in rural communities by providing the leadership, infrastructure, venture capital, and technical support that enables rural communities to prosper and supports them in the dynamic global environment defined by the Internet revolution, and the rise of new technologies, products, and markets.

To achieve its mission, Rural Development provides financial support (including direct loans, grants, and loan guarantees) and technical assistance to help enhance the quality of life and provide the foundation for economic development in rural areas. This proposed rulemaking addresses the use of guaranteed loans in achieving Rural Development's mission.

#### B. Current Guaranteed Loan Programs

Under this proposed rule, Rural Development is combining under one regulation the four guaranteed loan regulations of the following programs: Community Facilities, Water and Waste Disposal, Business and Industry, and Renewable Energy Systems and Energy Efficiency Improvements. The following paragraphs describe briefly the scope of each of the four current programs with regard to eligible projects, borrowers, and lenders; application processes; and guarantee and loan terms.

*Community Facilities Guaranteed Loan Program.* The Community Facilities Guaranteed Loan Program guarantees loans to develop essential community facilities in rural areas and towns of up to 20,000 in population. Loan funds may be used to construct, enlarge, or improve community facilities for health care, public safety,

and public services. This can include costs to acquire land needed for a facility, pay necessary professional fees, and purchase equipment required for its operation. Refinancing existing loans may be considered an eligible guaranteed loan purpose under some circumstances.

Eligible borrowers for Community Facilities guaranteed loans are public entities, such as municipalities, counties, and special-purpose districts, as well as not-for-profit corporations and tribal governments who are unable to obtain a loan without the Government's guarantee. Borrowers must have the legal authority to borrow and repay loans; to pledge security for loans, and to construct, operate; and maintain the facilities.

Eligible lenders for Community Facilities guaranteed loans include banks, savings and loan associations, mortgage companies that are part of bank holding companies, banks of the Farm Credit System, and insurance companies regulated by the National Association of Insurance Commissioners. These lenders must be subject to credit examination and supervision by an appropriate agency of the United States or a State that supervises and regulates credit institutions. Lenders must also have the capability to adequately service the loans for which a guarantee is requested.

The lender is responsible for conducting an analysis of the proposed project to ensure loan repayment, taking into consideration tax assessments, revenues, fees, or other sources of money sufficient for operation and maintenance, reserves, and debt retirement. Financial feasibility studies, prepared by independent consultants, are normally required when loans are for start-up facilities or for existing facilities when the project will significantly change the borrower's financial operations.

Recently under this program, guarantees have averaged 85 percent of the eligible loss of the loan. Lenders may impose an interest rate that is similar to unguaranteed projects. Interest rates may be fixed or variable, are determined by the lender and borrower, and are subject to Agency review and approval.

Loan repayment terms may not exceed the lender's authority (under State law or organizational structure), the useful life of the facility, or a maximum 40 years.

*Water and Waste Disposal Guaranteed Loan Program.* The Water and Waste Disposal Guaranteed Loan Program guarantees loans to develop

water and wastewater systems, including solid waste disposal and storm drainage, in rural areas and to cities and towns with a population of 10,000 or less. Example projects include construction of water lines, pumping stations, wells, storage tanks, and sewage treatment facilities.

Eligible borrowers include public entities, such as municipalities, counties, special-purpose districts, and Indian tribes. In addition, funds may be made available to corporations operated on a not-for-profit basis. Borrowers must be unable to obtain funds from other sources at reasonable rates and terms. Borrowers must have the legal authority to borrow and repay loans, to pledge security for loans, and to construct, operate, and maintain the facilities.

Eligible lenders for Water and Waste Disposal guaranteed loans include banks, savings and loan associations, mortgage companies that are part of a bank holding company, banks of the Farm Credit System, and insurance companies regulated by the National Association of Insurance Commissioners. These lenders must be subject to credit examination and supervision by an appropriate agency of the United States or a State that supervises and regulates credit institutions. Lenders must also have the capability to adequately service the loans for which a guarantee is requested.

The lender is responsible for conducting an analysis of the proposed project to ensure loan repayment, taking into consideration tax assessments, revenues, fees, or other sources of money sufficient for operation and maintenance, reserves, and debt retirement. Feasibility studies are normally required when loans are for start-up facilities or existing facilities when the project will significantly change the borrower's financial operations. The feasibility study should be prepared by an independent consultant with recognized expertise in the type of facility being financed.

The Agency will determine borrower eligibility, project priority status, and funding availability. Priority is given to public entities, in areas with less than 5,500 people, to restore a deteriorating water supply, or to improve, enlarge, or modify a water facility or an inadequate waste facility. Preference is also given to requests that involve the merging of small facilities and those serving low-income communities. After an application is submitted, the time to process the application depends upon the scope of the project, environmental review, and legal issues.

Recently under this program, guarantees have averaged 90 percent of the eligible loss of the loan. Interest rates are set periodically, usually quarterly, and are based on current market yields for municipal obligations. Interest rates may be fixed or variable, are determined by the lender and borrower, and are subject to Agency review and approval.

The maximum term for all loans is 40 years; however, no repayment period will exceed State statutes or the useful life of the facility.

*Business and Industry Guaranteed Loan Program.* The Business and Industry (B&I) Guaranteed Loan Program guarantees loans that help create jobs and stimulate rural economies by providing financial backing for rural businesses. Loan guarantees expand the lending capability of private lenders who provide financing to credit worthy entities and individuals in rural areas, helping them make and service quality loans that provide lasting community benefits. Loan proceeds may be used for permanent working capital, machinery and equipment, buildings and real estate, and refinancing of any loan. Except for the refinancing of Agency direct loans, refinancing of other loans will be limited to a minority portion of the guaranteed loan. The primary purpose is to create and maintain employment and improve the economic climate in rural communities.

Eligible borrowers for B&I loans include virtually any legally organized entity, including a cooperative, corporation, partnership, trust or other profit or not-for-profit entity, Indian tribe or Federally recognized tribal group, municipality, county, or other political subdivision of a State. Pursuant to section 310B(a) of the Consolidated Farm and Rural Development Act, borrowers need not have been denied credit elsewhere to apply for this program.

Eligible lenders for B&I loans include recognized commercial or other authorized lenders in rural areas (all areas other than cities of more than 50,000 people and the contiguous and adjacent urbanized areas of such cities or towns). Generally, authorized lenders include Federal or State chartered banks, credit unions, insurance companies, savings and loan associations, Farm Credit Banks or other Farm Credit System institutions with direct lending authority, a mortgage company that is part of a bank holding company, and the National Rural Utilities Cooperative Finance Corporation. Other lenders include eligible Rural Utilities Program electric

and telecommunications borrowers, acting as financial intermediaries, and other lenders approved by Business and Cooperative Programs who have met the designated criteria.

The application process may be initiated using a preapplication or application. The Agency reviews each application for compliance with borrower eligibility guidelines, project priority, and the availability of funds.

Recently under this program, guarantees have averaged 78 percent of the eligible loss of the loan. The maximum aggregate debt that can be incurred by a borrowing entity at any given time under the B&I Guaranteed Loan program is \$25 million. A maximum of 10 percent of program funding is available to value-added cooperative organizations for loans above \$25 million to a maximum aggregate of \$40 million. Repayment terms are up to 30 years for real estate; up to 15 years or useful life, whichever is less, for machinery and equipment; up to 30 years for combined loans on real estate and equipment; and up to 7 years on working capital loans.

*Renewable Energy Systems and Energy Efficiency Improvements Guaranteed Loan Program.* The Renewable Energy Systems and Energy Efficiency Improvements Guaranteed Loan Program provides loan guarantees for the purchase and installation of renewable energy systems and energy efficiency improvements. Eligible borrowers include farmers, ranchers, and rural small businesses. In addition to being a renewable energy system or energy efficiency improvement project, project eligibility requirements include the project site being controlled by the agricultural producer or small business for the proposed financing term of any associated Federal loans or loan guarantees.

Recently under this program, guarantees have averaged 78 percent of the eligible loss of the loan. Repayment terms are up to 30 years for real estate; up to 20 years or useful life, whichever is less, for machinery and equipment; up to 30 years for combined loans on real estate and equipment; and up to 7 years on working capital loans.

The minimum amount of a guaranteed loan is \$5,000 (less any program grant awards). The maximum amount of a guaranteed loan is \$10 million. The amount of the loan that will be made available to an eligible project can not exceed 50 percent of total eligible project costs.

#### How the Current Programs Work

While differences occur within each of the programs (e.g., borrower and

project eligibility, necessary documentation, and funding limits), the same basic framework for making loan guarantees applies to each.

- Each prospective borrower works with a lender to obtain a loan for a project eligible under one of the four programs, providing the lender with necessary information on the borrower and the project.

- Each lender evaluates borrower and project eligibility and performs a detailed credit analysis and, as applicable, an economic or financial analysis of the project to ensure that the project will be able to repay the loan.

- Each lender submits the guaranteed loan application, including its credit analysis, and all accompanying documentation to the Agency for review and approval.

- The Agency reviews each guaranteed loan application package in accordance with program requirements and approves or denies the guarantee. Subject to the availability of funds, each approved package is provided a loan guarantee.

- Each lender is responsible for the origination and servicing of its guaranteed loan portfolio and for working with the Agency, as necessary, to resolve borrower issues (such as default).

Variations do occur in this basic framework, but for the most part are not as significant as the scope of each of the programs.

#### Issues With the Current Programs

The regulations that are being combined under the proposed rule have developed over time and, in some aspects, independently of each other. Issues have developed when looking at all four program regulations as a whole as well as individually. Four of these operational issues are discussed below.

*Inefficiencies.* Many of the same lenders and, in some cases, borrowers, seek loan guarantees under more than one of these four programs. Thus, the same entities are required to learn multiple programs. This is inefficient and costly to the lenders and makes the programs less attractive to lenders.

Currently, when new programs are implemented, a whole new regulation is developed that, in many respects, addresses or adopts many of the same requirements. Time and effort are wasted in readdressing issues during the development of new program regulations leading to inefficient rulemaking and a delay in program implementation.

*Inflexibility.* Maintaining four separate sets of basic requirements creates certain inflexibilities. For

example, with each program administered under separate regulations, any change to basic requirements calls for multiple concurrences. Similarly, adding a new program requires the addition of a new set of basic requirements, as these are not currently shared. The proposed combined platform will streamline basic loan guarantee requirements, allowing all programs to reach a uniform functionality of process.

*Use of Agency Resources.* Agency personnel spend a large amount of time performing process-related tasks that are not necessarily productive in making loan guarantees available to more lenders and, in turn, to more borrowers. These tasks are often inefficient and could be better managed by the private sector at the lender level. Further, these tasks are applied equally regardless of the relative level of risk of the associated loans. In sum, the current delivery of these four programs is not making the best use of Agency resources.

*Risk Management.* In making and managing a portfolio of loan guarantees, consideration must be given to project risk, institutional risk, Agency loss exposure, and internal operational risk.

*Project risk* refers to the ability of a project to repay its debt. The current process relies on the lender's evaluation of the project and then the Agency's review of the lender's analysis. The types of information required to be assessed under each of the programs by the lender may vary. Currently, the Agency lacks definitive parameters to evaluate project risk and is inconsistent in its evaluation of risk across State Offices.

The lack of definitive parameters inherently creates more risk. It allows projects to be funded based on completed processes as opposed to appropriate evaluation. Furthermore, this funding may come at the expense of less risky projects over time because of limitations of available funds. The proposed unified platform will significantly reduce inconsistencies in the implementation of these four programs across State offices and improve underwriting for loan guarantees, which should result in a reduction in risk and an improvement in the credit subsidy scores for these programs.

*Institutional risk* refers to the quality of the lender seeking the loan guarantee. Some lenders simply do a better job at managing their portfolios and thereby have a lower rate of defaults. The current system does little to pre-qualify lenders; that is, the criteria for a lender to originate a loan with the Agency are

insufficient. By implementing a defined set of criteria to assess lender performance, the Agency can improve its management of lenders participating in these programs.

*Agency loss exposure* refers to the Agency's risk for potential loss in any one project in terms of the percent of guarantee and the size of the loan. Currently, Agency loss exposure is managed by putting limits on the percent of guarantee relative to the size of the loan, by having collateral requirements, and, for some of the programs, by limiting the size of the loan. While these limits are the primary mechanism for managing Agency loss exposure, the current programs could do more to manage this risk.

*Agency operational risk* refers to internal weaknesses inherent in administering multiple programs using a variety of regulations that require unique sets of processes and procedures. The new platform will reduce operational risk through reliance on commonalities, reduction of regulatory language, and integration of information management systems.

#### C. The New Platform

As noted above, Rural Development manages multiple guaranteed loan programs in separate regulations requiring users to become familiar with each. These regulations share many common elements. The inefficiencies in maintaining separate regulations have resulted in an in-depth evaluation of current program delivery. Further, in assessing the delivery of these programs, Rural Development sees the opportunity to better manage the risks associated with their delivery.

The proposed new platform simplifies, improves, and enhances the delivery of Rural Development's guaranteed loan programs, applies shared requirements when applicable, maintains programmatic nuances for varying rural development needs, and intends to reduce the amount of Agency loss claims paid through the provision of loan guarantees through improved underwriting. This new structure will also make it easier and faster to promulgate regulations for new loan guarantee programs in the future.

The following paragraphs address improvements under the proposed platform. These improvements provide the requisite flexibility to accommodate additional or new programs and enable the Agency to better manage its risk.

1. *Increase efficiency.* Having a common rule for multiple programs will reduce burden for the Rural Development staff, lenders, and borrowers, easing delivery and

increasing efficiency. A common platform will be easier to administer, improve communication of basic program aspects, and reduce end user confusion.

Internally, a common regulation will reduce the time, effort, and training necessary to guarantee a loan. Externally, a common regulation will reduce the lender's and borrower's cost by providing simpler and more consistent program requirements.

Further efficiencies will be realized as common program elements facilitate consolidation of information technology platforms and systems' maintenance cost. Internal management controls will improve with standardized servicing and oversight. Common elements will assist lenders in managing a diverse portfolio and meeting Federal requirements. Uniform processes will facilitate electronic commerce between Rural Development and its customers.

2. *Flexibility.* The structure of the new platform provides for the addition of other Agency, or newly authorized, guaranteed loan programs as needed without the addition of new sets of basic requirements. The common elements (proposed subpart A) of the proposed rule are intended to remain unchanged, while additional programs would be added to proposed subpart B.

3. *Refocus of Agency resources.* The new platform directs Agency resources away from a processing centric model toward a rural development model by emphasizing lender expertise, refocusing time spent on process to time spent with clients, and increasing access by eliminating regulatory redundancy.

4. *Reduce risk.* In developing the proposed new platform, the key consideration was how to implement it in a manner that reduces the overall risk that a loan would not be repaid. The Agency considered the risk associated with making and managing a portfolio of guaranteed loans in developing the new platform. How these risks are addressed in the proposed new platform is covered in the following section.

#### D. How the New Platform Works

Under the proposed platform, the common features of the four programs are incorporated into a single subpart (subpart A), with program specific features provided in a separate subpart (subpart B). While each of the four existing programs remains, the way these four programs will be delivered to Rural Development's customers is different. In delivering the proposed platform, the Agency will also publish **Federal Register** notices containing specific information associated with the guaranteed loan program.

The following paragraphs address the new platform by examining the proposed delivery mechanisms, concluding with a discussion of the **Federal Register** notices that will be used as part of the implementation of the new platform.

1. *Eligibility.* Under the new platform, three basic types of eligibility are identified—project eligibility, borrower eligibility, and lender eligibility.

*Project eligibility* is based on the proposed project being for the benefit of a rural area, on the ability of the activity to be funded to meet the requirements of the applicable program, on meeting a minimum set of project criteria, and, when applicable, on the boundaries of the proposed service area meeting a non-discrimination criterion. Projects that do not meet these proposed criteria would be ineligible under the new program. In addition, these criteria can not be voided under the exception authority provided in the proposed rule.

The applicable project eligibility requirements, located in proposed subpart B, remain essentially unchanged for those of the four current programs. Some differences are being proposed and these are discussed in sections II. and III. of this preamble. One important difference is that the proposed platform uses three minimum project financial conditions, which are specifically discussed, in detail, in section II.B. of this preamble, to reduce project risk by screening out those projects less likely to achieve a level of success that will support loan repayment. These three financial conditions establish minimum requirements for debt coverage ratio, cash equity or community support, and loan-to-value ratio. While the four existing programs address cash equity and community support, they do not have requirements associated with debt coverage ratios and loan-to-value ratios. By specifying these project financial conditions within the rule, borrowers and lenders will be able to determine a project's eligibility for a loan guarantee early in the process.

In addition to identifying eligible projects, the proposed rule identifies specific projects and purposes that are ineligible under all circumstances from receiving a loan guarantee. The Agency assembled this list mainly from the list of ineligible projects and purposes identified in the regulations for the four current programs.

*Borrower eligibility* is based on the borrower meeting two common requirements, which are citizenship and legal authority and responsibility, and program-specific criteria, which are contained in proposed subpart B. The

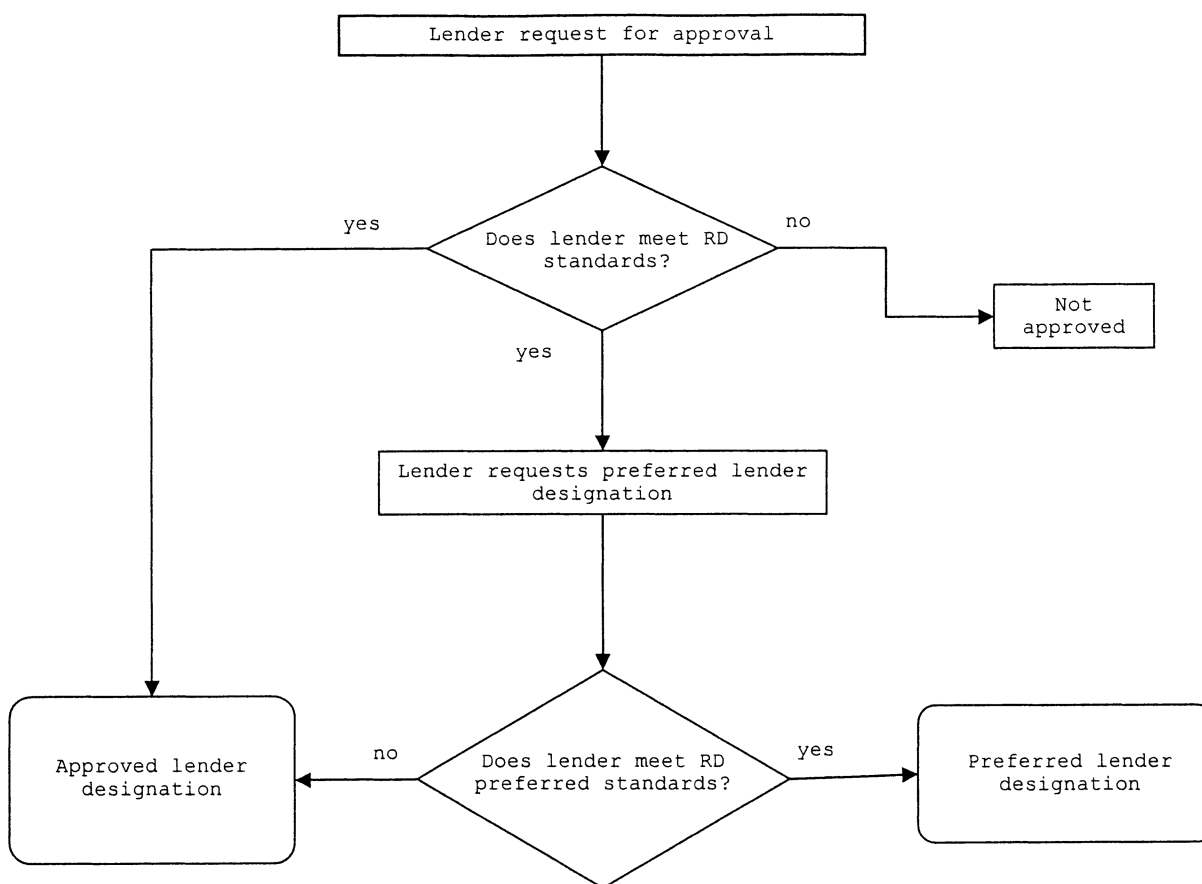
proposed rule also identifies borrowers who would be categorically ineligible. In terms of eligible and ineligible entities, little has changed under the new platform compared to the four current programs.

*Lender eligibility* is based on criteria dependent on whether or not the lender is a regulated or supervised lender. A lender, who is not otherwise debarred or suspended by the Federal government, must be approved, as described below, by the Agency to participate in this program. As part of the approval process, the Agency may consider the experience and capabilities of the lender to properly originate and service the variety of guaranteed loans available within the Agency. If the Agency disapproves a lender for participation, the lender has the right to appeal that decision. In addition, all participating lenders will be reviewed for eligibility at least every two years.

Although the B&I guaranteed loan program has a process for "other lenders" to participate in the current B&I guaranteed loan program, the process for an eligible lender to participate in the proposed platform is generally new compared to the four current programs. Figure 1 illustrates the basic process for lender approval under the proposed platform, with the following paragraphs describing this process.

Any lender that is a regulated or supervised lender is eligible to participate in the guaranteed loan programs described in proposed subpart B. If a regulated or supervised lender has an existing portfolio with the Agency, it is considered to be "approved" for participation and would not be required to submit an application to the Agency for approval to participate. However, the lender would be required to submit certification to the Agency that it is in "good standing" with its regulator. If a regulated or supervised lender does not have an existing portfolio with the Agency, it must submit an application for lender approval to the Rural Development State Office in the State in which the lender is chartered. The State Office will review the application and make a decision to approve or disapprove the lender for participation in this program. State Office approval of the lender will extend to all States and all programs covered by this part. If disapproved, the lender will have the right to appeal the decision to the National Appeals Division. To be approved, a regulated or supervised lender must be in good standing with its regulator(s).

Figure 1. Lender Approval



As proposed, all regulated or supervised lenders would be required to submit to the Agency a copy of their current written policies and procedures for originating and servicing guaranteed loans. This is not currently required under any of the four current programs.

If the lender is not a regulated or supervised lender, it must submit an application to the Rural Development State Office in the State in which the lender is chartered for approval for participation. The application will address a number of criteria that the Agency will consider in approving or disapproving the lender (see section II.B. for more detail on these criteria). The State Office will review the application and submit it, along with its comments, to the National Office for review. The National Office will make the determination as to whether to approve the lender for participation. If the National Office approves the lender, that approval will apply to all States for all programs covered by this part. If disapproved by the National Office, the lender will have the right to appeal the decision to the National Appeals Division.

The process described above is intended to help the Agency ensure that only qualified lenders participate in this program, and thereby mitigate institutional risk by encouraging the participation of better qualified and performing lenders.

**2. Preferred Lender versus Approved Lender.** An important aspect for managing institutional risk under the new platform is the ability of an approved lender to apply for preferred lender status (see Figure 1 above and § 5001.9(c) of the proposed rule). Currently, only the B&I guaranteed loan program has provisions for a preferred lender program, although there has been no material participation in it to date.

Under the proposed program, there are several benefits for being a preferred lender. Preferred lenders would have more opportunities to submit applications for guarantee with less supporting documentation, would be subject to fewer Agency visits, and would be eligible to receive higher percent guarantees than lenders without preferred status. In addition, the Agency may expend fewer resources evaluating preferred lender loan guarantee

applications and reallocate resources to better manage risk and encourage program participation.

To receive preferred lender status, a Rural Development approved lender would submit an application for preferred lender status to the State Office in the State in which the lender is chartered. The State Office would then forward the application and its comments to the National Office for review and decision.

The criteria proposed for obtaining preferred lender status (see Figure 2) address the qualifications of the lender for loans of similar nature and the quality of the lender in managing its loan portfolio by examining its commercial loan losses and any instances of Federal negligent loan origination or servicing. The Agency will also consider any comments submitted by State Offices when evaluating these applications. National Office approval will apply to all States.

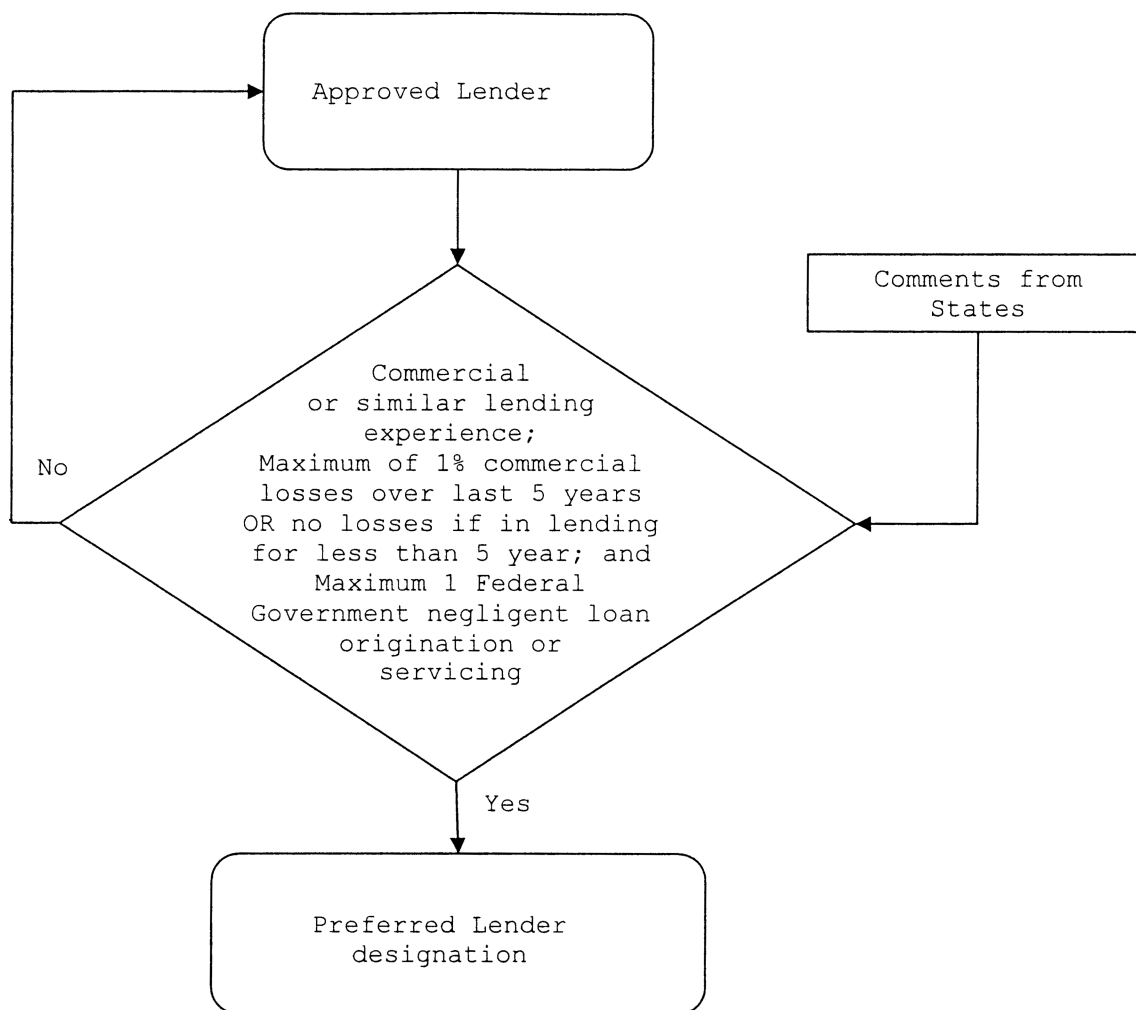
**3. Guaranteed loan approval.** Under the four current programs, the Agency views proper loan origination as a responsibility of the lender. The new platform clarifies this responsibility by

reinforcing the concept of negligent loan origination. To help lenders understand the importance of conducting proper credit analysis and sound loan origination, the new platform will clarify the Agency's policy regarding negligence in the origination and servicing of loans. In the case where the

lender is the holder of the guarantee, losses associated with the lender's negligence will be deducted from the loss claims paid under the guarantee. In the case where there is a subsequent holder, losses associated with the lender's negligence will not be deducted from the loss payment under the

guarantee. However, in such cases, loss claims paid under the guaranteed will be collected from the lender. The Agency anticipates that the clarification for negligent loan origination will reduce loan defaults through improved loan origination.

Figure 2. Preferred Lender Designation Criteria



Under the new platform, Rural Development has standardized, to the extent possible, the type of information to be included in the loan guarantee application, although some additional content information is required by some of the programs described in subpart B. In general, the information associated with a loan guarantee application is not significantly different than currently required under the four current programs.

The main difference in the application for loan guarantee under the new platform will be the amount of

supporting documentation that is required to be submitted with or accompany the application for certain projects. If criteria are met as described below, the lender will have the option of submitting a "low documentation" application, which would allow the lender to self-certify that it has complied with certain Agency requirements. (See section II.B. for more information.) The Agency expects the lender to obtain the same level of documentation and to perform the same level of analysis and other origination activities whether the lender submits a

full documentation application or a low documentation application.

The determination of whether a low documentation application can be submitted will depend on the borrower's status as a startup or existing business, on whether the lender has preferred lender status, and on certain project criteria.

As proposed, all loan guarantee applications for startup businesses must be submitted with full documentation (see section II.B. for details) given the risk associated with startup businesses.



For existing businesses, the proposed rule would allow Rural Development approved lenders with preferred lender status to submit applications with either low or full documentation if the loan guarantee request is for \$5 million or less. For a larger loan guarantee request, a full documentation application would be required. These provisions apply to all four programs under the proposed platform.

For Rural Development approved lenders that do not have preferred lender status, all applications would have to be submitted with full documentation unless the project meets certain criteria, as discussed in section II.B., intended to lower the risk associated with the project. If the project meets the lower risk identification criteria, the Rural Development approved lender without preferred status would be allowed to submit a low documentation application.

The Agency will examine the lender's analysis of the project, the technical merit, any business plans or feasibility studies required, and environmental information. If the Agency disapproves the application, the lender and borrower have the right to appeal the decision.

4. *Servicing.* Once the loan has been approved, the lender will continue to be responsible for servicing the entire loan. The lender's servicing responsibilities, including those regarding negligent servicing, under the proposed unified platform are essentially the same as under the four existing regulations.

5. *Oversight and Monitoring.* As under the four current programs, the Agency will conduct under the proposed new platform any and all oversight and monitoring activities necessary to ensure that lenders are originating and servicing Agency guaranteed loans in a manner consistent with lender and Agency standards. These tools include, but are not limited to, conducting lender visits and meetings and requiring various reports and notifications. There are a few differences between the proposed platform and the four current programs for conducting these activities. These differences are discussed later in this preamble.

The Agency will also use this oversight and monitoring to ensure that lenders maintain the qualification criteria for being a Rural Development approved lender and, where applicable, for being a preferred lender.

6. *Managing Risk.* As noted above, the Agency has incorporated into the proposed new platform certain features to help manage risk.

To limit loss exposure, the Agency will require full supporting documentation on all applications for

projects from startup businesses and from existing businesses unless, for existing businesses, the project is a "lower risk" project as defined by the criteria in the proposed rule. Applications for projects that meet these criteria may be submitted with less supporting documentation (i.e., a low documentation application).

The Agency will mitigate the possibility of increased loss exposure associated with low documentation applications as the discussed below.

- The loan amount that will be guaranteed under a low documentation application would be limited to \$5 million. In other words, all loan requests for more than this amount must be submitted as full documentation applications. This applies across all four programs under the new platform. Setting a maximum value for which a low documentation application can be submitted will provide the Agency the ability to better monitor loans that represent greater potential liability.

- If the low documentation application is from a lender who does not have preferred status, the maximum percent guarantee that the Agency will consider for that loan is 10 percentage points lower than for a full documentation application. Reducing the maximum percent guarantee available will mitigate Agency loss exposure. In consideration of the additional criteria necessary to become a preferred lender, the Agency has determined that the risk mitigation obtained by applying the preferred lender criteria offsets the risk mitigation obtained by reducing the guarantee. Therefore, the Agency is proposing to not apply this reduction in the maximum guarantee available to a preferred lender.

- If the low documentation application is from a lender who does not have preferred status, the proposed rule requires additional financial criteria in order to qualify the project for a low documentation application. Requiring projects to meet additional financial criteria will mitigate project risk.

To limit project risk, the new platform requires projects to meet a minimum set of project financial criteria to prevent high risk projects from being proposed at all. In addition, in order to avoid bypassing project eligibility criteria, the Agency is proposing that exception authority not be extended to any project eligibility criterion, including the project financial criteria.

To limit institutional risk, the new platform requires lenders to meet criteria that help ensure the lender has the appropriate origination and

servicing experience and track record to reduce the likelihood of loan defaults. The Agency is proposing different criteria for regulated and supervised lenders as opposed to those that are unregulated and not supervised. Further, by providing a preferred status designation, the Agency is hoping to attract more qualified lenders to the programs.

Finally, to limit operational risk, the new platform relies on commonalities, reduction of regulatory language, and integration of information management systems. The use of electronic reporting and standardized forms also allows the Agency to better manage its portfolio of outstanding guaranteed loans.

7. **Federal Register** notices. To implement the new platform, the Agency will publish at least one **Federal Register** notice each year. Each notice will address the following items as necessary:

- *Ineligible projects and purposes.* If the Agency has identified any additional projects or purposes for which guaranteed loans will not be made, it will include such ineligible projects and purposes in the **Federal Register** notice. If there are no new ineligible projects or purposes have been identified, the notice would include a statement to that effect.

- *Maximum loan amounts.* The Agency will identify in the **Federal Register** notice the maximum loan amount per loan that will be available under each of the programs.

- *Fees.* If any are required, the Agency will identify in the **Federal Register** notice the guarantee fee and the renewal fee that will be used for that year in the calculation of the guarantee fee and the renewal fee for each program. In addition, for the B&I guaranteed loan program, the Agency will specify in the **Federal Register** notice the limit on the maximum portion of the guarantee authority available for that fiscal year that may be used to guarantee loans with the reduced guarantee fee of 1 percent.

- *Priority Scoring.* For the B&I guaranteed loan program, the Agency will identify the scoring criteria that will be used, if necessary, to allocate funds if funds are insufficient to cover all applications within the program. The Agency will manage the Renewable Energy Systems and Energy Efficiency Improvements guaranteed loan program funds in the same manner.

## II. Discussion of Proposed Rule

In this section, the proposed rule is described. First, an overall organization of the proposed rule is presented,

followed by a section-by-section discussion of each part.

#### A. Overall Organization of the Rule

The proposed rule is divided into two main parts. The first part, subpart A, contains the provisions that apply to all of the guaranteed loan programs covered by the proposed rule. The second part, subpart B, contains the provisions specific to the four programs identified earlier in this preamble.

*Subpart A.* Subpart A is divided into five major elements. In the first element are *general provisions* that cover the purpose of this part (§ 5001.1), the definitions and abbreviations used in this part (§ 5001.2), various Agency authorities associated with providing guaranteed loans (§ 5001.3), oversight and monitoring (§ 5001.4), and forms, regulations, and instructions (§ 5001.5).

The second element covers the basic *eligibility requirements* for the project (§ 5001.6) and unauthorized projects and purposes (§ 5001.7), for the borrower (§ 5001.8), and for the lender, including how a lender can be approved for preferred status, (§ 5001.9).

The third element covers the basic requirements associated with the *guaranteed loan application*, describing the process for submitting an application and its approval (§ 5001.11) and the contents of the application (§ 5001.12).

The fourth element covers the *responsibilities of the lender and the borrower*. Section 5001.15 covers general responsibilities of the lender. Lender responsibilities for originating the loan are covered by § 5001.16 and for servicing the loan by § 5001.17. Responsibilities of the borrower are found in § 5001.25.

The fifth element covers basic *provisions associated with the guarantee, including parameters for the guaranteed loan*. General guarantee provisions are found in § 5001.30, with guaranteed loan parameters (e.g., interest rates, term length, maximum percent guarantee, etc.) found in § 5001.31. The remaining sections in the fifth element address the process for obtaining the guarantee through changes in the guarantee and concluding with termination of the guarantee.

*Subpart B.* This subpart addresses provisions that are specific to the individual programs. Section 5001.101 covers provisions specific to the Community Facilities Program, § 5001.102 covers provisions specific to the Water and Waste Disposal Facilities Program, § 5001.103 covers provisions specific to the Business and Industry Program, and § 5001.104 covers provisions specific to the Renewable

Energy Systems and Energy Efficiency Improvements Program.

Within each of these four sections, the specific provisions are related back to a corresponding section in subpart A. For example, each of the four sections has subsections that address project eligibility. Another example is additional application documentation requirements. The intent of subpart B is to identify all of the provisions specific to each of the four programs. In this way, each of the four programs maintains their integrity under the new platform.

#### B. Discussion of Sections

##### Purpose (§ 5001.1)

This section defines the purpose of this part.

##### Definitions and Abbreviations (§ 5001.2)

This section presents the definitions and abbreviations used in this part, including terms that may be specific to one of the four programs found in subpart B.

The proposed rule contains fewer definitions than found in the four existing regulations, primarily because the deleted terms are no longer used in the proposed rule. Some definitions have been added or revised, including, but not limited to: Essential community facility, negligent loan origination, negligent loan servicing, rural or rural areas, and water and waste disposal project.

##### Agency Authorities (§ 5001.3)

Under this section, the proposed rulemaking identifies Exception Authority and Appeal Rights.

*Exception authority.* This paragraph identifies the situations under which the Administrator may make exceptions to the requirements contained in the regulation. The exceptions will be made on a case-by-case basis.

Unlike the four current regulations, the proposed rule identifies four exceptions to this Exception Authority, where the Administrator would not be allowed to make exceptions. These four exceptions are:

- Applicant and borrower eligibility, including both prospective borrowers and lenders.
- Project eligibility, as found in proposed § 5001.6 and the individual program in subpart B.
- Rural area definition, as found in proposed § 5001.2.
- Maximum term length of a guaranteed loan, as found in proposed § 5001.31(c).

The Agency believes that applicant/borrower and project eligibility criteria must be maintained at all times in order

to maintain an acceptable level of risk associated with guaranteed loans made under this part. The Agency also believes that it is important to maintain the definition of rural area at all times in order to ensure that loans guaranteed under this program are used to benefit rural areas. Lastly, the Agency believes that it is important to ensure a reasonable period of payback on guaranteed loans in order to manage its portfolio of outstanding loans and, therefore, is proposing not to allow exceptions to the maximum term length of a guaranteed loan. For these reasons, the Agency is proposing that the Administrator not be allowed to exempt a project from any of these four criteria.

*Appeal rights.* As provided by the four current programs, this paragraph provides the legal basis for a person to file an appeal of an adverse decision made by the Agency in implementing the proposed program. Such adverse decisions include, but are not limited to: (1) disapproving a lender for participation in the program, (2) disapproving an approved lender for preferred lender status, and (3) denying an application for a loan guarantee for reasons other than a lack of funds. When the Agency makes an adverse decision, a person may file an appeal with either the appropriate Agency official that oversees the program or with the National Appeals Division. Some negative determinations may affect a holder, in which case this paragraph provides the holder the legal right to file an appeal.

##### Oversight and Monitoring (§ 5001.4)

This section of the rule lays out the types of oversight and monitoring the Agency will perform in implementing this program. Consistent with the four current programs, these activities include, but are not necessarily limited to, reviewing lender records and meeting with the lenders to review the status of their guaranteed loans. The purposes of these oversight and monitoring activities are to: (1) Ensure that the lender has implemented, and is in compliance with, the provisions of this part and (2) determine if the lender is maintaining the appropriate requirements to maintain their status as a Rural Development approved lender and, if applicable, a preferred lender. The amount of oversight and monitoring will vary depending on whether the Rural Development approved lender has preferred lender status or not.

*Reports.* The proposed rule would require each lender to submit periodic reports to the Agency on the condition of its Agency guaranteed loan portfolio. These reports include borrower status,

loan classification, and any material changes in the general financial condition of the lender since the last periodic report was submitted. For loans that are not in default, these reports would be submitted semiannually, as is the practice in the four current programs.

The Agency considered requiring these reports on a monthly basis. This shorter duration provides the Agency with the more current information on the lenders' portfolio status, which would allow the Agency more "up-to-date" information to evaluate its loss exposure. The Agency, however, believes that the benefit of having this more "up-to-date" information did not outweigh the costs associated with generating this information on a monthly basis using current Agency technology. The Agency also considered annual submittal of these reports, but rejected this option because it does not provide for a timely assessment of the Agency's loss exposure of all its guaranteed loans.

For loans that go into or are in default, the proposed program would require default status reports to be provided on a monthly basis, regardless of the guaranteed loan amortization schedule, until such time the loan is no longer in default. This reporting frequency, which is shorter than found in the four current programs, helps the Agency focus its resources on problem loans sooner and with more frequency, thereby helping to mitigate the risk associated with such loans.

**Notifications.** The Agency is proposing that the lender notify it within 5 days when the borrower has violated any terms of the loan agreement (including if the borrower has missed a scheduled payment by more than 30 days) and when there has been any permanent reduction in the interest rate. The Agency is seeking these notifications to further allow the Agency to better manage its loss exposure in such instances that could affect repayment of the loan. Because both situations have substantial lead times, the Agency believes that 5 days is sufficient time for the lender to notify the Agency when either situation occurs.

All four programs currently require notification when there has been a permanent reduction in the interest rate, although they allow a 10-day notification period. Only the current Community Facility and Water and Waste Disposal Facilities guaranteed loan programs require lender notification when a borrower has violated any term of the loan agreement, and those programs currently allow a

longer notification period (30 days versus 5 days under the proposed rule).

#### Forms, Regulations, and Instructions (§ 5001.5)

This section describes where the lender and borrower can obtain all of the forms, regulations, and instructions necessary to participate in this program. These are available from any Rural Development State Office of the Agency and from the Agency's Web site.

#### Project Eligibility (§ 5001.6)

In order for a project to receive a guaranteed loan under this program, it must be an "eligible" project. This section identifies four criteria that each project must meet in order to be eligible. For some projects, the fourth criterion is not applicable. In such cases, the project must meet each of the first three criteria in order to be eligible.

Loan guarantee applications for projects that meet these criteria are not automatically approved. Instead, any project that fails to meet any one of these criteria are automatically ineligible for consideration for a loan guarantee, regardless of the other attributes of the project.

**Benefit a rural area.** The first criterion (§ 5001.6(a)) addresses the purpose of the project—the project must be for the benefit of a rural area. This criterion is generally consistent with what the four current programs, but, unless otherwise specified in subpart B, does not require the project to be physically located within a rural area.

**Eligible project.** The second criterion (§ 5001.6(b)) addresses the requirement that the project must meet the criteria specified in the applicable program identified in subpart B of the proposed rule. For example, if a project is for an anaerobic digester, it must meet the eligibility requirements specified in proposed § 5001.104 for renewable energy projects. If a project is for a community meeting hall, it must meet the eligibility requirements specified in proposed § 5001.101 for community facility projects. Generally, the same project criteria found in the four current programs have been carried over to subpart B of the proposed rule.

**Financial conditions.** The third criterion (§ 5001.6(c)) addresses three financial conditions that the project must meet. The conditions are: (1) Be able to demonstrate a debt coverage ratio of 1.0 or higher, (2) have a cash equity of 10 percent for existing businesses or 20 percent for new businesses or, for community facility guaranteed loans and water and waste disposal guaranteed loans only, be able to demonstrate community support, and

(3) have a loan-to-value ratio of no more than 1.0.

As specified in subpart B, community facility guaranteed loans and water and waste disposal guaranteed loans may either satisfy the cash equity requirements noted above or demonstrate community support. However, as proposed, if a lender has stricter eligibility requirements, a project would be required to meet the lender's requirements. For example, if a lender requires a community facility project to meet a cash equity requirement of 30 percent, which is more stringent than the proposed rule, and the lender does not accept community support in lieu of cash equity, then the project would be required to meet the lender's cash equity requirement of 30 percent.

As noted earlier, these financial metric criteria represent minimum conditions that a project must meet in order to be considered for a loan guarantee. If a project does not meet any one of these criteria, it is automatically ineligible for a loan guarantee. If it meets these criteria, the project is not automatically guaranteed a loan guarantee. For example, based on the Agency's evaluation of the loan guarantee application and associated risks, the Agency may require more stringent financial ratios as a condition of approval.

The four current programs do not have specific minimum criteria that a project must pass in order to be eligible for a guaranteed loan. Instead, the four programs rely on an evaluation of equity, cash flow, and collateral as appropriate to assess the viability of projects to repay the loan.

There are no equivalent requirements in the four current programs regarding debt coverage ratios and loan-to-value ratios. With regard to the cash equity/community support requirement, this is similar or the same as to what is required under the current programs. For example, both the Community Facilities and Water and Waste Disposal guaranteed loan programs require that projects demonstrate community support. The Renewable Energy Systems and Energy Efficiency Improvements guaranteed loan program currently requires demonstration of the adequacy of equity based on either 15 or 25 percent of eligible project costs. Under the B&I guaranteed loan program, tangible balance sheet equity (rather than cash equity) is used to assess the adequacy of equity, requiring 10 percent for existing businesses and 20 percent for new businesses.

**Service area selection.** The fourth criterion (§ 5001.6(d)) specifies that, for

projects that are determined by a service area, the proposed service area of the project must be chosen in a way that no user or area is excluded because of race, color, religion, sex, marital status, age, disability, or national origin. This criterion, where applicable, is the same as found under the current regulations of the Community Facilities and the Water and Waste Disposal guaranteed loan programs.

To reiterate, a project must meet each one of the four project eligibility criteria, or each of the first three criteria if the fourth criterion is not applicable, in order to be eligible for a guaranteed loan under the proposed rule. Meeting only some of the criteria is insufficient to be eligible. These criteria would be applied to all projects seeking a loan guarantee under each program covered by the proposed rule and cannot be waived under the Exception Authority (§ 5001.3(a)).

The Agency is proposing the project financial conditions under the third criterion in order to manage project risk. The Agency is concerned that under the current programs, loans are being sought for projects that are “too risky” and, in some cases, such projects are being funded. This increases the potential for loan defaults and reduces funding for projects that are inherently less risky. The Agency believes that setting such project financial conditions will allow more projects with less risk to be funded.

The Agency selected these three project financial conditions because they represent the best metrics for initially evaluating the overall risk of any single project. The specific numerical values are those that the Agency believes are reasonable measures of risk. The Agency requests comments on the three project financial conditions of the third criterion (see section IV.A. of this preamble), and is specifically interested in receiving comments on the three project financial conditions selected and the values used.

#### Unauthorized Projects and Purposes (§ 5001.7)

This section of the proposed rule identifies the types of projects that are ineligible for loan guarantees under this program regardless of whether the project meets the conditions specified in subpart B and § 5001.6. These projects represent both an aggregation of projects already prohibited under the four programs being included in today’s proposed rulemaking and the addition of projects that the Agency has determined represent significant risk based on past experience (e.g., golf courses).

The Agency has determined that certain recreational projects, such as golf courses, require a level of support or patronage beyond the local rural community that may be insufficient in order to sustain the project over the life of the loan. This determination by the Agency stems from the Agency’s poor loss experience in providing loan guarantees in the past to recreational projects of this type. Other recreational facilities may exhibit the same characteristics that would lead to similar Agency losses. In order for the Agency to mitigate the increased risk associated with these types of projects, the Agency is proposing to make ineligible certain recreational projects as specified in § 5001.7(b).

As noted earlier in this preamble, the Agency will publish at least once per year a notice in the **Federal Register** to identify additional projects or purposes that the Agency has determined are ineligible for loan guarantees under this part.

#### Borrower Eligibility (§ 5001.8)

As for projects, in order for a prospective borrower to be eligible under this program, the borrower must also be an “eligible” borrower. This section identifies the eligibility requirements for prospective borrowers.

Prospective borrowers must meet the program-specific eligibility requirements found in subpart B for the program under which their project falls. These specific requirements are discussed later in this preamble.

This section also identifies two common borrower eligibility requirements that all prospective borrowers must meet, regardless of which program is applicable for their project. These two criteria address citizenship and legal authority and responsibility. These two criteria are in some of the four current regulations, but not in each.

To be eligible, a prospective borrower must either be a citizen of the United States (U.S.) or reside in the United States after legal admittance for permanent residence. If the prospective borrower is an entity other than an individual, the borrower must be at least 51 percent owned by persons who are U.S. citizens or are legally admitted permanent residents residing in the U.S.

In addition, the prospective borrower must have, or be able to obtain, the legal authority to construct, operate, and maintain the proposed facility and services and to obtain, give security for, and repay the proposed loan.

This section also identifies ineligible borrowers (§ 5001.8(b)). A prospective borrower is ineligible if the borrower

has an outstanding judgment obtained by the U.S. in a Federal Court is delinquent on the payment of Federal income taxes, is delinquent on Federal debt, or is debarred or suspended from receiving Federal assistance. These conditions are generally consistent with those found in the four current programs.

#### Lender Eligibility and Designation (§ 5001.9)

As proposed, all lenders must be approved by the Agency under the standards of this regulation in order to participate. If a lender is debarred or suspended by the Federal government, the lender would be ineligible to participate. As noted earlier in this preamble and as discussed later in section III.C., there are differences between the lender approval process under the proposed rule and under the four current programs.

*Lender approval process.* The Agency is proposing requirements to approve lenders in order to reduce institutional risk. There are some lenders that simply do a better job than others in originating and servicing their loans. The Agency is seeking, therefore, to reduce this institutional risk by setting lender requirements for participation, which in turn will lower the risk to the Agency’s outstanding loan guarantees.

The proposed rules would use two different processes and requirements—one for lenders that are regulated or supervised and one for lenders that are not regulated or supervised.

As noted earlier in this preamble, any lender that is a regulated or supervised lender is eligible to participate in the guaranteed loan programs described in proposed subpart B. If a regulated or supervised lender has an existing portfolio with the Agency (see proposed § 5001.9(a)(1)(ii)), it is considered to be “approved” for participation and would not be required to submit an application to the Agency for approval to participate. However, the lender would be required to submit a certification to the Agency that it is in “good standing” with its regulator and a copy of its current written policies and procedures for origination and servicing guaranteed loans.

If a regulated or supervised lender does not have an existing portfolio with the Agency (see proposed § 5001.9(a)(1)(i)), it must submit an application for lender approval to the Rural Development State Office in the State in which the lender is chartered. Along with this application, the lender would submit a copy of its current written policies and procedures for origination and servicing guaranteed

loans. The Rural Development State Office will review the application and make a decision to approve or disapprove the lender for participation in this program. Rural Development State Office approval of the lender will extend to all States and all programs covered by this part. If disapproved, the lender will have the right to appeal the decision to the National Appeals Division. To be approved, a regulated or supervised lender must be in good standing with its regulator(s).

The criteria for approving a non-regulated or supervised lender are substantially more detailed (see proposed § 5001.9(b)). A non-supervised lender must have:

- a minimum net worth of \$2.5 million,
- liquid assets of at least \$500,000, and
- an Agency-approved line of credit that totals \$5 million or more.

If a non-regulated or supervised lender can not meet each of the above three criteria, then the National Office will not approve the lender for participation in this program. If the lender meets each of the above three criteria, then the lender can submit an application for lender approval to the Rural Development State Office in the State in which it is chartered that presents additional information on the lender. This information addresses:

- Evidence showing that the lender has the necessary capital, resources, and funding capacity to successfully meet its requirements;
- Copies of any license, charter, or other evidence of legal authority to engage in the proposed loan making and servicing activities;
- Certification(s) of good standing from the States in which the lender intends to do business; and
- Satisfactory description of its lending history and experience.

If approved (by a Rural Development State Office for a regulated or supervised lender or by the National Office for a non-regulated or supervised lender), the lender may sign a Lender's Agreement with the Agency. If the Lender's Agreement is executed by the lender and the Agency, the lender may submit an application for guarantee in any State in which it is authorized to do business. In addition, approved lenders may submit an application for any of the four programs identified in subpart B.

Finally, a Rural Development approved lender retains approved status for as long as the lender maintains the minimum requirements for approval. For regulated or supervised lenders, this means for as long as the lender remains in good standing with its regulator and

as long as it meets the Agency requirements under this regulation or until otherwise notified by the Agency. For non-regulated or supervised lenders, this means for as long as the lender meets or exceeds the minimum Agency requirements specified and remains in good standing with the States in which they intend to conduct business.

*Preferred lender designation.* A lender that has been approved as described above for participation is referred to as a "Rural Development approved lender" in the proposed rule. Under the proposed rule, a Rural Development approved lender may apply for preferred lender status.

To become a preferred lender under the proposed rule, a Rural Development approved lender would submit an application for preferred lender status to the Agency in the State in which it is chartered or domiciled. The Rural Development State Office would review the application, comment on it, and then forward the application and its comments to the National Office for review and decision. If approved by the National Office, the lender will be afforded preferred lender status, which will be applicable in each State. If disapproved, the lender would be able to appeal the decision.

The criteria that the Agency will use to make in determining whether to approve an application for preferred lender status are:

- The lender's current level of experience in commercial lending, government guaranteed commercial lending, financing, or other activity under similar loan programs;
- Having had no annual losses of greater than 1 percent of its outstanding commercial loan portfolio if the lender has been making commercial loans for 5 years or more or, no losses for the length or time the lender has been making commercial loans, if the lender has been making commercial loans for less than 5 years; and
- Having no more than one instance of Federal government negligent loan origination or servicing.

By including a preferred lender status, the Agency is seeking to encourage more participation by higher qualified lenders in this program. This would reduce institutional risk, which in turn reduces the risk to the Agency's portfolio of outstanding loan guarantees. While Rural Development approved lenders with referred lender status would still be required to meet the same origination and servicing requirements as Rural Development approved lenders who do not have preferred lender status, lenders with preferred lender status would, as noted earlier in this preamble, have a

reduced loan guarantee application burden for certain projects, would be subject to fewer Agency visits, and would be able to apply for higher loan guarantees for certain projects.

#### Guarantee Application Process (§ 5001.11)

To begin the application process, an approved lender may submit either a preapplication or a guarantee application. In the evaluation of the application, the Agency may require the lender to obtain additional assistance in those areas where the lender does not have the requisite expertise to originate or service the loan.

The Agency is providing the preapplication option, which is not found in all of the four current programs, to allow lenders and borrowers a lower cost alternative to obtain Agency input on the proposed project before spending the time and effort assembling the guarantee application.

If a lender submits a preapplication, the Agency will review the information in it and make an informal assessment of the project's and prospective borrower's eligibilities. The Agency will provide the lender with a written assessment of its findings, including the strengths and weaknesses of the project and borrower. It is important to note that the Agency's findings may change as more information on the project and borrower is made available. It is also important to note that the Agency's findings are solely advisory in nature and does not obligate the Agency to approve a guarantee if a guarantee application is subsequently submitted. Finally, the Agency's findings are considered neither a favorable or adverse decision and are thus not appealable.

#### Guarantee Application Content (§ 5001.12)

This section of the proposed rule identifies the content of the application for guarantee. As proposed, the supporting documentation that must be submitted with the application for the guarantee varies, requiring either all of the supporting documentation (referred herein as a "full documentation" guarantee application) or some supporting documentation with certification to the remaining documentation (referred herein as a "low documentation" guarantee application). The contents of a full documentation application are generally the same as being requested by the four current programs. The main difference is found under the low documentation application, which is discussed in

section III.B. of this preamble. As noted earlier in the preamble, the Agency expects the lender to perform the same level of analysis and other origination activities whether the lender submits a full documentation application or a low documentation application.

*Full documentation guarantee application.* These applications must contain the following:

- (1) Agency-approved application forms;
- (2) Lender's analysis and credit evaluation (conforming to § 5001.16(b));
- (3) Environmental information;
- (4) Technical reports and energy audits (see subpart B);
- (5) A copy of Form 10-K, "Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934," for companies listed on major stock exchanges and/or subject to the Securities and Exchange Commission regulations;
- (6) Proposed loan agreement between the lender and borrower;
- (7) Energy assessments (see subpart B);
- (8) Appraisals;
- (9) Business plan (only if the information is not already provided in the feasibility study);
- (10) Feasibility study (see subpart B);
- (11) If the application is for 5 or more residential units or for for-profit nursing homes or assisted-living centers, an Affirmative Fair Housing Marketing Plan that is in conformance with 7 CFR 1901.203(c)(3);
- (12) Preliminary engineering report (as specified in subpart B);
- (13) Current credit reports or equivalent on the prospective borrower and any other person liable for the debt, except for public bodies; and
- (14) If the guaranteed loan is \$1 million or more, the most recent audited financial statements of the borrower or, if the guaranteed loan is less than \$1 million, the most recent audited or unaudited financial statements of the borrower.

*Low documentation guarantee applications.* These applications must contain the following:

- (1) Agency-approved application forms;
- (2) Lender's analysis and credit evaluation (conforming to § 5001.16(b));
- (3) Environmental information;
- (4) Technical reports and energy audits (see subpart B);
- (5) A copy of Form 10-K, "Annual Report Pursuant to Section 13 or 15D of the Act of 1934," for companies listed on major stock exchanges and/or subject to the Securities and Exchange Commission regulations;
- (6) Proposed loan agreement between the lender and borrower;

- (7) Certification to (as applicable):
  - Energy assessment;
  - Appraisals;
  - Business plan;
  - Feasibility study;
  - Affirmative Fair Marketing Housing plan;
  - Preliminary engineering report;
  - Current credit reports; and
  - Audited or unaudited financial statements.

For a low documentation application, the certifications required indicate that the lender possesses and has reviewed the information to which it is certifying. In addition, the lender submitting a low documentation application must also certify that it has identified and reported to the Agency any significant risks that would jeopardize the repayment of the loan.

A lender who is not yet a Rural Development approved lender may submit a guarantee application provided the lender submits with the application the lender application for approval and, if necessary, the application for preferred lender status. In this scenario, the review of the guarantee application will be deferred until the lender application and, if applicable, preferred lender status application are approved.

*Determination of documentation level.* As stated above, the guarantee application may be submitted with full supporting documentation or with low supporting documentation. As proposed (see proposed § 5001.12(c)), the criteria for determining which level of supporting documentation is required depends on four factors:

- Whether the application is for a startup business or an existing business
- Whether the application is from a preferred lender or not;
- The size of the guarantee request; and
- The project's ability to meet certain metric criteria (similar to the floor metric criteria noted earlier).

If the guarantee application is for a startup business, it must always be submitted with the full supporting documentation regardless of the lender or project. The Agency believes this is appropriate to minimize the typically greater risk of projects associated with startup businesses.

If the guarantee application is for an existing business submitted by a Rural Development approved lender with preferred lender status, a full documentation application must always be submitted if the requested loan guarantee is greater than \$5 million. If, however, the requested loan guarantee is for \$5 million or less, a preferred lender has the option of submitting either a full documentation guarantee

application or a low documentation guarantee application for the project.

If the guarantee application is for an existing business submitted by a Rural Development approved lender that does not have preferred lender status, a full documentation application must be submitted unless the project has:

- Debt coverage of 1.25 or higher;
- Cash equity of at least 25 percent of eligible project costs or community support as described in subpart B;
- A minimum FICO (Fair Isaac and Company) credit score of 680 or equivalent industry credit score for each individual who signs the promissory note or guarantees repayment of the loan;
- A loan-to-value ratio of no more than 0.8; and
- Loan guarantee portion of the loan at or below \$5 million.

If the project meets each of the five criteria specified above, the Rural Development approved lender without preferred lender status has the option of submitting either a full documentation guarantee application or a low documentation guarantee application for the project. The purpose of the non-preferred lender criteria is to offset institutional and project risk by allowing non-preferred lenders to submit low documentation guarantee applications for lower risk projects. The Agency welcomes comments on this set of project criteria for determining when a low documentation guarantee application from a non-preferred lender can be submitted.

#### Lender Responsibilities—General (§ 5001.15)

This section spells out three basic responsibilities of the lender, which are generally consistent with lender's responsibilities under the four current programs.

First, the lender must make sure that the project for which it is submitting a guarantee application complies with all Federal, State, and local laws and regulations at the time the guarantee application is submitted and that affect the project, the borrower, or lender activities.

Second, the lender must provide full cooperation to the Agency and its representatives in all oversight and monitoring activities the Agency uses in implementing this program.

Third, the lender remains responsible for the origination and servicing of a loan guaranteed under this part regardless of any action or inaction by the Agency.

### Lender Responsibilities—Origination (§ 5001.16)

This section lays out the basic responsibilities associated with originating a guarantee under this program. These responsibilities cover: A general requirement of conformity with this part and the lender's policies and procedures; credit evaluation; appraisals; personal and corporate guarantees; design requirements; monitoring requirements; compliance with other Federal laws; environmental responsibilities; and conflicts of interest.

#### General

Under the proposed rule, the lender is responsible for originating the loan in accordance with their current written policies and procedures and with the requirements of this part. Where a lender's current written policies and procedures address a corresponding requirement in this part, the lender would be required to comply with whichever is more stringent.

Compared to the four current programs, these requirements represent a departure by incorporating into the proposed rule reference to each lender's own policies and procedures for loan origination. The appropriate standards to be followed by each lender for loan origination will be based on the lender's own origination policies and procedures and those specified in the proposed rule, whichever is more stringent.

#### Credit Evaluation

The lender has the responsibility for conducting a credit evaluation of the project for which it is submitting the guarantee application. This credit evaluation must be consistent with Agency standards found in this part and with the lender's policies, procedures, and lending practices. Where a lender's current policy or procedure addresses a corresponding requirement in this part, the lender must comply with whichever is more stringent.

The proposed rule identifies what the Agency considers to be an acceptable credit evaluation. Specifically, the lender must use credit documentation procedures and an underwriting process that are consistent with generally accepted commercial lending practices, and the lender's own policies, procedures, and lending practices, and the lender must include an analysis of all credit factors associated with each guarantee application to ensure loan repayment.

In making this analysis, the proposed rule requires the lender to consider the following:

- *Credit worthiness.* This refers to those qualities that generally impel the prospective borrower to meet its obligations as demonstrated by its credit history.

- *Cash flow.* This refers to a prospective borrower's ability to produce sufficient cash to repay the loan as agreed.

- *Capital.* This refers to the financial resources that the prospective borrower currently has and those it is likely to have when payment is due. The prospective borrower must be adequately capitalized.

- *Collateral.* This refers to the assets pledged by the prospective borrower in support of the loan. Adequacy will be based on market value. For the purchase of cooperative stock, the lender must at least secure the loan with a lien on the stock acquired with loan funds, an assignment of any patronage refund, and the full and unconditional personal or corporate guarantee of the borrower.

- *Conditions.* This refers to the general business environment and status of the prospective borrower's industry.

The elements that lenders must include in their credit evaluation are essentially the same as currently required under the current programs. However, as noted for the general loan origination requirements, the credit evaluation requirements of the proposed rule represent a departure for the four current programs by incorporating into the proposed rule reference to each lender's own policies and procedures for credit evaluation. The appropriate standards to be followed by each lender for credit evaluation will be based on the lender's own loan origination policies and procedures and those specified in the proposed rule, whichever is more stringent.

#### Appraisals

The lender would be required to have real property collateral appraised in accordance with the appropriate guidelines contained in Standards 1 and 2 of the Uniform Standards of Professional Appraisal Practices to determine its value. All appraisals used to establish the fair market value of the real property would have to be no more than 1 year old, unless otherwise specified in subpart B. Because market value can be affected by environmental conditions, all appraisals would have to include consideration of the potential effects from a release of hazardous substances or petroleum products or other environmental hazards on the market value of the collateral. This requirement is generally consistent with the conduct of appraisals under the four current programs.

### Personal and Corporate Guarantees

Under the proposed rule, Agency-approved personal and corporate guarantees for the full term of the loan, and at least equal to the guarantor's percent interest in the borrower times the loan amount, would be required from those owning at least a 20 percent interest in the borrower, unless, as discussed in the next paragraph, the lender documents to the Agency's satisfaction that collateral, equity, cashflow, and profitability indicate an above-average ability to repay the loan. When warranted by an Agency assessment of potential financial risk, the Agency may also require Agency-approved guarantees from parent, subsidiaries, and affiliated companies owning less than a 20 percent interest in the borrower and require security for any guarantee provided under this section.

The proposed rule would allow exceptions to the requirement for personal guarantees. Such exemptions would have to be requested by the lender and concurred by the Agency approval official, and would be done on a case-by-case basis. In order to be considered for an exemption, the lender would have to document that collateral, equity, cashflow, and profitability indicate an above-average ability to repay the loan.

As proposed, guarantors would be required to execute an Agency-approved unconditional guarantee form. This provides the Agency with another resource to recover losses on loans that are defaulted. Unconditional personal and corporate guarantees obtained under this program would be part of the collateral for the loan, but would not be considered in determining whether a loan is adequately secured for loan making purposes.

Overall, the requirements for personal and corporate guarantees are generally consistent with those in the current B&I guaranteed loan program and, by incorporation, in the Renewable Energy Systems and Energy Efficiency Improvements program. The other two programs, however, do not currently use similar personal and corporate guarantee provisions.

#### Design Requirements

As under the four current programs, the lender would be required to ensure that all projects are designed utilizing accepted architectural and engineering practices. If the Agency comments on the design of the project, the lender would also be responsible for ensuring that the Agency's comments are taken into consideration when the facility is



being designed. The design and construction of the project must conform to applicable Federal, State, and local codes and requirements. Lastly, the lender would also be required to ensure that the planned project will be fully constructed, within the original budget, to facilitate completion of the loan purpose and will be suitable, once completed, for the borrower's needs in accordance with the borrower's loan application.

#### Monitoring Requirements

The lender would be required to monitor the progress of construction and ensure that construction conforms to applicable Federal, State, and local code requirements and proceeds in accordance with the approved plans, specifications, and contract documents. The lender would also be required to ensure that funds are used only for eligible project costs. If any problems develop during project development, the lender must expeditiously report them to the Agency. These requirements are consistent with the four current programs.

#### Compliance With Other Federal Laws

As required under the four current programs, lenders would be required to comply with other applicable Federal laws including Equal Employment Opportunities, Americans with Disabilities Act, Equal Credit Opportunity Act, Fair Housing Act, and the Civil Rights Act of 1964.

#### Environmental Responsibilities

As proposed, the lender has several responsibilities for overseeing the borrower with regard to environmental requirements. These responsibilities are generally consistent with those under the four current programs.

First, the lender must ensure that the prospective borrower has provided the necessary environmental information to enable the Agency to undertake its environmental review process in accordance with subpart G of either 7 CFR part 1940 or 7 CFR part 1794, including the provision of all required Federal, State, and local permits.

Second, the lender must ensure that the prospective borrower has complied with any mitigation measures required by the Agency's environmental review for the purpose of avoiding or reducing adverse environmental impacts of construction or operation of the facility financed with the guaranteed loan.

Third, the lender must ensure that the prospective borrower has not taken any actions or incurred any obligations with respect to the proposed project that would either limit the range of

alternatives to be considered during the Agency's environmental review process or which would have an adverse effect on the environment. If such actions or obligations have been incurred that would limit the range of alternatives, the project will be denied a guarantee.

#### Conflicts of Interest

The proposed rule, consistent with the four current programs, requires the lender to report to the Agency all appearances of conflicts of interest.

#### Lender Responsibilities—Servicing (§ 5001.17)

This section of the proposed rule lays out the lender's requirements for servicing guaranteed loans made under this part, which are generally consistent with lender's responsibilities under the four current programs. However, the Agency has made revisions in some servicing areas to incorporate industry standard practices.

#### General

Each lender is responsible for servicing the loan in accordance with the Lender's Agreement, the requirements specified within this regulation, and their current written policies and procedures for servicing loans. Where a lender's current written policies and procedures address a corresponding requirement in this regulation or in the Lender's agreement, the lender must comply with whichever is more stringent.

The lender must also ensure that the borrower has obtained all necessary insurance coverage appropriate to the proposed project. Such coverage is subject to Agency review and approval. In addition, the lender must ensure that the borrower maintains the necessary insurance coverage for the life of the loan.

Finally, the Agency may determine that the lender is not adequately protecting the rights of the lender or the Agency in its servicing of the loan. The Agency, therefore, reserves the right to take any legal action it determines necessary to protect the rights of the lender and the Agency with respect to the loan.

Compared to the four current programs, these requirements represent a departure by incorporating into the proposed rule reference to each lender's own policies and procedures for loan servicing. The appropriate standards to be followed by each lender for loan servicing will be based on the lender's own loan servicing policies and procedures and those specified in the proposed rule, whichever is more stringent.

#### Certification

For each guarantee loan application it submits to the Agency, the lender would be required to certify in the Lender's Agreement that it will service the guaranteed loan according to Agency requirements and the lender's current written servicing policies and procedures and that, where the lender's current written policies and procedures address corresponding requirements of this regulation, it will comply with whichever is more stringent. Such certification is not part of the policies of the four current programs.

When applicable, the lender will require an audit of the borrower in accordance with Office of Management and Budget requirements. This is consistent with the policies of the four current programs.

#### Collateral Inspection and Release

As proposed, the requirements for collateral inspection and release are generally consistent with the four current programs. Under the proposed rule, the lender would be required to inspect the collateral as often as necessary to properly service the loan.

The Agency may require the lender to obtain Agency approval prior to releasing any collateral. In addition, the Agency may, at its discretion, require an appraisal of the remaining collateral in cases in which the Agency determines that it may be adversely affected by the release of the collateral. If an appraisal is required, it will be at the expense of the borrower and must meet the requirements of proposed § 5001.16(c).

In all cases, the sale or release of collateral must be based on an arm's-length transaction.

#### Transfers and Assumptions

Under the proposed rule, the Agency is generally less involved in the processing of transfers and assumptions than under the four current programs. The proposed rule relies more on a lender's own policies and procedures for conducting transfers and assumptions.

*General.* Under the proposed rule, any time that a third party assumes a loan guaranteed under this part, it would be required to be processed and approved by the Agency as if it were a new loan guarantee. This is consistent with the four current programs.

*Processing transfers and assumptions.* Under the proposed rule, the lender is allowed to release the transferor (including any guarantor) from liability, regardless of the amount of the loan being transferred or assumed.

If a lender wants to change the terms of the loan, the lender would be



required to first obtain, in writing, Agency approval with the concurrence of the holder and transferor (including guarantor if it has not been released from personal liability). Any new loan terms would not be allowed to exceed those authorized in this part as measured from the date the loan was initially guaranteed.

In the case of a transfer and assumption of less than the outstanding balance, the lender (if holding the guaranteed portion) may file an estimated Report of Loss with respect to the difference.

*Transfer fees.* As under the four current programs, the Agency may charge the lender a nonrefundable transfer fee at the time of a transfer application. The Agency would set the amount of the transfer fee in an annual notice of funds availability.

#### Mergers

The Agency may withdraw the guarantee when a borrower participates in a merger, but the Agency is no longer requiring that it provide prior approval of the merger.

#### Subordination of Lien Position.

The Agency currently has the authority to allow lenders to subordinate under each of the four programs being addressed under the proposed rule. However, the Agency has rarely used this authority. As proposed, the consolidated rule would allow the Agency to continue to provide the Agency the ability to allow subordinations when it has determined that it is in the Federal government's financial interest. Before a subordination of the lender's lien position can occur, the lender would be required to first make the request for subordination of the lien position in writing to the Agency and receive Agency concurrence for the subordination. Agency concurrence would require that the Agency's financial interest will be enhanced, collateral will remain adequate to secure the loan, the lien to which the guaranteed loan is subordinated will be for a fixed dollar limit and that lien priorities remain for the portion of the loan that was not subordinated, and subordination to a revolving line of credit does not exceed 1 year.

#### Repurchases From Holder(s)

Under the proposed rule, the requirements associated with repurchases from holders, including repurchase by the lender and by the Agency, are generally consistent with those under the four current programs.

The holder may make written demand on the lender or the Agency to repurchase the unpaid guarantee portion of the loan under two situations. The first situation is in the case of borrower default. The second situation is the failure of the lender to pay the holder its pro-rata share. The lender or Agency may determine that repurchase of the loan from the holder is necessary to adequately service the loan. In this situation, the holder must sell the guaranteed portion to the lender or Agency, whichever made the request.

*Repurchases by lender.* The lender must respond to the holder's demand within 30 days and notify the Agency, in writing, of its decision, including notifying the Agency of all repurchases it makes. If the lender decides to repurchase the loan, the lender would be required to accept an assignment without recourse from the holder upon repurchase. As proposed, all repurchases would be for an amount equal to the unpaid principal balance of the guaranteed portion and accrued interest less the lender's servicing fee and must cover the principal and interest on the guaranteed loan accruing only up to 90 days after the date of the demand by the holder.

*Repurchases by Agency.* If the Agency repurchases the loan, the holder would be required to submit a specific written demand to the Agency, along with appropriate documentation. The Agency will be subrogated to all rights of the holder and, subject to satisfactory documentation, will purchase the unpaid principal balance and interest of the guaranteed portion to date of repurchase less the lender's servicing fee within 30 days after receipt of the demand. The lender would not be allowed to charge the Agency any fees unless provided for in the Assignment Guarantee Agreement. The lender would be required to use a form approved by the Agency to send the guaranteed loan payments to the Agency on all loans repurchased by the Agency from holders. Any purchase by the Agency does not change, alter, or modify any of the lender's obligations to the Agency arising from the loan or guarantee and does not waive any of the Agency's rights against the lender, borrower, or guarantor.

#### Additional Expenditures and Loans

As proposed and consistent with the four current programs, the lender would not be allowed to make additional expenditures or new loans to the borrower with an outstanding loan guaranteed under this part without first obtaining in writing Agency approval.

#### Lender Failure

In the event a lending institution fails, the applicable Administrator will provide instruction to the successor entity on a case-by-case basis. Such instructions may include that the Agency may determine to service the entire loan or the guaranteed portion of the loan. This provision is consistent with the four current programs.

Under the proposed rule, the Agency reserves the right to enforce the provisions of the loan documents on behalf of the lender or to purchase the lender's interest in the loan in the event no successor entity can be determined. The intent of this new provision is to permit the Agency to take over and/or service loans when a non-regulated or non-supervised lender does not have a successor entity appointed. With regulated or supervised lenders, State law usually provides a structure for the identification of a successor to a failed lender, but not necessarily for failed lenders who are not regulated or supervised. Thus, the Agency sees a need for this provision.

#### Delinquent Loans

Under the proposed rule, the lender would be required to service delinquent loans in accordance with the Lender's Agreement, its current servicing standards, and reasonable and prudent lending standards. This is consistent with the four current programs except that the proposed rule adds the requirement to service delinquent loans in accordance with the lender's own current servicing standards.

If a borrower is delinquent more than 30 days, the lender would be required to coordinate with the Agency and the borrower to implement appropriate curative actions to resolve the problem. Any curative action that affects the return to the holder would be required to receive the holder's concurrence. Any change in the repayment schedule would be limited to the remaining life of the collateral. Finally, any loan performing in accordance with a curative action will no longer be delinquent.

#### Protective Advances

Under the proposed rule and consistent with the four current programs, protective advances would be allowed only when they are necessary to preserve the value of the collateral and must be reasonable with respect to the outstanding loan amount and the value of the collateral being preserved. Protective advances would not be allowed to include attorneys' fees and advances in lieu of additional loans.

As proposed, the lender must obtain written Agency approval for any protective advance that will singularly or cumulatively amount to more than \$200,000 or 10 percent of the guaranteed loan, whichever is less. This provision is different from current policy which requires Agency approval when the amount is \$5,000 or more to the same borrower.

#### Liquidation

Under the proposed rule and consistent with the four current programs, the lender may decide to liquidate a loan when one or more incidents of default or third party actions occur that the borrower can not or will not cure or eliminate within a reasonable period of time. The Agency reserves the right to unilaterally conclude that liquidation is necessary and require the lender to assign the security instruments to the Agency.

*Liquidation by the lender.* If the lender decides to liquidate a loan, the lender must first develop, in consultation with the Agency, a liquidation plan to determine the best course of action. The lender must include in this plan all aspects of liquidation, including, but not limited to, reports to the Agency, protection of collateral, loss payment, transmission of proceeds to the Agency, and future recovery. The lender would be required to submit its liquidation plan to the Agency at least 30 days before implementing the plan and must notify the Agency of any changes to or deviations from the plan.

As under the four current programs, the proposed rule requires the lender to prepare a liquidation plan. However, the proposed rule would not require Agency's prior approval of the liquidation plan, but would require the lender to notify the Agency of deviations from the plan. These two aspects are different from the current programs.

*Compromise settlement and release of personal guarantors.* The lender may consider a compromise settlement at any time, unless otherwise provided in subpart B. However, before a guarantor is released from liability, the Agency must concur with the lender. Once agreement is reached, the lender may then proceed to implement a settlement compromise. These provisions are consistent with those found in the B&I guaranteed loan program, but have been simplified.

#### Litigation

Under the proposed rule, the Agency has consolidated requirements associated with all litigation into this

new section. The provisions of this section are generally consistent with current Agency policy in implementing the four current programs.

In all litigation proceedings, the lender would be responsible for protecting the rights of the lender or 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 would be required to cooperate with the Agency. Any cost to the Agency associated with such action would be assessed against the lender.

#### Loss Calculations and Payment

Similar to the litigation section above, the Agency has consolidated into one section the requirements associated with loss calculations and payment. Generally, these provisions are consistent, but simplified, with the policies being implemented under the four current programs for loss calculations and payments.

The proposed plan describes the general calculation procedures that would be followed in determining losses (see proposed § 5001.17(n)).

During the course of any reorganization plan, the lender would be required to request and revise estimated loss payments using Agency-approved forms. The estimated loss claim, as well as any revisions to this claim, would be accompanied by documentation to support the claim.

In a chapter 9 or chapter 11 reorganization, the lender would be required to obtain an independent appraisal of the collateral if so directed by the Agency. The Agency and the lender would share the appraisal fee equally.

Final settlement of liquidation would be made with the lender after the collateral is liquidated (unless otherwise designated as a future recovery) or after settlement and compromise of all parties has been completed. The Agency retains the right to recover losses paid under the guarantee from any liable party. Final settlement would be subject to the following:

- If the lender takes title to collateral, any loss will be based on the collateral value at the time the lender obtains title.
- If the lender is conducting the liquidation and owns any of the

guaranteed portion of the loan, the lender may request an estimated loss payment by submitting an estimate of loss that will occur in connection with liquidation of the loan.

- Within 30 days after liquidation of all collateral, except for certain unsecured personal or corporate guarantees as provided for in this section, the lender would have to prepare a final report of loss and submit it to the Agency. The Agency will not guarantee interest beyond this 30-day period other than for the period of time it takes the Agency to process the loss claim. Before Agency approval of any final loss report, the lender must account for all funds, disposition of the collateral, and costs incurred, and must provide any other information necessary for successful completion of the liquidation.

- After a final loss has been paid by the Agency, any future funds recovered by the lender would be pro-rated between the Agency and the lender based on the original percentage of guarantee even if the Loan Note Guarantee has been terminated.

- In a bankruptcy, the lender would submit an estimated loss claim based on the final orders of the bankruptcy court's direction. The Agency would pay the lender the estimated final loss based on these directions.

Lastly, the proposed rule would require the lender to submit with each loss claim a copy of the current version of the lender's written policies and procedures for origination and servicing. This new requirement reflects the intent of the proposed rule to ensure that the guaranteed loan is serviced to the lender's own standards consistent with this rule.

#### Basic Borrower Provisions

##### Borrower Responsibilities (§ 5001.25)

Under the proposed rule, the Agency has consolidated and simplified the responsibilities of borrowers under the guaranteed loan program. These responsibilities are consistent with those associated with the four current programs.

Under the proposed rule, borrowers must comply with all Federal, State, and local laws and rules that are in existence and that affect the project including, but not limited to land use zoning; health, safety, and sanitation standards as well as design and installation standards; and protection of the environment and consumer affairs. Borrowers must also obtain all permits, agreements, and licenses that are applicable to the project. The borrower would also be responsible for maintaining all hazard,

flood, liability, worker compensation, and personal life insurance, when required, on the project.

Upon request by the Agency, the borrower would be required to permit representatives of the Agency (or other agencies of the U.S. Department of Agriculture authorized by that Department or the U.S. Government) to inspect and make copies of any of the records of the borrower pertaining to any Agency guaranteed loan.

#### Basic Guarantee and Loan Provisions General (§ 5001.30)

##### Underwriting

All loans guaranteed by the Agency must be underwritten in accordance with the credit evaluation requirements specified in proposed § 5001.16(b). As discussed earlier in this preamble, the credit evaluation requirements are generally consistent with the requirements found in the four current programs.

##### Conditions of Guarantee

Each loan guarantee issued under this part would be evidenced by a Loan Note Guarantee, which would be issued by the Agency. In addition, each lender would be required to execute a Lender's Agreement.

The entire loan would be required to be secured by the same security, with equal lien priority being given for the guaranteed and unguaranteed portions of the loan. The guaranteed portion would be paid first and given preference and priority over the unguaranteed portion.

The lender would remain mortgagee or secured party of record notwithstanding the fact that another party may hold a portion of the loan.

The holder of a guaranteed portion would have all rights of payment, as defined in the Loan Note Guarantee to the extent of the portion purchased. The lender would remain bound by all obligations under the Loan Note Guarantee, Lender's Agreement, and Agency program regulations.

The lender would receive all payments of principal and interest on the entire loan and would be required to promptly remit to each holder a pro-rata share, less any lender servicing fee.

No loan guaranteed by the Agency under this part would be conditioned on any requirement that the borrower accept or receive electric service from any particular utility, supplier, or cooperative.

These provisions are consistent with those found in the four current programs.

##### Full Faith and Credit

A guarantee under this part constitutes an obligation supported by the full faith and credit of the United States and is not contestable except for fraud or misrepresentation by the lender or holder, as appropriate, when the lender or holder has actual knowledge, participates in, or condones such fraud or misrepresentation.

A note that provides for the payment of interest on interest would not be guaranteed and any Loan Note Guarantee or Assignment Guarantee Agreement attached to, or relating to, a note which provides for payment of interest on interest would be void.

The guarantee would not be enforceable by the lender to the extent any loss is occasioned by the violation of usury laws, negligent loan origination, negligent loan servicing, or failure to obtain the required security regardless of the time at which the Agency acquires knowledge of the foregoing. Any losses occasioned would not be enforceable by the lender to the extent that loan funds are used for purposes other than those specifically approved by the Agency in its Conditional Commitment for Guarantee.

When in the hands of a holder, the Loan Note Guarantee or Assignment Guarantee Agreement would not cover interest accruing 90 days after the holder has demanded repurchase by the lender. When in the hands of a holder, the Loan Note Guarantee or Assignment Guarantee Agreement would not cover interest accruing 90 days after the lender or Agency has requested the holder to surrender the evidence of debt for repurchase.

As proposed, the Agency would guarantee payment as follows:

- To any holder, 100 percent of any loss sustained by the holder on the guaranteed portion of the loan and on interest due on such portion.
- To the lender, the lesser of any loss sustained by the lender on the guaranteed portion, including principal and interest evidenced by the notes or assumption agreements and secured advances for protection and preservation of collateral made with the Agency's authorization; or the guaranteed principal advanced to or assumed by the borrower and any interest due thereon.

These provisions are consistent with those found in the four current programs. The proposed rule, however, does make explicit that negligent loan servicing may result in the guarantee not being enforceable to the extent any loss is occasioned by such negligent loan servicing.

##### Soundness of Guarantee

Consistent with the four current programs, all loans guaranteed under this part must be financially sound and feasible, with reasonable assurance of repayment.

##### Rights and Liabilities

When a guaranteed portion of a loan is sold to a holder, the holder would succeed to all payments of the lender under the Loan Note Guarantee to the extent of the portion purchased. While consistent in intent with the current policy, this provision has been revised to reflect that the holder "would succeed to all payments" of the lender rather than the holder "shall have all rights" of the lender.

A guarantee and right to require purchase would be directly enforceable by a holder notwithstanding any fraud or misrepresentation by the lender or any unenforceability of the guarantee by the lender, except for fraud or misrepresentation of which the holder had actual knowledge at the time it became the holder or in which the holder participates or condones.

The lender would not be allowed to represent a Conditional Commitment of Guarantee as a guarantee. This is a clarification of Agency policy to prevent misrepresentation of the Conditional Commitment of Guarantee.

The Agency continues to reserve the right to collect from the lender any payments made to the holder that would not have been payable to the lender had they been the holder.

##### Reduction of Loss Claims Payable

As proposed, the Agency may reduce the amount of loss claims payable under the loan guarantee to the lender, to zero if necessary, where the Agency has determined that the lender has engaged in either negligent loan origination or in negligent loan servicing that has resulted in a loss. The amount of the reduction would be based on the loss sustained as a result of the negligence. The Agency notes, however, that any reduction in claims payable under the guarantee would not apply to any subsequent holders. Claims payable associated with the lender's negligence paid to subsequent holders will be collected from the lender.

While new compared to the four current regulations, this section of the proposed rule would implement current Agency policy to clarify how the Agency will address reduction of loss claims payable.

##### Write-Downs

Consistent with current B&I policy, as proposed, debt write-downs for an

existing borrower where the same principals retain control of and decision-making authority for the business would be prohibited.

#### Guaranteed Loan Parameters (§ 5001.31) Interest Rates

Under the proposed rule, the provisions addressing interest rates and changes to interest rates (reductions and increases) are consistent with the provisions of the four current programs.

As proposed, interest rates on the loan for which a guarantee is made would be allowed to be fixed or variable or a combination of both, as long as they are legal. If variable interest rates are used, they must be tied to an acceptable published index and the lender must incorporate the provision for adjustment of payment installments into the Note. When combined fixed and variable rates are used, the lender would provide the Agency with the overall effective interest rate for the entire loan.

Under the proposed rule, interest rates, interest rate caps, and incremental adjustment limitations would be negotiated between the lender and the borrower.

If the lender and borrower agree, the interest rate on the guaranteed portion of a loan may differ from the rate on the unguaranteed portion provided under certain conditions. These conditions are:

- The rate on the unguaranteed portion is equal to or below the market rate and does not exceed that currently being charged on loans for similar purposes to borrowers under similar circumstances; and
- the rate on the guaranteed portion does not exceed the rate on the unguaranteed portion unless the rate on the guaranteed portion is fixed and the unguaranteed portion is variable.

#### Interest Rate Changes

Under the proposed rule, the Agency must approve, in writing, any change in the interest rate between issuance of the Conditional Commitment for Guarantee and issuance of the Loan Note Guarantee. All changes would then be shown as an amendment to the Conditional Commitment for Guarantee.

The interest rate change may be either a reduction or increase, but are subject to certain restrictions.

**Reductions.** The borrower, lender, and holder (if any) would be allowed to collectively effect a permanent or temporary reduction in the interest rate on the guaranteed loan at any time during the life of the loan by their written agreement, subject to the following conditions:

- If a permanent reduction was implemented, the Loan Note Guarantee would be allowed to cover only losses of interest at the reduced interest rate.

- In a final loss settlement when qualifying rate changes are made with the required written agreements and notification, the interest would be calculated for the periods the given rates were in effect. The lender would be required to maintain records that adequately document the accrued interest claimed.

- The lender would be 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 may be issued. The lender would have to provide copies of all legal documents to the Agency.

The lender would be required to keep sufficient records to allow the Agency to calculate any loss at the reduced interest rate and to notify the Agency of all permanent interest rate reductions, as specified in proposed § 5001.4(b)(3)(ii).

**Increases.** Increases in interest rates, in general, are prohibited under the proposed rule. However, increases would be allowed only when the increase results from normal fluctuations in approved variable interest rates or the increase returns the rate to the rate prior to the temporary reduction.

#### Term Length

Under the proposed rule, the loan term would be based on (1) the use of proceeds, (2) the useful economic life of the assets being financed, and (3) the borrower's repayment ability. However, under no circumstances would the term be allowed to exceed the lesser of the useful economic life of the asset, or 40 years.

The proposed rule's provisions for term length are consistent with those found in the Community Facility and the Water and Waste Disposal Facilities programs, but are different from those found in the other two programs. The other two programs have shorter timeframes for several types of assets.

#### Loan Schedule and Repayment

Repayment of loans for which a loan guarantee has been obtained under this part would be required to be structured in accordance with proposed § 5001.31 and in accordance with the Loan Agreement. Repayments would be due and payable in accordance with the Note.

As proposed, only loans that require a periodic payment schedule that retires the debt over the term of the loan without a balloon payment will be

guaranteed by the Agency. Lenders, therefore, must ensure that the principal balance of a guaranteed loan is properly amortized within the prescribed loan maturity.

These provisions are consistent with those found in the four current programs.

#### Maximum Loan Amounts

Under the proposed rule, the maximum amount that may be guaranteed would be determined on a program-by-program basis. The Agency will publish a notice in the **Federal Register** each year in which it will specify the maximum loan amounts for each of the programs in this part. As seen later in this preamble, the maximum loan amounts being proposed are consistent with those in the current programs.

#### Maximum Percent of Guarantee

As proposed, the maximum guarantee for each guaranteed loan program covered by this part is specified in subpart B. As seen later in this preamble, the maximum percent guarantees are consistent with those found in the current programs, except that a lower maximum percent guarantee is being proposed in specific situations.

#### Fees

Under the proposed rule, a guarantee fee and a renewal fee are used to offset the costs of the guaranteed loan programs. Each year, the Agency will establish the guarantee fee and renewal fee for each guaranteed loan program, subject to any statutory limitations. The Agency will publish a notice in the **Federal Register** each year identifying these fees.

**Guarantee fee.** This fee is a one-time, upfront fee based on the principal loan amount, and the percent of guarantee. Consistent with standard industry practice, this fee is referred to as the "guarantee fee." As proposed, the guarantee fee would be paid to the Agency by the lender at the time the Guarantee is issued and is non-refundable. The lender, however, would be allowed to pass this fee on to the borrower. Each of the four programs covered by the proposed rule currently charge a guarantee fee.

**Renewal fee.** This fee is assessed annually, is based on a fixed fee rate established at the beginning of the loan, and, consistent with standard industry terminology, is referred to as a "renewal fee." As applicable, the renewal fee would be calculated on the unpaid guaranteed principal balance as of close of business on December 31 of each

year. The fee would be billed to the lender and is non-refundable. Like the guarantee fee, the lender would be allowed to pass the renewal fee on to the borrower. Currently, the Business and Industry guaranteed loan program and the Renewable Energy Systems and Energy Efficiency Improvements guaranteed loan program have provisions for an annual renewal fee, while the Community Facilities and the Water and Waste Disposal guarantee loan programs do not. The proposed rule allows for, but does not require, the charging of the renewal fee for all of the four programs. At the present time, the Agency is not considering the implementation of an annual renewal fee in the Community Facility and Water and Waste Disposal programs.

#### Lender Fees

As proposed and consistent with the four current programs, the lender may levy reasonable, routine, and customary charges and fees for the guaranteed loan provided they are similar to those charged other applicants for the same type of loan for which a non-guaranteed borrower would be assessed. The proposed rule prohibits late payment charges from being covered by the Loan Note Guarantee. Further, the lender would be prohibited from adding such charges to the principal and interest due under any guaranteed note.

#### Conditional Commitment for Guarantee (§ 5001.32)

Consistent with the four current programs, upon approval of a loan guarantee, the Agency will issue a Conditional Commitment for Guarantee to the lender containing conditions under which the Guarantee will be issued. The lender must complete and sign the Acceptance of Conditions and return a copy to the Agency. The lender may propose alternate conditions for Agency consideration.

#### Conditions Precedent to Issuance of Loan Note Guarantee (§ 5001.33)

This section identifies the conditions that need to have occurred in order for the Agency to issue the Loan Note Guarantee. These conditions are consistent with the conditions in the four current programs, but have been simplified.

The Loan Note Guarantee would be issued once all of the conditions specified in the Conditional Commitment for Guarantee have been met and each of the following has occurred:

- The lender has paid the appropriate guarantee fee;

- The lender has advised the Agency of any plans to sell or assign any part of the loan as provided in the Lender's Agreement; and

- The lender has certified that the prospective borrower has obtained all necessary insurance appropriate to the proposed project.

#### Issuance of the guarantee (§ 5001.34)

As proposed and consistent with the four current programs, the Agency, at its sole discretion, will determine if the conditions within the Conditional Commitment for Guarantee have been met and whether or not to issue the guarantee.

#### Loan Closing

At loan closings, the lender would provide the lender's certifications, guarantee fee, and, if applicable, secondary market sale document.

#### Issuance

Consistent with the four current programs, but simplified, under the proposed rule, the Agency would issue the Loan Note Guarantee and Assignment Guarantee Agreement upon the lender's compliance with requirements of the Conditional Commitment for Guarantee.

#### Refusal To Execute Loan Note Guarantee

Consistent with the four current programs, if the Agency determines that it can not execute the Loan Note Guarantee, the Agency would promptly inform the lender of the reasons and give the lender a reasonable period within which to satisfy the objections. If the lender satisfies the objections within the time allowed, the guarantee would be issued.

#### Replacement of Loan Note Guarantee or Assignment Guarantee Agreement

Consistent with the four current programs, if the Loan Note Guarantee or Assignment Guarantee Agreement has been lost, stolen, destroyed, mutilated, or defaced, the Agency may issue a replacement to the lender or holder upon receipt from the lender of a notarized certificate of loss and an indemnity bond acceptable to the Agency. An indemnity bond would not be required, however, if the holder is the United States, a Federal Reserve Bank, a Federal Government corporation, a State or Territory, or the District of Columbia.

#### Alterations to Loan Instruments (§ 5001.35)

Consistent with the B&I and the Renewable Energy Systems and Energy

Efficiency Improvements guaranteed loan programs, the provisions of this section would prohibit the lender from altering or approving any alterations of the Loan Note Guarantee or any other loan instrument without the prior written approval of the Agency.

#### Reorganizations (§ 5001.36)

The provisions in this section of the proposed rule address changes in borrowers and lenders. In general, these provisions are consistent with those found in the current programs.

#### Change in Borrower Prior to Closing

As proposed, any change in borrower ownership or organization prior to the issuance of the Loan Note Guarantee would be required to meet program eligibility requirements. Agency approval would be required prior to the issuance of the Conditional Commitment for Guarantee. Once the Conditional Commitment for Guarantee is issued, no substitution of borrower(s) or change in the form of legal entity would be approved, except that a change in the legal entity may be approved when the original borrower is replaced with substantially the same individuals or officers with the same interest as originally approved.

#### Transfer of Lender Prior to Issuance of the Loan Note Guarantee

Prior to issuance of a Loan Note Guarantee, the Agency may approve the transfer of an outstanding Conditional Commitment for Guarantee to a new eligible lender, provided the present lender makes the request in writing and no substantive changes have occurred in the borrower, project, loan agreement, or Conditional Commitment for Guarantee. The new lender would have to meet the appropriate requirements specified in this part to become a Rural Development approved lender. In addition, a new application for guarantee would have to be executed.

#### Substitution of Lender After Issuance of the Loan Note Guarantee

After the issuance of a Loan Note Guarantee, the lender would not be allowed to be substituted without the prior written approval of the Agency. A substitution of the lender would have to be requested in writing by the borrower, the proposed substitute lender, and the original lender if still in existence. The Agency may approve the substitution of a lender if the new lender is Rural Development approved; agrees in writing to acquire title to any unguaranteed portion of the loan held by the original lender; and assumes all

original loan requirements and lender responsibilities.

The Agency would not pay any loss or share in any costs with a substitute lender who is not in compliance with the requirement of this section (i.e., proposed § 5001.36).

#### Sale or Assignment of Guaranteed Loan (§ 5001.37)

##### General

As proposed, the lender would be allowed to sell all or part of the guaranteed portion of the loan on the secondary market, subject to the following conditions:

- Any sale or assignment by the lender of the guaranteed portion of the loan would have to be accomplished in accordance with the conditions in the Lender's Agreement.
- The lender would obtain participation in the loan under its normal operating procedures; however, the lender must retain sufficient interest to perform its duties under this part.
- The lender would be prohibited from selling or participating any amount of the guaranteed, or non-guaranteed, portion of the loan to the borrower or members of the borrower's immediate family, the borrower's officers, directors, stockholders, other owners, or a parent, subsidiary, or affiliate.
- Disposition of the guaranteed portion of a loan would not be allowed prior to full disbursement, completion of construction, and acquisition of real estate and equipment without the prior written approval of the Agency.
- If the lender desires to market all or part of the guaranteed portion of the loan at, or subsequent to, loan closing, the loan must not be in default.
- The lender would be required to retain all or part of the unguaranteed portion of the loan. However, if the lender does not have preferred lender status, the lender would be required to retain a minimum of 5 percent of the total loan amount in its portfolio. The amount required to be retained would have to be of the unguaranteed portion of the loan and could not be participated. Lenders would be allowed to sell the remaining amount of the unretained portion of the loan only through participation.

These provisions are generally consistent with those found in the four current programs. One difference concerns the minimum retention provision. Under the current programs, all lenders would be required to retain a minimum of 5 percent of the total loan amount. Under the proposed rule, this 5 percent requirement would apply only to lenders who do not have preferred lender status.

#### Termination of Lender Servicing Fee

As proposed and consistent with the four current programs, the lender's servicing fee would stop when the Agency purchases the guaranteed portion of the loan from the secondary market. No such servicing fee would be allowed to be charged to the Agency and all loan payments and collateral proceeds received would be applied first to the guaranteed loan.

#### Termination of Loan Note Guarantee (§ 5001.38)

This section identifies the situations under which a Loan Note Guarantee will terminate. These situations, which are consistent with those found in the regulations for the four current programs, are:

- Full payment of the guaranteed loan; or
- full payment of any loss obligation or negotiated loss settlement except for future recovery provisions and payments made as a result of the Debt Collection Improvement Act (DCIA). After final payment of claims to lenders and/or holders, the Agency will retain all funds received as the result of the DCIA; or
- written request from the lender to the Agency that the guarantee will terminate 30 days after the date of the request, provided that the lender holds all of the guaranteed portion and the original Loan Note Guarantee is returned to the Agency to be canceled.

#### Subpart B—Program Specific Provisions

Subpart B presents the program specific requirements for each of the four programs covered by this subpart.

##### Community Facilities (§ 5001.101)

This section identifies program specific requirements for community facility projects seeking loan guarantees. The lender and prospective borrower must comply both with subpart A provisions and the provisions in this section when seeking a community facility loan guarantee. The program specific provisions for community facility projects follow.

##### Project Eligibility

Project eligibility for community facility projects under the proposed rule is similar to the requirements found in the current community facility regulations. The proposed rule requires projects to be an eligible project for public use located in a rural area, unless otherwise excepted, with demonstrated community support. In addition, the proposed rule allows leased space to qualify under certain conditions.

While the proposed rule streamlines the current regulatory language that identifies the types of projects that are eligible, its requirements are intended to be consistent with the types of projects and purposes currently eligible for community facility guaranteed loans. This includes considering the various types of other improvements to community projects, as found in 7 CFR 3575.24(a)(2), as being eligible for guaranteed loans, and considering the use of funds identified in 7 CFR 3573.24(b) as part of an essential community facility. In some instances, some of the currently eligible projects and purposes will be addressed in guidance material (e.g., a handbook) rather than in the regulatory language. Overall, the intent of the proposed rule is to allow more flexibility, but to maintain the current intent of the program as to the types of projects eligible for community facility guaranteed loans.

*Eligible projects.* As proposed, to be eligible for community facility funding, the project would have to meet the project eligibility requirements specified in subpart A and be one of the types of projects or purposes shown below.

- Essential community facilities. These are facilities such as, but not limited to, fire, rescue, health and public safety facilities or equipment, telecommunications, supplemental and supporting structures for other rural electrification or telephone systems, the purchase of major equipment that in themselves provide an essential service to rural residents, and the purchase of facilities necessary to improve or prevent a loss of service.

- Community services or community-based social, recreational or cultural services.

- Transportation infrastructure and support.
- Hydroelectric generating facilities.
- Natural gas distribution systems.
- Acquisition of land and site preparation for industrial parks.

*Facilities for public use.* As found in the current Community Facilities regulation, to be eligible for Community Facility funding, all facilities would have to be for public purposes. These facilities would have to be installed to serve any user within the service area who desires service and can be feasibly and legally served. In addition, the lender would have to determine that, when feasibly and legally possible, inequities within the proposed project's service area for the same type service proposed (e.g., gas distribution systems) would be remedied by the owner on, or before, completion of the project. Under the proposed rule, inequities are defined

as unjustified variations in availability, adequacy, or quality of service. However, user rate schedules for portions of existing systems or facilities that were developed under different financing, rates, terms, or conditions would not necessarily constitute inequities.

*Leased space.* As proposed, a facility would remain eligible for community facility funding provided it has less than 25 percent of its floor space occupied by ineligible organizations or activities. The ineligible organization and the ineligible commercial activity, however, must be related to and enhance the primary purpose for which the facility is being established by the borrower. This eligible purpose is being included in the proposed rule to incorporate existing Agency practice.

*Facility location.* As found in the current Community Facilities regulation, another requirement to be eligible for community facility funding is that facilities must be located in rural areas. Two exceptions to this requirement are proposed. These are for:

- Utility services, such as natural gas or hydroelectric serving both rural and non-rural areas. In such cases, Agency funds may be used to finance only that portion serving rural areas, regardless of facility location.
- Telecommunication projects. For these projects, the part of the facility located in a non-rural area must be necessary to provide the essential services to rural areas.

*Demonstration of community support.* Instead of meeting the cash equity criterion for determining project eligibility under subpart A, a community facility may instead demonstrate community support, which the Agency will accept in lieu of cash equity. If a facility meets the other criteria in proposed § 5001.6(c)(2) or § 5001.12(c)(2)(ii)(B), as applicable, and this demonstration of community support, then the project is eligible under this program. The Agency is allowing the use of a community support criterion in lieu of cash equity because community support is often a better predictor of project success.

Under the proposed rule, community support would be evidenced in the form of a certification of support for each project or facility from any affected local government body. A certificate of support would have to be obtained from each affected local government within the service area of the facility, except for essential community facilities owned by a local public body or a Federally-recognized Indian tribe serving local residents or tribal members. The certificate of support would have to be

signed by an authorized official of the local government, and should include sufficient information to determine that a community facility will provide needed services to the community and will have no adverse impact on other community facilities providing similar services. The organization would be required to provide sufficient information to affected local governments as may be needed to obtain the certificate of support.

While the current Community Facilities guaranteed loan regulation requires projects to have significant ties to the community, requiring a demonstration of this community support provision in the regulation incorporates existing Agency practice for evaluating and approving loan guarantee applications for Community Facilities.

#### Unauthorized Projects and Purposes

Under the proposed rule, the projects and purposes identified in the current Community Facilities guaranteed loan program are carried over into this proposed rule, except for new combined sanitary and storm water sewer facilities. These types of combined facilities are excluded from the regulatory language because the Agency does not see such facilities ever receiving approval from other regulatory agencies rather than an indication that such facilities are now eligible for community facilities guaranteed loans.

In addition to the unauthorized projects and purposes identified in subpart A, loans guaranteed with Community Facility funding can not be used to finance the following:

- Properties to be used for commercial rental when the borrower has no control over tenants and services offered except for industrial-site infrastructure development;
- Facilities that are 25 percent or more for the purpose of housing Federal or State agencies;
- Community antenna television services or facilities;
- Telephone systems;
- Facilities that are not modest in size, design, and cost; and
- Finder's and packager's fees.

#### Borrower Eligibility

To be eligible for a community facility guaranteed loan, a prospective borrower must meet the eligibility criteria specified in subpart A of the proposed rule. In addition, subpart B for the Community Facilities program (see proposed § 5001.101(c)) provides two additional requirements, where applicable, as follows:

- YMCA, YWCA, Girl Scouts, and Boy Scouts are eligible applicant organizations (this provision incorporates current Agency practice), and

- A private not-for-profit essential community facility (other than utilities) must have significant ties with the local rural community to be eligible. Such ties are necessary to ensure to the greatest extent possible that a facility under private control will carry out a public purpose and continue to primarily serve rural areas. This provision and the conditions associated with, as discussed below, are found in the current Community Facilities regulation.

The proposed rule identifies two conditions under which ties with the local rural community can be evidenced. These conditions, which are not inclusive, are:

- Association with, or controlled by, a local public body or bodies or broadly based ownership and controlled by members of the community, and
- Substantial public funding through taxes, revenue bonds, or other local government sources, or substantial voluntary community funding such as would be obtained through a community-wide funding campaign.

*Credit not available elsewhere.* As found in the current Community Facilities regulation and as proposed, to be eligible, the prospective borrower would have to be found by the Agency as being unable to obtain the required credit without the loan guarantee from private, commercial, or cooperative sources at reasonable rates and terms for loans for similar purposes and periods of time.

#### Additional Application Documentation Requirements

*Feasibility study.* The Agency may require a feasibility study by a qualified independent consultant. As defined in the proposed rule, the feasibility study is essentially the same as found in the current Community Facilities regulation. However, the current Community Facilities guaranteed loan program makes the feasibility study a prerequisite, while the proposed rule does not.

#### Additional Guarantee- and Loan-Related Requirements

*Funding limit.* Under the proposed rule, the principal amount of a community facility loan guaranteed under this section would not be allowed to exceed \$50 million. The current Community Facilities guaranteed loan program does not have a specified funding limit. Community Facility

projects in excess of \$50 million are likely to require a level of support or patronage beyond the local rural community that the Agency is concerned may be insufficient in order to sustain the project over the life of the

loan. Therefore, consistent with the Agency's approach for the management of risk under the proposed rule, the Agency is proposing to limit the maximum size loan for Community Facility projects.

*Maximum percent of guarantee.* The maximum loan guarantees issued to lenders approved under this part with community facility funding are specified in Table 1.

TABLE 1.—MAXIMUM LOAN GUARANTEE PERCENTAGES FOR COMMUNITY FACILITIES GUARANTEED LOANS

Type of rural development approved lender	Type of application	Guaranteed loan amount		
		\$5 million or less (percent)	Over \$5 million up to and including \$10 million (percent)	Over \$10* million (percent)
Without preferred lender status .....	Low documentation .....	80	na	na
	Full documentation .....	90	90	90
With preferred lender status .....	Low documentation .....	90	na	na
	Full documentation .....	90	90	90

na = not applicable.

\*Per proposed § 5001.101(e)(1), the maximum guaranteed loan amount is \$50 million.

These maximum loan guarantees are the same as found in the current Community Facilities regulation except that, under the proposed rule, the maximum guarantee is 10 percentage points lower for low documentation applications seeking a loan guarantee of \$5 million or less from lenders who do not have preferred lender status.

*Fees.* Any guarantee fee and renewal fee charged for community facility guaranteed loans will be established in a **Federal Register** notice that the Agency will publish annually, as provided under subpart A of the proposed rule. Under the current Community Facilities program, a guarantee fee is charged, but a renewal fee is not.

*Parity lien requirements.* Whenever both a community facility guaranteed loan and a community facility direct loan are utilized to finance a single project, the Agency will require a parity lien, unless the lender cannot meet its regulatory requirements. This is a new provision for the Community Facilities program. This parity requirement ensures that when community facility direct and guaranteed loans are used on the same project, there is an opportunity for both to be adequately and independently secured, which is in the financial interest of the Agency.

#### Water and Waste Disposal Facilities (§ 5001.102)

This section identifies program specific requirements for water and waste disposal projects seeking loan guarantees. The lender and prospective borrower must comply both with subpart A provisions and the provisions in this section when seeking a water or waste disposal loan guarantee. The

program specific provisions for water and waste disposal projects follow.

#### Project Eligibility

Project eligibility for water and waste disposal facilities under the proposed rule are similar to the requirements found in the current water and waste disposal regulations. The proposed rule requires such facilities to be an eligible project for public use with demonstrated community support or with cash equity, as specified in the regulation. The location requirement for a water and waste disposal facility under the proposed rule is equivalent to that under the current regulation.

While the proposed rule streamlines the current regulatory language that identifies the types of projects and costs that are eligible, its requirements are generally intended to be consistent with the types of projects and costs currently eligible for water and waste disposal guaranteed loans. This includes considering the various other types of improvements necessary for the successful operation or protection of such facilities, as found in 7 CFR 1779.24(b) and (c), and considering the use of funds towards those items listed in 7 CFR 1779.234(e) when they are a necessary part of the project. Overall, the intent of the proposed rule is to allow more flexibility, but to maintain the current intent of the program as to the types of projects and costs eligible for water and waste disposal guaranteed loans.

*Eligible projects and costs.* To be eligible for a water and waste disposal guaranteed loan, a project would have to meet the requirements in proposed § 5001.6 in subpart A and be for one of the types of projects or costs shown below.

- A water or waste disposal facility. Such facilities include, but are not limited to, drinking water, sanitary sewage, solid waste disposal, and storm wastewater disposal. In addition, public improvements necessary for the successful operation or protection of such facilities are included. Improvements could include, for example, relocating buildings, roads, fences, or utilities.

- Payment of other utility connection charges as provided in service contracts between utility systems.

- Refinancing any loan. Except for the refinancing of Agency direct loans, refinancing of other loans will be limited to a minority portion of the guaranteed loan.

*Facilities for public use.* As proposed and as found in the current Water and Waste Disposal regulation, to be eligible for water and waste disposal funding, facilities would also have to be for public purposes. These facilities would have to be installed to serve any user within the service area who desires service and can be feasibly and legally served. In addition, the lender would have to determine that, when feasibly and legally possible, inequities within the proposed project's service area for the same type service proposed (e.g., gas distribution systems) would be remedied by the owner on, or before, completion of the project. Under the proposed rule, inequities are defined as unjustified variations in availability, adequacy, or quality of service. However, user rate schedules for portions of existing systems or facilities that were developed under different financing, rates, terms, or conditions would not necessarily constitute inequities.



*Demonstration of community support.* Instead of meeting the cash equity criterion for determining project eligibility under subpart A, a water and waste disposal project may instead demonstrate community support, which the Agency will accept in lieu of cash equity. If a project meets the other criteria in proposed § 5001.6(c)(2) or § 5001.12(c)(2)(ii)(B), as applicable, and demonstrates community support, then the project is eligible under this program.

Demonstration of community support would be required as discussed earlier in this preamble for the Community Facilities program. While the current Water and Waste Disposal guaranteed loan regulation requires projects to have significant ties to the community, this community support provision in the regulation incorporates current Agency practice for evaluating and approving loan guarantee applications for Community Facilities.

#### Unauthorized Projects and Purposes

Under the proposed rule, the projects and purposes identified in the current Water and Waste Disposal guaranteed loan program are carried over into this proposed rule.

In addition to the unauthorized projects and purposes identified in subpart A, loan guarantees with water and waste disposal funding would not be allowed to finance any of the following:

- Facilities that are not modest in size, design, and cost;
- Loan or grant finder's fees;
- The construction of any new combined storm and sanitary sewer facilities;
- Any portion of the cost of a facility that does not serve a rural area;
- That portion of project costs normally provided by a business or industrial user, such as wastewater pretreatment;
- Rental for the use of equipment or machinery owned by the applicant;
- For other purposes not directly related to operating and maintenance of the facility being installed or improved; or
- The payment of a judgment which would disqualify an applicant for a loan under proposed § 5001.102(c)(2).

#### Borrower Eligibility

Consistent with the current Water and Waste Disposal guaranteed loan program, to be eligible for a water and waste disposal guaranteed loan, a prospective borrower not only must meet the eligibility criteria specified in subpart A of the proposed rule, but the borrower eligibility criteria specified in subpart B for the water and waste disposal program (see proposed § 5001.102(c)). Specifically, these criteria specify that the prospective borrower must be a particular type of entity and must not have credit available elsewhere, as discussed below.

*Eligible entity.* Under the proposed rule, a prospective borrower would have to meet one of the following types of entities to be eligible for a water and waste disposal guaranteed loan:

- A public body, such as a municipality, county, district, authority, or other political subdivision of a State located in a rural area;
- An organization operated on a not-for-profit basis, such as an association, cooperative, or private corporation. The organization must be an association controlled by a local public body or bodies, or have a broadly based ownership by or membership of people of the local community; or
- An Indian tribe on a Federal or State reservation or any other Federally-recognized Indian tribe.

*Credit not available elsewhere.* As found in the current Water and Waste Disposal regulation, to be eligible, the prospective borrower would have to be found by the Agency as being unable to obtain the required credit without the loan guarantee from private, commercial, or cooperative sources at reasonable rates and terms for loans for similar purposes and periods of time.

#### Additional Application Documentation Requirements

*Feasibility study.* The Agency may require a feasibility study by a qualified independent consultant. As defined in the proposed rule, the feasibility study is essentially the same as found in the current Water and Waste Disposal regulation. However, the current Water and Waste Disposal regulation makes the feasibility study a prerequisite, while the proposed rule does not.

*Preliminary engineering report (PER).* As required under the current Water

and Waste Disposal guaranteed loan program, applications for water and waste disposal facilities would have to be submitted, with two copies of a preliminary engineering report (PER), under the proposed rule. The PER is a document normally prepared by the owner's consulting engineer that describes the owner's present situation, analyzes alternatives, and proposes a specific course of action from an engineering and environmental perspective.

Preliminary engineering reports would be required to conform to customary professional standards. If a preliminary review by the Agency is desired, the PER may be submitted to the Agency prior to the rest of the application material. To assist in their preparation, PER guidelines for water, sanitary sewer, solid waste, and storm sewer are available from the Agency. The proposed rule does not include the same specifics for content as found in the current Water and Waste Disposal regulation. It is the Agency's intent that specific content requirements, which would be consistent with current Agency practices for these reports, would be available through a handbook or other means available from State offices.

*Financial reports.* Under the proposed rule and consistent with the current Water and Waste Disposal guaranteed loan program, all lenders would be required to obtain and analyze financial statements as required by the Loan Agreement. A Rural Development approved lender that does not have preferred lender status would be required to submit a copy of the analysis to the Agency within 120 days of receipt of the financial statements. A Rural Development approved lender with preferred lender status would be required to provide evidence that it has such analysis on file, but would not be required to submit a copy to the Agency unless specifically requested.

#### Additional Guarantee- and Loan-Related Requirements

*Maximum percent of guarantee.* The maximum loan guarantees issued to lenders approved under this part with Water and Waste Disposal funding are specified in Table 2.

TABLE 2.—MAXIMUM LOAN GUARANTEE PERCENTAGES FOR WATER AND WASTE DISPOSAL FACILITY GUARANTEED LOANS

Type of rural development approved lender	Type of application	Guaranteed loan amount		
		\$5 million or less (percent)	Over \$5 million up to and including \$10 million	Over \$10 million (percent)
Without preferred lender status .....	Low documentation .....	80	na	na
	Full documentation .....	90	90	90
With preferred lender status .....	Low documentation .....	90	na	na
	Full documentation .....	90	90	90

na = not applicable.

These maximum loan guarantees are the same as found in the current Water and Waste Disposal regulation except that, under the proposed rule, the maximum guarantee is 10 percentage points lower for low documentation applications seeking a loan guarantee of \$5 million or less from lenders who do not have preferred lender status.

**Fees.** Any guarantee fee or renewal fee charged for Water and Waste Disposal guaranteed loans will be established in a **Federal Register** notice that the Agency will publish annually, as provided under subpart A of the proposed rule. Under the current Water and Waste Disposal program, a guarantee fee is charged, but a renewal fee is not.

#### Business and Industry (§ 5001.103)

This section identifies program specific requirements for business and industry projects seeking loan guarantees. The lender and prospective borrower must comply both with subpart A provisions and the provisions in this section when seeking a business and industry loan guarantee. The program specific provisions for business and industry projects follow.

#### Project Eligibility

To be eligible for a business and industry guaranteed loan, a project would have to meet the requirements in proposed § 5001.6 in subpart A and the following requirements found in proposed § 5001.103(a) in subpart B. The same types of projects eligible under the current B&I guaranteed loan program are eligible under this proposed rule.

**Eligible Projects.** As proposed, to be eligible for business and industry funding, the project would have to meet one of the following types of projects or purposes:

- Business and industrial acquisitions when the loan will keep the business from closing, prevent the loss of employment opportunities, or provide expanded job opportunities;
- Business conversion, enlargement, repair, modernization, or development;

- Purchase and development of land, easements, rights-of-way, buildings, or facilities;

- The purchase of equipment, leasehold improvements, machinery, supplies, inventory, start up costs, permanent working capital, pollution control and abatement, or feasibility studies;

- Transportation services incidental to industrial development;

- Agricultural production, with advance written approval from the Agency, when it is not eligible for Farm Service Agency farmer program assistance and when it is part of an integrated business also involved in the processing of agricultural products;

- The purchase of membership, stocks, bonds, debentures, or cooperative stock (as discussed further below);

- Commercial fishing, aquaculture, commercial nurseries, forestry, hydroponics, or the growing of mushrooms;

- Interest during the period before the first principal payment becomes due or when the facility becomes income producing, whichever is earlier;

- Refinancing any loan. Except for the refinancing of Agency direct loans, refinancing of other loans will be limited to a minority portion of the guaranteed loan;

- Providing takeover of interim financing when the lender submits a complete preapplication or application in which the interim financing is proposed, prior to extending any portion of the interim loan;

- Fees and charges for professional services and routine lender fees and the Agency guarantee fee;

- Tourist and recreation facilities, including hotels, motels, and bed and breakfast establishments;

- Educational, training, or community facilities;

- Housing development sites with certain restrictions;

- Community antenna television services or facilities;

- Assistance to industries adjusting to terminated Federal agricultural

programs or increased foreign competition; or

- Assisting cooperative organizations.

As proposed, “permanent working capital” is defined as “liquid assets available to support a business’ long-term operations and growth.” It is the Agency’s position that “permanent working capital” does not include lines of credit providing temporary financing for seasonal financial requirements.

**Purchase of cooperative stock.** Under the proposed program and consistent with the current B&I guaranteed loan program, loans may be made to individual farmers or ranchers for the purchase of cooperative stock provided the entity that receives the proceeds from the stock sale is a farmer or rancher cooperative established for the purpose of processing agricultural commodities; not for electricity or other financial investments. Proceeds from the stock sale would be allowed for recapitalizing existing cooperatives, developing new processing facilities or product lines, and expanding an existing production facility. In addition, the cooperative would be allowed to contract for services to process agricultural commodities or otherwise process value-added agricultural products during the 5-year period beginning on the operation startup date of the cooperative in order to provide adequate time for the planning and construction of the processing facility of the cooperative.

**Unauthorized projects and purposes.** Consistent with those found in the current B&I guaranteed loan regulations, the proposed rule identifies specific projects and purposes that would be ineligible for a business and industry guaranteed loan. These are:

- Businesses housed in private homes, except when the pro-rata value of the owner’s living quarters is deleted from the value of the project;

- Projects in excess of \$1 million that would likely result in the transfer of jobs from one area to another and increase direct employment by more than 50 employees; and

- Projects in excess of \$1 million that would increase direct employment by more than 50 employees, if the project would result in an increase in the production of goods for which there is not sufficient demand, or if the availability of services or facilities is insufficient to meet the needs of the business.

- Interim financing.
- Distribution or payment to an individual owner, partner, stockholder, or beneficiary of the borrower or a close relative of such an individual when such individual will retain any portion of the ownership of the borrower.

- Assistance to Government employees and military personnel who are directors or officers or have a major ownership of 20 percent or more in the business.

- The guarantee of lease payments.
- The guarantee of loans made by other Federal agencies.
- Loans made with the proceeds of any obligation the interest on which is excludable from income under 26 U.S.C. 103 or a successor statute. Funds generated through the issuance of tax-exempt obligations may neither be used to purchase the guaranteed portion of any Agency guaranteed loan nor may an Agency guaranteed loan serve as collateral for a tax-exempt issue. The Agency may guarantee a loan for a project which involves tax-exempt financing only when the guaranteed loan funds are used to finance a part of the project that is separate and distinct from the part which is financed by the tax-exempt obligation, and the guaranteed loan has at least a parity security position with the tax-exempt obligation.

#### Borrower Eligibility

To be eligible for a business and industry guaranteed loan, a prospective borrower not only must meet the eligibility criteria specified in subpart A of the proposed rule, but the borrower eligibility criteria specified in subpart B for the business and industry program (see proposed § 5001.103(c)). The requirements for borrower eligibility under the proposed rule are consistent with those in the current B&I guaranteed loan regulations. Specifically, these criteria require that the borrower be:

- A cooperative organization, corporation, partnership, or other legal entity organized and operated on a profit or not-for-profit basis; an Indian tribe on a Federal or State reservation or other Federally recognized tribal group; a public body; or an individual; and
- Engaged in or proposing to engage in a business.

Qualifying businesses include manufacturing, wholesaling, retailing, providing services, or other activities that provide employment; improve the economic or environmental climate; promote the conservation, development, and use of water for aquaculture; or reduce reliance on nonrenewable energy resources by encouraging the development and construction of solar energy systems and other renewable energy systems (including wind energy systems, geothermal energy systems, and anaerobic digesters for the purpose of energy generation).

#### Additional Application Process Requirements—Obligation of Funds

Under the current B&I guaranteed loan regulations, the Agency uses a scoring system to prioritize applications. Under the proposed rule, the Agency would only use a scoring priority system to allocate funds, which would give a priority to encourage economic development in communities that are suffering economic hardships, if funds are insufficient to cover all approved applications. The Agency would establish the scoring criteria each fiscal year and provide the criteria in a notice that would be published in the **Federal Register**.

#### Additional Application Documentation Requirements

*Audited financial statements.* As found in the current B&I guaranteed loan regulations, if the proposed guaranteed loan exceeds \$3 million, the Agency may require audited financial statements to be submitted annually when the Agency is concerned about the borrower's credit risk.

*Feasibility study.* As found in the current B&I guaranteed loan regulations, the Agency may require a feasibility study by a qualified independent consultant for start-up businesses or existing businesses when the project will significantly affect the borrower's operations. Under the proposed rule, the Agency is clarifying that, if the Agency requires a feasibility study of a cooperative, the feasibility study would determine the viability of the business and not the individual farm operators.

*Certification of Non-Relocation and Market Capacity.* As found in the current B&I guaranteed loan regulations, if the loan will exceed \$1 million and will increase direct employment by more than 50 employees, the lender must provide the Agency with information on non-relocation and market capacity using a form approved by the Agency.

#### Additional Lender Responsibilities—Origination—Collateral

Under the proposed rule and as found in the current B&I guaranteed loan regulations, when a business and industry guaranteed loan is used for the purchase of cooperative stock, the lender must secure the loan, at a minimum, with a lien on the stock acquired with loan funds, an assignment of any patronage refund, and the full and unconditional personal or corporate guarantee of the borrower.

#### Additional Guarantee- and Loan-Related Requirements

*Conditional Commitment for Guarantee.* Under the proposed rule and as found in the current B&I guaranteed loan regulations, when a business and industry guaranteed loan is used for the purchase of cooperative stock, the Conditional Commitment for Guarantee would require the cooperative to provide the lender with all required Federal, State, and local permits and other clearances involving the environmental aspects for review and approval.

*Issuance of Loan Note Guarantee.* Under the proposed rule and as found in the current B&I guaranteed loan regulations, if, for the purchase of cooperative stock, the lender requests the Agency to issue the Loan Note Guarantee before the cooperative becomes operational, the lender would be required to certify to the Agency that the cooperative has all of the required Federal, State, and Local permits and other clearances involving the environmental aspects for review and approval.

*Funding limits.* Under the proposed rule and consistent with the current B&I guaranteed loan program, the maximum principal amount of a business and industry loan guaranteed that would be allowed is \$25 million, except that the maximum principal amount of a business and industry guaranteed loan for a cooperative organization for rural projects processing value added commodities would be \$40 million.

The proposed rule would also limit the total principal amounts of business and industry guaranteed loans made to cooperative organizations for a fiscal year that are in excess of \$25 million to no more than 10 percent of the business and industry loans guaranteed for the fiscal year.

Lastly, the principal amount of a business and industry guaranteed loan for the purchase of cooperative stock would be limited to no more than \$600,000.

*Fees.* Any guarantee fee and renewal fee charged for B&I guaranteed loans

will be established in a **Federal Register** notice that the Agency will publish annually, as provided under subpart A of the proposed rule. Under the current B&I program, a guarantee fee and a renewal fee are charged.

As provided in proposed § 5001.103(g)(4) and consistent with the current B&I regulations, the maximum guarantee fee that could be charged would be 2 percent. The guarantee fee would be allowed to be reduced to 1 percent if the borrower is a high impact

business and is located in an area of long term population decline and job deterioration as a result of persistent economic hardship, significant economic loss from a Presidentially-declared disaster, or a fundamental structural economic change. Each fiscal year, the Agency will establish a limit on the maximum portion of guarantee authority available for that fiscal year that may be used to guarantee loans with a guarantee fee of 1 percent. The Agency will announce the limit in a

notice published in the **Federal Register**. Once the limit has been reached, the guarantee fee for all additional loans obligated during the remainder of that fiscal year would be 2 percent.

*Maximum percent of guarantee.* The maximum loan guarantees issued to lenders approved under this part with Business and Industry funding are specified in Table 3.

TABLE 3.—MAXIMUM LOAN GUARANTEE PERCENTAGES FOR BUSINESS AND INDUSTRY GUARANTEED LOANS

Type of rural development approved lender	Type of application	Guaranteed loan amount		
		\$5 million or less (percent)	Over \$5 million up to and including \$10 million (percent)	Over \$10 million* (percent)
Without preferred lender status .....	Low documentation .....	70	na	na
	Full documentation .....	80	70	60
With preferred lender status .....	Low documentation .....	80	na	na
	Full documentation .....	80	70	60

na = not applicable.

\*Per proposed § 5001.103(g)(3), the maximum guaranteed loan amount is \$25 million except for a cooperative producing a value added commodity for which the maximum is \$40 million.

These maximum loan guarantees are the same as found in the current B&I guaranteed loan regulation except that, under the proposed rule, the maximum guarantee is 10 percentage points lower for low documentation applications seeking a loan guarantee of \$5 million or less from lenders who do not have preferred lender status.

#### Renewable Energy Systems and Energy Efficiency Improvements (§ 5001.104)

This section identifies program specific requirements for renewable energy system or energy efficiency improvement projects seeking loan guarantees. The lender and prospective borrower must comply both with subpart A provisions and the provisions in this section when seeking a renewable energy system or energy efficiency improvement loan guarantee. The program specific provisions for renewable energy systems and energy efficiency improvement projects follow.

#### Project Eligibility

To be eligible for a renewable energy system and energy efficiency improvement guaranteed loan, a project would have to meet the requirements in proposed § 5001.6 in subpart A and the following requirements found in proposed § 5001.104 in subpart B.

*Eligible projects.* As proposed, a renewable energy system or energy efficiency improvement project would have to be for the purchase, installation, expansion, and/or other energy-related

improvement of a renewable energy system or to make energy efficiency improvements where the technology used is replicable and either pre-commercial or commercially available. These two criteria are found in the current Renewable Energy Systems and Energy Efficiency Improvements regulation (7 CFR part 4280, subpart B).

#### Borrower Eligibility

To be eligible for a renewable energy systems and energy efficiency improvements guaranteed loan, a borrower must meet not only the eligibility criteria specified in subpart A of the proposed rule, but the borrower eligibility criterion specified in subpart B for the renewable energy systems and energy efficiency improvements program (see proposed § 5001.104(b)). Specifically, this criterion, which is in the current Renewable Energy Systems and Energy Efficiency Improvements regulation, requires that the borrower be an agricultural producer or rural small business.

#### Additional Application Process Requirements—Obligation of Funds

Under the current Renewable Energy Systems and Energy Efficiency Improvements regulation, the Agency uses a scoring system to prioritize applications. Under the proposed rule, the Agency would only use a scoring priority system to allocate funds to encourage development of promising pre-commercial and commercially

available alternative energy sources that are currently unable to obtain financing from commercial lending sources if funds are insufficient to cover all approved applications. The Agency would establish the scoring criteria on a periodic basis as changes are made and provide the criteria in a notice that would be published in the **Federal Register**.

#### Additional Application Documentation Requirements

In addition to the application requirements specified in subpart A, applications would be required to contain the following, as applicable:

*Certifications.* The lender would be required to certify in the application that the project is able to demonstrate technical merit and the prospective borrower is a small agricultural producer or rural small business. This provision implements two requirements found in the current Renewable Energy Systems and Energy Efficiency Improvements regulation.

*Technical Report.* For renewable energy systems projects seeking a loan guarantee of more than \$200,000, a satisfactory technical report must be provided that demonstrates that the project is commercially viable and can be installed and perform as intended in a reliable, safe, cost-effective, and legally compliant manner. To determine the overall technical merit of the renewable energy system, the lender must submit its proposal to an approved

Department of Energy (DOE) laboratory and obtain a DOE technical report. A Rural Development approved lender that does not have preferred lender status must submit the DOE technical report with its application. A preferred lender may instead certify in the application that a DOE technical report, deemed satisfactory by a DOE energy laboratory, has been obtained prior to the request for guarantee in lieu of submitting the technical report with the application.

This provision under the proposed rule differs from the current Renewable Energy Systems and Energy Efficiency Improvements regulation in that the proposed rule does not apply to renewable energy systems seeking a loan guarantee of \$200,000 or less or to any energy efficiency improvement project and does not specify the contents of the technical report.

Due to the variety of potential projects, the content of these technical reports will be negotiated with the lender/borrower and further guidance will be provided through an agency handbook or other agency documents.

**Energy assessment/audit.** For energy efficiency improvement projects, an energy assessment, with adequate and appropriate evidence of energy savings expected when the system is operated as designed, must be provided. For energy efficiency improvement projects with total eligible project costs greater than \$50,000, an energy audit is required. Preferred lenders may certify in the application that an energy assessment or audit, as applicable, has been obtained prior to the request for guarantee in lieu of submitting the assessment or audit with the application. These provisions are the same as found in the current Renewable Energy Systems and Energy Efficiency Improvements regulation.

**Feasibility study.** Under the proposed rule and consistent with the current Renewable Energy Systems and Energy Efficiency Improvements regulation, lenders are required to obtain feasibility studies for projects seeking a loan guarantee of greater than \$200,000. To be acceptable, the feasibility study would have to be conducted by a qualified independent consultant.

**Financial statements.** Consistent with the current Renewable Energy Systems and Energy Efficiency Improvements regulation, but applied only to lenders without preferred lender status, applications from Rural Development

approved lenders without preferred lender status must include financial statements for the lesser of the past 3 years or the business life of the applicant. If the proposed guaranteed loan exceeds \$3 million, the Agency may require audited financial statements annually when the Agency is concerned about the borrower's credit risk.

#### Additional Servicing Requirements—Post-Construction Requirements

Once the project has been constructed, the lender would be required to provide the Agency annual reports from the borrower on the performance characteristics and results of the projects. For renewable energy system projects, these reports would be provided commencing in the first full calendar year after construction is completed and continuing for 3 full years. For Energy Efficiency Improvement projects, these reports would be provided commencing the first full calendar year following the year in which project construction was completed and continuing for 2 full years.

The requirement to submit these reports is consistent with that found in the current Renewable Energy Systems and Energy Efficiency Improvements regulation. However, due to the variety of potential projects, the proposed rule does not specify a comprehensive list of the report contents. Instead, the proposed rule identifies minimum content requirements with additional content to be negotiated between the Agency and the lender/borrower, which must be clearly articulated before the loan note guarantee is executed. Further guidance will be provided through an agency handbook or other agency documents.

#### Additional Guarantee- and Loan-Related Requirements

**Conditions precedent to issuance of loan note guarantee.** In addition to the requirements specified in proposed § 5001.33, prior to the issuance of the loan note guarantee for renewable energy systems and energy efficiency improvements loans, the following conditions would have to be demonstrated:

- All planned property acquisitions and development have been performing at a steady state operating level in accordance with the technical requirements, plans, and specifications;

- The project conforms with applicable Federal, State, and local codes; and

- Costs have not exceeded the amount approved by the lender and the Agency.

The above conditions are the same as those found in the current Renewable Energy Systems and Energy Efficiency Improvements regulation.

**Funding limits.** Consistent with the current Renewable Energy Systems and Energy Efficiency Improvements regulation, the amount of assistance, which would be based on guaranteed loans, direct loans, and grants provided under the proposed program, available to an eligible project under the Renewable Energy Systems and Energy Efficiency program will not exceed 50 percent of total eligible project costs. Eligible project costs are only those costs specified by the Agency, as long as the items are an integral and necessary part of the renewable energy system or energy efficiency improvement. The eligible project costs, which are the same as those found in the current Renewable Energy Systems and Energy Efficiency Improvements regulation, are identified in proposed § 5001.104(f)(2)(i) through (xi).

The proposed rule, however, is not including the minimum and maximum funding limits specified in the current Renewable Energy Systems and Energy Efficiency Improvements regulation. Currently, the Renewable Energy Systems and Energy Efficiency Improvements program requires a minimum guaranteed loan request of \$5,000 and limits the maximum guaranteed loan amounts to the same borrower to \$10 million.

**Fees.** Any guarantee fee and renewal fee charged for Renewable Energy Systems and Energy Efficiency Improvements guaranteed loans will be established in a **Federal Register** notice that the Agency will publish annually, as provided under subpart A of the proposed rule. Under the current Renewable Energy Systems and Energy Efficiency Improvements program, a guarantee fee and a renewal fee are charged.

**Maximum percent of guarantee.** The maximum loan guarantees issued to lenders approved under this part with Renewable Energy Systems and Energy Efficiency Improvements funding are specified in Table 4.

TABLE 4.—MAXIMUM LOAN GUARANTEE PERCENTAGES FOR RENEWABLE ENERGY SYSTEM AND ENERGY EFFICIENCY IMPROVEMENT GUARANTEED LOANS

Type of rural development approved lender	Type of application	Guaranteed loan amount			
		\$600,000 or less (percent)	Over \$600,000 up to and including \$5 million (percent)	Over \$5 million up to and including \$10 million	Over \$10 million (percent)
Without preferred lender status	Low documentation .....	75	70	na	na
	Full documentation .....	85	80	70	60
With preferred lender status .....	Low documentation .....	85	80	na	na
	Full documentation .....	85	80	70	60

na = not applicable.

These maximum loan guarantees are the same as found in the current Renewable Energy Systems and Energy Efficiency Improvements regulation except that, under the proposed rule, the maximum guarantee is 10 percentage points lower for low documentation applications seeking a loan guarantee of \$5 million or less from lenders who do not have preferred lender status.

The maximum percent guarantees for each of the four programs for lenders who have preferred lender status under the proposed rule are the same as the current programs. For those lenders that do not have preferred lender status, however, the maximum percent guarantees are 10 percentage points less than for those lenders with preferred lender status. Under the current four programs, no such distinction is made.

### III. Significant Differences From Current Regulations

The purpose of this section is to discuss significant differences between the proposed rule and the current regulations.

#### A. Project Eligibility—Metric Floor Criteria

All four current programs identify the types of projects that are eligible for guaranteed loans. However, none identify project eligibility criteria that specifically address project risk. One of the new features included in the proposed rule is the requirement for all projects to meet a minimum set of criteria (referred to as the metric floor criteria) that address the potential risk associated with a project. As discussed earlier in this preamble, by incorporating risk-based eligibility criteria, the Agency seeks to mitigate its project based risk.

#### B. Application Documentation

Under the proposed rule, the amount of supporting documentation required would, in general, depend on certain

conditions associated with the application. These conditions are:

- Whether the project application is for a startup business or an existing business. (If the project is a startup business, then full supporting documentation must be submitted with the application.)
- Whether the lender submitting the application has preferred lender status. (If the lender has preferred lender status, the lender has the opportunity to submit an application with a reduced level of supporting documentation.)
- For lenders that do not have preferred lender status, whether the project meets certain criteria. (If it meets these criteria, then reduced documentation is permitted with the application.)
- The size of the loan guarantee being requested. (The loan guarantee being requested must be below certain sizes in order for its application to be submitted with the lower amount of supporting documentation.)

The proposed rule applies the same set of criteria across all four programs, bringing an overall consistency to delivery. To address statutory intent, it also provides documentation requirements that are specific to some of the programs. These program-specific requirements include documentation such as feasibility studies, technical reports, certifications, and energy assessments and audits.

Compared to the proposed rule, the amount of documentation required among the four current programs varies more widely from program to program. The program-specific requirements are similar, but not necessarily identical, to those currently found within the four programs. For example, currently, the Renewable Energy Systems and Energy Efficiency Improvement Projects guaranteed loan program requires technical reports on all projects, with required documentation levels differing based on a project size of more or less than \$200,000. Under the proposed rule, technical reports will only be required

on projects greater than \$200,000. Another difference is that technical reports for energy efficiency improvement projects would not be required under the proposed rule. However, an energy assessment or audit, depending on the size of the energy efficiency improvement project, would be required.

#### C. Lender Eligibility

The proposed rule sets up criteria for lender participation that are different from the existing programs. The current programs generally make eligible regulated and supervised lenders that possess the capability to service the loan being requested, and then list the types of lender that fit the description. The Business and Industry program and the Renewable Energy System and Energy Efficiency Improvements program (by incorporating the B&I provisions) go one step further in identifying additional requirements that must be met for lenders that are not regulated or supervised.

Under the proposed rule, two categories of lenders are created—regulated or supervised lenders and other lenders. Regulated or supervised lenders would be eligible if they are in good standing with their regulators. This criterion is not found under the current programs. In addition, regulated or supervised lenders that do not have an existing portfolio with the Agency would be required to file an application, along with a copy of their policies and procedures for loan origination and servicing, to the Agency to be considered for participation. Under the current programs, such lenders are not required to submit such an application or their loan origination and servicing policies and procedures. Lastly, the proposed rulemaking does not list eligible lenders by lender type. The Agency does not believe that it is necessary to continue listing specific types of lenders.

The second category of lender under the proposed rule—lenders that are not

regulated or supervised lenders—would be required to submit an application to the Agency, along with information to document their capabilities and experience and including a copy of their loan origination and servicing policies and procedures and certificate(s) of good standing from the States in which they intend to conduct business. For the most part, this is very similar to the current B&I guaranteed loan program.

#### D. Negligent Loan Origination

As proposed, the Agency is making clear that negligent loan origination will be considered in determining whether or not to reduce loss claims payable under the loan guarantee to the lender when a loan is in default. The Agency believes that negligent loan origination may not have been articulated as clearly as it should have been in the previous programs. Therefore, the Agency recognizes that there may be some confusion within the lending community as to whether negligent loan origination could result in a reduction in the guarantee. In order to clarify this situation, the Agency is including in the proposed rule a definition of negligent loan origination and making explicit that negligent loan origination can be used to reduce loss claims payable under the guarantee held by the lender when a loss has occurred.

#### E. Criteria for Becoming a Preferred Lender

The current B&I guaranteed loan program has a provision for lenders to become certified preferred lenders. The other three programs do not have a similar provision.

Under the proposed rule, any Rural Development approved lender may apply for preferred lender status regardless of the program in which the lender wishes to participate. The criteria for becoming a preferred lender focus on lender experience, history of losses, and instances of negligent origination and servicing. These criteria are somewhat narrower and more stringent than those in the current B&I guaranteed loan program for qualifying as a certified preferred lender.

#### F. Percent Guarantee

The maximum percent guarantees for each of the four programs for lenders who have preferred lender status under the proposed rule are the same as the current programs, except for loans over \$10 million under the Renewable Energy Systems and Energy Efficiency Improvement Projects program. For that program, the proposed rule would limit the maximum percent guarantees for loans over \$10 million to 60 percent

compared to the current maximum of 70 percent. This change is being made for consistency in the guaranteed percentage for projects with similar risk profiles between this program and the Business and Industry program. For those lenders that do not have preferred lender status, the maximum percent guarantees are 10 percentage points less than for those lenders with preferred lender status. Under the current four programs, no such distinction is made.

The Agency is implementing this distinction in an effort to encourage more lenders to qualify under a higher standard as “Preferred” lenders. This allows the Agency to better manage institutional risk and lower Agency loss exposure by improving the quality of lenders who participate in these programs and by reducing the size of the loan guarantee to lenders that do not qualify for preferred lender status.

#### G. Tangible Balance Sheet Equity Versus Cash Equity

Under the current B&I guaranteed loan program, one of the eligibility criteria for projects is based on meeting certain tangible balance sheet equity requirements. The new rule proposes to use, instead, cash equity. The Agency is proposing this change because of difficulties in applying the tangible balance sheet equity criteria, and because the private sector is moving away from the use of tangible balance sheet equity as a qualifying factor. The Agency believes that requiring cash equity will result in greater consistency with the lending industry, clarified equity expectations, and stronger guarantee applications.

#### H. Oversight and Monitoring—Default Reports

Under the proposed rule, lenders would be required to submit information on each loan in default, including delinquent loans, on a monthly basis. This is more frequent than under the four current programs. The Agency believes this increase in frequency is necessary to provide the Agency with the most current information on the status on loans in default within its outstanding loan guarantee portfolio, thereby allowing the Agency to improve risk management and reduce its loss exposure.

#### I. Preapplications

Under the proposed rule, lenders have the option of submitting a preapplication to obtain Agency input. Three of the four programs currently allow preapplications, but preapplications are not currently part of the renewable energy systems and

energy efficiency improvement project guaranteed loan program.

#### IV. Request for Comments

The Agency is interested in receiving comments on all aspects of the proposed rule. In particular, the Agency is seeking comments in the areas listed below. All comments should be submitted as indicated in the **ADDRESSES** section of this preamble.

##### A. Project Financial Metric Criteria (Proposed § 5001.6(c))

The Agency is seeking to establish minimum financial metric criteria that each project must first meet in order to be eligible under the new program. The Agency is seeking comments on the proposed section as follows:

- Are these three criteria reasonable and appropriate to help mitigate project risk? If not, what other criteria should the Agency consider and why?
- Are the values proposed for the criteria reasonable? If not, what value(s) should the Agency consider and why?

##### B. Other Lender Criteria (Proposed § 5001.9(b))

The Agency is seeking to mitigate institutional risk by establishing an initial set of three criteria for lenders who are not regulated or supervised. These criteria address minimum net worth, liquid assets, and line(s) of credit. The Agency is seeking comments on these eligibility criteria for these “other” lenders as follows:

- Are these three criteria reasonable and appropriate to help manage and mitigate institutional risk? If not, what other criteria should the Agency consider and why?
- Are the values proposed for the criteria reasonable? If not, what value(s) should the Agency consider and why?

##### C. Preferred Lender Status Criteria (Proposed § 5001.9(c)(1)(i) Through (iii))

To further mitigate institutional risk, the Agency is proposing to designate approved lenders as “preferred lenders” if they meet three criteria. These criteria address the lender’s experience in commercial lending, government guaranteed commercial lending, financing, or other activity under similar loan programs; the lender’s annual losses depending on how long the lender has been in business; and instances of negligent loan origination or servicing of Federal Government loans. The Agency is seeking comments on these eligibility criteria for obtaining “preferred lender” status as follows:

- Are these three criteria reasonable and appropriate to designate approved lenders as “preferred lenders”? If not,

what other criteria should the Agency consider and why?

- Are the values proposed for the criteria reasonable? If not, what value(s) should the Agency consider and why?

#### D. Low Documentation Application Content and Criteria (Proposed § 5001.12(b) and (c))

The Agency is proposing that applications be submitted with either full supporting documentation or low supporting documentation, with criteria proposed for determining when a lender may submit a low documentation application. The Agency is seeking comments on the following areas:

- Proposed § 5001.12(b) identifies five supporting documents (as found in proposed § 5001.12(a)(2) through (a)(6)) that need to be submitted with the application and eight supporting documents (as found in proposed § 5001.12(a)(7) through (a)(14)) that do not need to be submitted, but which the lenders must certify that they possess and used in the analysis of the project. Is this a reasonable and appropriate “split” between the documentation to be submitted versus the documentation to be certified to? If not, what would you recommend and why?

- Proposed § 5001.12(c)(2)(ii)(A) through (E) proposes five project criteria that must be met in order for lenders that do not have preferred lender status to submit low documentation applications. Are these reasonable and appropriate criteria? If not, what other criteria should the Agency consider and why? Are the values proposed for the criteria reasonable? If not, what value(s) should the Agency consider and why?

- Proposed § 5001.12(c)(2)(i) proposes to set the guaranteed loan value for submitting a low documentation application at \$5 million; that is, if the guaranteed loan value is less than \$5 million, a low documentation application may be submitted. As stated earlier in the preamble, the Agency is proposing to limit the guaranteed loan value in order to offset Agency loss exposure. The Agency is seeking comment on (1) whether this is an appropriate value, (2) whether the value should vary depending on the program (e.g., a different threshold value for community facilities versus renewable energy systems) and (3) whether an alternative method (e.g., using an annual average loan value; the median loan value) should be used.

- As proposed in subpart B for each of the four programs, the Agency is further proposing to reduce the maximum loan guarantee by 10 percentage points for low

documentation applications submitted by approved lenders who do not have preferred lender status. As stated earlier in the preamble, the Agency is proposing this reduction in maximum loan guarantee in order to offset Agency loss exposure. The Agency is seeking comment on (1) whether this is an appropriate value, (2) whether the value should vary depending on the program, and (3) whether the reduction should be applied to preferred lenders.

#### E. Reporting Frequency (Proposed § 5001.4(b))

The Agency is seeking comments on the frequency for periodic reports and for default reports as proposed in § 5001.4(b)(2). For periodic reports, the Agency is interested in comments on whether more frequent reporting (i.e., monthly) would be useful to the Agency and what increase level of lender burden would be associated with more frequent reporting. For default reports, if you propose an alternative frequency, please address how the alternative frequency would allow the Agency to maintain up-to-date information on the status of the guaranteed loans in default or explain why the Agency's proposed information requirements are onerous, in order to adequately manage and mitigate its guaranteed loan portfolio risk and loss exposure.

#### List of Subjects

##### 7 CFR 1779

Guaranteed loans, Loan programs, Waste treatment and disposal, Water supply.

##### 7 CFR 3575

Community facilities, Guaranteed loans, Loan programs.

##### 7 CFR 4279 and 4280

Loan programs—Business and industry—Rural development assistance, Economic development, Energy, Direct loan programs, Grant programs, Guaranteed loan programs, Renewable energy systems, Energy efficiency improvements, Rural areas.

##### 7 CFR Part 5001

Business and industry, Community facility, Energy efficiency improvement, Loan programs, Renewable energy, Rural Development, Rural areas, Water and waste disposal.

For the reasons set forth in the preamble, under the authority at 5 U.S.C. 301 and 7 U.S.C. 1989, Chapters XVII, XXXV, and XLII of title 7 of the Code of Federal Regulations are proposed to be amended and Chapter L is proposed to be established as follows:

## CHAPTER XVII—RURAL UTILITIES SERVICE, DEPARTMENT OF AGRICULTURE

### PART 1779—[REMOVED]

1. Part 1779 is removed and reserved.

## CHAPTER XXXV—RURAL HOUSING SERVICE, DEPARTMENT OF AGRICULTURE

### PART 3575—[REMOVED]

2. Part 3575 is removed and reserved.

## CHAPTER XLII—RURAL BUSINESS-COOPERATIVE SERVICE AND RURAL UTILITIES SERVICE, DEPARTMENT OF AGRICULTURE

### PART 4279—GUARANTEED LOANMAKING

3. The authority citation for part 4279, continues to read as follows:

**Authority:** 5 U.S.C. 301; 7 U.S.C. 1989.

#### Subpart B of Part 4279 [Removed and Reserved]

4. Subpart B of part 4279 is removed and reserved.

### PART 4280—LOANS AND GRANTS

5. The authority citation for part 4280, continues to read as follows:

**Authority:** 7 U.S.C. 8106.

#### Subpart B of Part 4280 [Removed and Reserved]

6. Subpart B of part 4280, is removed and reserved.

7. Chapter L consisting of parts 5000 through 5099 is established and a new part 5001 is added to read as follows:

## CHAPTER L—RURAL DEVELOPMENT, DEPARTMENT OF AGRICULTURE

### PART 5001—GUARANTEED LOANS

#### Subpart A—General Provisions

##### Sec.

- 5001.1 Purpose.
- 5001.2 Definitions and abbreviations.
- 5001.3 Agency authorities.
- 5001.4 Oversight and monitoring.
- 5001.5 Forms, regulations, and instructions.

#### Basic Eligibility Provisions

- 5001.6 Project eligibility.
- 5001.7 Unauthorized projects and purposes.
- 5001.8 Borrower eligibility.
- 5001.9 Lender eligibility and designation.
- 5001.10 [Reserved]

#### Basic Guarantee Application Provisions

- 5001.11 Guarantee application process.
- 5001.12 Guarantee application content.
- 5001.13–5001.14 [Reserved]

#### Basic Lender Provisions

- 5001.15 Lender responsibilities—General.



- 5001.16 Lender responsibilities—  
Origination.  
5001.17 Lender responsibilities—Servicing.  
5001.18–5001.24 [Reserved]

#### Basic Borrower Provisions

- 5001.25 Borrower responsibilities.  
5001.26–5001.29 [Reserved]

#### Basic Guarantee and Loan Provisions

##### 5001.30

##### General.

- 5001.31 Guaranteed loan requirements.  
5001.32 Conditional commitment for  
guarantee.  
5001.33 Conditions precedent to issuance  
of Loan Note Guarantee.  
5001.34 Issuance of the guarantee.  
5001.35 Alterations to loan instruments.  
5001.36 Reorganizations.  
5001.37 Sale or assignment of guaranteed  
loan.  
5001.38 Termination of Loan Note  
Guarantee.  
5001.39–5001.100 [Reserved]

#### Subpart B—Program Specific Provisions

- 5001.101 Community Facilities Program.  
5001.102 Water and Waste Disposal  
Facilities Program.  
5001.103 Business and Industry Program.  
5001.104 Renewable Energy Systems and  
Energy Efficiency Improvements  
Program.  
5001.105–5001.200 [Reserved]

**Authority:** 5 U.S.C. 301; 7 U.S.C.  
1926(a)(1); 7 U.S.C. 1932(a); 7 U.S.C. 8106.

#### Subpart A—General Provisions

##### § 5001.1 Purpose.

This part regulates the making, guaranteeing, holding, servicing, and liquidating of Rural Development guaranteed loans.

##### § 5001.2 Definitions and abbreviations.

(a) *General definitions.* The following definitions are applicable to the terms used in this part.

*Agency.* The Rural Housing Service or successor for the programs it administers; the Rural Utilities Service or successor for the programs it administers; and the Rural Business—Cooperative Service or successor for the programs it administers.

*Agricultural producer.* An individual or entity directly engaged in the production of agricultural products, including crops (including farming); livestock (including ranching); forestry products; hydroponics; nursery stock; or aquaculture, whereby 50 percent or greater of their gross income is derived from the operations.

*Applicant.* The entity that is seeking a loan guarantee under this part.

*Arm's length transaction.* A transaction between ready, willing, and able disinterested parties who are not affiliated with or related to each other

and have no security, monetary, or stockholder interest in each other.

*Assignment guarantee agreement.* A signed, Agency-approved agreement between the Agency, the lender, and the holder setting forth the terms and conditions of an assignment of a guaranteed portion of a loan or any part thereof.

*Assurance agreement.* A signed, Agency-approved agreement between the Agency and the lender that assures the Agency that the lender is in compliance with and will continue to be in compliance with Title VI of the Civil Rights Act of 1964, 7 CFR part 15, and Agency regulations promulgated there under.

*Biomass.* Any organic material, excluding paper that is commonly recycled and unsegregated solid waste, that is available on a renewable or recurring basis, including agricultural crops; trees grown for energy production; wood waste; wood residues; plants, aquatic plants and grasses; natural fibers; animal waste and other waste materials; and fats, oils, and greases, including recycled fats, oils, and greases.

*Borrower.* The entity that borrows money from the lender, including any party or parties liable for the guaranteed loan except guarantors.

*Business plan.* A comprehensive document that clearly describes the applicant's ownership structure and management experience including, if applicable, discussion of a parent, affiliates, and subsidiaries; a discussion of how the applicant will operate the proposed project, including, at a minimum, a description of the business and project, the products and services to be provided, pro forma financial statements for a period of 2 years, including balance sheet, income and expense, and cash flows, and the availability of the resources necessary to provide those product and services.

*Collateral.* The asset(s) pledged by the borrower in support of the loan.

*Commercially available.* A system that has a proven operating history of viability of at least one year, specific to the proposed application. Such a system is based on established design, and installation procedures and practices. Professional service providers, trades, large construction equipment providers, and labor are familiar with installation procedures and practices. Proprietary and balance of system equipment and spare parts are readily available. Service is readily available to properly maintain and operate the system. An established warranty exists for parts, labor, and performance.

*Community support.* Sufficient evidence of the area to be served that there is enough demand and support for the service or facility to make the project economically viable.

*Conditional commitment for guarantee.* An Agency-approved form to the lender that the loan guarantee it has requested is approved subject to the completion of all conditions and requirements contained in the commitment as set forth by the Agency.

*Conflicts of interest.* Conflicts of interest include, but are not limited to, distribution or payment of guaranteed loan funds or award of project contracts to an individual owner, partner, stockholder, or beneficiary of the lender or borrower or an immediate family member of such an individual when such individual will retain any portion of the ownership of the lender or borrower.

*Cooperative organization.* Any entity that is not legally chartered as a cooperative and that is owned and operated for the benefit of its members, including the manner in which it distributes its dividends and assets, provided those members are not employees of the organization.

*Debt coverage ratio.* The ratio obtained when dividing the net operating income by a business's annual debt service. The annual debt service equals the annual total of all interest and principal paid for all loans on a business.

*Default.* The condition that exists when a borrower is not in compliance with the promissory note, the loan agreement, or other related documents evidencing the loan.

*Delinquent loan.* A loan for which a scheduled loan payment has not been received by the due date or within any grace period as stipulated in the promissory note and loan agreement.

*Eligible project costs.* Those expenses approved by the Agency for the project.

*Energy assessment.* A report conducted by an experienced energy assessor, certified energy manager or professional engineer assessing energy cost and efficiency. The report identifies and provides a savings and cost analysis of low-cost/no-cost measures, estimates overall costs and expected energy savings from the funded improvements, and dollars saved per year and provides an estimate of the anticipated weighted-average payback period in years.

*Energy audit.* A report conducted by a Certified Energy Manager or Professional Engineer that focuses on potential capital-intensive projects and involves detailed gathering of field data and engineering analysis. The report will provide detailed project costs and

savings information with a high level of confidence sufficient for major capital investment decisions similar to but in more detail than an energy assessment.

**Energy efficiency improvement.** A product or process installed in a facility, or building, that reduces energy consumption.

**Essential community facility.** The physical structure financed or the resulting service provided to primarily rural residents that combined or severally must:

- (i) Perform or fulfill a function customarily provided by a local unit of government;
- (ii) Be a public improvement needed for the orderly development of a rural community;
- (iii) Not include a project that benefits a single individual or group of single individuals as opposed to a class within a community;
- (iv) Not include commercial or business undertakings (except for limited authority for industrial parks);
- (v) Be within the area of jurisdiction or operation for eligible public bodies or a similar local rural service area of a not-for-profit corporation; and
- (vi) Be located in a rural area.

**Existing business.** A business that has been in operation for at least one full year. Mergers or changes in business name or legal type of currently operating businesses are considered to be existing businesses as long as the business purpose has not changed significantly.

**Feasibility study.** An analysis of the economic, market, technical, financial, and management capabilities of a proposed project or business in terms of its expectation for success.

**Future recovery.** Funds collected by lender after final loss claim.

**Guaranteed loan.** A loan made and serviced by a lender for which the Agency has issued a Loan Note Guarantee.

**High-impact business.** A business that offers specialized products and services that permit high prices for the products produced, may have a strong presence in international market sales, may provide a market for existing local business products and services, and which is locally owned and managed.

**Holder.** The person or entity, other than the lender, who owns all or part of the guaranteed portion of the loan with no servicing responsibilities.

**Immediate family.** Individuals who are closely related by blood or by marriage, or within the same household, such as a spouse, parent, child, brother, sister, aunt, uncle, grandparent, grandchild, niece, or nephew.

**Interim financing.** A temporary or short-term loan made with the clear

intent that it will be repaid through another loan, cash, or other financing mechanism.

**Lender.** The organization making, servicing, and collecting the loan that is guaranteed under the provisions of this part.

**Lender's agreement.** The Agency-approved signed agreement between the Agency and the lender setting forth the lender's loan responsibilities under an issued Loan Note Guarantee.

**Lender's analysis.** The analysis and evaluation of the credit factors associated with each guarantee application to ensure loan repayment through the use of credit document procedures and an underwriting process that is consistent with industry standards and the lender's written policy and procedures.

**Loan agreement.** The Agency-approved agreement between the borrower and lender containing the terms and conditions of the loan and the responsibilities of the borrower and lender.

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

**Loan Note Guarantee.** The Agency-approved agreement containing the terms and conditions of the guarantee of an identified loan.

**Loan-to-value ratio.** The ratio of the dollar amount of a loan to the dollar value of the collateral pledged as security for the loan.

**Local government.** A county, municipality, town, township, village, or other unit of general government below the State level. The term also includes tribal governments when tribal lands are within the service area.

**Market value.** The amount for which property would sell for its highest and best use at a voluntary sale in an arm's length transaction.

**Negligent loan origination.**

(i) The failure of a lender to perform those services that a reasonably prudent lender would perform in originating its own portfolio of unguaranteed loans; or

(ii) 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.

(iii) 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 loan servicing.**

(i) The failure of a lender to perform those services that a reasonably prudent lender would perform in servicing and

liquidating its own portfolio of unguaranteed loans; or

(ii) The failure of the lender to perform its servicing responsibilities in accordance with its current servicing policies and procedures.

(iii) 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.

**Participation.** Sale of an interest in a loan by the lender wherein the lender retains the note, collateral securing the note, and all responsibility for loan servicing and liquidation.

**Permanent working capital.** Liquid assets available to support a business's long-term operations and growth.

**Person.** Any individual, corporation, company, foundation, association, labor organization, firm, partnership, society, joint stock company, group of organizations, or State or local government.

**Post-application.** The date that the Agency receives an essentially completed application. An "essentially completed" application is an application that contains all parts necessary for the Agency to determine applicant and project eligibility, to score the application, and to conduct the technical evaluation.

**Pre-commercial technology.** Technology that has emerged through the research and development process and has technical and economic potential for commercial application, but is not yet commercially available.

**Preliminary engineering report.** A document normally prepared by the owner's consulting engineer that describes the owner's present situation, analyzes alternatives, and proposes a specific course of action from an engineering and environmental perspective. For further details see RUS Bulletins 1780-2, -3, -4, and -5.

**Promissory Note.** A legal instrument that a borrower signs promising to pay a specific amount of money at a stated time or on demand. "Note" or "Promissory Note" shall also be construed to include "Bond" or other evidence of debt where appropriate.

**Protective advances.** Advances made by the lender for the purpose of preserving and protecting the collateral where the debtor has failed to, and will not or can not, meet obligations to protect or preserve collateral.

**Public body.** A municipality, county, or other political subdivision of a State; a special purpose district; or an Indian tribe on a Federal or State reservation or other Federally recognized Indian tribe or an organization controlled by any of the above.

*Regulated or supervised lender.* A lender that is subject to credit examination and supervision by an appropriate agency of the United States or a State that supervises and regulates credit institutions.

*Renewable energy.* Energy derived from a wind, solar, biomass, or geothermal source; or hydrogen derived from biomass or water using wind, solar, biomass, or geothermal energy sources.

*Renewable energy system.* A system that produces or produces and delivers usable energy from a renewable energy source.

*Report of loss.* An Agency-approved form used by lenders when reporting a loss under an Agency guarantee.

*Rural or rural area.*

(i) For purposes of providing Business and Industry, or Renewable Energy/ Energy Efficiency loan guarantees, Rural and Rural area are defined as any area of a State other than a city, town, or Census Designated Place that has a population of more than 50,000 inhabitants, according to the latest decennial census of the United States, and the contiguous and adjacent urbanized area.

(ii) For the purpose of providing Community Facilities loan guarantees, the terms "rural" and "rural area" mean a city, town, or unincorporated area with a population of not more than 20,000 inhabitants according to the latest decennial census.

(iii) For the purpose of providing Water and Waste Disposal loan guarantees, Rural or Rural area is defined as any area not in a city, town, or unincorporated area with a population in excess of 10,000 inhabitants, according to the latest decennial census of the United States.

(iv) For the purposes of this definition, cities and towns are incorporated population centers with definite boundaries, local self-government, and legal powers set forth in a charter granted by the State. For Puerto Rico, Census Designated Place (CDP), as defined by the U.S. Census Bureau, will be used as the equivalent to city or town. The appropriate population limit by applicable program will apply to the population of CDP.

*Small agricultural producer.* An agricultural producer producing agricultural products with a gross market value of less than \$600,000 in the preceding year.

*Small business.* An entity is considered a small business in accordance with the Small Business Administration's (SBA) small business size standards by the North American Industry Classification System (NAICS)

found in Title 13 CFR part 121. A private entity, including a sole proprietorship, partnership, corporation, cooperative (including a cooperative qualified under section 501(c)(12) of the Internal Revenue Code), and an electric utility, including a Tribal or governmental electric utility, that provides service to rural consumers on a cost-of-service basis without support from public funds or subsidy from the Government authority establishing the district, provided such utilities meet SBA's definition of small business. These entities must operate independent of direct Government control. With the exception of the entities described above, all other not-for-profit entities are excluded.

*Startup business.* A business that is a newly opened establishment that has been in operation for less than one full year. Newly-formed entities building ground-up facilities, even if there are affiliated businesses doing the same kind of business, are new businesses.

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

*State Bond Banks and State Bond Pools.* An entity authorized by the State to issue State debt instruments and utilize the funds received to finance projects that qualify for a guaranteed loan under this part.

*Substantive change.* Any change in the purpose of the loan, the financial condition of the borrower, or the collateral, that might jeopardize loan performance.

*Total project cost.* The sum of all costs associated with a completed project.

*Transfer and assumption.* The conveyance by a debtor to an assuming party of the assets, collateral, and liabilities of the loan in return for the assuming party's binding promise to pay the outstanding debt.

*Unincorporated area.* A Census Designated Place.

*Water and waste disposal facility.* A physical structure or series of structures used to provide water and waste disposal services. Such structures include, but are not necessarily limited to, those for rural drinking water, sanitary sewage, solid waste disposal, and storm wastewater disposal.

(b) *Abbreviations.* The following are applicable to this part:

RUS—Rural Utilities Service.

SBA—Small Business Administration.

### § 5001.3 Agency authorities.

(a) *Exception authority.* Except as specified in paragraphs (a)(1) through (4) of this section, the applicable Administrator may, on a case-by-case basis, make exceptions to any requirement or provision of this part, if such exception is necessary to implement the intent of the authorizing statute in a time of national emergency or in accordance with a Presidentially declared disaster, or when such an exception is in the best financial interests of the Federal Government and is otherwise not in conflict with applicable law.

(1) *Applicant and borrower eligibility.* No exception to applicant or borrower eligibility can be made.

(2) *Project eligibility.* No exception to project eligibility can be made.

(3) *Rural area definition.* No exception to the definition of rural area, as defined in § 5001.2, can be made.

(4) *Term length.* No exception to the maximum length of the loan term, as specified in § 5001.31(c), can be made.

(b) *Appeal rights.* A person may seek a review of an Agency decision under this part from the appropriate Agency official that oversees the program in question or appeal to the National Appeals Division in accordance with 7 CFR part 11 of this title.

### § 5001.4 Oversight and monitoring.

(a) *General.* The Agency will conduct oversight and monitoring of all lenders involved in any manner with any guarantee under this program to ensure compliance with this Part including ensuring lenders continue to meet the criteria for being an approved lender or a preferred lender. Such oversight and monitoring will include, but is not limited to, reviewing lender records and meeting with lenders. In addition, the Agency will review all approved and preferred lenders for eligibility at least every two years.

(b) *Reports and notifications.* The Agency will require lenders to submit to the Agency reports and notifications to facilitate the Agency's oversight and monitoring. These reports and notifications include, but are not necessarily limited to:

(1) Periodic reports regarding the condition of its Agency guaranteed loan portfolio (including borrower status and loan classification) and any material change in the general financial condition of the lender since the last periodic report to be submitted semiannually.

(2) If a loan goes into default, the lender shall provide a monthly default report in a form approved by the Agency.

(3) Notification within 5 days of:

(i) any loan agreement violation by any borrower, including when a borrower is 30 days past due or is otherwise in default; and

(ii) any permanent or temporary reduction in interest rate.

#### **§ 5001.5 Forms, regulations, and instructions.**

Copies of all forms, regulations, and instructions referenced in this part may be obtained through the Agency.

#### **Basic Eligibility Provisions**

##### **§ 5001.6 Project eligibility.**

To be eligible for a guaranteed loan under this part, at a minimum, a project must meet each of the requirements specified in paragraphs (a) through (d) of this section.

(a) The project must benefit a rural area.

(b) The project must meet the ownership, control, and revenue requirements specified in subpart B of this part.

(c) The project must meet the following financial metric criteria:

(1) A debt coverage ratio of 1.0 or higher;

(2) A cash equity of 10 percent for guarantees on loans to existing businesses and 20 percent cash equity for guarantees on loans to startup businesses as determined using Generally Accepted Accounting Principles, or, as specified in Subpart B, community support; and

(3) A loan-to-value ratio of no more than 1.0.

(d) For projects that are determined by a service area, boundaries for the proposed service area must be chosen in such a way that no user or area will be excluded because of race, color, religion, sex, marital status, age, disability, or national origin. This does not preclude:

(1) Financing or constructing projects in phases when it is not practical to finance or construct the entire project at one time, and

(2) Financing or constructing facilities where it is not economically feasible to serve the entire area, provided economic feasibility is determined on the basis of the entire system or facility and not by considering the cost of separate extensions to, or parts thereof. Additionally, the borrower must publicly announce a plan for extending service to areas not initially receiving service. Also, the borrower must provide written notice to potential users located in the areas not to be initially served.

##### **§ 5001.7 Unauthorized projects and purposes.**

Loans guaranteed under this part must not be used for any projects other than those authorized in subpart B of this part. In addition, loan proceeds must not be used for:

(a) Investment or arbitrage, or speculative real estate investment.

(b) Racetracks, golf courses, water parks, ski slopes, or similar recreational facilities listed in the annual Notice of Funds Availability.

(c) Any business deriving more than 10 percent of its annual gross revenue from gambling activity.

(d) Prostitution or businesses deriving income from activities of a prurient sexual nature.

(e) Any line of credit, lease payment, or loan made by other Federal agencies.

(f) Any project eligible for Rural Rental Housing and Rural Cooperative Housing loans under sections 515, 521, and 538 of the Housing Act of 1949, as amended.

(g) Any facility used primarily for the purpose of housing Federal or State agencies.

(h) Finders', packagers', or loan brokers' fees.

(i) Any business deriving income from the sale of illegal drugs, drug paraphernalia, or any other illegal product.

(j) Rental for the use of equipment or machinery owned by the applicant.

(k) The payment of a judgment.

(l) Any project resulting in a conflict of interest.

(m) Properties to be used for commercial rental when the borrower has no control over tenants and services offered except for industrial-site infrastructure development and limited sections of essential community facilities when the activity in the leased space is related to and enhances the primary purpose for which the facility is being established by the borrower.

(n) Any project located within the Coastal Barriers Resource System that does not qualify for an exception as defined in section 6 of the Coastal Barriers Resource Act, 16 U.S.C. 3501 *et seq.*

(o) Any project located in a special flood or mudslide hazard area as designated by the Federal Emergency Management Agency in a community that is not participating in the National Flood Insurance Program unless the project is an integral part of a community's flood control plan.

(p) Any other similar project or purpose that the Agency determines is ineligible for funding under this part and publishes in a **Federal Register** notice.

##### **§ 5001.8 Borrower eligibility.**

(a) *Eligible entities.* To be eligible, a prospective borrower must meet the requirements specified in paragraphs (a)(1) and (2) of this section and in subpart B to this part, as applicable.

(1) *Citizenship.* Individual borrowers must be citizens of the United States (U.S.), or reside in the U.S. after legal admittance for permanent residence. Entities other than individuals must be at least 51 percent owned by persons who are U.S. citizens or are legally admitted permanent residents residing in the U.S.

(2) *Legal authority and responsibility.* Each borrower must have, or obtain, the legal authority necessary to construct, operate, and maintain the proposed facility and services and to obtain, give security for, and repay the proposed loan.

(b) *Ineligible entities.* A borrower will be considered ineligible for a guarantee due to an outstanding judgment obtained by the U.S. in a Federal Court (other than U.S. Tax Court), is delinquent on the payment of Federal income taxes, is delinquent on Federal debt, or is debarred or suspended from receiving Federal assistance.

##### **§ 5001.9 Lender eligibility and designation.**

Only lenders approved by the Agency are eligible to participate in the guaranteed loan programs described in this part.

(a) *Regulated and supervised lenders.* Any regulated or supervised lender who is not otherwise debarred or suspended by the Federal government is eligible to participate in the guaranteed loan programs described in subpart B to this part.

(1) The requirements for a regulated or supervised lender that does not have an existing portfolio of guaranteed loans with the Agency to be eligible to participate are identified in paragraph (a)(1)(i) of this section. The requirements for a regulated or supervised lender that has an existing portfolio of guaranteed loans with the Agency to be eligible to participate are identified in paragraph (a)(1)(ii) of this section.

(i) A regulated or supervised lender that does not have an existing portfolio of guaranteed loans with the Agency must apply for lender approval to the Agency in the State in which it is chartered. The lender must also submit with the application a copy of its current written policies and procedures for loan origination and servicing. A lender must be in good standing with its regulator to be approved for participation.

(ii) A regulated or supervised lender that has an existing portfolio of guaranteed loans with the Agency is considered "proved" for participation and is not required to submit an application for lender approval. Such lender, however, is required, as specified by the Agency, to certify that it is in good standing with its regulator and submit copies of its current written policies and procedures for loan origination and servicing.

(2) If approved, the lender may sign a Lender's Agreement with the Agency. If the Lender's Agreement is executed by the lender and the Agency, the lender may submit an application for guarantee in any State in which it is authorized to do business. Approval for participation constitutes approval to participate in all guaranteed loan programs described in this part.

(3) Approved status is maintained as long as the lender remains in good standing with its regulator, in conformance with this part, or until otherwise notified by the Agency.

(b) *Other lenders.* Any lender not eligible in paragraph (a) of this section that wishes to originate or service a new loan under this part, who is not otherwise debarred or suspended by the Federal government, may apply for approved status, as specified in paragraph (b)(1) of this section, provided it has a minimum net worth of \$2.5 million; liquid assets of at least \$500,000; and an Agency-approved line of credit that totals \$5 million or more.

(1) *Application for lender approval.* The lender must submit an application to the Rural Development State Office in the State in which the lender is chartered providing the following information:

(i) Evidence showing that the lender has the necessary capital, resources, and funding capacity to successfully meet its responsibilities;

(ii) Copies of any license, charter, or other evidence of legal authority to engage in the proposed loan making and servicing activities;

(iii) Certificate(s) of good standing from the States in which they intend to conduct business; and

(iv) Description of its lending history and experience, including:

(A) evidence of demonstrated expertise in loan origination, making, securing, servicing, and collecting loans; length of time in the commercial lending business; experience with government guaranteed lending, particularly within any of the subject programs; the range and volume of lending and servicing activity; the current status of the loan portfolio; the lender's commercial loan fee structure;

and the level of experience of the lender's management, lending, and servicing staff;

(B) copies of the lender's credit evaluation policy and procedures documents, including evidence of the criteria stated in § 5001.16(b); the lender's loan origination and servicing policies and procedures, including delineating ratio requirements and minimum reserves, delineating collection, loan document compliance, post-closing financial statement analysis, verification of payment of taxes and insurance, and maintenance of liens; and audited financial statements not more than 1 year old;

(C) documented sources of funds for funding and closing loans; and

(D) office location(s) and proposed lending area(s).

(2) *Agency review.* The Agency will review the application and request additional clarification or information if necessary. If approved, the lender may sign a Lender's Agreement with the Agency. If the Lender's Agreement is executed by the lender and the Agency, the lender may submit an application for guarantee in any State in which it is authorized to do business. Approved status is maintained as long as the lender meets or exceeds minimum Agency requirements.

(c) *Lender designation.* A lender that meets the criteria specified in paragraph (a) or (b) of this section will be designated as a "Rural Development Approved lender" under this part. A Rural Development approved lender may submit to the Agency at any time, including when submitting its application for lender approval, an application for designation as a Preferred lender. No Rural Development approved lender will be afforded preferred lender status until approved by the Agency.

(1) The criteria the Agency will use to determine if a Rural Development approved lender qualifies for preferred lender status are:

(i) Current level of experience in commercial lending, government guaranteed commercial lending, financing, or other activity under similar loan programs;

(ii) If the lender has been making commercial loans for 5 or more years, has had no annual losses in the last 5 years greater than 1 percent of its outstanding commercial loan portfolio or if the lender has been making commercial loans for less than 5 years, has had no losses for the length of time the lender has been making commercial loans; and

(iii) Having no more than one instance of Federal government negligent loan origination or servicing.

(2) If approved as a Preferred lender, the lender has preferred lender status in each State.

(3) Preferred lender status is maintained as long as the lender continues to meet each of the criteria under which it was approved as specified in paragraph (c)(1) of this section. Maintenance of preferred lender status will be based on paragraphs (c)(1)(i), (c)(1)(ii)(A), and (c)(1)(iii) for all lenders who have been making commercial loans for 5 years or more, including those lenders who received Preferred lender status when having less than 5 years of commercial loan experience.

#### **§ 5001.10 [Reserved]**

Basic Guarantee Application Provisions

#### **§ 5001.11 Guarantee application process.**

(a) *Beginning the process.* Any lender may submit a pre-application or a full application to begin an application for guarantee.

(1) *Pre-application.* Based on the information in the pre-application, the Agency will make an informal assessment of the eligibility of the prospective borrower and project. The Agency will provide written informal comments regarding the pre-application's strengths and weaknesses. The Agency's assessment may change based on subsequently submitted information, is solely advisory in nature, does not obligate the Agency to approve a guarantee request, and is not considered a favorable or adverse decision by the Agency.

(2) *Guarantee application.* For each guarantee request, the lender must submit to the Agency an application that is in conformance with § 5001.12.

(b) *Guarantee application evaluation.* All loan guarantee applications will be evaluated according to this part.

(1) The Agency will notify the lender in writing of its decision.

(2) In the evaluation of the application, the Agency may require the lender to obtain additional assistance in those areas where the lender does not have the requisite expertise to originate or service the loan.

#### **§ 5001.12 Guarantee Application Content.**

All guarantee applications must contain the information specified in either paragraph (a) or (b) of this section, as determined under paragraph (c), and as specified in subpart B of this part.

(a) *Full documentation applications.* Full documentation applications must contain the following:

- (1) Agency-approved application forms;
  - (2) Lender's analysis and credit evaluation (conforming to § 5001.16(b));
  - (3) Environmental information required by the Agency to conduct its environmental reviews (as specified in § 5001.16(h));
  - (4) Technical reports and energy audits (as specified in subpart B);
  - (5) A copy of Form 10-K, "Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934," for companies listed on major stock exchanges and/or subject to the Securities and Exchange Commission regulations;
  - (6) Proposed loan agreement between the lender and borrower;
  - (7) Energy assessments (as specified in subpart B);
  - (8) Appraisals (as specified in § 5001.16(c));
  - (9) Business plan, unless the information is contained in the feasibility study;
  - (10) Feasibility study (as specified in subpart B);
  - (11) If the application is for 5 or more residential units or for for-profit nursing homes or assisted-living centers, an Affirmative Fair Housing Marketing Plan that is in conformance with 7 CFR 1901.203(c)(3);
  - (12) Preliminary engineering report (as specified in subpart B);
  - (13) Current credit reports or equivalent on the prospective borrower and any other person liable for the debt, except for public bodies; and
  - (14) If the guaranteed loan is \$1 million or more, the most recent audited financial statements of the borrower or if the guaranteed loan is less than \$1 million, the most recent audited or unaudited financial statements of the borrower.
  - (15) If the lender is not yet a Rural Development approved lender, the application for lender approval specified in § 5001.9(a) or (b), as applicable.
- (b) *Low documentation applications.* Low documentation applications must contain:
- (1) The information specified in paragraphs (a)(1) through (6) of this section; and
  - (2) Certification that the lender possesses and has reviewed the information specified in paragraphs (a)(7) through (14) of this section and has identified and reported to the Agency any significant risks that would jeopardize the repayment of the loan.
  - (3) If the lender is not yet a Rural Development approved lender, the

application for lender approval specified in § 5001.9(a) or (b), as applicable, must also be submitted.

(c) *Determination of documentation level.*

- (1) *Startup business.* All applications for startup businesses must be full documentation applications.
- (2) *Existing business.*
  - (i) Rural Development approved lenders that have preferred lender status may submit either a full or low documentation application for a loan guarantee request of \$5 million or less. Only a full documentation application will be acceptable for a loan guarantee request of greater than \$5 million.
  - (ii) Rural Development approved lenders that do not have preferred lender status must submit full documentation applications unless the project meets the criteria specified in paragraphs (c)(2)(ii)(A) through (E) of this section. If the project meets each of these criteria, as applicable, the lender may submit either a low or full documentation application.
    - (A) Debt coverage ratio of 1.25 or higher.
    - (B) Cash equity of at least 25 percent of eligible project costs or, as specified in Subpart B, community support.
    - (C) A minimum FICO (Fair Isaac and Company) credit score of 680 or equivalent industry credit score for each individual who signs the promissory note or guarantees repayment of the loan.
    - (D) A loan-to-value ratio of no more than 0.8.
    - (E) Loan guarantee portion of the loan at or below \$5 million.

#### §§ 5001.13–5001.14 [Reserved]

#### Basic Lender Provisions

##### Lender responsibilities— General. § 5001.15

- (a) Lenders must ensure that proposals for facilities seeking a guarantee under this part comply with all Federal, State, and local laws and regulatory rules that are in existence and that affect the project, the borrower, or lender activities.
- (b) Any lender involved in any manner with any guarantee under this part must cooperate fully with all oversight and monitoring efforts of the Agency or its representatives.
- (c) Any action or inaction on the part of the Agency does not relieve the lender of its responsibilities to originate and service the loan guaranteed under this part.

##### § 5001.16 Lender responsibilities— Origination.

- (a) *General.* The lender is responsible for originating all loans in accordance

with their current written policies and procedures and with the requirements of this part. Where a lender's current written policies and procedures address a corresponding requirement in this part, the lender must comply with whichever is more stringent. The Agency may require, at its discretion, an independent credit risk analysis (e.g., a credit rating or assessment) on the loan without consideration of the guarantee.

(b) *Credit evaluation.* For all applications for guarantee, the lender must prepare a credit evaluation that is consistent with Agency standards found in this part and with the current written policies and procedures of the lender submitting the application. Where a lender's current written policies and procedures address a corresponding requirement in this part, the lender must comply with whichever is more stringent. An acceptable credit evaluation must:

- (1) Use credit documentation procedures and an underwriting process that are consistent with generally accepted commercial lending practices, and the lender's own policies, procedures, and lending practices, and
- (2) Include an analysis of the credit factors associated with each guarantee application to ensure loan repayment, including consideration of each of the following five elements.

(i) *Credit worthiness.* Those financial qualities that generally impel the prospective borrower to meet its obligations as demonstrated by its credit history.

(ii) *Cash flow.* A prospective borrower's ability to produce sufficient cash to repay the loan as agreed.

(iii) *Capital.* The financial resources that the prospective borrower currently has and those it is likely to have when payments are due. The prospective borrower must be adequately capitalized.

(iv) *Collateral.* The assets pledged by the prospective borrower in support of the loan. Adequacy will be based on market value. For the purchase of cooperative stock, the lender must at least secure the loan with a lien on the stock acquired with loan funds, an assignment of any patronage refund, and the full and unconditional personal or corporate guarantee of the borrower.

(v) *Conditions.* The general business environment and status of the prospective borrower's industry.

(c) *Appraisals.* Real property collateral will be appraised by the lender in accordance with the appropriate guidelines contained in the current Standards 1 and 2 of the Uniform Standards of Professional

Appraisal Practices or successor standards.

(1) All appraisals used to establish the fair market value of the real property must not be more than 1 year old, except as otherwise specified in subpart B of this part.

(2) All appraisals will include consideration of the potential effects from a release of hazardous substances or petroleum products or other environmental hazards on the market value of the collateral.

(d) *Personal and corporate guarantees.* Unconditional personal and corporate guarantees are part of the collateral for the loan, but are not considered in determining whether a loan is adequately secured for loan making purposes.

(1) Agency-approved personal and corporate guarantees for the full term of the loan and at least equal to the guarantor's percent interest in the borrower, times the loan amount are required from those owning greater than a 20 percent interest in the borrower, unless the lender documents to the Agency's satisfaction that collateral, equity, cashflow, and profitability indicate an above-average ability to repay the loan. The guarantors will execute an Agency-approved unconditional guarantee form. When warranted by an Agency assessment of potential financial risk, Agency-approved guarantees may also be required of parent, subsidiaries, or affiliated companies (owning less than a 20 percent interest in the borrower) and require security for any guarantee provided under this section.

(2) Exceptions to the requirement for personal guarantees must be requested by the lender and concurred by the Agency approval official on a case-by-case basis. The lender must document that collateral, equity, cashflow, and profitability indicate an above-average ability to repay the loan.

(e) *Design requirements.* The lender must ensure that all projects are designed utilizing accepted architectural and engineering practices, taking into consideration any Agency comments when the facility is being designed, and conform to applicable Federal, State, and local codes and requirements. The lender must also ensure that the planned project will be fully constructed, within the original budget, to facilitate completion of the loan purpose and will be suitable, once completed, for the borrower's needs in accordance with the borrower's loan application.

(f) *Monitoring requirements.* The lender must monitor the progress of construction and ensure that

construction conforms to applicable Federal, State, and local code requirements and proceeds in accordance with the approved plans, specifications, and contract documents. The lender must also ensure that funds are used for eligible project costs. The lender must expeditiously report any problems in project development to the Agency.

(g) *Compliance with other Federal laws.* Lenders must comply with other applicable Federal laws including Equal Employment Opportunities, Americans with Disabilities Act, Equal Credit Opportunity Act, Fair Housing Act, and the Civil Rights Act of 1964. With regard to the Civil Rights Act of 1964, data must be made available to conduct compliance reviews in accordance with 7 CFR 1901.204 of this title or successor regulation; initial reviews will be conducted after the Assurance Agreement is signed and all subsequent reviews every 3 years thereafter for loans; and the last review will occur 3 years after the date of loan closing.

(h) *Environmental responsibilities.* The lender must ensure that the borrower has:

(1) Provided the necessary environmental information to enable the Agency to undertake its environmental review process in accordance with subpart G of either 7 CFR part 1940 or 7 CFR part 1794 or successor regulations, including the provision of all required Federal, State, and local permits;

(2) Complied with any mitigation measures required by the Agency; and

(3) Not taken any actions or incurred any obligations with respect to the proposed project that would either limit the range of alternatives to be considered during the Agency's environmental review process or which would have an adverse effect on the environment.

(i) *Conflicts of interest.* The lender must report to the Agency all appearances of conflicts of interest.

#### **§ 5001.17 Lender's responsibilities—Servicing.**

(a) *General.* The lender is responsible for servicing the loan in accordance with the Lender's Agreement, this part, and their current written policies and procedures. Where a lender's current written policies and procedures address a corresponding requirement in this part or in the Lender's agreement, the lender must comply with whichever is more stringent. The lender must ensure that the borrower has obtained, and will maintain for the life of the loan, all necessary insurance coverage appropriate to the proposed project. 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. Any cost to the Agency associated with such action will be assessed against the lender.

(b) *Certification.* The lender will certify in the Lender's Agreement that it will service the guaranteed loan according to Agency requirements and the lender's current written servicing policies and procedures and that, where the lender's current written policies and procedures address corresponding requirements of this part, it will comply with whichever is more stringent. When applicable, the lender will require an audit of the borrower in accordance with Office of Management and Budget requirements.

(c) *Collateral inspection and release.* The lender must inspect the collateral as often as necessary to properly service the loan. The Agency may require the lender to obtain prior Agency approval of any release of any collateral. The Agency may, at its discretion, require an appraisal of the remaining collateral in cases in which the Agency determines that it may be adversely affected by the release of the collateral. The appraisal will be at the expense of the borrower and must meet the requirements of § 5001.16(c). In all cases, the sale or release of collateral must be based on an arm's length transaction.

(d) *Transfers and assumptions.*

(1) *General.* Any time that a third party assumes a loan guaranteed under this part, it shall be processed and approved by the Agency as if it were a new loan guarantee.

(2) *Processing transfers and assumptions.* The lender may release the transferor (including any guarantor) from liability, regardless of the amount of the loan being transferred or assumed.

(i) Loan terms cannot be changed unless previously approved in writing by the Agency with the concurrence of the holder and transferor (including guarantor if it has not been released from personal liability). Any new loan term cannot exceed those authorized in this part as measured from the date the loan was initially guaranteed.

(ii) In the case of a transfer and assumption of less than the outstanding balance, the lender (if holding the guaranteed portion) may file an estimated Report of Loss with respect to the difference.



(3) *Transfer fees.* The Agency may charge the lender a nonrefundable transfer fee at the time of a transfer application. The Agency will set the amount of the transfer fee in an annual notice of funds availability.

(e) *Mergers.* The Agency may withdraw the guarantee when a borrower participates in a merger.

(f) *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. Agency concurrence requires that the Agency's financial interest will be enhanced; collateral will remain adequate to secure the loan; the lien to which the guaranteed loan is subordinated will be for a fixed dollar limit and that lien priorities remain for the portion of the loan that was not subordinated; and subordination to a revolving line of credit does not exceed 1 year.

(g) *Repurchases from holder(s).* The holder may make written demand on the lender or the Agency to repurchase the unpaid guarantee portion of the loan in the case of borrower default or failure of the lender to pay the holder its pro-rata share. When either the lender or the Agency determines that repurchase is necessary to adequately service the loan, the holder must sell the guaranteed portion to the requesting entity.

(1) *Repurchases by lender.* The lender must respond to the holder's demand within 30 days and will notify the Agency in writing of its decision, including notifying the Agency in writing of all repurchases it makes. When repurchased, the lender will accept an assignment without recourse from the holder upon repurchase. All repurchases must be for an amount equal to the holder's interest in the unpaid principal balance of the guaranteed portion and accrued interest less the lender's servicing fee and cover the principal and interest on the guaranteed loan accruing only up to 90 days after the date of the demand by the holder.

(2) *Repurchases by Agency.* When the Agency repurchases the loan, the holder must submit a specific written demand to the Agency, along with appropriate documentation. The Agency will be subrogated to all rights of the holder and, subject to satisfactory documentation, will purchase the unpaid principal and interest of the guaranteed portion to date of repurchase less the lender's servicing fee within 30 days after receipt of the demand. The lender may not charge the Agency any fees unless provided for in the Assignment Guarantee Agreement. The

lender shall use a form approved by the Agency to send the guaranteed loan payments to the Agency on all loans repurchased by the Agency from holders. Any purchase by the Agency does not change, alter, or modify any of the lender's obligations to the Agency arising from the loan or guarantee and does not waive any of the Agency's rights against the lender, borrower, or guarantor.

(h) *Additional expenditures and loans.* The lender will not make additional expenditures or new loans to a borrower with an outstanding loan guaranteed under this part without obtaining prior written Agency approval.

(i) *Lender failure.* In the event a lending institution fails, the Agency will provide instruction to the successor entity on a case-by-case basis. Such instructions may include that the Agency may determine to service the entire loan or the guaranteed portion of the loan. In the event no successor entity can be determined, the Agency reserves the right to enforce the provisions of the loan documents on behalf of the lender or to purchase the lender's interest in the loan.

(j) *Delinquent loans.* The lender must service delinquent loans in accordance with the Lender's Agreement, its current servicing standards, and reasonable and prudent lending standards. If a borrower is delinquent more than 30 days, the lender must coordinate with the Agency and the borrower to implement appropriate curative actions to resolve the problem. Any curative action that affects the return to the holder must receive the holder's concurrence. Any change in the repayment schedule must be limited to the remaining life of the collateral. Any loan performing in accordance with a curative action will no longer be delinquent.

(k) *Protective advances.* Protective advances are allowed only when they are necessary to preserve the value of the collateral and must be reasonable with respect to the outstanding loan amount and the value of the collateral being preserved. Protective advances will not include attorneys' fees or advances in lieu of additional loans. The lender must obtain written Agency approval for any protective advance that will singularly or cumulatively amount to more than \$200,000 or 10 percent of the guaranteed loan, whichever is less.

(l) *Liquidation.* The lender may liquidate a loan when one or more incidents of default or third party actions occur that the borrower can not or will not cure or eliminate within a reasonable period of time. The Agency reserves the right to unilaterally

conclude that liquidation is necessary and require the lender to assign the security instruments to the Agency.

(1) *Liquidation by the lender.* The lender must develop, in consultation with the Agency, a liquidation plan to determine the best course of action. This plan must include all aspects of liquidation, including but not limited to reports to the Agency, protection of collateral, loss payment, transmission of proceeds to the Agency, and future recovery. The lender must submit its liquidation plan to the Agency at least 30 days before implementing the plan. The Agency must be notified of any changes to or deviations from the plan.

(2) *Compromise settlement and release of personal guarantors.* A compromise settlement may be considered at any time, except as provided in subpart B to this part. Before a guarantor is released from liability, the Agency must concur with the lender. Upon agreement, the lender may proceed to effect a settlement compromise.

(m) *Litigation.* In all litigation proceedings involving the borrower, the lender is responsible for protecting the rights of the lender or 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.

(n) *Loss calculations and payment.* Losses shall be calculated by determining the total guaranteed loan amount including principal, protective advances, and accrued interest. From this amount will be deducted prior lien amounts owed through the settlement date, the net value of collateral, and other funds that can be applied to the debt. The maximum loss allowed is the lower of the percent of loss guarantee time the foregoing or the sum of principal advances and accrued interest. The amount due the lender is adjusted to take into account protective advances and interest.

(1) During the course of any reorganization plan, the lender will request and revise estimated loss payments using Agency-approved forms. The estimated loss claim, as well



as any revisions to this claim, will be accompanied by documentation to support the claim.

(2) In a chapter 9 or chapter 11 reorganization, the lender must obtain an independent appraisal of the collateral if so directed by the Agency. The Agency and the lender will share the appraisal fee equally.

(3) Final settlement of liquidation will be made with the lender after the collateral is liquidated (unless otherwise designated as a future recovery) or after settlement and compromise of all parties has been completed. The Agency retains the right to recover losses paid under the guarantee from any liable party.

(i) If the lender takes title to collateral, any loss will be based on the collateral value at the time the lender obtains title.

(ii) When the lender is conducting the liquidation and owns any of the guaranteed portion of the loan, it may request an estimated loss payment by submitting an estimate of loss that will occur in connection with liquidation of the loan.

(iii) Within 30 days after liquidation of all collateral, 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. The Agency will not guarantee interest beyond this 30-day period other than for the period of time it takes the Agency to process the loss claim. Before Agency approval of any final loss report, the lender must account for all funds, disposition of the collateral, and costs incurred, and must provide any other information necessary for successful completion of the liquidation.

(iv) After a final loss has been paid by the Agency, any future funds recovered by the lender will be pro-rated between the Agency and the lender based on the original percentage of guarantee even if the Loan Note Guarantee has been terminated.

(v) In a bankruptcy, the lender will submit an estimated loss claim based on the final orders of the bankruptcy court's direction. The Agency will pay the lender the estimated final loss based on these directions.

(4) The lender shall submit with each loss claim the current version of its written policies and procedures for origination and servicing.

#### **§§ 5001.18–5001.24 [Reserved]**

#### **Basic Borrower Provisions**

##### **§ 5001.25 Borrower responsibilities.**

(a) *Federal, State, and local regulations.* Borrowers must comply with all Federal, State, and local laws

and rules that are in existence and that affect the project including, but not limited to

(1) Land use zoning;

(2) Health, safety, and sanitation standards as well as design and installation standards; and

(3) Protection of the environment and consumer affairs.

(b) *Permits, agreements, and licenses.* Borrowers must obtain all permits, agreements, and licenses that are applicable to the project.

(c) *Insurance.* The borrower is responsible for maintaining all hazard, flood, liability, worker compensation, and personal life insurance, when required, on the project.

(d) *Access to borrower's records.* Upon request by the Agency, the borrower will permit representatives of the Agency (or other agencies of the U.S. Department of Agriculture authorized by that Department or the U.S. Government) to inspect and make copies of any of the records of the borrower pertaining to any Agency guaranteed loan. Such inspection and copying may be made during regular office hours of the borrower or at any other time agreed upon between the borrower and the Agency.

#### **§ 5001.26–5001.29 [Reserved]**

#### **Basic Guarantee and Loan Provisions**

##### **§ 5001.30 General.**

(a) *Underwriting.* All loans guaranteed by the Agency must be underwritten in accordance with the credit evaluation requirements specified in § 5001.16(b).

(b) *Conditions of guarantee.* A loan guarantee under this part will be evidenced by a Loan Note Guarantee issued by the Agency. Each lender will execute a Lender's Agreement.

(1) The entire loan will be secured by the same security with equal lien priority for the guaranteed and unguaranteed portions of the loan. The guaranteed portion will be paid first and given preference and priority over the unguaranteed portion.

(2) The lender will remain mortgagee or secured party of record notwithstanding the fact that another party may hold a portion of the loan.

(3) The holder of a guaranteed portion shall have all rights of payment, as defined in the Loan Note Guarantee to the extent of the portion purchased. The lender will remain bound by all obligations under the Loan Note Guarantee, Lender's Agreement, and Agency program regulations.

(4) The lender will receive all payments of principal and interest on the entire loan and will promptly remit

to each holder a pro-rata share, less any lender servicing fee.

(5) No loan guaranteed by the Agency under this part will be conditioned on any requirement that the borrower accept or receive electric service from any particular utility, supplier, or cooperative.

(c) *Full faith and credit.* A guarantee under this part constitutes an obligation supported by the full faith and credit of the United States and is not contestable except for fraud or misrepresentation by the lender or holder, as appropriate, when the lender or holder has actual knowledge, participates in, or condones such fraud or misrepresentation.

(1) A note that provides for the payment of interest on interest will not be guaranteed and any Loan Note Guarantee or Assignment Guarantee Agreement attached to, or relating to, a note which provides for payment of interest on interest is void.

(2) The guarantee will not be enforceable by the lender to the extent any loss is occasioned by the violation of usury laws, negligent loan origination or servicing, or failure to obtain the required security regardless of the time at which the Agency acquires knowledge of the foregoing. Any losses occasioned will not be enforceable by the lender to the extent that loan funds are used for purposes other than those specifically approved by the Agency in its Conditional Commitment for Guarantee.

(3) When in the hands of a holder, the Loan Note Guarantee or Assignment Guarantee Agreement shall not cover interest accruing 90 days after the holder has demanded repurchase by the lender. When in the hands of a holder, the Loan Note Guarantee or Assignment Guarantee Agreement shall not cover interest accruing 90 days after the lender or Agency has requested the holder to surrender the evidence of debt for repurchase.

(4) The Agency will guarantee payment as follows:

(i) To any holder, 100 percent of any loss sustained by the holder on the guaranteed portion of the loan and on interest due on such portion.

(ii) To the lender, the lesser of:

(A) Any loss sustained by the lender on the guaranteed portion, including principal and interest evidenced by the notes or assumption agreements and secured advances for protection and preservation of collateral made with the Agency's authorization; or

(B) The guaranteed principal advanced to or assumed by the borrower and any interest due thereon.

(d) *Soundness of guarantee.* All loans guaranteed under this part must be

financially sound and feasible, with reasonable assurance of repayment.

(e) *Rights and liabilities.* When a guaranteed portion of a loan is sold to a holder, the holder shall succeed to all payments of the lender under the Loan Note Guarantee to the extent of the portion purchased. A guarantee and right to require purchase will be directly enforceable by a holder notwithstanding any fraud or misrepresentation by the lender or any unenforceability of the guarantee by the lender, except for fraud or misrepresentation of which the holder had actual knowledge at the time it became the holder or in which the holder participates or condones. The lender shall not represent a Conditional Commitment of Guarantee as a guarantee. The Agency reserves the right to collect from the lender any payments made to the holder that would not have been payable to the lender had they been the holder.

(f) *Reduction of loss claims payable.* Negligent loan origination or servicing will result in reduction of loss claims payable under the guarantee to the lender if any losses have occurred as the result of such negligence. The extent of the reduction, which could be a total reduction, of the loss claims payable, will depend on the extent of the losses occasioned as the result of the negligent loan origination and servicing.

(g) *Write-downs.* Debt write-downs for an existing borrower where the same principals retain control of and decision-making authority for the business are prohibited.

#### **§ 5001.31 Guaranteed loan requirements.**

(a) *Interest rates.* Interest rates may be fixed or variable or a combination of both, as long as they are legal. Variable interest rates must be tied to an acceptable published index and the lender must incorporate the provision for adjustment of payment installments into the Note. When combined fixed and variable rates are used, the lender will provide the Agency with the overall effective interest rate for the entire loan.

(1) *Negotiated rates.* Interest rates, interest rate caps, and incremental adjustment limitations will be negotiated between the lender and the borrower.

(2) *Different rates on guaranteed and unguaranteed portion of the loan.* If the lender and borrower agree, the interest rate on the guaranteed portion of a loan may differ from the rate on the unguaranteed portion provided:

(i) The rate on the unguaranteed portion is equal to or below the market rate and does not exceed that currently being charged on loans for similar

purposes to borrowers under similar circumstances; and

(ii) the rate on the guaranteed portion does not exceed the rate on the unguaranteed portion unless the rate on the guaranteed portion is fixed and the unguaranteed portion is variable.

(b) *Interest rate changes.* Any change in the interest rate between issuance of the Conditional Commitment for Guarantee and issuance of the Loan Note Guarantee must be approved in writing by the Agency and shown as an amendment to the Conditional Commitment for Guarantee, and are subject to the restrictions specified in paragraphs (b)(1) and (2) of this section.

(1) *Reductions.* The borrower, lender, and holder (if any) may collectively effect a permanent or temporary reduction in the interest rate on the guaranteed loan at any time during the life of the loan by their written agreement, subject to the conditions specified in paragraphs (b)(1)(i) through (iii) of this section. The lender must keep sufficient records to allow the Agency to calculate any loss at the reduced interest rate. The lender must notify the Agency of all permanent interest rate reductions, as specified in § 5001.4(b)(3)(ii).

(i) After a permanent reduction, the Loan Note Guarantee will only cover losses of interest at the reduced interest rate.

(ii) In a final loss settlement when qualifying rate changes are made with the required written agreements and notification, the interest will be calculated for the periods the given rates were in effect. The lender must maintain records that adequately document the accrued interest claimed.

(iii) 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 may be issued. Copies of all legal documents must be provided to the Agency.

(2) *Increases.* Increases in interest rates are not permitted except when the increase results from normal fluctuations in approved variable interest rates, or the increase returns the rate to the rate prior to the temporary reduction.

(c) *Term length.* The loan term will be based on the use of proceeds, the useful economic life of the assets being financed, and the borrower's repayment ability. In no event may the term exceed 40 years.

(d) *Loan schedule and repayment.* Repayment will be structured in accordance with this section and the Loan Agreement, and will be due and

payable in accordance with the Note. Only loans that require a periodic payment schedule that will retire the debt over the term of the loan without a balloon payment will be guaranteed. Lenders must ensure that the principal balance of a guaranteed loan is properly amortized within the prescribed loan maturity.

(e) *Maximum loan amounts.* The maximum amount that may be guaranteed will be determined on a program-by-program basis and will be published each year in the **Federal Register**.

(f) *Maximum percent of guarantee.* The maximum guarantee is specified in subpart B for each guaranteed loan program covered by this part.

(g) *Fees.* Each year, the Agency will establish, and publish in a **Federal Register** notice, the guarantee fee and renewal fee for each guaranteed loan program. A guarantee fee and a renewal fee will be assessed on each loan, as specified in the **Federal Register** notice. Both the guarantee fee and the renewal fee are nonrefundable.

(1) *Guarantee fee.* The guarantee fee will be paid to the Agency by the lender at the time the Guarantee is issued. The fee may be passed on to the borrower.

(2) *Renewal fee.* As applicable, the renewal fee is assessed annually, is based on a fixed fee rate established at the beginning of the loan, and will be calculated on the unpaid guaranteed principal balance as of close of business on December 31 of each year. The fee will be billed to the lender and may be passed on to the borrower.

(h) *Lender fees.* The lender may levy reasonable, routine, and customary charges and fees for the guaranteed loan provided they are similar to those charged other applicants for the same type of loan for which a non-guaranteed borrower would be assessed. Late payment charges will not be covered by the Loan Note Guarantee. Such charges may not be added to the principal and interest due under any guaranteed note.

#### **§ 5001.32 Conditional commitment for guarantee.**

Upon approval of a loan guarantee, the Agency will issue a Conditional Commitment for Guarantee to the lender containing conditions under which the Guarantee will be issued. The lender must complete and sign the Acceptance of Conditions and return a copy to the Agency. The lender may propose alternate conditions for Agency consideration.

#### **§ 5001.33 Conditions precedent to issuance of Loan Note Guarantee.**

The Loan Note Guarantee will be issued once all of the conditions

specified in the Conditional Commitment for Guarantee have been met and each of the following has occurred:

(a) Payment of the appropriate guarantee fee;

(b) The lender has advised the Agency of any plans to sell or assign any part of the loan as provided in the Lender's Agreement; and

(c) The lender has certified that the prospective borrower has obtained all necessary insurance appropriate to the proposed project.

#### **§ 5001.34 Issuance of the guarantee.**

The Agency, at its sole discretion, will determine if the conditions within the Conditional Commitment for Guarantee have been met. The Agency, at its sole discretion, will determine whether or not to issue the guarantee.

(a) *Loan closing.* At loan closings, the lender must provide the lender's certifications, guarantee fee, and, if applicable, secondary market sale document.

(b) *Issuance.* Upon the lender's compliance with requirements of the Conditional Commitment for Guarantee, the Agency will issue the Loan Note Guarantee and Assignment Guarantee Agreement.

(c) *Refusal to execute Loan Note Guarantee.* If the Agency determines that it can not execute the Loan Note Guarantee, the Agency will promptly inform the lender of the reasons and give the lender a reasonable period within which to satisfy the objections. If the lender satisfies the objections within the time allowed, the guarantee will be issued.

(d) *Replacement of Loan Note Guarantee or Assignment Guarantee Agreement.* If the Loan Note Guarantee or Assignment Guarantee Agreement has been lost, stolen, destroyed, mutilated, or defaced, the Agency may issue a replacement to the lender or holder upon receipt from the lender of a notarized certificate of loss and an indemnity bond acceptable to the Agency. If the holder is the United States, a Federal Reserve Bank, a Federal Government corporation, a State or Territory, or the District of Columbia, an indemnity bond is not required.

#### **§ 5001.35 Alterations of loan instruments.**

Under no circumstances shall the lender alter or approve any alterations of the Loan Note Guarantee or any other loan instrument without the prior written approval of the Agency.

#### **§ 5001.36 Reorganizations.**

(a) *Change in borrower prior to closing.* Any change in borrower

ownership or organization prior to the issuance of the Loan Note Guarantee must meet program eligibility requirements and be approved by the Agency prior to the issuance of the Conditional Commitment for Guarantee. Once the Conditional Commitment for Guarantee is issued, no substitution of borrower(s) or change in the form of legal entity will be approved, except that a change in the legal entity may be approved when the original borrower is replaced with substantially the same individuals or officers with the same interest as originally approved.

(b) *Transfer of lender prior to issuance of the Loan Note Guarantee.* Prior to issuance of a Loan Note Guarantee, the Agency may approve the transfer of an outstanding Conditional Commitment for Guarantee to a new eligible lender, provided the present lender makes the request in writing and no substantive changes have occurred in the borrower, project, loan agreement, or Conditional Commitment for Guarantee. The new lender must be approved under this part and must execute a new application for guarantee in conformance with this part.

(c) *Substitution of lender after issuance of the Loan Note Guarantee.* After the issuance of a Loan Note Guarantee, the lender shall not be substituted without the prior written approval of the Agency. A substitution of the lender must be requested in writing by the borrower, the proposed substitute lender, and the original lender if still in existence. The Agency may approve the substitution of a lender if the new lender is Rural Development approved; agrees in writing to acquire title to any unguaranteed portion of the loan held by the original lender; and assumes all original loan requirements and lender responsibilities. The Agency will not pay any loss or share in any costs with a lender who is not in compliance with this section.

#### **§ 5001.37 Sale or assignment of guaranteed loan.**

(a) *General.* The lender may sell all or part of the guaranteed portion of the loan, subject to the conditions specified in paragraphs (a)(1) through (6) of this section.

(1) Any sale or assignment by the lender of the guaranteed portion of the loan must be accomplished in accordance with the conditions in the Lender's Agreement.

(2) The lender may obtain participation in the loan under its normal operating procedures; however, the lender must retain sufficient interest to perform its duties under this part.

(3) The lender must not sell or participate any amount of the guaranteed, or non-guaranteed, portion of the loan to the borrower or members of the borrower's immediate family, the borrower's officers, directors, stockholders, other owners, or a parent, subsidiary, or affiliate.

(4) Disposition of the guaranteed portion of a loan may not be made prior to full disbursement, completion of construction, and acquisition of real estate and equipment without the prior written approval of the Agency.

(5) If the lender desires to market all or part of the guaranteed portion of the loan at, or subsequent to, loan closing, the loan must not be in default.

(6) The lender may retain all or part of the unguaranteed portion of the loan. However, if the lender does not have preferred lender status, the lender is required to retain a minimum of 5 percent of the total loan amount in its portfolio. The amount required to be retained must be of the unguaranteed portion of the loan and can not be participated. Lenders may sell the remaining amount of the unretained amount of the loan only through participation.

(b) *Termination of lender servicing fee.* The lender's servicing fee will stop when the Agency purchases the guaranteed portion of the loan from the secondary market. No such servicing fee may be charged to the Agency and all loan payments and collateral proceeds received will be applied first to the guaranteed loan.

#### **§ 5001.38 Termination of Loan Note Guarantee.**

Each Loan Note Guarantee issued under this part will terminate automatically upon:

(a) Full payment of the guaranteed loan; or

(b) full payment of any loss obligation or negotiated loss settlement except for future recovery provisions and payments made as a result of the Debt Collection Improvement Act (DCIA). After final payment of claims to lenders and/or holders, the Agency will retain all funds received as the result of the DCIA; or

(c) written request from the lender to the Agency that the guarantee will terminate 30 days after the date of the request, provided that the lender holds all of the guaranteed portion, and the original Loan Note Guarantee is returned to the Agency to be canceled.

**§§ 5001.39–5001.100 [Reserved]****Subpart B—Program-Specific Provisions****§ 5001.101 Community Facilities Program.**

(a) *Project eligibility.* To be eligible for a Community Facility guaranteed loan, the project must meet the criteria specified in paragraphs (a)(1) through (4) of this section and in § 5001.6.

(1) *Eligible projects.* All loans guaranteed with community facility funding shall be for:

(i) Essential community facilities;

(ii) community services or community-based social, recreational or cultural services;

(iii) transportation infrastructure and support;

(iv) hydroelectric generating facilities or supplemental and supporting structures for rural electrification only with advance written approval from the Agency;

(v) natural gas distribution systems;

(vi) acquisition of land and site preparation for industrial parks; or

(vii) refinancing any loan. Except for the refinancing of Agency direct loans, refinancing of other loans will be limited to a minority portion of the guaranteed loan.

(2) *Facilities for public use.* All facilities financed under the provisions of this section shall be for public purposes.

(i) Facilities will be installed to serve any user within the service area who desires service and can be feasibly and legally served.

(ii) The lender will determine that, when feasibly and legally possible, inequities within the proposed project's service area for the same type service proposed (*e.g.*, gas distribution systems) will be remedied by the owner on, or before, completion of the project. Inequities are defined as unjustified variations in availability, adequacy, or quality of service. User rate schedules for portions of existing systems or facilities that were developed under different financing, rates, terms, or conditions do not necessarily constitute inequities.

(3) *Leased space.* A facility will remain eligible for CF funding provided it has less than 25 percent of its floor space occupied by ineligible

organizations or activities. The ineligible organization and the ineligible commercial activity must be related to and enhance the primary purpose for which the facility is being established by the borrower.

(4) *Facility location.* Facilities must be located in rural areas, except:

(i) For utility services such as natural gas or hydroelectric serving both rural and non-rural areas. In such cases, Agency funds may be used to finance only that portion serving rural areas, regardless of facility location.

(ii) For telecommunication projects, the part of the facility located in a non-rural area must be necessary to provide the essential services to rural areas.

(5) *Demonstration of community support.* A project may demonstrate community support in lieu of the cash equity required under § 5001.6(c)(2) or § 5001.12(c)(2)(ii)(B), as applicable.

(i) Evidence of community support in the form of a certification of support for each project or facility from any affected local government body is required.

(ii) With the exceptions of essential community facilities owned by a local public body or a Federally-recognized Indian tribe serving local residents or tribal members, a certificate of support must be obtained from each affected local government within the service area of the facility. The certificate of support must be signed by an authorized official of the local government.

(iii) The certificate of support should include sufficient information to determine that a community facility will provide needed services to the community and will have no adverse impact on other community facilities providing similar services. The organization is required to provide sufficient information to affected local governments as may be needed to obtain the certificate of support.

(b) *Unauthorized projects and purposes.* Loan funds may not be used to finance:

(1) Properties to be used for commercial rental when the borrower has no control over tenants and services offered except for industrial-site infrastructure development;

(2) Facilities that are 25 percent or more for the purpose of housing Federal or State agencies;

(3) Community antenna television services or facilities;

(4) Telephone systems;

(5) Facilities that are not modest in size, design, and cost; and

(6) Finder's and packager's fees.

(c) *Borrower eligibility.* In addition to the requirements specified in subpart A of this part, the following requirements also apply where applicable:

(1) YMCA, YWCA, Girl Scouts, and Boy Scouts are eligible applicant organizations.

(2) A private not-for-profit essential community facility (other than utilities) must have significant ties with the local rural community. Such ties are necessary to ensure to the greatest extent possible that a facility under private control will carry out a public purpose and continue to primarily serve rural areas. Ties may be evidenced by items such as:

(i) Association with, or controlled by, a local public body or bodies or broadly based ownership and controlled by members of the community.

(ii) Substantial public funding through taxes, revenue bonds, or other local government sources, or substantial voluntary community funding such as would be obtained through a community-wide funding campaign.

(3) *Credit not available elsewhere.* The Agency must determine that the borrower is unable to obtain the required credit without the loan guarantee from private, commercial, or cooperative sources at reasonable rates and terms for loans for similar purposes and periods of time.

(d) *Additional application documentation requirements—feasibility study.* A feasibility study by a qualified independent consultant may be required by the Agency.

(e) *Additional guarantee- and loan-related requirements.*

(1) *Funding limit.* The principal amount of a Community Facility loan guaranteed under this section may not exceed \$50 million.

(2) *Maximum percent of guarantee.* The maximum loan guarantees issued to a Rural Development approved lender with Community Facilities funding are specified in the table to paragraph (e).

TABLE TO PARAGRAPH (E).—MAXIMUM LOAN GUARANTEE PERCENTAGES FOR COMMUNITY FACILITIES GUARANTEED LOANS

Type of rural development approved lender	Type of application	Guaranteed loan amount		
		\$5 million or less (percent)	Over \$5 million up to and including \$10 million (percent)	Over \$10* million (percent)
Without preferred lender status .....	Low documentation .....	80	na	na
	Full documentation .....	90	90	90
With preferred lender status .....	Low documentation .....	90	na	na
	Full documentation .....	90	90	90

na = not applicable.

\* Per § 5001.101(e)(1), the maximum guaranteed loan amount is \$50 million.

### (3) *Parity lien requirements.*

Whenever both a Community Facilities guaranteed loan and a Community Facilities direct loan are utilized to finance a single project, the Agency will require a parity lien, unless the lender can not meet its regulatory requirements.

### **§ 5001.102 Water and Waste Disposal Facilities Program.**

(a) *Project eligibility.* To be eligible for a Water and Waste Disposal Facilities guaranteed loan, the project must meet the criteria specified in paragraphs (a)(1) through (3) of this section and in § 5001.6.

(1) *Eligible projects and costs.* All loans guaranteed with Water and Waste Disposal funding shall be for:

(i) A water or wastewater disposal facility;

(ii) payment of other utility connection charges as provided in service contracts between utility systems; or

(iii) refinancing any loan. Except for the refinancing of Agency direct loans, refinancing of other loans will be limited to a minority portion of the guaranteed loan.

(2) *Facilities for public use.* All facilities financed under the provisions of this section shall be for public purposes.

(i) Facilities will be installed to serve any user within the service area who desires service and can be feasibly and legally served.

(ii) The lender will determine that, when feasible and legally possible, inequities within the proposed project's service area for the same type service proposed will be remedied by the owner on, or before, completion of the project. Inequities are defined as unjustified variations in availability, adequacy, or quality of service. User rate schedules for portions of existing systems or facilities that were developed under different financing, rates, terms, or conditions do not necessarily constitute inequities.

(3) *Demonstration of community support.* A project may demonstrate community support in lieu of the cash equity required under § 5001.6(c)(2) or § 5001.12(c)(2)(ii)(B), as applicable. Demonstration of community support shall be made as specified in § 5001.101(a)(5)(i) through (iii).

(b) *Unauthorized projects and purposes.* Loan funds may not be used to finance:

(1) Facilities that are not modest in size, design, and cost;

(2) Loan or grant finder's fees;

(3) The construction of any new combined storm and sanitary sewer facilities;

(4) Any portion of the cost of a facility that does not serve a rural area;

(5) That portion of project costs normally provided by a business or industrial user, such as wastewater pretreatment;

(6) Rental for the use of equipment or machinery owned by the applicant;

(7) For other purposes not directly related to operating and maintenance of the facility being installed or improved; or

(8) The payment of a judgment which would disqualify an applicant for a loan under § 5001.102(c)(2).

(c) *Borrower eligibility.* To be eligible for a Water and Waste Disposal Facilities guaranteed loan, a prospective borrower must meet the criteria specified in paragraphs (c)(1) and (2) of this section and in § 5001.8(a)(1) and (2).

(1) *Eligible entity.* The prospective borrower must be one of the following types of entities:

(i) A public body such as a municipality, county, district, authority, or other political subdivision of a State located in a rural area;

(ii) An organization operated on a not-for-profit basis, such as an association, cooperative, or private corporation. The organization must be an association controlled by a local public body or bodies, or have a broadly based

ownership by or membership of people of the local community; or

(iii) An Indian tribe on a Federal or State reservation or any other Federally-recognized Indian tribe.

(2) *Credit not available elsewhere.* The Agency must determine that the borrower is unable to obtain the required credit without the loan guarantee from private, commercial, or cooperative sources at reasonable rates and terms for loans for similar purposes and periods of time.

(d) *Additional application documentation requirements.*

(1) *Feasibility study.* A feasibility study by a qualified independent consultant may be required by the Agency.

(2) *Preliminary engineering report (PER).* Two copies of the PER are to be submitted. Preliminary engineering reports must conform to customary professional standards. PER guidelines for water, sanitary sewer, solid waste, and storm sewer are available from the Agency. The PER may be submitted to the Agency prior to the rest of the application material if a preliminary review by the Agency is desired.

(3) *Financial reports.* Lenders are required to obtain and analyze financial statements as required by the Loan Agreement. Rural Development approved lenders that do not have preferred lender status must submit a copy of the analysis to the Agency within 120 days of receipt of the financial statements. Rural Development approved lenders that have preferred lender status must provide evidence that they have such an analysis in their file, but are not required to submit a copy to the Agency unless specifically requested.

(e) *Additional guarantee- and loan-related requirements—maximum percent of guarantee.* The maximum loan guarantees issued to a Rural Development approved lender with Water and Waste Disposal Facility

funding are specified in Table to paragraph (e).

TABLE TO PARAGRAPH (E).—MAXIMUM LOAN GUARANTEE PERCENTAGES FOR WATER AND WASTE DISPOSAL FACILITY GUARANTEED LOANS

Type of rural development approved lender	Type of application	Guaranteed loan amount		
		\$5 million or less (percent)	Over \$5 million up to and including \$10 million (percent)	Over \$10 million (percent)
Without preferred lender status .....	Low documentation .....	80	na	na
	Full documentation .....	90	90	90
With preferred lender status .....	Low documentation .....	90	na	na
	Full documentation .....	90	90	90

na = not applicable.

#### § 5001.103 Business and Industry Program.

(a) *Project eligibility.* To be eligible for a Business and Industry guaranteed loan, the project must meet the criteria specified in paragraph (a) of this section and in § 5001.6.

(1) All loans guaranteed with Business and Industry funding shall be for:

- (i) Business and industrial acquisitions when the loan will keep the business from closing, prevent the loss of employment opportunities, or provide expanded job opportunities;
- (ii) business conversion, enlargement, repair, modernization, or development;
- (iii) the purchase and development of land, easements, rights-of-way, buildings, or facilities;
- (iv) the purchase of equipment, leasehold improvements, machinery, supplies, inventory, start up costs, permanent working capital, pollution control and abatement, or feasibility studies;
- (v) transportation services incidental to industrial development;
- (vi) agricultural production, with advance written approval from the Agency, when it is not eligible for Farm Service Agency farmer program assistance and when it is part of an integrated business also involved in the processing of agricultural products;
- (vii) the purchase of membership, stocks, bonds, or debentures or, as allowed under paragraph (a)(2) of this section, cooperative stock;
- (viii) commercial fishing, aquaculture, commercial nurseries, forestry, hydroponics, or the growing of mushrooms;
- (ix) interest during the period before the first principal payment becomes due or when the facility becomes income producing, whichever is earlier;
- (x) refinancing any loan. Except for the refinancing of Agency direct loans, refinancing of other loans will be

limited to a minority portion of the guaranteed loan;

(xi) providing takeout of interim financing when the lender submits a complete preapplication or application in which the interim financing is proposed, prior to extending any portion of the interim loan;

(xii) fees and charges for professional services and routine lender fees and the Agency guarantee fee;

(xiii) tourist and recreation facilities, including hotels, motels, and bed and breakfast establishments;

(xiv) educational, training, or community facilities;

(xv) housing development sites with certain restrictions;

(xvi) community antenna television services or facilities;

(xvii) assistance to industries adjusting to terminated Federal agricultural programs or increased foreign competition; or

(xviii) assisting cooperative organizations.

#### (2) *Purchase of cooperative stock.*

Loans may be made to individual farmers or ranchers for the purchase of cooperative stock. The entity to receive the proceeds from the stock sale must be a farmer or rancher cooperative established for the purpose of processing agricultural commodities. Proceeds from the stock sale may be used to recapitalize an existing cooperative, to develop a new processing facility or product line, or to expand an existing production facility. The cooperative may contract for services to process agricultural commodities or otherwise process value-added agricultural products during the 5-year period beginning on the operation startup date of the cooperative in order to provide adequate time for the planning and construction of the processing facility of the cooperative.

#### (b) *Unauthorized projects and purposes.*

(1) Businesses housed in private homes, except when the pro-rata value of the owner's living quarters is deleted from the value of the project.

(2) Projects in excess of \$1 million that would likely result in the transfer of jobs from one area to another and increase direct employment by more than 50 employees.

(3) Projects in excess of \$1 million that would increase direct employment by more than 50 employees, if the project would result in an increase in the production of goods for which there is not sufficient demand, or if the availability of services or facilities is insufficient to meet the needs of the business.

(4) Interim financing.

(5) Distribution or payment to an individual owner, partner, stockholder, or beneficiary of the borrower or a close relative of such an individual when such individual will retain any portion of the ownership of the borrower.

(6) Assistance to Government employees and military personnel who are directors or officers or have a major ownership of 20 percent or more in the business.

(7) The guarantee of lease payments.

(8) The guarantee of loans made by other Federal agencies.

(9) Loans made with the proceeds of any obligation the interest on which is excludable from income under 26 U.S.C. § 103 or a successor statute. Funds generated through the issuance of tax-exempt obligations may neither be used to purchase the guaranteed portion of any Agency guaranteed loan nor may an Agency guaranteed loan serve as collateral for a tax-exempt issue. The Agency may guarantee a loan for a project which involves tax-exempt financing only when the guaranteed loan funds are used to finance a part of the project that is separate and distinct

from the part which is financed by the tax-exempt obligation, and the guaranteed loan has at least a parity security position with the tax-exempt obligation.

(c) *Borrower eligibility.* In addition to the criteria specified in § 5001.8(a)(1) and (2), a prospective borrower must meet both of the criteria specified in paragraphs (c)(1) and (2) of this section to be eligible for a Business and Industry guaranteed loan.

(1) A borrower must be a cooperative organization, corporation, partnership, or other legal entity organized and operated on a profit or not-for-profit basis; an Indian tribe on a Federal or State reservation or other Federally recognized tribal group; a public body; or an individual.

(2) A borrower must be engaged in or proposing to engage in a business. Business may include manufacturing, wholesaling, retailing, providing services, or other activities that will:

- (i) Provide employment;
- (ii) Improve the economic or environmental climate;
- (iii) Promote the conservation, development, and use of water for aquaculture; or
- (iv) Reduce reliance on nonrenewable energy resources by encouraging the development and construction of solar energy systems and other renewable energy systems (including wind energy systems, geothermal energy systems, and anaerobic digesters for the purpose of energy generation).

(d) *Additional application process requirements—obligation of funds.* If funds are insufficient to cover all approved applications, the Agency will use a scoring priority system to allocate funds, which will give a priority to encourage economic development in communities that are suffering economic hardships. The Agency will establish the scoring criteria each fiscal year and provide them in a notice in the **Federal Register**.

(e) *Additional application documentation requirements.*

(1) *Audited financial statements.* If the proposed guaranteed loan exceeds \$3 million, the Agency may, at its sole discretion, require audited financial statements to be submitted annually when the Agency is concerned about the borrower's credit risk.

(2) *Feasibility study.* A feasibility study by a qualified independent consultant may be required by the Agency for start-up businesses or existing businesses when the project will significantly affect the borrower's operations. If a feasibility study of a cooperative is required, the feasibility study will determine the viability of the business and not the individual farm operators.

(3) *Certification of Non-Relocation and Market Capacity.* If the loan will exceed \$1 million and will increase direct employment by more than 50 employees, a form approved by the Agency concerning non-relocation and market capacity.

(f) *Additional Lender Responsibilities—Origination—Collateral.* At a minimum, for the purchase of cooperative stock, the lender must secure the loan with a lien on the stock acquired with loan funds, an assignment of any patronage refund, and the full and unconditional personal or corporate guarantee of the borrower.

(g) *Additional guarantee- and loan-related requirements.*

(1) *Conditional Commitment for Guarantee.* For the purchase of cooperative stock, the Conditional Commitment for Guarantee shall require the cooperative to provide the lender with all required Federal, State, and local permits and other clearances involving the environmental aspects for review and approval.

(2) *Issuance of Loan Note Guarantee.* If, for the purchase of cooperative stock, the lender requests the issuance of the Loan Note Guarantee before the cooperative becomes operational, the lender must certify to the Agency that the cooperative has all of the required Federal, State, and local permits and other clearances involving the

environmental aspects for review and approval.

(3) *Funding limits.* The principal amount of a Business and Industry loan guaranteed under this section may not exceed \$25,000,000, except that the principal amount made to a cooperative organization and guaranteed under this section may not exceed \$40,000,000 for rural projects processing value added commodities.

(i) The total amount of Business and Industry loans made to cooperative organizations and guaranteed for a fiscal year under this section with principal amounts that are in excess of \$25,000,000 may not exceed 10 percent of the business and industry loans guaranteed for the fiscal year.

(ii) The principal amount of a Business and Industry loan made under this section for the purchase of cooperative stock may not exceed \$600,000.

(4) *Guarantee fee.* The maximum guarantee fee that may be charged is 2 percent. The guarantee fee may be reduced to 1 percent if the borrower is a high impact business and is located in an area of long term population decline and job deterioration as a result of persistent economic hardship, significant economic loss from a Presidentially-declared disaster, or a fundamental structural economic change. Each fiscal year, the Agency will establish a limit on the maximum portion of guarantee authority available for that fiscal year that may be used to guarantee loans with a guarantee fee of 1 percent. The limit will be announced by publishing a notice in the **Federal Register**. Once the limit has been reached, the guarantee fee for all additional loans obligated during the remainder of that fiscal year will be 2 percent.

(5) *Maximum percent of guarantee.* The maximum loan guarantees issued to a Rural Development approved lender with Business and Industry funding are specified in Table to paragraph (g).

TABLE TO PARAGRAPH (G).—MAXIMUM LOAN GUARANTEE PERCENTAGES FOR BUSINESS AND INDUSTRY GUARANTEED LOANS

Type of rural development approved lender	Type of application	Guaranteed loan amount		
		\$5 million or less (percent)	Over \$5 million up to and including \$10 million (percent)	Over \$10 million* (percent)
Without preferred lender status .....	Low documentation .....	70	na	na
	Full documentation .....	80	70	60
With preferred lender status .....	Low documentation .....	80	na	na
	Full documentation .....	80	70	60

na = not applicable.

\* Per § 5001.103(g)(3), the maximum guaranteed loan amount is \$25 million except for a cooperative producing a value added commodity for which the maximum is \$40 million.

#### **5001.104 Renewable Energy Systems and Energy Efficiency Improvements Program.**

(a) *Project eligibility.* To be eligible for a Renewable Energy Systems and Energy Efficiency Improvements guaranteed loan, the project must meet the criteria specified in paragraphs (a)(1) and (2) of this section and in § 5001.6.

(1) The project shall be for the purchase, installation, expansion and/or other energy-related improvement of a renewable energy system or to make energy efficiency improvements project; and

(2) The project shall be for technology that is

(i) pre-commercial or commercially available, and

(ii) replicable.

(b) *Borrower eligibility.* To be eligible for a renewable energy systems and energy efficiency improvements guaranteed loan, a prospective borrower must be an agricultural producer or rural small business and must meet the criteria specified in § 5001.8(a)(1) and (2).

(c) *Additional application process requirements—obligation of funds.* If funds are insufficient to cover all approved applications, the Agency will use a scoring priority system to allocate funds to encourage development of promising pre-commercial and commercially available alternative energy sources that are currently unable to obtain financing from commercial lending sources. The Agency will establish the scoring criteria on a periodic basis and publish it in the **Federal Register**.

(d) *Additional application documentation requirements.* Applications must also contain the following, as applicable:

(1) *Certifications.* The lender must certify in the application that the project is able to demonstrate technical merit and that the prospective borrower is a small agricultural producer or rural small business.

(2) *Technical report.* For renewable energy systems projects seeking a loan guarantee of more than \$200,000, a satisfactory technical report that demonstrates that the project is commercially viable and can be installed and perform as intended in a reliable, safe, cost-effective, and legally compliant manner must be provided. To determine the overall technical merit of the renewable energy system, the lender must submit its proposal to an approved Department of Energy (DOE) laboratory and obtain a DOE technical report. A

Rural Development approved lender that does not have preferred lender status must submit the DOE technical report with its application. A Preferred lender may instead certify in the application that a DOE technical report, deemed satisfactory by a DOE energy laboratory, has been obtained prior to the request for guarantee in lieu of submitting the technical report with the application.

(3) *Energy assessment/audit.* For energy efficiency improvement projects, an energy assessment, with adequate and appropriate evidence of energy savings expected when the system is operated as designed, must be provided. For energy efficiency improvement projects with total eligible project costs greater than \$50,000, an energy audit is required. Rural Development approved lenders with preferred lender status may certify in the application that an energy assessment or audit, as applicable, has been obtained prior to the request for guarantee in lieu of submitting the assessment or audit with the application.

(4) *Feasibility study.* Lenders are required to obtain a feasibility study for each project seeking a loan guarantee of greater than \$200,000. To be acceptable, the feasibility study must be conducted by a qualified independent consultant.

(5) *Financial statements.* Applications from Rural Development approved lenders without preferred lender status must include financial statements for the lesser of the past 3 years or the business life of the applicant. If the proposed guaranteed loan exceeds \$3 million, the Agency may require audited financial statements annually when the Agency is concerned about the borrower's credit risk.

(e) *Additional servicing requirements—post-construction reporting requirements.* Once the project has been constructed, the lender must provide to the Agency annual reports from the borrower on the performance characteristics and results of the projects.

(1) *Schedule.* For renewable energy system projects, these reports are to be provided commencing in the first full calendar year after construction is completed and continuing for 3 full years. For energy efficiency improvement projects, these reports are to be provided commencing the first full calendar year following the year in which project construction was completed and continuing for 2 full years.

(2) *Contents.* Reports for renewable energy system projects must contain, at a minimum, information on output and sales and/or energy savings. Reports for Energy Efficiency Improvement projects must contain, at a minimum, information on energy savings. Additional information to be included in these reports will be negotiated between the Agency and the lender/borrower prior to the execution of the loan note guarantee.

(f) *Additional guarantee- and loan-related requirements—(1) Conditions precedent to issuance of loan note guarantee.* In addition to the requirements specified in § 5001.33, for renewable energy systems and energy efficiency improvements loans, all planned property acquisitions and development have been performing at a steady state operating level in accordance with the technical requirements, plans, and specifications; the project conforms with applicable Federal, State, and local codes; and costs have not exceeded the amount approved by the lender and the Agency.

(2) *Funding limits.* The amount of a Renewable Energy Systems and Energy Efficiency loan guarantee, including any grants and direct loans made under this program, that will be made available to an eligible project will not exceed 50 percent of total eligible project costs. Eligible project costs are only those costs associated with the items identified in paragraphs (f)(2)(i) through (xi) of this section, as long as the items are an integral and necessary part of the renewable energy system or energy efficiency improvement.

(i) Post-application purchase and installation of equipment (new, refurbished, or remanufactured), except agricultural tillage equipment, used equipment, and vehicles.

(ii) Post-application construction or improvements, except residential.

(iii) Energy audits or assessments.

(iv) Permit and license fees.

(v) Professional service fees, except for application preparation.

(vi) Feasibility studies and technical reports.

(vii) Business plans.

(viii) Retrofitting.

(ix) Construction of a new energy efficient facility only when the facility is used for the same purpose, is approximately the same size, and based on the energy audit will provide more energy savings than improving an existing facility. Only costs identified in the energy audit for energy efficiency improvements are allowed.



(x) Permanent working capital.  
(xi) Land acquisition.  
(3) *Maximum percent of guarantee.*  
The maximum loan guarantees issued to

a Rural Development approved lender  
with Renewable Energy Systems and  
Energy Efficiency Improvements

funding are shown in Table to  
paragraph (f).

TABLE TO PARAGRAPH (F).—MAXIMUM LOAN GUARANTEE PERCENTAGES FOR RENEWABLE ENERGY SYSTEM AND ENERGY EFFICIENCY IMPROVEMENT GUARANTEED LOANS

Type of rural development approved lender	Type of application	Guaranteed loan amount			
		\$600,000 or less (percent)	Over \$600,000 up to and including \$5 million (percent)	Over \$5 million up to and including \$10 million (percent)	Over \$10 million (percent)
Without preferred lender status .....	Low documentation .....	75	70	na	na
	Full documentation .....	85	80	70	60
With preferred lender status .....	Low documentation .....	85	80	na	na
	Full documentation .....	85	80	70	60

na = not applicable.

§§ 5001.105–5001.200 [Reserved]

Dated: August 30, 2007.  
**Thomas C. Dorr,**  
*Under Secretary, Rural Development.*  
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