DEPARTMENT OF AGRICULTURE

Rural Housing Service

Rural Business-Cooperative Service

Rural Utilities Service

Farm Service Agency

7 CFR Part 1980

RIN: 0560–AF38

Implementation of Preferred Lender Program and Streamlining of Guaranteed Regulations

AGENCY: Rural Housing Service, Rural Business-Cooperative Service, Rural Utilities Service, and Farm Service Agency, USDA.

ACTION: Proposed rule.

SUMMARY: This rule proposes to amend the regulations governing the Farm Service Agency Guaranteed Farm Loan Programs. It proposes to clarify and simplify the procedures to apply for, make, and service an FSA Guaranteed Loan. This rule also proposes to establish the Preferred Lender Program.

DATES: Comments on this proposed rule, or comments on alternatives to this proposal, must be received on or before October 26, 1998 to be given full consideration.

ADDRESSES: Submit written comments to the Farm Service Agency, U.S. Department of Agriculture, Farm Loan Programs Loan Making Division, Attention: Director, Room 5438–S, 1400 Independence Avenue, SW, STOP 0522, Washington, DC 20250–0522. All written comments received in connection with this rule will be available for public inspection 8:15 am–4:45 pm, except holidays, at 1400 Independence Avenue, SW, Washington, DC 20250–0522.

Comments on the information collection requirements of this proposed rule must be sent to the Office of Management and Budget (OMB) or the Department at the address listed in the Paperwork Reduction Act section of this preamble.

FOR FURTHER INFORMATION CONTACT: Steven K. Ford, Senior Loan Officer, Farm Service Agency; telephone: 202–720–3889; Facsimile: 202–690–1117; E-mail: sford@wdc.fsa.usda.gov

SUPPLEMENTARY INFORMATION:

Executive Order 12866

This rule has been determined to be significant and was reviewed by the Office of Management and Budget under Executive Order 12866.

This rule substantially streamlines FSA's forms and procedures implementing the Guaranteed Loan Program. By making FSA's Guaranteed Loan Program more consistent with standard practices used within the lending industry, lenders will be more willing to use the program. This will increase the availability of commercial credit for family size farmers.

FSA currently guarantees repayment on approximately 65,000 farm loans to 40,000 farmers. Each year, FSA receives 15,000 request for new loans. By reducing the application burden on lenders, and making FSA rules more consistent with industry practices, we expect lenders will increase requests for loan guarantees by 25%, or an additional $395 million. This means an additional 3000 farmers will be able to receive commercial credit. These farmers would otherwise have gone without credit or required assistance through FSA's Direct loan programs.

The Agency is requesting comments regarding the accuracy of the projected benefits described above as well as any actual benefits experienced by farmers or lenders affected by these program changes.

Regulatory Flexibility Act

The Agency certifies that this rule will not have a significant economic impact on a substantial number of small entities as defined in the Regulatory Flexibility Act, Pub. L. 96–534, as amended (5 U.S.C. 601). An insignificant number of guaranteed loan borrowers and no lenders are small entities. This rule does not impact the small entities to a greater extent than large entities.

Environmental Impact Statement

It is the determination of the issuing agency that this action is not a major Federal action significantly affecting the environment. Therefore, in accordance with the National Environmental Policy Act of 1969, Pub. L. 91–190, and 7 CFR part 1940, subpart G, an Environmental Impact Statement is not required.

Executive Order 12988

This proposed rule has been reviewed in accordance with E.O. 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 to this rule: and (3) administrative proceedings in accordance with 7 CFR parts 11 and 780 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 12372

For reasons set forth in the Notice to 7 CFR, part 3015, subpart V (48 FR 29115, June 24, 1983), the programs and activities within this rule are excluded from the scope of Executive Order 12372, which requires intergovernmental consultation with State and local officials.

Unfunded Mandates

Title II of the Unfunded Mandates Reform Act of 1995 (UMRA), Public Law 104–4, requires Federal agencies to assess the effects of their regulatory actions on state, local, and tribal governments or the private sector. Agencies generally must prepare a written statement, including a cost benefit analysis, for proposed and final rules with ''Federal mandates'' that may result in expenditures of $100 million or more in any 1 year for State, local, or tribal governments, in the aggregate, or to the private sector. UMRA generally requires agencies to consider alternatives and adopt the more cost effective or least burdensome alternative that achieves the objectives of the rule.

The rule contains no Federal mandates, as defined under 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 UMRA.

Paperwork Reduction Act

The amendments to 7 CFR part 1980 contained in this proposed rule make several revisions to the information collection requirements that were previously approved by OMB under the provisions of 44 U.S.C. chapter 35. Comments regarding the following issues should be sent to the Desk Officer for Agriculture, Office of Information and Regulatory Affairs, Office of Management and Budget, Washington, D.C. 20503 and to Steve Ford, Senior Loan Officer, USDA, FSA, Farm Loan Programs Loan Making Division, Farm Service Agency, USDA, 1400 Independence Avenue, SW, STOP 0522, Washington, D.C. 20013–0522: (a) whether the collection of information is necessary for the proper performance of the functions of the agency, including whether the information will have practical utility; (b) the accuracy of the agency's estimate of burden including the validity of the methodology and assumptions used; (c) ways to enhance the quality, utility and clarity of the information to be collected; (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 regarding paperwork burden will be summarized and included in the request for OMB approval of the information collection. All comments will also become a matter of public record.

Good cause is shown for a comment period of less than 60 days because of the need to accelerate the availability of assistance under this program. Numerous natural disasters throughout the country have reduced farm production and income which has resulted in deteriorating financial conditions for numerous producers. As a result of those deteriorating financial conditions, we anticipate an increased demand for guaranteed farm loans. The proposed streamlined regulations will enable the Agency to serve the needs of the financially stressed farmers and their lenders more quickly and efficiently; therefore it is justified to implement the proposed guaranteed farm loan changes as soon as possible.

Title: 7 CFR 1980, subpart B, Farmer Program Loans.

OMB Control Number: 0560–0155.

Expiration Date of Approval: March 31, 1998.

Type of Request: Request for Comments.

Abstract: The information collected under OMB Control Number 0560–0155, as identified above, is needed in order for FSA to effectively administer its guaranteed farm loan programs. The information is collected by the FSA loan official in consultation with participating commercial lenders. The basic objective of the guaranteed loan program is to provide credit to applicants who are unable to obtain credit from lending institutions without a guarantee. The reporting requirements imposed on the public by the regulations set out in 7 CFR part 1980, subpart B, are necessary to administer the guaranteed loan program in accordance with statutory requirements of the Consolidated Farm and Rural Development Act and are consistent with commonly performed lending practices. Collection of information after loans are made is necessary to protect the Government's financial interest.

This proposed rule will reduce information requirements which are imposed on the public. Savings will be reflected in (1) reduced loan origination and servicing requirements under the new Preferred Lender program, (2) reduced application requirements for loans under $50,000, (3) reduced historical financial and production history requirements for all lenders, (4) more flexible appraisal requirements, and (5) simplified borrower default procedures. However, increased information requirements are necessary with new regulatory authorities. Additional financial information will be required when a lender is requesting a partial release, subordination, or a release from liability. This information was not needed previously because the authority to grant these actions did not exist in regulation.

Estimate of Burden: Public reporting burden for the collection of information in this regulation is estimated to average .71 hours per response.

Respondents: Commercial Banks, Farm Credit System, farmers and ranchers.

Estimated Number of Respondents: 5500 lenders, 15,000 loan applicants.

Estimated Number of Responses per Respondent: 52.26 per lender, 1 per loan applicant.

Estimated Total Annual Burden on Respondents: 212,218.75.

Discussion of the Proposed Rule

General Changes

The regulations governing the FSA guaranteed farm loan programs are being totally revised in the following manner. First, the requirements in subpart A, of part 1980, which contains general provisions for farm loan guarantees, community program guarantees and business and industry loan guarantees, applicable to Guaranteed Farm Program Loans, will be incorporated into subpart B, and subpart A will no longer be applicable to farm loan guarantees.

Second, Subpart B is being rewritten and reorganized into a more logical structure. Under current regulations, many topics are addressed in different locations. For example, loan collateral requirements are contained in sections 1980.108, 1980.175, 1980.180, and 1980.185. Current and proposed sections of this subpart do not correspond directly since it is being rewritten entirely and program rules are being revised throughout. Thus, the Agency has not prepared a side by side comparison of current and planned provisions. If a comparison is desired, current regulations are available by inquiring at the address above.

Third, clarity, readability and structure is being improved, and policies are being explained or simplified. The Agency has identified several provisions as vague and confusing over the years through inquiries from lenders and Agency field personnel. Provisions have been added where the regulation is currently silent and to clarify those requirements that frequently cause confusion. However, the requirements for interest assistance are not being revised in this proposed rule. The interim rule published at 56 FR 8258–8272 (February 28, 1991) will be finalized in a separate final rule, and Exhibit D to subpart B of 1980 will be removed from the **Federal Register**.

Finally, specific references to use of FSA County Committees in the guaranteed farm loan program regulations are being eliminated. Current plans are to not have these committees involved in the guaranteed farm loan program. Should that policy change, however, the definition of ''Agency'' is broad enough to include these committees too. Proposed substantive changes to program rules are discussed below by subject matter.

Conflict of Interest

Lender reporting requirements for actual or potential conflicts of interest as currently covered by the lender's agreement are clarified. The Agency defines what it considers an actual or potential conflict of interest to be reported, based on the degree of relationship or association between the lender, applicant, or FSA employees. The Agency hopes to reduce lender confusion by clarifying what is considered a reportable relationship. When the Agency determines that potential conflicts of interest exist, the regulation provides lenders flexibility to develop safeguards to control potential conflicts of interest. This was felt to be less onerous of a burden than prohibiting all loans where a potential conflict of interest exists. The new section also restricts directors and employees of lenders and FSA employees from deliberations, decisions, and actions that impact loans where they have a personal interest. This restriction is also applied to defined relatives, associates and entities of the restricted individuals. This section was developed to clarify and enhance existing restrictions and enhance consistency of application. The section attempts to be minimally restrictive while assuring that high levels of objectivity are maintained in dealing with loans to directors or employees and their relatives and business associates.

Certified Lender Program

An interim rule was published on June 24, 1994, [58 FR 34302–34342] to implement a Certified Lender Program (CLP) for Guaranteed Operating loans (OL) as required by § 339(c) of the Consolidated Farm and Rural Development Act (Act). This Act did not

include Farm Ownership (FO) or Soil and Water (SW) loans in the CLP nor did it address the relationship between the Approved Lender Program (ALP) and the CLP. The primary benefits to being a CLP were (1) the ability to certify to, rather than provide, supporting documentation for loan requests, (2) reduced application requirements, (3) faster Agency response times, and (4) streamlined line of credit procedures.

The CLP was established largely due to problems with the ALP. The ALP provided lenders with a less burdensome application, but did not establish a strict set of criteria for eligibility as the CLP does. This caused several Agency offices to over-scrutinize the ALP applications, resulting in excessive paperwork and unacceptably lengthy processing times. We propose to expand the CLP under the general rule making authority of § 339(a) of the Act to include FO loans. The Agency supports expansion to cover SW loans, but has removed all references to guaranteed SW loans because the Agency has not received appropriations for SW loans since 1994 and does not anticipate future appropriations for these guaranteed loans. Almost all lenders active in the guaranteed loan program make and service both OL and FO loans. If the Agency trusts the lender to properly make an OL loan, it is difficult to justify imposing additional requirements on the lender for an FO loan. The risk for the Agency is not increased by incorporating FO loans into the CLP. The performance of CLP lenders has been good. Losses on Guaranteed OL loans made by Standard Eligible lenders has averaged 1.47 percent, while losses in the CLP averaged only .78 percent. The decision processes are very similar for OL and FO loans. Requiring a separate application process and additional documentation for FO loans from CLP lenders reduces lender acceptability of the guaranteed loan program.

The criteria for lenders to gain and retain CLP status also are clarified in the proposed rule. Only one change to the criteria for having status revoked is being proposed with this rule—failure to repurchase a loan that was sold on the secondary market upon request from the holder. A vibrant secondary market for FSA guarantees is integral to the continued growth and effectiveness of our program. In order to protect the integrity of the secondary market for FSA guaranteed loans, the Agency has adhered to a policy of universal buyback from holders upon default, when the original lender refuses to do so. Unfortunately, this Agency policy has resulted in some lenders using the secondary market as a means to avert risk rather than as a liquidity or earnings tool as intended. The Agency has little recourse for inadequate handling of a loan when a lender refuses to repurchase from holders. Also, the borrower is denied the benefit of loan servicing actions unless the guaranteed portion is not held by the Government. Therefore, the Agency proposes that a Certified or Preferred lender repurchase a defaulted loan or a loan that needs servicing from a holder in order to maintain that status.

Approved Lender Program

Since the CLP provides FSA's best lenders with additional authority and less paperwork, there is no longer a need for the less effective ALP, and we propose to eliminate the program. The Agency cannot reasonably offer lenders enough different combinations of benefits, such as faster approval time, reduced application requirements, and increased authorities to differentiate between four levels of lender status (standard eligible, approved, certified, and preferred). The application process will be less confusing and burdensome to the lenders and Agency employees with fewer levels of lender status. Therefore, the Agency will no longer enter into new ALP agreements and expiring agreements will not be renewed. ALP lenders may continue to participate in the program as Standard Eligible Lenders or qualify for CLP or Preferred Lender Program (PLP) status.

Certified and Preferred Lender Programs

Section 339(d) of the Act requires the Agency to implement a Preferred Lender Program (PLP). The statutory provision also requires the Agency to automatically approve loans not acted upon within 14 days of receipt of an application from a Preferred lender. Provisions of that section also require CLP loans to be acted upon by the Agency within 14 days; however, the Agency is not penalized for failure to act within that time period. Additional statutory provisions related to being a Preferred Lender include an 80 percent guarantee, permitting the lender to make all decisions concerning credit worthiness, the closing, monitoring, collection and liquidation of loans and to provide appropriate certifications that the borrower is in compliance with all requirements of law and regulation. In contrast, statutory provisions for the CLP permit Certified Lenders to make certifications regarding creditworthiness, repayment ability, and adequacy of collateral, but do not give the lender the authority to make all decisions on these issues or the closing, collection and liquidation of guaranteed loans.

The PLP lender will be given the maximum authority possible. The Agency cannot, however, give the lender authority to approve FSA guaranteed loans without prior Agency review. Section 339(c)(5) of the Act maintains the Agency's responsibility to certify eligibility, review financial information, and otherwise assess an application. Therefore, approval authority must remain with the Agency.

Because of the automatic approval provisions, the requirements to become a PLP lender will be more strict, but will follow closely with the CLP criteria and cover experience with, and knowledge of the program and performance measured through losses and quality of applications and servicing. Section 339(d) of the Act requires PLP lenders to establish knowledge of, experience under, and demonstrate proficiency in the CLP program before obtaining PLP status. The Agency proposes for PLP lenders to have made a minimum of 20 CLP loans and have a loss rate of not more than 3 percent. This compares with 10 guaranteed loans and no more than a 7 percent loss rate to hold CLP status. This PLP loss rate is established at a level that will permit the Agency to grant PLP status to one percent of its approximately 2500 lenders that make guaranteed farm loans each year.

The approval of CLP status has been based primarily on these objective quantity and loss rate criteria with minimal reliance on loan origination and servicing performance. CLP criteria will be strengthened in this proposed rule to require the lender to have submitted substantially complete and correct applications and serviced guaranteed loans according to Agency regulations.

For PLP, in addition to the objective quantity and loss rate criteria, even stronger performance criteria are proposed for loan origination and servicing quality. Through Agency review of previous applications and lender file reviews, the Agency must determine that there have been no major errors and no recurring minor errors in the loan applications submitted as a CLP lender. Major errors are those which could directly affect the soundness of a loan. In addition, PLP lenders must have a history of using the guaranteed program for new loans, instead of refinancing the lender's existing debts. While the Agency does not want to restrict lenders from using the program for authorized purposes, we are concerned about lenders using the

program excessively to reduce their existing exposure. This may also reflect lender capability to assess loan quality.

The main difference between PLP lenders and other lenders will be the Agency's approval of the lender's credit management system when PLP status is granted. In the past, the Agency has required its Approved and Certified lenders to process and service loans and maintain their files according to the same set of Agency regulations. PLP lenders, however, will be allowed to propose to the Agency how they intend to process and service loans. The Agency will review and approve these proposals to assure that the lender is utilizing prudent lending practices and is protecting the Government's interests. Loan documentation, underwriting rules and processes, and servicing procedures will differ between PLP lenders. Since these are the industry's elite lenders, the Agency is allowing them this additional flexibility.

The items to be submitted to the Agency with the loan application will be substantially simplified for PLP lenders. The PLP lender's credit management system will outline what procedures that lender will follow to originate guaranteed loans. A guarantee request may consist of a one page FSA loan application form and a complete loan narrative. The narrative, outlining the 5 ''C's'' of credit; character, capacity, collateral, capital, and conditions, must provide the necessary information to permit FSA to adequately assess the application. The PLP is certifying that the loan was processed as proposed in their application for PLP status. In addition, the PLP lender will receive an automatic approval of the guarantee if no response is given within 14 calendar days, as required by the Act. This approval will be contingent on the availability of funds, as are all Agency approvals now.

In the case of servicing activities, a similar policy is proposed. PLP lenders will service the account in accordance with their agreement with the Agency at the time of PLP certification. CLP lenders are given reduced paperwork burdens and greater authority in the following areas: CLP lenders only perform annual analyses if needed based on the financial strength of the borrower, and only a narrative analysis need be submitted to the Agency. They are not required to notify the Agency upon completion of construction, repair, or land development. The Agency also will consider CLP and PLP lenders' request for subordination, partial release, or transfer and assumption within 14 (versus 30 for standard eligible lenders) calendar days from the receipt of a complete request. CLP lenders must obtain Agency prior written approval of restructuring only in the case of writedown. For other restructuring actions, the CLP lender need only provide certification of regulatory compliance, a narrative and copies of any calculations.

All of the changes to a lender's loan servicing authorities made by this rule are intended to be retroactive, unless otherwise noted in the rule. After the effective date of this rule, servicing authority will be based on the lender's status and the requirements of this rule without regard for the date the loan was closed. That is to say that a lender's authority to conduct servicing activities, obtain Agency concurrence, or provide the Agency documentation and reports on a particular loan at a given time, is based on the lender's status when they desire to take the action and not based on the lender's status at the time the loan was closed. When a lender is awarded Preferred status, they must certify that they have serviced the loans in their portfolio as required by the applicable regulations, servicing agreements, and loan agreements. If a status is revoked, future actions on a loan will be as required for standard eligible lenders, although the loan may have been closed while Preferred status was in effect.

Lender Eligibility

The Agency is considering allowing certain non-traditional financial entities to be eligible to make FSA guaranteed loans. Currently, a lender must be regulated by a State or Federal government body, such as the State banking commissioner, the Federal Reserve, or the Office of Thrift Supervision. We also guarantee loans made by Government Sponsored Enterprises, like the Farm Credit System and state agencies, such as the Vermont Economic Development Authority. This requirement was initially broad enough to permit most major agricultural lending organizations to participate in the Guaranteed loan program. Recently, however, certain nontraditional lenders, such as machinery manufacturers, agricultural supply firms, and others have acquired a significant share of the agricultural credit market. To assist us in considering this proposal, we are specifically asking for comments regarding the reasons for or against such action and any limitations the Agency should include.

The Agency will also add a requirement that lenders agree to provide credit information to consumer and commercial credit reporting agencies, as appropriate. This requirement is mandated by the Debt Collection Improvement Act of 1996 (31 U.S.C. 3711).

Year 2000 Compliance

The Agency is considering adding a requirement that lenders have computer systems which are Year 2000 compliant. This requirement is needed because of the potential risk to the Agency from lenders servicing Guaranteed loans using inadequate computer systems. The Agency is requesting comments on the impact of such a requirement.

Loan Application Forms and Regulations

The Agency plans to further shorten its guaranteed application form and reduce application requirements to minimize burden on all lenders applying for guarantees and their borrowers. Several requirements have been eliminated such as the need for the lender to submit copies of all leases and contracts, and the requirement to submit detailed legal documentation on all entity borrowers. In addition to requirements for individuals, entity borrowers will only be required to submit a list of members with personal balance sheets. Corporate charters, joint operation agreements, articles of incorporation, etc, will no longer be required. The Agency believes lending standards are sufficiently established to permit the lender to review the customary documents and determine their effect on the soundness of a loan. It is the lender's responsibility to ensure the loan applicant has authority to operate in their state and they have the security interest in the items of collateral they propose.

The amount of historical documentation will be reduced to conform closer to industry standards. Currently, the Agency requires 5 years of financial and production documentation, while most commercial agricultural lenders use 3 years of financial records and many do not rely on production records at all. While some additional requirements are necessary because of the additional risk inherent in a loan requiring a guarantee, the additional material that has been requested does not significantly improve the quality of the loan officers' decisions. This is indicated by strong loan portfolio performance of experienced private industry lenders who do not use the additional information. This rule proposes that lenders with CLP or PLP status will not be required to obtain specific documentation on an applicant's production history. CLP and PLP lenders are certifying that the cash flow

budget in the application is based on the loan applicant's history. Since these are proven lenders, the Agency will not dictate whether this is to be based on production records, income statements, or a combination of the two. The Agency also proposes to reduce the requirement for financial records from 5 to 3 years to reflect industry standards.

The Agency feels that the documentation requirements needed to support the loan decision generally should be left to the lender's judgment and prudent credit administration practices. However, for lenders that are less active in the guaranteed program, those without CLP or PLP status, the Agency needs more documentation to complete an adequate analysis. Reduction of the documentation requirements should increase participation in the guaranteed program, reduce demand for more costly direct loans, and provide funding to areas currently under served. Therefore, we choose to retain the requirement for obtaining both production and financial records, but reduce the amount required to 3 years.

The Agency also plans to further reduce the application requirements for small loans as directed by 333A(g) of the Act. When implementing this change for loans under $50,000, the Agency did not reduce the amount of documentation the lender must obtain, it only reduced the documentation the lender must submit to the Agency. It is not reasonable for the Agency to require the lender to put the same time and effort into a $25,000 loan as a $400,000 loan. Lenders find it more difficult to justify their processing costs for the income received on small loans, therefore, they avoid small loans and leave the smaller farmers under served. The Agency proposes to reduce the verification and historical documentation requirements on these small loans. However, the lender would be required to perform at least the same level of documentation and review as they do on their non-guaranteed loans under $50,000, and complete an application form with a cash flow budget and balance sheet. Supporting financial and production history and verifications would not be required unless the lender obtains this for their non-guaranteed loans. This reduced documentation requirement will increase the availability of credit to small farmers. Should the lender begin to experience increased loss claims, we have included a provision to permit the Agency to require full financial and production documentation and verification at its discretion to make eligibility and approval decisions.

Packager Requirements

Many parts of the country are served by management consultants, record keeping firms, and similar companies that actively promote the guaranteed loan program. These firms or individuals are often hired by producers and lenders to provide assistance on debt and financial management and assemble or ''package'' FSA guaranteed loan applications. The Agency is concerned about loan packagers charging excessive fees to prepare guaranteed loan applications. Therefore, it proposes to restrict loan processing or packaging fees to those charged non-guaranteed customers for similar transactions. The Agency has had a long-standing limitation on fees charged by lenders, but has had no similar requirement for fees charged by independent loan packagers. The Agency recognizes the benefits loan packagers provide and knows that most are reasonably priced. We also recognize the variation in costs in different parts of the country due to appraisal requirements and competition among packagers. However, with the simplified forms, reduced application requirements, and software packages available, lenders should be able to process guaranteed applications in the same manner that they do other agricultural loans. Also, Agency personnel are able to assist lenders and loan applicants in completing applications through the Market Placement Program at no charge.

Environmental Requirements

Various environmental requirements have been clarified to better define Agency and lender responsibilities and update program regulations to reflect statutory and regulatory changes regarding floodplains. Pursuant to the National Flood Insurance Reform Act of 1994 and implementing regulations, 60 FR 35286—35289 (July 6, 1995), the Agency is requiring the lender to use the standard flood hazard determination form to decide whether improved real estate or mobile home security is located in a floodplain. The Agency, not the lender, is responsible for compliance with the National Environmental Policy Act and must diligently seek the information it needs to comply. The lender has the responsibility to properly monitor a loan applicant's operation as it relates to environmental laws. A guarantee remains valid only so long as the lender acts prudently. The lender must provide Agency officials with any information on the loan applicant's operation that may impact compliance with environmental and other laws. The final determination on National Environmental Policy Act issues are required to be made by the Agency.

A provision will be added concerning lender requirements in relation to hazardous substances. Lenders must perform ''due diligence'' in evaluating any real estate security for contamination from the release of hazardous substances, petroleum products, or other environmental hazards and determining the effect of such contamination on the security value of the property. This change is necessary to assure accurate valuation of security for guaranteed loans. Hazardous waste contamination may substantially lower the value of any real estate security and may be hidden or overlooked. Evidence of due diligence must be shown by the most current version of the American Society of Testing and Materials (ASTM) Transaction Screen Questionnaire, supplemented as necessary by the ASTM Phase I Environmental Site Assessments form, or similar documentation. Lenders will maintain due diligence documentation in the applicant or borrower loan file and provide the Agency with copies upon request.

Loan Limits

No changes are proposed by this rule to the existing statutory limits of $300,000 for the Guaranteed FO program and $400,000 for the Guaranteed OL program—$700,000 combined.

Collateral

The Agency plans to consolidate and add flexibility to its collateral regulations. Over the years, additional collateral requirements were adopted for certain loans to address specific situations. This has culminated in a very confusing, and often conflicting regulation. We plan to reduce these detailed constraints to a clearer, more flexible set of requirements. The type of security for each loan has been clarified to permit any collateral as long as the life and depreciation rate of the collateral will not cause the loan to be undersecured. The amount of collateral required and basic restrictions that protect the government's interest will not be reduced. In fact, the more flexible guidance may lead to more secure loans as lenders use collateral which is appropriate for the situation without being constrained by regulatory requirements. The Agency anticipates that the proposed change will result in increased participation in the guaranteed program and decreased

demand on FSA's more costly direct loan program.

The Agency also will have authority to grant an exception to any of the security requirements if the repayment of the loan will not be impaired and the proposed action is in the Government's best interest. This will permit quality guaranteed loans to be made without jeopardizing the Government's interest.

The Agency has removed the requirement that all nonessential real estate assets be liquidated to receive a Guaranteed FO loan. This requirement was unnecessary and often put the lender and government in a difficult position of defining which assets were nonessential. The borrower will still be required to pledge the assets as collateral for the loan, and the assets will be considered when evaluating the ability to obtain credit without a guarantee.

Appraisals

The Agency proposes to permit approval of loans subject to the lenders obtaining an acceptable appraisal. In many areas of the country, appraisals are expensive and loan applicants are reluctant to incur this expense without some indication that the other factors of the loan proposal are acceptable. The lender and Agency would continue to be protected by the approval condition specifying the security required and minimum appraised value.

Also, the Agency proposes to bring its appraisal standards more in line with the private lending industry. FSA will raise its threshold to require a State Certified General Appraiser on real estate transactions from $100,000 to $250,000. Loans under $250,000 must have an appraisal using all three conventional approaches to value, and the appraiser must be acceptable to the agency. This change will permit the lenders greater use of their normal practices.

Lender's Forms

The Agency proposes to clarify its restriction against notes that contain a ''payment on demand'' clause. The lender's promissory note must still set forth a schedule of payments; however, the lender does not need to modify the ''boiler plate'' language commonly used in the industry.

Use of Line of Credit Funds

This rule proposes to revise the use of guaranteed line of credit funds in two areas. First, the Agency proposes to allow lenders to advance funds from a line of credit for a borrower to make term debt payments on capital items. This change is being made as a result of input from participating lenders who have indicated that current restrictions on this practice are contrary to normal industry practice. Many farm borrowers have automobile loans and debts with manufacturers' credit arms with payment schedules that often do not conform to the farm operation's cash flow cycle. Lenders have indicated that they would like to have the option of making such regularly occurring payments with lines of credit, instead of having to release crop proceeds, or refinance the loan with a guaranteed loan note. Such purpose is permissible under § 312(b) of the Act as an essential operating expense or other farm, ranch or home need. This change will be applicable to future lines of credit, as well as those outstanding as of the effective date of this rule, with regard to subsequent years' advances.

Second, this rule specifies that total advances on a line of credit cannot exceed the total projected credit needs indicated on the plan. This requirement is implicit in current regulations through use of the ''total credit needs'' column on plans that must be submitted with a request for guarantee. However, there is some confusion regarding this requirement, and some lenders continue to readvance on lines of credit in excess of the planned expenses with no reasonable prospects of repayment. This leaves the Agency vulnerable to unnecessary loss claim payments. This requirement will apply to all current and future lines of credit upon publication of this rule in final.

Loan Underwriting Criteria

For many years, the Agency has relied solely on the projected cash flow to determine whether a loan applicant has the financial strength to qualify for a loan, with the single determining factor being the ability to develop what the Agency has defined as a positive cash flow. The Agency is concerned that the single, typical year's projection does not adequately analyze a loan applicant's financial position, considering solvency, liquidity, and profitability. In many cases the Agency does observe and evaluate these items, but does not use them directly in the approval process. The Agency believes more comprehensive guidelines incorporating a loan applicant's balance sheet and past income statement measures should be incorporated into the approval process. Comments are requested regarding the Agency adopting more comprehensive underwriting criteria, the Agency's definition of positive cash flow, and the potential for use of credit screens.

Discussion of Loan Servicing Regulation Changes

Delinquent Account Servicing

In order to reduce the reporting burden on lenders and the review burden on Agency personnel, this rule proposes a simplified procedure for lenders to follow when a guaranteed borrower defaults on their loan. The lender must meet with a borrower within 30 days after default and determine a course of action to correct the delinquency within 90 days. The lender must inform FSA of their plans and may consult FSA officials for regulatory interpretations and ideas. However, since the Agency is not directly involved with servicing the loan, it is no longer mandatory for FSA officials to be involved in initial discussions following default. Also, a separate written summary of the default meeting is not required and may be provided on the regular default report due within 45 days of the default and every 60 days thereafter. Agency personnel will still be available to lenders for advice on complicated cases, procedural matters or regulatory guidance. This change will apply to all loans after it becomes effective.

Also, the Agency is removing the requirement that the delinquency be beyond the borrower's control because the requirement is viewed as superfluous. The Agency can find no example of a case when it would benefit a borrower to not make an installment as agreed when they have the capability to do so. Nonetheless, the lender in such a case would have the option of not requesting Agency concurrence with a restructuring action, should they feel that the borrower has exhibited a lack of good faith and the loan should be liquidated instead.

Agency Repurchase of Loans

The Agency recognizes the importance of the secondary market as a source of capital for rural credit. In this rule, we attempt to make several modifications to current policies and procedures that are intended to improve the working relationship between secondary market participants, lenders, and the Agency.

First, for all loans guaranteed after publication of this rule in final, the Agency will require a lender to repurchase the guaranteed portion of the loan unless they are physically or financially unable to complete repurchase. If a lender does not repurchase, or refuses to repurchase when they were able to, the lender's future involvement in the Agency's guaranteed loan program may be

jeopardized. Furthermore, the Agency plans to apply this requirement retroactively as a condition for maintenance of Preferred or Certified Lender status. Both for loans currently sold on the secondary market and those sold after this rule is final, status will be revoked if the lender does not repurchase a loan when requested.

Second, the Agency plans to provide a method for the Government to continue as holder of a loan when it has purchased the guaranteed portion from a secondary market holder and reimbursement from the lender is not practical. Currently, after the Agency repurchases a guaranteed loan from a secondary market holder, the lender generally must liquidate the loan to compensate the Agency for the repurchase. In some cases, the borrower may pay the loan current or file for bankruptcy protection while the repurchase is being processed. Thus, liquidation becomes inappropriate. Regardless, under current provisions the lender is required to purchase the loan back from the Agency. Under the proposed change, the Agency will be able to allow lenders to continue to receive payments on a repurchased guaranteed loan held by the Government and forward those payments to FSA, as long as the account remains current or in compliance with an approved bankruptcy plan. This change will allow the Agency to keep the loan performing, keep the affected farmers in business, and avoid the losses associated with legal action to recover the repurchase expense.

Third, in conjunction with this change, the Agency proposes to allow the lender to purchase the guaranteed portion from the Agency without recourse at the Agency's discretion.

Bankruptcy Fees

The Agency intends to allow the guarantee to cover a lender's reasonable legal fees in bankruptcy. Legal fees, when a borrower files under Chapter 7 of the bankruptcy code, will be deducted from the proceeds of the liquidation of the collateral after discharge. Lender attorney fees incurred when a borrower files under Chapter 11, 12, and 13 will be paid in the same percentage as the guarantee.

Currently, regulations do not authorize the Agency to pay attorney's fees in reorganization bankruptcies. Legal fees in reorganizations were considered ''normal'' servicing costs similar to farm visits, filing fees, documentation, and overhead and are the lender's responsibility. However, program lenders have suggested that the nature of a guarantee should be to protect the lender against any additional expenses or loss that occurs when a borrower defaults, which includes the filing under Chapter 11, 12, or 13 of the bankruptcy code. The Agency agrees. Lenders should be very actively involved in the bankruptcy legal proceedings to assure that collateral is protected, plans are realistic, and actions taken are not adverse to the interests of the borrower or the Government under the guaranteed loan.

Currently, the Agency allows legal fees necessary to repossess or foreclose collateral to be deducted as liquidation costs from collateral proceeds whether the liquidation is forcible, voluntary, or as the result of liquidation under Chapter 7 of the bankruptcy code. Reimbursement of most of the attorney fees by the Agency will provide incentive for lenders to closely monitor all cases that are in bankruptcy. Still, the Agency will not guarantee legal fees in any bankruptcy action if those fees are frivolous, unreasonable or exorbitant. Furthermore, the Agency will not include as part of any loss payment a lender's legal fees resulting from a lender liability suit or similar action.

Appraisal Expenses

Currently, the lender and FSA share equally in the cost of appraisals obtained for liquidation purposes. The Agency is proposing to allow appraisal fees to be deducted from liquidation proceeds in the case of liquidation and allow the cost of appraisals for bankruptcies to be included on the bankruptcy loss claim as applicable. Lenders will still be required to bear the cost of appraisals necessary in connection with normal servicing, such as releases, reamortization or writedown.

This change is being proposed for a number of reasons. First, this will reduce the burden on lenders by no longer requiring that a special form be completed to obtain reimbursement of the Government's share of the appraisal expense. Second, this will make payment of the fee for an appraisal consistent with Agency regulations governing payment of other expenses associated with liquidation. Finally, this change will encourage lenders to obtain an appraisal to document that the amount being obtained in the liquidation represents market value.

Partial Releases

This rule proposes to clarify provisions for partial releases of guaranteed loan collateral. Current regulations allow lenders to release security only when full market value is received or when replacement or substitute collateral is obtained. The Agency feels that this proposed change is justified for a number of reasons. First, the Agency has begun to receive more frequent requests for concurrence with releases of security without consideration and many of these requests are reasonable. For example, FSA regularly receives requests for concurrence to the release of an acre or so of land from real estate security for the borrower's child to construct a dwelling. Second, many guaranteed loans are over 10 years old and may be secured by items that have served their useful life and are now valueless. These items could be released without damaging the lender's security position. Third, the rise in farm asset values and income may have reduced the risk of loss on a guaranteed loan substantially. The lack of release provisions often prevents guaranteed lenders from doing ''business as usual'' and may place them at a competitive disadvantage. Without these provisions, the release request may be affected only by refinancing with a new loan, or through an action that would place the guarantee at risk.

In order to protect the interest of the Government, this proposal will allow releases only in farming operations where there is substantial equity (loan to value ratio of .75 or less) or in which approval would not increase the Government's exposure on its guarantee. Also, releases are intended to be for reasonable purposes, and generally releases of income-generating assets will be prohibited. For example, a partial release of productive cropland, with no consideration, simply because the borrower would like to have the property free of a mortgage or deed of trust would not be a valid request, regardless of whether the borrower's cash flow and security exceeded the requirements contained in this proposal. Also, while it is expected that a partial release of a residence may be necessary in conjunction with release of liability of a divorced spouse, it is not intended that these provisions be used to allow a member of the farm family to be given acreage, equipment, mineral rights, and other business assets without paying consideration.

Subordinations

The Agency also plans to provide authority to approve a lender's request to subordinate a guaranteed loan in certain situations. This proposal is being made for similar reasons as discussed above for partial releases. This authority will be limited to subordinations requested by a guaranteed lender to facilitate outside financing for lower-

risk guaranteed borrowers who have the opportunity to refinance higher interest debt or otherwise improve their situation. The rule proposes to allow subordinations when the Agency determines that a subordination will reduce the risk of loss to the Government. It is anticipated that such subordinations will be seldom and only approved at the National office level of the Agency.

Rescheduling Lines of Credit

The Agency intends to clearly state that when a line of credit loan is rescheduled, subsequent advances on the line of credit are not authorized. This will eliminate the partial rescheduling and advancing of line of credit loans. Current regulations are silent on this issue. Many lenders reschedule unpaid portions of lines of credit over a period of years but continue to make advances against the portion of the line of credit that was previously paid. This practice often results in the borrower not having adequate funding under the original line of credit, increased financial stress on the operation, and ultimately a loss claim. The line of credit should not take on a dual role of providing short-term and intermediate term credit. This proposal provides that rescheduled lines of credit will still not be allowed to be sold to secondary market purchasers, despite multi-year terms.

Shared Appreciation Agreements

The Agency also proposes to clarify policy and procedures for handling Shared Appreciation Agreements (SAA) that expire or are triggered. Current regulations allow the recapture amount to be rescheduled or reamortized if the borrower is unable to pay the recapture amount at the expiration date of the agreement. This rule proposes that upon recapture at any time, the lender may pay the Agency its pro rata share of the recapture due in a lump sum and pursue collection of the recapture from the borrower, or forward the Agency its pro-rata share of each payment. If the lender reamortizes the recapture debt, such debt will be covered by the guarantee only if the lender pays the Agency its pro rata share of the recapture amount first. This proposed policy will reduce the burden on lenders by making the treatment of recapture more flexible and encourage lenders to accept installment payments on recapture amounts instead of liquidating the account.

Release of Liability

The Agency plans to establish specific criteria under which lenders may release guaranteed borrowers from personal liability. This proposal is being made as a result of the advancing age of a portion of the Agency's guaranteed loan portfolio and the Agency's experiences with the silence of current regulations. Lack of clear provisions with regard to releasing obligors in cases of divorce, bankruptcy, liquidation or withdrawal from the operation has resulted in a lack of flexibility that reduces lender satisfaction with the program. In many instances of divorce, a spouse will convey all interest in the farming operation to the remaining spouse. Often this creates a need for a new guaranteed loan, use of scarce loan funds, and the payment of a guarantee fee, when a release of liability would have been a sound and reasonable alternative.

Approval of release of liability will be based on the strength of the remaining party, determined by criteria proposed in this rule. The withdrawing party will not have to document total lack of assets and income from which to collect, if the remaining party meets the established criteria. However, some restriction will apply. First, releases are not to be extended to dissolution of the farming operation. This is because guaranteed loans are to be made to eligible family farmers. When a party is quitting the operation and the remaining party does not plan to continue the farming operation, the objectives of the program are not met. Second, restrictions are proposed on releases of entity principals when the withdrawal of that principal may result in the legal dissolution of the entity to which the loans were made. The more appropriate action in those cases would be a transfer of the security to, and assumption of the debt by, the new entity or remaining party.

Consolidations of Loans

The Agency proposes to restrict the consolidation of loans made prior to October 1, 1991, to only those made before that date. Likewise, loans made on or after October 1, 1991, may only be consolidated with loans made on or after that date. This is due to restrictions placed on loan subsidies as a result of the Federal Credit Reform Act of 1990 and appropriation laws. The Agency has no budgetary authority to provide Interest Assistance for servicing purposes for those loans made after October 1, 1991, which do not have Interest Assistance obligated when the loan is made. Therefore, if loans made without Interest Assistance are consolidated with those loans that are eligible for Interest Assistance, the older loan loses Interest Assistance eligibility. Office of Management and Budget rules governing the Agency's loan subsidies dictate that when consolidation takes place the most recent loan made is the budgetary cost factor used to determine funding priorities for that loan. This action is proposed in order to reduce the likelihood of the lender and borrower inadvertently losing the Interest Assistance option. The Agency would appreciate any public comments concerning whether the benefits of a consolidation would outweigh those of interest assistance eligibility.

Final Loss Claims

Currently, the Agency accepts final loss claims on the ultimate disposition of the real property only if the Agency approves the request and documentation is provided that this method results in cost savings to the Government. The Agency proposes to allow the lender to request a final payment based on receiving full appraised value at the time they receive title to the real property, or based on final disposition after deducting the expenses associated with the receipt, maintenance and sale of the property. This gives the lender flexibility and encourages proper maintenance of the inventory property. The Agency will reduce the final loss claim for any loss caused by the lender's negligent servicing of the account.

Electronic Funds Transfer (EFT)

The liquidation section of this proposed rule will be revised to address recent legislation of EFT payments. The Federal Financial Management Act of 1994, as amended, (31 U.S.C. 3332) generally requires Federal agencies to make payments to recipients by EFT. The statute further provides that recipients designate one or more financial institutions or other authorized agents to which any Agency payments will be made and provide the Agency information as necessary for them to receive EFT payments through each institution or agent designated. Lenders may be recipients of EFT payments under this proposed rule; therefore, they must designate the institutions or agents and provide other necessary information to carry out EFT payment.

Balloon Payments With Restructuring

The Agency proposes to prohibit reamortization of loans with a balloon payment. Current regulations are silent where reamortization is concerned. Since Agency servicing regulations allow for Interest Assistance, a deferral, or a writedown of the loan, the arguments often stated for balloon payments have little relevance to

guaranteed loans. Reamortizing with a balloon payment schedule becomes self-defeating by requiring additional servicing at a definite point in the future. The Agency has found that balloon payments are often used when a guaranteed borrower's cash flow is insufficient to make an amortized principal and interest payment over normal or allowable terms for reamortization of the loan. However, even when a borrower suffers a setback that requires reamortization, future cash flow should still be sufficient to cover interest accrual and a meaningful principal reduction in the loan. If that level of cash flow is not achieved, other servicing options that may be more beneficial, such as a deferral or writedown, must be considered. Further, balloon payments are often a means for lenders to impose a restricted term on those borrowers deemed higher risk. This may result in the denial of servicing options and possibly liquidation or the need for refinancing with another lender when the balloon becomes due. To simplify the procedure and provide for the development of meaningful plans of operation that protect both the borrower and the Government, the Agency will prohibit restructuring plans from including balloon payments.

Interest Assistance and Writedowns

This rule will prohibit Interest Assistance when a guaranteed loan is being written down. Guaranteed write downs are based upon the present value of the future projected income available for payment on the loan. If Interest Assistance is approved on a loan at the time of the writedown, the calculations will result in a reduced writedown, based on the interest subsidy being provided in future years. However, Interest Assistance is awarded on an annual basis and its future availability is in question. Moreover, although the writedown loss payment may be reduced through the use of Interest Assistance, this initial loss claim savings is offset by the processing and payment of a subsidy over a possible multiple-year term. Again, the requirements for interest assistance are not being revised in this proposed rule. The interim rule published at 56 FR 8258–8272 (February 28, 1991) will be finalized in a separate final rule, and Exhibit D to subpart B of 1980 will be removed from the **Federal Register**.

Feasible Plan versus Positive Cash Flow

The Agency proposes to provide a regulatory distinction between actions requiring a debt service margin and those that do not. Ideally, a guaranteed loan borrower would continually have sufficient resources to meet all of their obligations, plus have an excess that would allow for economic setbacks and replenishment of depleted assets or replacement of capital items. Current regulations define positive cash flow as having a Term Debt and Capital Lease Coverage Ratio (TDCLCR) of 1.10, meaning the borrower has a .10 or 10 percent cushion after meeting all obligations. Strict interpretation of this provision may result in liquidation of a borrower who can demonstrate the ability to make a restructured payment. However, the Agency did not intend to require that borrowers requiring guaranteed loan servicing have an excess margin. Therefore, this rule defines a feasible plan as a TDCLCR of 1.00 and establishes this as the minimum requirement for loan servicing actions. However, the Agency recommends loans be restructured to allow for a 10 percent cushion. The Agency is requesting comments on this recommendation. A feasible plan will also be the minimum required for renewed advances on a line of credit, renewal of Interest Assistance and calculation of present value. This requirement will allow restructuring of all loans that have repayment ability. Current regulations are not clear as to what margin is required for restructuring or writing down, however, the Agency believes that to require a margin for restructuring was never the intent of the program and would require lenders to put numerous potentially successful borrowers out of business and increase government loss payments on loans.

List of Subjects in 7 CFR Part 1980

Agriculture, Loan programs—Agriculture.

Accordingly, it is proposed that 7 CFR chapter XVIII be amended as follows:

PART 1980—GENERAL

1. The authority citation for part 1980 continues to read as follows:

Authority: 5 U.S.C. 301; 7 U.S.C. 1989 and 42 U.S.C. 1480.

Subpart A—General

2. Revise § 1980.1 to read as follows:

§ 1980.1 Purpose.

This subpart contains the general regulations and prescribed forms which are applicable to Community Programs Guaranteed Loans under subpart I of this part.

3. Amend § 1980.6 as follows:

a. Remove in paragraph (a) the definitions of ''Conditional Commitment (Farmer Programs) (Form FmHA or its successor agency under Public Law 103-354 1980–15),'' ''Contract of Guarantee (Line of Credit) (Form FmHA or its successor agency under Public Law 103–354 1980–27),'' ''Guaranteed line of credit,'' ''Insured loans,'' and ''Line of credit agreement'';

b. Remove in paragraph (a), in the definition of ''Guaranteed loan,'' the phrase ''or Form FmHA 1980–38,'';

c. Remove in paragraph (b), the abbreviations ''ASCS,'' ''CLP,'' ''EM,'' ''FO,'' ''OL,'' ''OL–Y,'' ''RL,'' and ''SW''; and

d. In paragraph (a), remove the definition of ''Lender's Agreement (Forms FmHA or its successor agency under Public Law 103–354 449–35 or 1980–38)'' and add a new definition to read as follows:

§ 1980.6 Definitions and abbreviations.

(a) * * *

Lender's Agreement (Form RD 449–35). The signed agreement between Rural Development and the lender setting forth the lender's loan responsibilities when the Loan Note Guarantee is issued.

* * * * *

§ 1980.11 [Amended]

4. Amend § 1980.11 as follows:

a. In the first sentence, remove the phrase ''and Contract of Guarantee'' and revise the word ''constitute'' to read ''constitutes'';

b. In the second sentence, remove the phrase '',Contract of Guarantee'';

c. In the fifth sentence, remove the phrase ''or Contract of Guarantee''; and

d. Remove the third and sixth sentences.

5. Amend § 1980.13 as follows:

a. In the introductory text to paragraph (b), remove the fourth sentence; and

b. Revise paragraph (b)(4) to read as follows:

§ 1980.13 Eligible lenders.

* * * * *

(b) * * *

(4) Conflict of interest. The Agency shall determine whether such ownership or business dealings are sufficient to likely result in a conflict of interest. All lenders will, for each proposed loan, inform the Agency in writing and furnish such additional evidence as the Agency requested as to whether and the extent for those loans covered by Form RD 449–35, the lender or its principal officers (including immediate family) or the borrower or its principals or officers (including immediate family) hold any stock or

other evidence of ownership in the other.

* * * * *

6. Amend the fourth sentence of the introductory paragraph of § 1980.20(a) to read as follows:

§ 1980.20 Loan Guarantee Limits.

(a) * * * Also, the maximum loss covered by Form FmHA 449–34 (available in any Agency office) can never exceed the lesser of:

* * * * *

7. Revise § 1980.21 to read as follows:

§ 1980.21 Guarantee fee.

The fee will be the applicable rate multiplied by the principal loan amount multiplied by the percent of guarantee, paid one time only at the time the Loan Note Guarantee is issued.

(a) The fee will be paid to the Agency by the lender and is nonreturnable. The lender may pass on the fee to the borrower.

(b) Guarantee fee rates are specified in exhibit K of Rural Development Instruction 440.1 (available in any Rural Development Office).

8. Amend § 1980.22 as follows:

a. In the introductory text of paragraph (b) and in paragraph (b)(3), remove the phrase ''or Contract of Guarantee''; and

b. Revise paragraph (a) to read as follows:

§ 1980.22 Charges and fees by lender.

(a) Routine charges and fees. The lender may establish the charges and fees for the loan, provided they are the same as those charged other applicants for similar types of transactions. ''Similar types of transactions'' means those transactions involving the same type of loan requested for which a non-guaranteed loan applicant would be assessed charges and fees.

* * * * *

§ 1980.46 [Removed and reserved]

9. § 1980.46 is removed and reserved.

§ 1980.60 [Amended]

10. Amend § 1980.60 as follows:

a. In the heading, remove the phrase ''or Contract of Guarantee'';

b. In the introductory text of paragraph (a) in the second sentence, remove the phrase ''For all other loans, Form FmHA or its successor agency under Public Law 103–354'' and in its place add ''Form'' and remove the first sentence;

c. In paragraph (a)(1), remove the phrases ''or line of credit'' and ''or Conditional Commitment for Contract of Guarantee'';

d. In paragraphs (a)(6) and (a)(7), remove the phrases ''or line of credit'';

e. In paragraph (a)(9), remove the phrase ''joint operation, (for Farmer Program loans only),'';

f. In paragraphs (a)(10) and (a)(11), remove the phrases ''or Conditional Commitment for Contract of Guarantee'';

g. In paragraph (a)(12), remove the second sentence;

h. In paragraph (b), remove the phrase ''or Contract of Guarantee''; and

i. In paragraph (c), remove the phrase at the end ''or Form FmHA or its successor agency under Public Law 103–354 1980–38''.

§ 1980.61 [Amended]

11. Amend § 1980.61 as follows:

a. In the heading, remove the phrase '', Contract of Guarantee'';

b. In the first sentence of paragraph (a)(1), remove the phrase ''Except for Farmer Programs loans, the'' and add in its place ''The'';

c. Remove paragraph (a)(2) in its entirety and redesignate paragraph (a)(3) as paragraph (a)(2), respectively;

d. In newly redesignated paragraph (a)(2), remove the phrase ''or Contract of Guarantee;''

e. In paragraph (b)(1) remove the phrase ''or Form FmHA or its successor agency under Public Law 103–354 1980–38'';

f. In paragraphs (b)(3) and (4), remove the phrases ''or § 1980.119 of subpart B of this part'';

g. Remove paragraph (c) and redesignate paragraphs (d) through (h) as paragraphs (c) through (g), respectively;

h. In newly redesignated paragraph (c), remove the last sentence;

i. In newly redesignated paragraph (d), remove the phrase ''or Contract of Guarantee'' from the first sentence;

j. In newly redesignated paragraph (f), remove the phrase ''or Contract of Guarantee''

k. In newly redesignated paragraph (g), remove the phrases ''or Form FmHA or its successor agency under Public Law 103–354 1980–38'' and ''the Contract of Guarantee,'' from the last sentence.

§ 1980.62 [Amended]

12. Amend § 1980.62 as follows:

a. In the first and third sentences, remove the phrase ''or § 1980.119 of subpart B of this part''; and

b. Remove the last sentence.

§ 1980.63 [Amended]

13. Amend § 1980.63(a) to remove the phrase ''or I.D.6. of Form FmHA or its successor agency under Public Law 103–354 1980–38''.

§ 1980.64 [Amended]

14. Amend § 1980.64 as follows:

a. In paragraph (a), remove the phrase ''or paragraph I.D.6. of Form FmHA or its successor agency under Public Law 103–354 1980–38''; and

b. In paragraph (b), remove the two occurrences of the phrase ''or line of credit.''

§ 1980.65 [Amended]

15. Amend § 1980.65 to remove the phrase '', or for Farmer Programs Loans, § 1980.136 of subpart B of this part''.

§ 1980.66 [Amended]

16. Amend § 1980.66 to remove the phrase '', or paragraph I.D.6.(b) of Form FmHA or its successor agency under Public Law 103–354 1980–38''.

§ 1980.67 [Amended]

17. Amend § 1980.67 as follows:

a. In paragraph (a), remove the first sentence; and

b. In paragraph (b), remove the phrase ''or line of credit''.

§ 1980.68 [Amended]

18. Amend § 1980.68 as follows:

a. In the heading, remove the phrase ''or Contract of Guarantee'';

b. In the first sentence, remove the phrase ''or Contract(s) of Guarantee'';

c. In the second sentence in the parentheticals, remove the phrase '', or paragraph 6 of Form FmHA or its successor agency under Public Law 103–354 1980–27'';

d. In the third sentence, remove the phrases ''or line(s) of credit,'' ''or Contract(s) of Guarantee,'' and ''or Form FmHA or its successor agency under Public Law 103–354 1980–27''; and

e. Remove the last two sentences.

§ 1980.83 [Amended]

19. Amend § 1980.83 to remove the second sentence.

§ 1980.84 [Amended]

20. Amend § 1980.84 as follows:

a. Remove the phrases ''Contract of Guarantee'' and ''or Contract of Guarantee'' from the first sentence of paragraph (b)(1)(iv);

b. Remove the phrase ''Contract of Guarantee'' from paragraph (b)(1)(v); and

c. Remove the phrase ''or § 1980.119 of subpart B of this part'' from the first and fourth sentences in paragraph (b)(4).

Appendices D–L to Subpart A [Removed]

21. Amend part 1980, subpart A to remove Appendices D through L.

22. In subpart B, § 1980.101 is revised to read as follows:

§ 1980.101 Introduction.

(a) Scope. This subpart contains regulations governing Operating Loans

and Farm Ownership loans guaranteed by the Farm Service Agency. This subpart applies to lenders, holders, borrowers, Agency personnel, and other parties involved in making, guaranteeing, holding, servicing, or liquidating such loans.

(b) Policy. The Agency issues guarantees on loans made to qualified loan applicants without regard to race, color, religion, sex, national origin, marital status, age, or physical or mental handicap, provided the loan applicant can enter into a legal and binding contract, or whether all or part of the applicant's income derives from any public assistance program or whether the applicant, in good faith, exercises any rights under the Consumer Protection Act.

(c) Lender list and classification.

(1) The Agency maintains a current list of lenders who express a desire to participate in the guaranteed loan program. This list is made available to farmers upon request.

(2) Lenders who participate in the Agency guaranteed loan program will be classified into one of the following categories:

(i) Standard Eligible Lender under § 1980.105,

(ii) Certified Lender, or

(iii) Preferred Lender under § 1980.106.

(d) Type of Guarantee. There are two types of guarantees issued under the Farm Loan Programs Guaranteed Loan Program:

(1) Loan Note Guarantee. A Loan Note Guarantee is used for a loan of fixed amount and term.

(2) Contract of Guarantee. A Contract of Guarantee is only available for Operating Loan lines of credit. The Contract of Guarantee has a fixed term, but no fixed amount. The principal amount outstanding at any time, however, may not exceed the line of credit ceiling contained in the contract.

(e) Termination of Loan Note Guarantee or Contract of Guarantee. The Loan Note or Contract of Guarantee will automatically terminate as follows:

(1) Upon full payment of the guaranteed loan. A zero balance within the period authorized for advances on a line of credit will not terminate the contract of guarantee;

(2) Upon payment of a final loss claim; or

(3) Upon written notice from the lender to the Agency that a guarantee is no longer desired provided the lender holds all of the guaranteed portion of the loan. The Loan Note or Contract of Guarantee will be returned to the Agency office for cancellation within 30 days of the date of the notice by the lender.

23. Sections 1980.102 through 1980.105 are added to read as follows:

§ 1980.102 Abbreviations and definitions.

(a) Abbreviations:

CLP—Certified Lender Program
CONACT—Consolidated Farm and Rural Development Act (7 U.S.C. 1921 *et seq.*)
EPA—Environmental Protection Agency
EIS—Environmental Impact Statement
EM—Emergency loans
FO—Farm Ownership loans
FSA—Farm Service Agency
OL—Operating loans
PLP—Preferred Lender Program
SW—Soil and Water
USDA—United States Department of Agriculture

(b) Definitions:

Additional security. Collateral in excess of that needed to fully secure the loan.

Agency. The Farm Service Agency, including its employees and state and area committee members, and any successor agency.

Allonge. An attachment or an addendum to a note.

Applicant. For guaranteed loans, the lender requesting a guarantee is the applicant. The party applying to the lender for a loan will be considered the loan applicant.

Aquaculture. The husbandry of aquatic organisms in a controlled or selected environment. An aquatic organism is any fish, amphibian, reptile, or aquatic plant. An aquaculture operation is considered to be farm only if it is conducted on the grounds which the loan applicant owns, leases, or has an exclusive right to use. An exclusive right to use must be evidenced by a permit issued to the loan applicant and the permit must specifically identify the waters available to be used by the loan applicant only.

Assignment of guaranteed portion. A process by which the lender transfers the right to receive payments or income on the guaranteed loan to another party, usually in return for payment in the amount of the loan's guaranteed principal. The lender retains the unguaranteed portion in its portfolio and receives a fee from the purchaser or assignee to service the loan, and receive and remit payments according to a written assignment agreement. This assignment can be reassigned or sold multiple times.

Average farm customers. Those conventional farm borrowers who are required to pledge their crops, livestock, and other chattel and real estate security for the loan. This does not include those high-risk farmers with limited security and management ability who are generally charged a higher interest rate by conventional agricultural lenders. Also, this does not include those low-risk farm customers who obtain financing on a secured or unsecured basis, who have as collateral items, such as savings accounts, time deposits, certificates of deposit, stocks and bonds, and life insurance, which they are able to pledge for the loan.

Beginning farmer or rancher. A beginning farmer or rancher is an individual or entity who:

(1) Meets the loan eligibility requirements for OL or FO loan assistance, as applicable, in accordance with this subpart;

(2) Has not operated a farm or ranch, or who has operated a farm or ranch for not more than 10 years. This requirement applies to all members of an entity;

(3) Will materially and substantially participate in the operation of the farm or ranch:

(i) In the case of a loan made to an individual, individually or with the immediate family, material and substantial participation requires that the individual provide substantial day-to-day labor and management of the farm or ranch, consistent with the practices in the county or State where the farm is located.

(ii) In the case of a loan made to an entity, all members must materially and substantially participate in the operation of the farm or ranch. Material and substantial participation requires that the individual provide some amount of the management, or labor and management necessary for day-to-day activities, such that if the individual did not provide these inputs, operation of the farm or ranch would be seriously impaired;

(4) Agrees to participate in any loan assessment, borrower training, and financial management programs required by Agency regulations;

(5) Does not own real farm or ranch property or who, directly or through interests in family farm entities owns real farm or ranch property, the aggregate acreage of which does not exceed 25 percent of the average farm or ranch acreage of the farms or ranches in the county where the property is located. If the farm is located in more than one county, the average farm acreage of the county where the loan applicant's residence is located will be used in the calculation. If the loan applicant's residence is not located on the farm or if the loan applicant is an entity, the average farm acreage of the

county where the major portion of the farm is located will be used. The average county farm or ranch acreage will be determined from the most recent Census of Agriculture developed by the U.S. Department of Commerce, Bureau of the Census or USDA;

(6) Demonstrates that the available resources of the loan applicant and spouse (if any) are not sufficient to enable the loan applicant to enter or continue farming or ranching on a viable scale; and

(7) In the case of an entity:

(i) All the members are related by blood or marriage; and

(ii) All the stockholders in a corporation are beginning farmers or ranchers.

Borrower. An individual or entity which has outstanding obligations to the lender under any Agency loan program. A borrower includes all parties liable for Agency debt, including collection-only borrowers, except those whose total loan and accounts have been voluntarily or involuntarily foreclosed or liquidated, or who have been discharged of all Agency debt.

Collateral. Property pledged as security for a loan to ensure repayment of an obligation.

Conditional Commitment. The Agency's commitment to the lender that the material it has submitted is approved subject to the completion of all conditions and requirements contained therein.

Consolidation. The combination of outstanding principal and interest balance of two or more OL loans.

Controlled. When a director or employee has more than a 50 percent ownership in the entity or, the director or employee, together with relatives of the director or employee, have more than a 50 percent ownership.

Cooperative. An entity which has farming as its purpose and whose members have agreed to share the profits of the farming enterprise. The entity must be recognized as a farm cooperative by the laws of the State in which the entity will operate a farm.

Cosigner. A party who joins in the execution of a promissory note to assure its repayment. The cosigner becomes jointly and severally liable to comply with the terms of the note. In the case of an entity loan applicant, the cosigner cannot be a member, partner, joint operator, or stockholder of the entity.

Debt writedown. To reduce the amount of the borrower's debt to that amount that is determined to be collectible based on an analysis of the security value and the borrower's ability to pay.

Deferral. A postponement of the payment of interest or principal or both.Principal may be deferred in whole or in part.

Direct loan. A loan made to a borrower and serviced by the Agency as lender.

Entity. Cooperatives, corporations, partnerships, or joint operations.

Family farm. A farm which:

(1) Produces agricultural commodities for sale in sufficient quantities so that it is recognized in the community as a farm rather than a rural residence;

(2) Provides enough agricultural income by itself, including rented land, or together with any other dependable income to enable the borrower to:

(i) Pay necessary family living and operating expenses;

(ii) Maintain essential chattel and real property; and

(iii) Pay debts;

(3) Is managed by:

(i) The borrower when a loan is made to an individual; or,

(ii) The members, stockholders, partners, or joint operators responsible for operating the farm when a loan is made to an entity;

(4) Has a substantial amount of the labor requirement for the farm and nonfarm enterprise provided by:

(i) The borrower and the borrower's immediate family for a loan made to an individual; or

(ii) The members, stockholders, partners, or joint operators responsible for operating the farm, along with the families of these individuals, for a loan made to an entity; and

(5) May use a reasonable amount of full-time hired labor and seasonal labor during peak load periods.

Farm. A tract or tracts of land, improvements, and other appurtenances which are used or will be used in the production of crops, livestock, or aquaculture products for sale in sufficient quantities so that the property is recognized as a farm rather than a rural residence. The term ''farm'' also includes any such land and improvements and facilities used in a nonfarm enterprise. It may also include the residence which, although physically separate from the farm acreage, is ordinarily treated as part of the farm in the local community.

Feasible plan. A plan for loan servicing purposes which shows the elements of ''positive cash flow'' except that the minimum acceptable ''Term Debt and Capital Lease Coverage Ratio'' is 1.0 rather than 1.1 required for ''positive cash flow.'' However, it is strongly recommended that any servicing action provide for a Term Debt and Capital Lease Coverage Ratio of 1.1.

Financially viable operation. A financially viable operation is one which, with Agency assistance, is projected to improve its financial condition over a period of time to the point that the operator can obtain commercial credit without further Agency direct or guaranteed assistance. A borrower that will meet the Agency classification of ''commercial,'' as defined in Agency Instruction 2006–W, available in any Agency office, will be considered to be financially viable. Such an operation must generate sufficient income to:

(1) Meet annual operating expenses and debt payments as they become due;

(2) Meet basic family living expenses to the extent they are not met by dependable nonfarm income;

(3) Provide for replacement of capital items; and

(4) Provide for long-term financial growth.

Fish. Any aquatic, gilled animal commonly known as ''fish'' as well as mollusks, or crustaceans (or other invertebrates) produced under controlled conditions (that is, feeding, tending, harvesting, and such other activities as are necessary to properly raise and market the products) in ponds, lakes, streams, or similar holding areas.

Fixture. Generally a chattel item attached to real estate in such a way that it cannot be removed without defacing or dismantling the structure, or substantially damaging the structure itself.

Graduation. The Agency's determination that a borrower on a direct loan, is financially stable enough to refinance that loan with a commercial lender with or without a guarantee.

Guaranteed loan. A loan made and serviced by a lender for which the Agency has entered into a Lenders Agreement and for which the Agency has issued a Loan Note Guarantee. This term also includes lines of credit except where otherwise indicated.

Hazard insurance. Includes fire, windstorm, lightning, hail, explosion, riot, civil commotion, aircraft, vehicles, smoke, builder's risk, public liability, property damage, flood or mudslide, workers compensation, or any similar insurance that is available and needed to protect the security, or that is required by law.

Holder. The person or organization other than the lender who holds all or a part of the guaranteed portion of an Agency guaranteed loan but who has no servicing responsibilities. When the lender assigns a part of the guaranteed loan to an assignee, the assignee becomes a holder when an Assignment form is executed.

In-house expenses. Expenses associated with credit management and loan servicing. In-house expenses include, but are not limited to: employee salaries, staff lawyers, travel, supplies, and overhead.

Joint operation. Individuals that have agreed to operate a farm or farms together as a business unit. The real and personal property is owned separately or jointly by the individuals. For example, husband and wife who apply for a loan together will be considered a joint operation. Joint operations include limited liability companies having more than one member.

Land development. Items such as terracing, clearing, leveling, fencing, drainage and irrigation systems, ponds, forestation, permanent pastures, perennial hay crops, basic soil amendments, and other items of land improvements which conserve or permanently enhance productivity.

Lender. The organization making and servicing the loan or advancing and servicing the line of credit which is guaranteed under the provisions of Agency regulations. The lender is also the party requesting a guarantee.

Lender's Agreement. The appropriate Agency form executed by the Agency and the lender setting forth the general loan responsibilities of the lender and agency when the Loan Note Guarantee or Contract of Guarantee is issued.

Lien. A legally enforceable hold or claim on the property of another obtained as security for the repayment of indebtedness or an encumbrance on property to enforce payment of an obligation.

Liquidation expenses. The cost of an appraisal, environmental assessment, outside attorney fees and other costs incurred as a direct result of liquidating the security for the guaranteed loan. Liquidation fees do not include in-house expenses.

Loan or Line of Credit Agreement. A document which contains certain lender and borrower agreements, conditions, limitations, and responsibilities in a process of credit extension and acceptance in a loan format where loan principal balance may fluctuate throughout the term of the document.

Loan Applicant. The party applying to a lender for a guaranteed loan or line of credit.

Loss Claim. A request made to the Agency by a lender to receive a reimbursement based on a percentage of the lender's loss on a loan covered by an Agency guarantee.

Majority interest. Any individual or a combination of individuals owning more than a 50 percent interest in a cooperative, corporation, joint operation, or partnership.

Market value. The amount which an informed and willing buyer would pay an informed and willing but not forced seller in a completely voluntary sale.

Mortgage. An instrument giving the lender a security interest or lien on real or personal property of any kind.

Negligent servicing. The failure to perform those services which would be considered normal industry standards of loan management or failure to comply with any servicing requirement of this subpart. The term includes the concept of a failure to act or failure to act timely consistent with actions of a reasonable lender in loan making, servicing, and collection.

Net recovery value. The estimated future value of security property that has been taken into inventory, exposed to prevailing market conditions and sold based on the properties highest and best use at the time of the sale less the Government's costs of liquidation, property maintenance, and disposition.

Nonessential asset. Assets in which the borrower has an ownership interest that do not contribute an income to pay essential family living expenses or maintain a sound farming operation, and are not exempt from judgment creditors.

Participation. A loan arrangement where a primary or lead lender is typically the lender of record but the loan funds may be provided by one or more other lenders due to loan size or other factors. Typically, participating lenders share in the interest income or profit on the loan based on the relative amount of the loan funds provided after deducting the servicing fees of the primary or lead lender.

Partnership. Any entity consisting of two or more individuals who have agreed to operate a farm as one business unit. The entity must be recognized as a partnership by the laws of the State in which the entity will operate and must be authorized to own both real estate and personal property and to incur debts in its own name.

Positive cash flow. The ability of a borrower's operation to demonstrate: a Term Debt and Capital Lease Coverage Ratio of at least 1.1; and a Capital Replacement and Term Debt Repayment Margin equal to or greater than any planned capital asset purchases not financed. The Term Debt and Capital Lease Coverage Ratio and the Capital Replacement and Term Debt Repayment Margin are calculated in the following manner:

(1) Add projected net farm operating income, projected annual nonfarm income, projected capital depreciation and amortization expenses, scheduled annual interest on term debt, and scheduled annual interest on capital leases.

(i) Net farm operating income is the gross income generated by a farming operation annually, minus all yearly operating expenses (including withdrawals from entities for living expenses), operating loan interest, interest on term debt and capital lease payments, and depreciation and amortization expenses. Net farm operating income does not include off-farm income and social security taxes, carryover debt and delinquent interest.

(ii) Depreciation and amortization expenses are an annual allocation of the cost or other basic value of tangible capital assets, less salvage value, over the estimated life of the unit (which may be a group of assets), in a systematic and rational manner.

(iii) Capital leases are agreements under which the lessee effectively acquires ownership of the asset being leased. A lease is a capital lease if it meets any one of the following criteria:

(A) The lease transfers ownership of the property to the lessee at the end of the lease term.

(B) The lessee has the right to purchase the property for significantly less than its market value at the end of the lease.

(C) The term of the lease is at least 75 percent of the estimated economic life of the leased property.

(D) The present value of the minimum lease payments equals or exceeds 90 percent of the fair market value of the leased property.

(2) Subtract from this sum projected annual income and social security tax payments, including any delinquent taxes, and family living expenses. The difference is the Balance Available for Term Debt Repayment.

(i) Family living expenses are any withdrawals from income to provide for needs of family members.

(ii) Family members are considered to be the immediate members of the family residing in the same household with the individual borrower, or, in the case of an entity, with the operator.

(3) Divide the Balance Available for Term Debt Repayment by the sum of the annual scheduled principal and interest payments on term debt, plus the annual scheduled principal and interest payments on capital leases, excluding delinquent installments. The quotient is the Term Debt and Capital Lease Coverage Ratio.

(4) Add the Balance Available for Term Debt Repayment to any cash carryover from the preceding year.

(5) Subtract from this sum the amount of the Total Annual Scheduled Term Debt and Capital Lease Payments, and any debt carried over from the previous year. The difference is the Capital Replacement and Term Debt Repayment Margin.

Potential liquidation value. The amount of the lender's protective bid at the foreclosure sale. Potential liquidation value is determined by an independent appraiser using comparables from other forced liquidation sales.

Present value. The present worth of a future stream of payments discounted to the current date.

Primary security. The minimum amount of collateral needed to fully secure a proposed loan.

Principals of borrowers. Includes owners, officers, directors, entities and others directly involved in the operation and management of a business.

Protective advances. Advances made by a lender to protect or preserve the collateral itself from loss or deterioration. Protective advances include but are not limited to:

(1) Payment of delinquent taxes,

(2) Annual assessments,

(3) Ground rents,

(4) Hazard or flood insurance premiums against or affecting the collateral,

(5) Harvesting costs,

(6) Other expenses needed for emergency measures to protect the collateral.

Reamortization. To rearrange the rates or terms, or both, of a loan made for real estate purposes.

Related by blood or marriage. Individuals who are connected to one another as husband, wife, parent, child, brother, or sister.

Relative. An individual or spouse and anyone having the following relationship to either: parent, son, daughter, sibling, stepparent, stepson, stepdaughter, stepbrother, stepsister, half brother, half sister, uncle, aunt, nephew, niece, grandparent, granddaughter, grandson, and the spouses of the foregoing.

Rescheduling. To rewrite the rates and terms of a single note or line of credit Agreement which acknowledges indebtedness for a loan made for operating purposes.

Restructuring. Changing terms of a debt through either a consolidation, rescheduling, reamortization, deferral, or writedown or a combination thereof.

Sale of guaranteed portion. See Assignment of guaranteed portion.

Security. Property of any kind subject to a real or personal property lien. Any reference to ''collateral'' or ''security property'' shall be considered a reference to the term ''security.''

Shared Appreciation Agreement. This agreement requires the borrower to repay the lender all or a portion of the debt written down in conjunction with a Debt Writedown when the agreement is triggered or expires and there is an increase in value of the real estate that secured the loans.

State. The major political subdivision of the United States and the organization of program delivery for the Agency.

Subsequent loans. Any loans processed by the Agency after an initial loan has been made to the same borrower.

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 debt outstanding.

United States. The United States itself, each of the several States, the Commonwealth of Puerto Rico, the Virgin Islands of the United States, Guam, American Samoa, and the Commonwealth of the Northern Mariana Islands.

Veteran. Any person who served in the active military, naval, or air service during the Spanish-American War, the Mexican border period, World War I, World War II, the Korean conflict, the Vietnam era, the Persian Gulf War, or the period beginning on the date of any future declaration of war by the Congress and ending on the date prescribed by Presidential proclamation or concurrent resolution of the Congress.

§ 1980.103 Full faith and credit.

(a) Fraud and misrepresentation. The Loan Note Guarantee and Contract of Guarantee constitute obligations supported by the full faith and credit of the United States. The Agency may contest the guarantee only in cases of fraud or misrepresentation by a lender or holder, in which:

(1) The lender or holder had actual knowledge of the fraud or misrepresentation at the time it became the lender or holder, or

(2) The lender or holder participated in or condoned the fraud or misrepresentation.

(b) Lender violations. The Loan Note Guarantee or Contract of Guarantee cannot be enforced by the lender, regardless of when the Agency discovers the violation, to the extent that the loss is a result of:

(1) Violation of usury laws;

(2) Negligent servicing;

(3) Failure to obtain the required security; or,

(4) Failure to use loan funds for purposes specifically approved by the Agency.

(c) *Enforcement by holder.* The guarantee and right to require purchase will be directly enforceable by the holder even if:

(1) The Loan Note Guarantee or Contract of Guarantee is contestable based on the lender's fraud or misrepresentation; or

(2) The Loan Note Guarantee is unenforceable by the lender based on a lender violation.

§ 1980.104 Appeals.

(a) The loan applicant or borrower and lender must generally jointly execute the written request for review of an alleged adverse decision made by Agency. However, in cases where the Agency has denied or reduced the amount of the final loss payment, the decision may be appealed by the lender only.

(b) A decision made by the lender adverse to the borrower is not a decision by the Agency, whether or not concurred in by the Agency, and may not be appealed.

(c) Appeals will be handled in accordance with parts 11 and 780 of this title.

§ 1980.105 Eligibility and substitution of lenders.

(a) General. To participate in FSA Guaranteed Farm Loan Programs, a lender must meet the eligibility criteria in this section. The Standard Eligible Lender must demonstrate eligibility for each guarantee request submitted and provide such evidence as the Agency may request.

(b) Standard Eligible Lender eligibility criteria.

(1) A lender must have the capability to adequately make and service the loan for which a guarantee is requested;

(2) A lender must be subject to credit examination and supervision by an acceptable State or Federal regulatory agency;

(3) A lender must be in good standing with all applicable State or Federal regulatory agencies;

(4) The lender must maintain an office near enough to the collateral's location so it can properly and efficiently discharge its loan making and loan servicing responsibilities or use agents, correspondents, branches, or other institutions or persons to provide expertise to assist in carrying out its responsibilities. The lender must be a local lender unless it:

(i) normally makes loans in the region or geographic location in which the loan applicant's operation being financed is located, or

(ii) demonstrates specific expertise in making and servicing loans for the proposed operation.

(5) The lender must not be debarred or suspended from participation in a Government contract or delinquent on a Government debt.

(c) Substitution of Lenders. A new eligible lender may be substituted for the original lender under the following conditions:

(1) The Agency approves of the substitution in writing;

(2) The new lender agrees in writing to assume all servicing and other responsibilities of the original lender and to acquire the unguaranteed portion of the loan; and

(3) The substituted lender agrees to notify any holder of the substitution.

(d) Lender Name or Ownership Changes.

(1) When a lender undergoes an ownership change or otherwise begins doing business under a new name, the lender will notify the Agency.

(2) The lender's CLP or PLP status is subject to reconsideration when ownership changes.

(3) The new lender will execute a new Lender's Agreement.

24. Section 1980.106 is revised to read as follows:

§ 1980.106 Preferred and Certified Lender Programs.

(a) General. (1) Lenders who desire PLP or CLP status must prepare a written request addressing:

(i) The States in which they desire to receive PLP or CLP status; and

(ii) Each item of the eligibility criteria for PLP or CLP in this section, as appropriate.

(2) The lender may include any additional supporting evidence or other information the lender believes would be helpful to the Agency in making its determination.

(3) The lender must send its request to the Agency State office for the State in which the lender's headquarters is located.

(4) The lender will provide any additional information needed to process a PLP or CLP request, upon Agency request.

(5) The term ''loss rate'' as used in this section equals the net amount of guaranteed OL, FO, and SW loss claims paid on loans made in the past 7 years divided by the total loan amount of the OL, FO, and SW loans made in the past 7 years.

(b) CLP Criteria. The lender must meet the following requirements to obtain CLP status:

(1) Qualify as a standard eligible lender under § 1980.105;

(2) Have a lender loss rate not in excess of the maximum CLP Loss Rate established by the Agency and available in any Agency office.

(3) Have proven an ability to process and service Agency guaranteed loans by showing that the lender:

(i) Submitted substantially complete and correct guaranteed loan applications; and

(ii) Serviced all guaranteed loans according to Agency regulations;

(4) Have closed a minimum of 10 Agency guaranteed loans or lines of credit;

(5) Have closed a total of five Agency guaranteed loans or lines of credit, not including readvances on lines of credit, within the past 2 years;

(6) Maintain an acceptable level of financial soundness as determined by a bank rating service or comparable rater acceptable to the Agency.

(7) Designate a qualified person or persons to process and service Agency guaranteed loans for each of the lender offices which will process CLP loans. To be qualified, the person must meet the following conditions:

(i) Have attended Agency sponsored training in the past 12 months or will attend training in the next 12 months; and

(ii) Agree to attend Agency sponsored training each year;

(8) Use forms acceptable to the Agency for processing, analyzing, securing, and servicing Agency guaranteed loans and lines of credit;

(9) Submit copies of financial statements, cash flow plans, budgets, loan agreements, analysis sheets, collateral control sheets, security agreements and other forms to be used for farm loan processing and servicing;

(10) Agree to provide credit information to consumer or commercial reporting agencies, as appropriate.

(c) PLP Criteria. The lender must meet the following requirements to obtain PLP status:

(1) Meet the CLP eligibility criteria under this section.

(2) Have a satisfactory credit management system based on the following:

(i) the lender's written credit policies and underwriting standards;

(ii) loan documentation requirements;

(iii) exceptions to policies;

(iv) analysis of new loan requests;

(v) credit file management;

(vi) loan funds and collateral management system;

(vii) portfolio management;

(viii) loan reviews;

(ix) internal credit review process;

(x) loan monitoring system; and

(xi) the board of director's responsibilities.

(3) Have made at least 20 PLP, CLP, or ALP loans, or a combination of these type loans, within the past 5 years.

(4) Have a lender loss rate not in excess of the rate for PLP lenders established by the Agency and available in any Agency office.

(5) Show a consistent practice of submitting applications for guaranteed loans detailed with accurate information that supports a sound loan proposal.

(6) Show a consistent practice of processing Agency guaranteed loans without any major or reoccurring minor deficiencies. A major deficiency is one that directly affects the soundness of the loan. A minor deficiency violates Agency procedure, but does not affect the soundness of a loan.

(7) Have a history of using the guaranteed program for new loans, instead of refinancing the lender's existing debts.

(8) Demonstrate a consistent, above average ability to service guaranteed loans based on the following:

(i) Borrower supervision and assistance;

(ii) Timely and effective servicing; and

(iii) Communication with the Agency.

(9) Designate a person or persons, approved by the Agency, to process and service PLP loans for the Agency.

(d) CLP and PLP approval.

(1) If a lender applying for CLP or PLP status has recently been involved in a merger or acquisition, all loans and losses attributed to both lenders will be considered in the eligibility calculations.

(2) The Agency will determine which branches of the lender have the necessary experience and ability to participate in the CLP or PLP program.

(3) Lenders who meet the criteria will be granted CLP or PLP status for a period of 5 years.

(4) PLP status will be conditioned on the lender carrying out its credit management system as proposed in its request for PLP status and any additional loan making or servicing requirements agreed to and documented in an attachment to the Lender's Agreement.

(e) Monitoring CLP and PLP lenders. CLP and PLP lenders will provide information and access to records upon Agency request to permit the Agency to monitor the lender for compliance with Agency regulations.

(f) Renewal of CLP or PLP status.

(1) PLP or CLP status will expire 5 years from the date the Lender's Agreement is executed, unless a new Lender's Agreement is executed.

(2) Renewal of PLP or CLP status is not automatic. A lender must submit a

written request for renewal of a Lender's Agreement with PLP or CLP status which includes information:

(i) Updating the material submitted for the initial application; and,

(ii) Addressing any new criteria established by the Agency since the initial application.

(3) PLP or CLP status will be renewed if the applicable eligibility criteria under this section are met, and no due cause exists for denying renewal under paragraph (g) of this section.

(g) Revocation of PLP or CLP Status.

(1) The Agency may revoke the lender's PLP or CLP status at any time during the 5 year term for due cause.

(2) Any of the following instances constitute due cause for revoking or not renewing PLP or CLP status:

(i) Violation of the terms of the Lender's Agreement;

(ii) Failure to maintain PLP or CLP eligibility criteria;

(iii) Knowingly submitting false or misleading information to the Agency;

(iv) Basing a request on information known to be false;

(v) Multiple deficiencies in processing or servicing Agency Guaranteed Farm Loan Programs loans in accordance with this subpart;

(vi) Failure to correct cited deficiencies in loan documents upon notification by the Agency;

(vii) Failure to submit status reports in a timely manner;

(viii) Failure to use forms, or follow credit management systems (for PLP lenders) accepted by the Agency; or

(ix) Failure to repurchase the guaranteed portion of a loan sold on the secondary market upon written request by the holder.

(3) A lender which has lost PLP or CLP status must be reconsidered for eligibility to continue as a Standard Eligible Lender (for former PLP and CLP lenders), or as a CLP lender (for former PLP lenders only) in submitting loan guarantee requests. They may reapply for CLP or PLP status when the problem causing them to lose their status has been resolved.

§ 1980.107 through 1980.109 [Removed and reserved]

25. Sections 1980.107 through 1980.109 are removed and reserved.

26. Section 1980.110 is revised to read as follows:

§ 1980.110 Loan Application.

(a) Loans for $50,000 or less. (1) A complete application for loans of $50,000 or less must, at least, consist of:

(i) the application form;

(ii) loan narrative;

(iii) balance sheet;

(iv) cash flow budget;

(v) credit report; and,

(vi) a plan for servicing the loan.

(2) In addition to the minimum requirements, the lender will perform at least the same level of evaluation and documentation for a guaranteed loan that the lender typically performs for non-guaranteed loans of a similar type and amount.

(b) Loans for over $50,000. A complete application for loans over $50,000 will consist of the items required in paragraph (a) of this section plus the following:

(1) verification of income;

(2) verification of debts over $1,000;

(3) 3 years financial history;

(4) 3 years of production history for Standard Eligible Lenders only;

(5) A proposed loan agreement; and

(6) If construction or development is planned, a copy of the plans, specifications, and development schedule.

(c) Applications from PLP lenders. Notwithstanding paragraphs (a) and (b) of this section, a complete application for PLP lenders will consist of at least:

(1) An application form;

(2) A loan narrative; and

(3) Any other items agreed to during the approval of the PLP lender's status.

(d) *Submitting applications.*

(1) All lenders must compile and maintain in their files a complete application for each guaranteed loan.

(2) The Agency will notify CLP lenders which items to submit to the Agency.

(3) PLP lenders will submit applications in accordance with their agreement with the Agency for PLP status.

(4) CLP and PLP lenders must certify that the required items are in its files.

(5) Also, the Agency may request additional information from any lender or review their loan file as needed to make eligibility and approval decisions.

(e) Incomplete applications. If the lender does not provide the information needed to complete its application by the deadline established in an Agency notice to the lender, the application will be considered withdrawn by the lender.

(f) Conflict of interest. (1) When a lender applies for a guaranteed loan, the lender will inform the Agency in writing of any actual or potential conflicts of interest.

(2) Actual or potential conflicts of interest include:

(i) The lender or its officers, directors, principal stockholders (except stockholders in a Farm Credit System institution that have stock requirements to obtain a loan), or other principal owners have a substantial financial interest in the loan applicant or borrower.

(ii) The loan applicant or borrower, a relative of the loan applicant or borrower, anyone residing in the household of the loan applicant or borrower, any officer, director, stockholder or other owner of the loan applicant or borrower holds any stock or other evidence of ownership in the lender.

(iii) The loan applicant or borrower, a relative of the loan applicant or borrower, or anyone residing in the household of the loan applicant or borrower is an Agency employee.

(iv) The officers, directors, principal stockholders (except stockholders in a Farm Credit System institution that have stock requirements to obtain a loan), or other principal owners of the lender have substantial business dealings (other than in the normal course of business) with the loan applicant or borrower.

(v) The lender or its officers, directors, principal stockholders, or other principal owners have substantial business dealings with an Agency employee.

(3) The lender must furnish additional information to the Agency upon request.

(4) The Agency will not approve the application until the lender develops acceptable safeguards to control any actual or potential conflicts of interest.

§ 1980.113 through 1980.119 [Removed and reserved]

27. Sections 1980.113 through 1980.119 are removed and reserved.

28. Sections 1980.120 through 1980.121 are added to read as follows:

§ 1980.120 Loan applicant eligibility.

Loan applicants must meet all of the following requirements to be eligible for a Guaranteed Operating loan or a Guaranteed Farm Ownership loan:

(a) The loan applicant, and anyone who will execute the promissory note, has not caused the Agency a loss by receiving debt forgiveness on all or a portion of any direct or guaranteed loan made under the authority of the CONACT by debt write-down, write-off, compromise under the provisions of section 331 of the CONACT, adjustment, reduction, charge-off, or discharge in bankruptcy or through any payment of a guaranteed loss claim under the same circumstances. Notwithstanding the preceding sentence, applicants who receive a write-down under section 353 of the CONACT may receive direct and guaranteed OL loans to pay annual farm and ranch operating expenses, which includes family subsistence, if the applicant meets all other requirements for the loan.

(b) The loan applicant, and anyone who will execute the promissory note, is not delinquent on any Federal debt, other than a debt under the Internal Revenue Code of 1996.

(c) The loan applicant, and anyone who will execute the promissory note, have no outstanding recorded judgments obtained by the United States in a Federal court. Such judgments do not include those filed by the United States Tax Courts.

(d) Citizenship. (1) The loan applicant is a citizen of the United States or an alien lawfully admitted to the United States for permanent residence under the Immigration and Nationalization Act. Indefinite parolees are not eligible. For an entity applicant, all members of an entity must meet the citizenship test.

(2) Aliens must provide the appropriate Immigration and Naturalization Service forms to document their permanent residency.

(e) The loan applicant must possess the legal capacity to incur the obligations of the loan.

(f) The individual loan applicant, or members of the entity applicant, must have sufficient applicable educational, on-the-job training, or farming experience in managing and operating a farm or ranch which indicates the managerial ability necessary to assure reasonable prospects of success in the proposed plan of operation. This education, training, or experience must have occurred within the past 5 years and the experience must have covered an entire production cycle.

(g) Credit History. (1) The individual or entity loan applicant and all entity members must have acceptable credit history demonstrated by debt repayment.

(2) A history of failures to repay past debts as they came due when the ability to repay was within their control will demonstrate unacceptable credit history.

(3) Unacceptable credit history will not include:

(i) Isolated instances of late payments which do not represent a pattern and were clearly beyond their control; or,

(ii) Lack of credit history.

(h) Test for Credit. (1) The loan applicant is unable to obtain sufficient credit elsewhere without a guarantee to finance actual needs at reasonable rates and terms.

(2) The potential for sale of any significant nonessential assets will be considered when evaluating the availability of other credit.

(3) Ownership interests in property and income received by an individual or entity loan applicant, or any entity members as individuals also will be considered when evaluating the availability of other credit to the loan applicant.

(i) Operating Loans. (1) For Operating Loans, the individual or entity loan applicant must be an operator of not larger than a family farm after the loan is closed.

(2) In the case of an entity borrower:

(i) The entity must be authorized to operate, and own if the entity is also an owner, a farm in the state or states in which the farm is located; and

(ii) If the entity members holding a majority interest are related by marriage or blood, at least one member of the entity also must operate the family farm; or,

(iii) If the entity members holding a majority interest are not related by marriage or blood, the entity members must also operate the family farm.

(j) Farm Ownership Loans. (1) For Farm Ownership Loans, the individual or entity loan applicant must be the operator and owner of not larger than a family farm after the loan is closed.

(2) In the case of an entity borrower:

(i) The entity must be authorized to own and operate a farm in the state or states in which the farm is located; and

(ii) If the entity members holding a majority interest are related by marriage or blood, at least one member of the entity also must own and operate the family farm; or,

(iii) If the entity members holding a majority interest are not related by marriage or blood, the entity members must also own and operate the family farm.

(k) For entity loan applicants. Entity loan applicants also must meet the following eligibility criteria:

(1) Each entity member's ownership interest may not exceed the family farm definition limits;

(2) The collective ownership interest of all entity members may exceed the family farm definition limits only if the following conditions are met:

(i) All of the entity members are related by blood or marriage;

(ii) All of the members are or will be operators of the entity; and,

(iii) The majority interest holders of the entity must meet the requirements of paragraphs (d), (f), (g), and (i) through (j) of this section;

(3) The entity must be controlled by farmers or ranchers engaged primarily and directly in farming or ranching in the United States after the loan is made; and

(4) The entity members are individuals and not entities.

(l) Neither the applicant nor any entity member has been convicted of planting, cultivating, growing, producing, harvesting, or storing a controlled substance under Federal or state law within the last five crop years. ''Controlled substance'' is defined at 21 CFR part 1308. Applicants must attest on the Agency application form that it and its members, if an entity, have not been convicted of such a crime within the relevant period.

(m) The loan applicant must execute an Agency agreement to meet any training requirements in accordance with § 1980.150.

§ 1980.121 Loan purposes.

(a) Operating Loan purposes.

(1) Loan note guarantee. Loan funds disbursed under a loan note guarantee may only be used for the following purposes:

(i) Payment of costs associated with reorganizing a farm or ranch to improve its profitability.

(ii) Purchase of livestock, including poultry, and farm or ranch equipment or fixtures, quotas and bases, and cooperative stock for credit, production, processing or marketing purposes.

(iii) Payment of annual farm or ranch operating expenses, examples of which include feed, seed, fertilizer, pesticides, farm or ranch supplies, repairs and improvements which are to be expensed, cash rent and family subsistence.

(iv) Payment of scheduled principal and interest payments on term debt.

(v) Other farm and ranch needs.

(vi) Payment of costs associated with land and water development for conservation or use purposes.

(vii) Refinancing indebtedness incurred for any authorized OL loan purpose, when the lender and loan applicant can demonstrate the need to refinance.

(viii) Payment of loan closing costs.

(ix) Payment of costs associated with complying with Federal or State-approved standards under the Occupational Safety and Health Act of 1970 (29 U.S.C. § § 655 and 667). This purpose is limited to applicants who demonstrate that compliance with the standards will cause them substantial economic injury.

(x) Payment of training costs required or recommended by the Agency.

(2) Contract of guarantee—line of credit. Lines of credit may be advanced only for the following purposes:

(i) Payment of annual operating expenses, family subsistence, and purchase of feeder animals.

(ii) Payment of current annual operating debts advanced for the current operating cycle. Under no circumstances can carry-over operating debts from a previous operating cycle be refinanced.

(iii) Purchase of routine capital assets, such as replacement of livestock, that will be repaid within the operating cycle.

(iv) Payment of scheduled, non-delinquent, term debt payments.

(v) Purchase of cooperative stock for credit, production, processing or marketing purposes.

(vi) Payment of loan closing costs.

(b) Farm Ownership loan purposes. Guaranteed FO loans are authorized only to:

(1) Acquire or enlarge a farm or ranch. Examples include, but are not limited to, providing down payments, purchasing easements for the loan applicant's portion of land being subdivided, and participating in the Beginning Farmer Downpayment Farm Ownership program under part 1943, subpart A, of this chapter.

(2) Make capital improvements. Examples include, but are not limited to, the construction, purchase, and improvement of farm dwellings, service buildings and facilities that can be made fixtures to the real estate. Capital improvements to leased land may be financed subject to the limitations in § 1980.122.

(3) Promote soil and water conservation and protection. Examples include the correction of hazardous environmental conditions, and the construction or installation of tiles, terraces and waterways.

(4) Pay closing costs, including but not limited to, purchasing stock in a cooperative, and appraisal and survey fees.

(5) Refinancing indebtedness incurred for authorized loan purposes, provided the lender and loan applicant demonstrate the need to refinance the debt.

(c) Highly Erodible Land or Wetlands Conservation.

(1) Loans may not be made for any purpose which contributes to excessive erosion of highly erodible land or to the conversion of wetlands to produce an agricultural commodity.

(2) A decision by the Agency to reject an application for this reason is appealable. However, an appeal questioning either the presence of a wetland, converted wetland, or highly erodible land on a particular property must be filed directly with the USDA agency making the determination in accordance with its appeal procedures.

(d) Loans may not be used to satisfy judgment debts filed in the United States Federal courts. However, Internal Revenue Service judgment liens may be paid with loan funds.

29. Sections 1980.122 through 1980.126 are revised to read as follows:

§ 1980.122 Loan Limitations.

(a) OL limitations. (1) The total outstanding combined OL direct and guaranteed principal balance owed by the loan applicant or anyone who will sign the note must not exceed $400,000 at loan closing.

(2) The total dollar amount of line of credit advances and income releases cannot exceed the total estimated expenses, less interest expense, as indicated on the borrower's plan, unless the plan is revised and continues to reflect a feasible plan.

(3) Term Limitations. (i) General. No guaranteed OL loan shall be made to any loan applicant after the 15th year that a loan applicant, or any individual signing the promissory note, received direct or guaranteed OL loans.

(ii) Transition rule. If a borrower was indebted for a direct or guaranteed OL loan on October 28, 1992, and had any combination of direct or guaranteed OL loans closed in 10 or more prior calendar years, eligibility to receive new guaranteed OL loans is extended for 5 additional years from October 28, 1992, and the years need not run consecutively. However, in the case of a line of credit, each year in which an advance is made after October 28, 1992, counts toward the 5 additional years. Once determined eligible, a loan or line of credit may be approved for any authorized term.

(b) FO limitations. (1) The total outstanding combined FO and SW direct and guaranteed principal balance owed by the loan applicant or anyone who will sign the note must not exceed $300,000 at loan closing.

(2) Leased Land. When FO funds are used for improvements to leased land the terms of the lease must provide reasonable assurance that the loan applicant will have use of the improvement over its useful life, or provides compensation for any unexhausted value of the improvement if the lease is terminated.

(c) Tax-exempt transactions. The Agency will not guarantee any loan or line of credit made with the proceeds of any obligation the interest on which is excludable from income under Section 103 of the Internal Revenue Code of 1954, as amended. Funds generated through the issuance of tax-exempt obligations may not be used to purchase the guaranteed portion of any Agency guaranteed loan or line of credit nor may an Agency guaranteed loan or line of credit serve as collateral for a tax-exempt issue.

§ 1980.123 Insurance and farm inspection requirements.

(a) Insurance. (1) Lenders are responsible for ensuring that borrowers maintain adequate property, public liability, and crop insurance coverage to protect the lender and Government's interests.

(2) By loan closing, loan applicants must either:

(i) Obtain at least the catastrophic risk protection (CAT) level of crop insurance coverage, if available, for each crop of economic significance, as defined by part 402 of this title, or

(ii) Waive eligibility for emergency crop loss assistance in connection with the uninsured crop. EM loss loan assistance under part 1945, subpart D, of this chapter is not considered emergency crop loss assistance for purposes of this waiver.

(3) Loan applicants must purchase flood insurance if buildings are or will be located in a special flood or mudslide hazard area and if flood insurance is available.

(4) Insurance, including crop insurance, also must be obtained as required by the lender or the Agency based on the strengths and weaknesses of the loan.

(b) Farm inspections. Before submitting an application the lender must make an inspection of the farm to assess the suitability of the farm and to determine any development that is needed to make it a suitable farm.

§ 1980.124 Interest rates, terms, charges, and fees.

(a) Interest rates. (1) *Fixed or variable.* The interest rate on a guaranteed loan or line of credit may be fixed or variable as agreed upon by the borrower and the lender.

The lender may charge different rates on the guaranteed and the non-guaranteed portions of the note. The guaranteed portion may be fixed while the unguaranteed portion may be variable, or vice versa. If both portions are variable, different bases may be used.

(2) *Variable rate.* If a variable rate is used, it must be tied to a rate specifically agreed to by the lender and borrower in the loan instruments. Variable rates may change according to the normal practices of the lender for its average farm customers, but the frequency of change must be specified in the loan or line of credit instrument.

(3) *Ceiling.* Neither the interest rate on the guaranteed portion nor the unguaranteed portion may exceed the rate the lender charges its average farm customer. At the request of the Agency, the lender must provide evidence of the

rate charged the average farm customer. This evidence may consist of average yield data, or documented administrative differential rate schedule formulas used by the lender.

(4) *Interest charges.* Interest must be charged only on the actual amount of funds advanced and for the actual time the funds are outstanding. Interest on protective advances made by the lender to protect the security may be charged at the rate specified in the security instruments.

(5) *Interest assistance program.* The lender and borrower may collectively obtain a temporary reduction in the interest rate through the Interest Assistance program in accordance with Exhibit D of this subpart.

(b) OL terms. (1) Loan funds or advances on a line of credit used to pay annual operating expenses will be repaid when the income from the year's operation is received, except when the borrower is establishing a new enterprise, developing a farm, purchasing feed while feed crops are being established, or recovering from disaster or economic reverses.

(2) The final maturity date for each loan cannot exceed 7 years from the date of the promissory note or line of credit agreement. Advances for purposes other than for annual operating expenses will be scheduled for repayment over the minimum period necessary considering the loan applicant's ability to repay and the useful life of the security, but not in excess of 7 years.

(3) Balloon installments under Loan Note Guarantee.

(i) Extended repayment schedules may include equal, unequal, or balloon installments if needed to establish a new enterprise, develop a farm, or recover from a disaster or an economical reversal.

(ii) Loans with balloon installments must have adequate collateral at the time the balloon installment comes due. Crops, livestock, or livestock products produced are not sufficient collateral for securing such a loan.

(iii) The borrower must likely be able to refinance the remaining debt at the time the balloon payment comes due based on the expected financial condition of the operation, the depreciated value of the collateral, and the principal balance on the loan.

(4) All advances on a line of credit must be made within 5 years from the date of the Contract of Guarantee.

(c) FO terms. Each loan must be scheduled for repayment over a period not to exceed 40 years from the date of the note or a shorter period as may be necessary to assure that the loan will be adequately secured, taking into account the probable depreciation of the security.

(d) Charges and Fees.

(1) Routine charges and fees. The lender may charge the loan applicant and borrower fees for the loan provided they are no greater than those charged to nonguaranteed customers for similar transactions. The lender may not charge, or cause to be charged, any processing or packaging fees not charged to nonguaranteed customers for similar transactions. Similar transactions are those involving the same type of loan requested (for example, operating loans or farm real estate loans).

(2) Late payment charges. Late payment charges (including default interest charges) are not covered by the guarantee. These charges may not be added to the principal and interest due under any guaranteed note or line of credit. However, late payment charges may be made outside of the guarantee if they are routinely made by the lender in similar types of loan transactions.

(3) Lenders may not charge a loan origination and servicing fee greater than 1 percent of the loan amount for the life of the loan when a guaranteed loan is made in conjunction with a down payment FO loan for beginning farmers under part 1943, subpart A, of this chapter.

§ 1980.125 Financial Feasibility.

(a) General. (1) Notwithstanding any other provision of this section, PLP lenders will follow their internal procedures on financial feasibility as agreed to by the Agency during their PLP certification.

(2) The loan applicant's proposed operation must project a positive cash flow as determined by the Agency.

(3) For standard eligible lenders, the projected income and expenses of the borrower and operation used to determine positive cash flow must be based on the loan applicant's proven record of production and financial management.

(4) For CLP lenders, the projected income and expenses of the borrower and operation will be based on the loan applicant's financial history and proven record of financial management.

(5) The plan of operation analyzed to determine positive cash flow must represent the predicted cash flow of the operating cycle.

(6) Lenders must use price forecasts that are reasonable and defensible. Sources must be documented by the lender and acceptable to the Agency.

(7) When positive cash flow depends on income from other sources in addition to income from owned land, the income must be dependable and likely to continue.

(8) The lender will analyze business ventures other than the farm operation to determine their soundness and contribution to the operation. Guaranteed loan funds will not be used to finance a nonfarm enterprise. Nonfarm enterprises include, but are not limited to: raising earthworms, exotic birds, tropical fish, dogs, or horses for nonfarm purposes; welding shops; roadside stands; boarding horses; and riding stables.

(9) When the loan applicant has or will have a farm operating plan developed in conjunction with a proposed or existing Agency direct loan, the two plans must be consistent.

(b) Estimating production. (1) Standard eligible lenders must use the best sources of information available for estimating production in accordance with this subsection when developing operating plans.

(2) Deviations from historical performance may be acceptable, if specific to changes in operation and adequately justified and acceptable to the Agency.

(3) For existing farmers, actual production for the past 3 years will be utilized.

(4) For those farmers without a proven history, a combination of any actual history and any other reliable source of information that are agreeable with the lender, the loan applicant, and the Agency will be used.

(5) When the production of a growing commodity can be estimated, it must be considered when projecting yields.

(6) When the loan applicant's production history has been so severely affected by a declared disaster that an accurate projection cannot be made, the following applies:

(i) County average yields are used for the disaster year if the loan applicant's disaster year yields are less that the county average yields. If county average yields are not available, State average yields are used. Adjustments can be made providing there is factual evidence to demonstrate that the yield used in the farm plan is the most probable to be realized.

(ii) To calculate a historical yield, the crop year with the lowest actual or county average yield may be excluded, provided the loan applicant's yields were affected by disasters at least 2 of the past 5 years.

(c) Refinancing. Loan guarantee requests for refinancing must ensure that a reasonable chance for success still exists. The lender must demonstrate that problems with the loan applicant's operation have been identified can be

corrected and the operation returned to a sound financial basis.

§ 1980.126 Security requirements.

(a) General. (1) The lender is responsible for ensuring that proper and adequate security is obtained and maintained to fully secure the loan, protect the interest of the lender and the Agency, and assure repayment of the loan or line of credit.

(2) The lender will obtain a lien on additional security when necessary to protect the Government's interest.

(b) Guaranteed and unguaranteed portions. (1) All security must secure the entire loan or line of credit. The lender may not take separate security to secure only that portion of the loan or line of credit not covered by the guarantee.

(2) The lender may not require compensating balances or certificates of deposit as means of eliminating the lender's exposure on the unguaranteed portion of the loan or line of credit. However, compensating balances or certificates of deposit as otherwise used in the ordinary course of business are allowed.

(c) Identifiable security. The guaranteed loan must be secured by identifiable collateral. To be identifiable, the lender must be able to distinguish the collateral item and adequately describe it in the security instrument.

(d) Type of security. (1) Typically, annual operating loans will be secured by crops and livestock, loans to be repaid within 2 to 7 years by breeding livestock and equipment, and loans repaid over greater than 7 years by real estate. However, guaranteed loans may be secured by any property provided the term of the loan and expected life of the property will not cause the loan to be undersecured.

(2) For loans with terms greater than 7 years, a lien must be taken on real estate.

(3) Loans can be secured by a mortgage on leasehold properties if the lease has a negotiable value and is mortgageable.

(4) The lender or Agency may require additional personal or corporate guarantees, or both, to adequately secure the loan. These guarantees are separate from, and in addition to, the personal obligations arising from members of an entity signing the note as individuals.

(e) Lien position. All guaranteed loans will be secured by the best lien obtainable provided:

(1) When the loan is made for refinancing purposes, the guaranteed loan must hold a security position no lower than on the existing loan.

(2) Any chattel-secured guaranteed loan must have a higher lien priority (including purchase money interest) than an unguaranteed loan secured by the same chattels and held by the same lender. Also, guaranteed loan installments will be paid before unguaranteed loans held by the same lender.

(3) Junior lien positions are acceptable only if the equity position is strong. Junior liens on livestock, crops, or livestock products will not be relied upon for security unless the lender is involved in multiple guaranteed loans to the same borrower, and also has first lien on the collateral.

(4) Any loan of $10,000 or less may be secured by the best lien obtainable on real estate without title clearance or legal services normally required, provided the lender believes from a search of the county records that the loan applicant can give a mortgage on the farm. This exception to title clearance will not apply when land is to be purchased.

(5) When taking a junior lien, prior lien instruments may not contain future advance clauses (except for taxes, insurance, or other reasonable costs to protect security), or cancellation, summary forfeiture, or other clauses that jeopardize the Government's or the lender's interest or the borrower's ability to pay the guaranteed loan, unless any such undesirable provisions are limited, modified, waived or subordinated insofar as the Government and the lender are concerned.

(f) Multiple owners. If security has multiple owners, all owners must pledge security for the loan.

(g) Nonessential assets. A lien will be taken on all significant nonessential assets.

(h) The Agency has the authority to grant an exception to any of the requirements involving security, if the proposed change is in the best interest of the Government and the collectability of the loan will not be impaired.

30. Sections 1980.127 through 1980.128 are added to read as follows:

§ 1980.127 Appraisal requirements.

(a) General.

(1) The Agency may require a lender to obtain an appraisal based on the type of security, loan size, and whether it is primary or additional security.

(2) Except for authorized liquidation expenses, the lender is responsible for all appraisal costs, which may be passed on to the borrower, or a transferee in the case of a transfer and assumption.

(b) Exception. Notwithstanding other provisions of this section, an appraisal is not required in the following cases:

(1) For any additional security.

(2) For loans of $50,000 or less if a strong equity position exists as determined by the Agency.

(c) Chattel appraisals. (1) A current appraisal (not more than 12 months old) of primary chattel security generally is required on all loans. An appraisal for loans or lines of credit for annual production purposes that are secured by crops is only required when a loan note or line of credit guarantee is requested late in the current production year and actual yields can be reasonably estimated.

(2) The appraised value of chattel property will be based on public sales of the same, or similar, property in the market area. In the absence of such public sales, reputable publications reflecting market values may be used.

(3) Appraisal reports may be on the Agency's Appraisal of Chattel Property form or on any other appraisal form containing at least the same information.

(4) Chattel appraisals will be performed by appraisers who possess sufficient experience or training to establish market (not retail) values as determined by the Agency.

(d) Real estate appraisals.

(1) A current real estate appraisal is required when real estate will be primary security. Agency officials may accept an existing appraisal only if the appraisal was properly completed within the past 12 months, or older if updated by a qualified appraiser, and there have been no significant changes in the market or on the subject real estate.

(2) Appraiser qualifications. (i) On loan transactions of $250,000 or less, the lender must demonstrate to the Agency's satisfaction that the appraiser possesses sufficient experience or training to estimate market values.

(ii) On loan transactions greater than $250,000, which includes principal plus accrued interest through the closing date, the appraisal must be completed by a state certified general appraiser. A loan transaction is defined as any loan approval or servicing action.

(3) Appraisal reports. Real estate appraisal reports must be completed in accordance with the Uniform Standards of Professional Appraisal Practice. Appraisals may be either a complete or limited appraisal provided in a self-contained or summary format. Restricted reports are not acceptable.

§ 1980.128 Environmental and special laws

(a) Environmental requirements. The requirements found in part 1940, subpart G, of this chapter must be met for guaranteed operating and farm

ownership loans. CLP and PLP lenders may certify that they have documentation in their file to demonstrate compliance with paragraph (c) of this section. Standard eligible lenders must submit evidence supporting compliance with this section.

(b) Determination. The Agency determination of whether an environmental problem exists will be based on:

(1) The information supplied with the application;

(2) The Agency's personal knowledge of the operation;

(3) Environmental resources available to the Agency including, but not limited to, documents, third parties, and governmental agencies;

(4) A visit to the farm operation when the available information is insufficient to make a determination;

(5) Other information supplied by the lender or loan applicant upon Agency request.

(c) Special requirements. Lenders will assist in the environmental review process by providing environmental information. In all cases, the lender must retain documentation of their investigation in the applicant or borrower's case file.

(1) *Floodplains.* A determination must be made as to whether there are any structures located within a 100 year floodplain as defined by Federal Emergency Management Agency floodplain maps, Natural Resources Conservation Service data, or other appropriate documentation. Floodplain determinations will be documented by using the Standard Flood HazardDetermination Form.

(2) *Water quality standards.* The lender will consult with the Agency for guidance on activities which require consultation with State regulatory agencies, special permitting or waste management plans. The lender will also assist in securing any applicable permits or plans.

(3) *Historical or archeological sites.* The lender will consult with the Agency for guidance on which situations will need further review in accordance with the National Historical Preservation Act and part 1940, subpart G, and part 1901, subpart F, of this chapter. The lender will examine the security property to determine if there are any structures or archeological sites which are listed or may be eligible for listing in the National Register of Historic Places.

(4) *Wetlands and highly erodible land.* The loan applicant must certify they will not violate the Food Security Act provisions relating to Highly Erodible Land and Wetland Conservation.

(5) *Hazardous substances.* All lenders are required to ensure that due diligence is performed in conjunction with a request for guarantee involving real estate. Due diligence is the process of evaluating real estate in the context of a real estate transaction to determine the presence of contamination from release of hazardous substances, petroleum products, or other environmental hazards and determining what effect, if any, the contamination has on the security value of the property. The Agency will accept as evidence of due diligence the most current version of the American Society of Testing Materials (ASTM) Transaction Screen Questionnaire available from 1916 Race Street, Philadelphia, Pennsylvania 19103, or similar documentation, supplemented as necessary by the ASTM Phase I Environmental Site Assessments form.

(d) Equal opportunity and nondiscrimination.

(1) With respect to any aspect of a credit transaction, the lender will not discriminate against any applicant on the basis of race, color, religion, national origin, age, sex, marital status, or physical or mental handicap, provided the applicant can execute a legal contract. Nor will the lender discriminate on the basis of whether all or a part of the applicant's income derives from any public assistance program, or whether the applicant in good faith, exercises any rights under the Consumer Protection Act.

(2) Where the guaranteed loan involves construction, contractor or subcontractor must file all compliance reports, equal opportunity and nondiscrimination forms, and otherwise comply with all regulations prescribed by the Secretary of Labor pursuant to Executive Orders 11246 and 11375.

(e) Other Federal, State and local requirements. Lenders are required to coordinate with all appropriate Federal, State, and local agencies and comply with special laws and regulations applicable to the loan proposal.

31. Sections 1980.129 and 1980.130 are revised to read as follows:

§ 1980.129 Percent of guarantee and maximum loss.

(a) General. The percent of guarantee will not exceed 90 percent as determined by the Agency based on the credit risk to the lender and the Agency both before and after the transaction.

(b) Exceptions. The guarantee will be issued at 95 percent in any of the following circumstances:

(1) The sole purpose of a guaranteed FO or OL loan is to refinance an Agency direct farm loan. When only a portion of the loan is used to refinance a direct Agency farm credit program loan, a weighted percentage of a guarantee will be provided;

(2) When the purpose of an FO loan guarantee is to participate in the down payment loan program; or

(3) When a guaranteed OL is made to a farmer or rancher who is participating in the Agency's down payment loan program. The guaranteed OL must be made during the period that a borrower has the down payment loan outstanding.

(c) PLP guarantees. All guarantees issued to PLP lenders ineligible for 95 percent guarantees under this section will be guaranteed at 80 percent.

(d) CLP Guarantees. All guarantees issued to CLP lenders will not be less than 80 percent.

(e) Maximum loss. The maximum amount the Agency will pay the lender under the Loan Note Guarantee or Contract of Guarantee will be any loss sustained by such lender on the guaranteed portion including:

(1) Principal and interest indebtedness as evidenced by the note or by assumption agreement;

(2) Any loan subsidy due and owing;

(3) Principal and interest indebtedness on secured protective advances for protection and preservation of collateral made in accordance with this subpart; and

(4) Principal and interest indebtedness on recapture debt pursuant to a Shared Appreciation agreement provided the lender has paid the Agency its pro rata share of the recapture amount due.

§ 1980.130 Loan approval and issuing the guarantee.

(a) Processing timeframes.

(1) Standard Eligible Lenders. Complete applications from Standard Eligible Lenders will be approved or rejected, and the lender notified in writing, no later than 30 calendar days after receipt.

(2) CLP and PLP lenders.

(i) Complete applications from CLP or PLP lenders will be approved or rejected not later than 14 calendar days after receipt.

(ii) For PLP lenders, if this time frame is not met, the proposed guaranteed loan will automatically be approved, subject to funding, and receive an 80 percent guarantee.

(b) Funding preference. Loans are approved subject to the availability of funding. When it appears that there are not adequate funds to meet the needs of all approved loan applicants, applications that have been approved will be placed on a preference list

according to the date of receipt of a complete application. If approved applications have been received on the same day, the following will be given priority:

(1) An application from a veteran

(2) An application from an Agency direct loan borrower

(3) An application from a loan applicant who:

(i) Has a dependent family, or

(ii) Is an owner of livestock and farm implements necessary to successfully carry out farming operations, or

(iii) Is able to make down payments.

(iv) Any other approved application.

(c) Conditional Commitment.

(1) The lender must meet all of the conditions specified in the conditional commitment to secure final Agency approval of the guarantee.

(2) The lender, after reviewing the conditions listed on the Conditional Commitment, will complete, execute, and return the form to the Agency. If the conditions are not acceptable to the lender, the Agency may agree to alternatives or inform the lender and the loan applicant of their appeal rights.

(d) Lender requirements prior to issuing the guarantee.

(1) *Lender certification.* The lender will certify as to the following on the appropriate Agency form:

(i) No major changes have been made in the lender's loan or line of credit conditions and requirements since the issuance of the Conditional Commitment (except those approved in the interim by the Agency in writing);

(ii) Required hazard, flood, or Federal crop insurance, worker's compensation, and personal life insurance (when required) are in effect;

(iii) Truth in lending requirements have been met;

(iv) All equal employment opportunity and nondiscrimination requirements have been or will be met at the appropriate time;

(v) The loan or line of credit has been properly closed, and the required security instruments have been obtained, or will be obtained, on any acquired property that cannot be recovered initially under State law;

(vi) The borrower has a marketable title to the collateral owned by the borrower, subject to the instrument securing the loan or line of credit to be guaranteed and subject to any other exceptions approved in writing by the Agency. When required, an assignment on all USDA crop and livestock program payment has been obtained;

(vii) When required, personal, joint operation, partnership, or corporate guarantees have been obtained;

(viii) Liens have been perfected and priorities are consistent with requirements of the Conditional Commitment;

(ix) Loan proceeds have been, or will be disbursed for purposes and in amounts consistent with the Conditional Commitment and as specified on the loan application. In line of credit cases, if any advances have occurred, advances have been disbursed for purposes and in amounts consistent with the Conditional Commitment and Line of Credit Agreements;

(x) There has been no material adverse changes in the borrower's condition, financial or otherwise, during the period of time from the Agency's issuance of the Conditional Commitment to issuance of the guarantee; and

(xi) All other requirements specified in the Conditional Commitment have been met.

(2) *Inspections.* The lender must notify the Agency of any scheduled inspections during construction and after the guarantee has been issued. The Agency may attend these field inspections. Any inspections or review performed by the Agency, including those with the lender, are for the benefit of the Agency only. Agency inspections do not relieve any other parties of their inspection responsibilities, nor can these parties rely on Agency inspections in any manner.

(3) *Execution of Lender's Agreement.* The lender must execute the Agency's lender's agreement and deliver it to the Agency.

(4) *Closing report and guarantee fees.* (i) The lender must complete a Closing Report and return it to the Agency along with any guarantee fees.

(ii) Guarantee fees are 1 percent and are calculated as follows: Initial Fee = Loan Amount × % Guaranteed × .01. The nonrefundable fee is paid to the Agency by the lender. The fee may be passed on to the borrower and included in loan funds.

(iii) The following guaranteed loan transactions are not charged a fee:

(A) Loans involving interest assistance;

(B) Loans where a majority of the funds are used to refinance an Agency direct loan; and

(C) Loans to beginning farmers or ranchers involved in the direct beginning farmer downpayment program.

(e) Promissory notes, line of credit agreements, mortgages, and security agreements. The lender will use its own promissory notes, line of credit agreements, real estate mortgages (including deeds of trust and similar instruments), and security agreements (including chattel mortgages in Louisiana and Puerto Rico), provided:

(1) The forms are consistent and meet Agency requirements;

(2) Documents comply with state law and regulation;

(3) The principal and interest repayment schedules are stated clearly in the notes and consistent with the conditional commitment;

(4) Promissory notes are signed as follows:

(i) For individuals, only one person signs the note as a borrower. If a cosigner is needed, the cosigner also signs the note.

(ii) For entities, the note is executed by the member who is authorized to sign for the entity, and by all members of the entity as individuals. Individual liability can be waived by the Agency for members holding less than 10 percent ownership in the entity if the collectability of the loan will not be impaired; and

(5) When the loan purpose is to refinance or restructure the lender's own debt, the lender may continue to use the existing debt instrument and attach an allonge that modifies the terms of the original note.

(f) Replacement of Loan Note Guarantee, Contract of Guarantee, or Assignment Guarantee Agreement. If the guarantee or assignment guarantee agreements are lost, stolen, destroyed, mutilated, or defaced, except where the evidence of debt was or is a bearer instrument, the Agency will issue a replacement to the lender or holder upon receipt of acceptable documentation including a certificate of loss and an indemnity bond.

§ 1980.131 [Removed and reserved]

32. Section 1980.131 is removed and reserved.

§ 1980.136 [Removed and reserved]

33. Section 1980.136 is removed and reserved.

§ 1980.139 [Removed and reserved]

34. Section 1980.139 is removed and reserved.

35. Sections 1980.140 through 1980.143 are added to read as follows:

§ 1980.140 General servicing responsibilities.

(a) General. (1) Lenders are responsible for servicing the entire loan in a reasonable and prudent manner, protecting and accounting for the collateral, and remaining the mortgagee r secured party of record.

(2) The lender cannot enforce the guarantee to the extent that a loss results from a violation of usury laws or negligent servicing.

(b) Borrower supervision. The lender's responsibilities regarding borrower supervision include, but are not limited to the following:

(1) Ensuring loan funds are not used for an unauthorized purpose.

(2) Ensuring borrower compliance with the covenants and provisions provided in the note, loan agreement, security instruments, any other agreements, and this subpart. Any violations which indicate non-compliance on the part of the borrower, must be reported, in writing, to both the Agency and the borrower.

(3) Ensure the borrower is in compliance with all laws and ordinances applicable to the loan, the collateral, and the operations of the farm.

(4) Receive all payments of principal and interest on the loan as they fall due and promptly disburse to any holder its pro-rata share according to the amount of interest the holder has in the loan, less only the lender's servicing fee.

(5) Perform an annual analysis of the borrower's financial condition to determine the borrower's progress. The annual analysis will include:

(i) For loans secured by real estate only, the analysis for standard eligible lenders must include a Statement of Financial Condition. CLP lenders will determine the need for the annual analysis based on the financial strength of the borrower and document the file accordingly. PLP lenders will perform a borrower analysis in accordance with the requirements established when the Lender's Agreement was signed.

(ii) For loans secured by chattels, all lenders will review the borrower's progress regarding liquidity, solvency, profitability, repayment capacity and financial and production efficiency, including a comparison of actual to planned income and expenses for the past year.

(iii) An account for the whereabouts or disposition of all collateral.

(iv) A discussion of any observations about the farm business with the borrower.

(v) Verification that the borrower and any party liable for the loan is not released from liability for all or any part of the loan, except in accordance with Agency regulations.

(c) Monitoring of development. The lender's responsibilities regarding the construction, repairs, or other development include, but are not limited to:

(1) Determining that all construction is completed as proposed in the loan application;

(2) Making periodic inspections during construction to ensure that any development is properly completed within a reasonable period of time; and

(3) Verification that the security is free of any mechanic's, materialmen's, or other liens which would affect the priority of the lender's lien which the lender agreed would be taken on the security.

§ 1980.141 Reporting requirements.

Lenders are responsible for providing the local Agency credit officer with all of the following information on the loan and the borrower:

(a) When a loan becomes 30 days past due, all lenders will submit the appropriate Agency form showing guaranteed loan borrower default status. The form will be resubmitted every 60 days until the default is resolved;.

(b) All lenders will provide the appropriate Agency guaranteed loan status reports as of March 31 and September 30 of each year;

(c) PLP lenders also must provide periodic reports as agreed on the application and the requirements established when the Lender's Agreement was signed.

(d) CLP lenders also must provide the following:

(1) A narrative indicating that an annual borrower analysis has been performed and the borrower's progress is acceptable, unless such analysis was not needed based on the borrower's financial strength. The reasons for not conducting an analysis will be documented in the narrative.

(2) For lines of credit, an annual certification stating that a projected cash flow has been developed and is feasible, that the borrower is in compliance with the provisions of the line of credit agreement, and that the previous year income and loan funds and security proceeds have been accounted for.

(e) The standard eligible lender also will provide:

(1) Borrower's Statement of Financial Condition, and Income and Expense Statement for the previous year.

(2) For lines of credit, the projected cash flow for the borrower's operation for the upcoming operating cycle. The standard eligible lender must receive approval from the Agency before advancing future years' funds.

(3) An annual farm inspection report.

(f) A lender receiving a final loss payment must complete and return an annual report on its collection activities for each unsatisfied account for 3 years following payment of the final loss claim.

§ 1980.142 Servicing related to collateral.

(a) General. The lender's responsibilities regarding servicing collateral include, but are not limited to, the following:

(1) Obtain income assignments when required.

(2) Ensure the borrower has or obtains marketable title to the collateral.

(3) Inspect the collateral as often as deemed necessary to properly service the loan.

(4) Ensure the borrower does not convert loan security.

(5) Ensure proceeds from the sale or other disposition of collateral are accounted for and applied in accordance with the lien priorities on which the guarantee is based or used for the purchase of replacement collateral.

(6) Ensure the loan and the collateral are protected in the event of foreclosure, bankruptcy, receivership, insolvency, condemnation, or other litigation.

(7) Ensure taxes, assessments, or ground rents against or affecting the collateral are paid.

(8) Ensure adequate insurance is maintained.

(9) Ensure that insurance loss payments, condemnation awards, or similar proceeds are applied on debts in accordance with lien priorities on which the guarantee was based, or used to rebuild or acquire needed replacement collateral.

(b) Partial releases and transfers and assumptions. Partial releases and transfers and assumptions are subject to the following conditions:

(1) For standard eligible and CLP lenders, the servicing action must be approved by the Agency in writing.

(2) In the case of standard eligible and CLP lenders, the request for Agency approval will include:

(i) An application provided by the Agency;

(ii) A narrative explaining then proposed servicing action;

(iii) A current balance sheet on the borrower;

(iv) A projected cash flow budget showing a positive cash flow after the proposed servicing action;

(v) A current appraisal of the guaranteed loan security, unless the lenders guaranteed loan lien position will not be adversely affected;

(vi) Any other information requested by the Agency needed to evaluate the proposed servicing action;

(3) PLP lenders will request servicing approval in accordance with their agreement with the Agency at the time of PLP status certification.

(4) Any required security appraisals must meet the requirements of § 1980.127.

(5) The Agency will review and approve or reject the request and notify a standard eligible lender within 30

calendar days, and CLP and PLP lenders within 14 calendar days, from receipt of a complete request for servicing.

(6) The lender will provide the Agency copies of any agreements executed to carry out the servicing action.

(c) Subordinations. (1) Subordinating direct loan security to secure a guaranteed loan. The Agency may subordinate its security interest on a direct loan when a guaranteed loan is being made if, as appropriate, the requirements of § 1962.30 of subpart A of part 1962 of this chapter and § 1965.12 of subpart A of part 1965 of this chapter are met and only in any of the following circumstances:

(i) To permit a guaranteed lender to advance funds and perfect a security interest in crops, feeder livestock, or livestock products, (e.g., milk, eggs, wool, etc.);

(ii) When the lender requesting the guarantee needs the subordination of the Agency's lien position to maintain its lien position when servicing or restructuring;

(iii) When the lender requesting the guarantee is refinancing the debt of another lender and the Agency's position on real estate security will not be adversely affected; or

(iv) To permit a Contract of Guarantee—Line of Credit to be advanced for annual operating expenses.

(v) The Agency may subordinate its basic security in a direct loan under paragraph (c)(1)(iv) of this section only when both of the following additional conditions are met:

(A) The total unpaid balance of the direct loans is less than or equal to 75 percent of the value of all of the security for the direct loans, excluding the value of growing crops or planned production, at the time of the subordination. The direct loan security value will be determined by an appraisal. The lender requesting the subordination and guarantee is responsible for providing the appraisal and may charge the applicant a reasonable appraisal fee.

(B) The applicant cannot obtain sufficient credit through a conventional guaranteed loan. Before approving a combination guaranteed loan and subordination, the local loan approval official will document that the applicant requested a Contract of Guarantee—Line of Credit through at least one participating lender.

(2) Subordinating guaranteed loan security. The lender may not subordinate its interest in property which secures a guaranteed loan.

(3) The Agency's National Office may provide an exception to the subordination prohibition if such action is in the Government's best interest as determined by the Agency. However, in no case can the loan made under the subordination include tax exempt financing.

(d) Partial releases. In addition to the conditions set out in paragraph (b) of this section, the following limitations apply to partial releases:

(1) A partial release of security interest may be approved by the Agency if any of the following conditions are met:

(i) Proceeds from the sale of the released security will be applied to debts in accordance of their lien priority.

(ii) The security item will be used as a trade-in or source of down payment funds for a like item that will be taken as security;

(iii) The security item has no present or prospective value.

(iv) The loan to value ratio after the release is .75 or less.

(2) Standard eligible lenders and CLP lenders will submit the following to the Agency:

(i) A current appraisal of the security, except for the following:

(A) Unless specifically requested by the Agency, the lender will not be required to provide an appraisal of any real estate security being released.

(B) Based on the level of risk and estimated equity involved, the Agency will determine what security needs to be appraised.

(ii) How the proceeds, if any, will be used.

(e) Transfer and assumption. In addition to the conditions set out in paragraph (b) of this section, the following limitations apply to transfers and assumptions:

(1) The transferee meets the eligibility requirements and loan limitations for the loan being transferred, all requirements relating to loan rates and terms, loan security, feasibility, and environmental and other laws applicable to a loan applicant under this subpart.

(2) The lender will use their own assumption agreements or conveyance instruments providing they are legally sufficient to obligate the transferee for the total outstanding debt.

(3) The lender must note the assumption on the Loan Note Guarantee or Contract of Guarantee in the space provided. If the loan terms or interest rates are changed, a new Loan Note Guarantee or Contract of Guarantee is required.

(4) The lender must give any holder notice of the transfer. If the rate and terms are changed, written concurrence from the holder is required.

(5) The Agency will agree to releasing the transferor or any guarantor from liability only if the requirements of § 1980.146(c) are met.

§ 1980.143 Servicing Distressed Accounts

(a) Default by borrower. A borrower is in default when they are 30 days past due on a payment or have otherwise violated a loan agreement.

(b) Lender responsibilities. In the event of a borrower default, all lenders will:

(1) Report to the Agency in accordance with § 1980.141.

(2) If the guaranteed portion of the loan was sold on the secondary market, the lender will repurchase the guaranteed portion from the holder in accordance with § 1980.144 of this subpart.

(3) Arrange a meeting with the borrower within 45 days of its occurrence to identify the nature of the delinquency and develop a course of action that will eliminate the delinquency and correct the underlying problems.

(i) The lender and borrower will prepare a current balance sheet and cash flow in preparation for the meeting. If the borrower refuses to cooperate, the lender will prepare a balance sheet and cash flow based upon the best available information.

(ii) The lender or the borrower may request the attendance of an Agency credit officer. If requested, the local credit officer will assist in developing solutions to the borrower's financial problems.

(iii) The lender will summarize the meeting and proposed solutions on the Agency form for guaranteed loan borrower default status completed after the meeting. The borrower's eligibility for interest assistance will be automatically determined upon receipt of this form. Copies of correspondence sent to the borrower regarding agreements reached may be attached to this report.

(iv) The lender must decide whether to restructure or liquidate the account within 90 days of default, unless circumstances justify an extension by the Agency. PLP lenders may document the need for an extension without Agency approval.

(v) The lender may not initiate foreclosure action on the loan until 60 days after eligibility of the borrower to participate in the Interest Assistance Programs has been established by the Agency. If the lender or the borrower does not wish to consider servicing options under this section, this should be documented, and then liquidation under § 1980.149 should begin.

36. Sections 1980.144 through 1980.146 are revised, and §§ 1980.147 through 1980.149 are added to read as follows:

§ 1980.144 Repurchase of guaranteed portion from a secondary market holder.

(a) Request for repurchase. The holder may request the lender to repurchase the unpaid guaranteed portion of the loan when:

(1) The borrower has not made a payment of principal and interest due on the loan for at least 60 days; or

(2) The lender has failed to give the holder its pro-rata share of any payment made by the borrower within 30 days of receipt of a payment.

(b) Repurchase by the lender. (1) A lender will repurchase a loan from the holder upon request of the holder.

(2) The repurchase by the lender will be for an amount equal to the unpaid guaranteed portion of the principal and accrued interest, less the lender's servicing fee.

(3) The Agency will not reimburse the lender for any servicing fees which have been assessed to the holder.

(c) Repurchase by the agency. (1) If the lender is unable to repurchase the loan, the Agency will purchase the unpaid principal balance of the guaranteed portion with accrued interest to the date of repurchase within 30 days after written demand to the Agency, from the holder.

(2) With its demand on the Agency, the holder will include:

(i) A copy of the written demand made upon the lender.

(ii) Evidence of its right to require payment from the Agency. Evidence consists of either the originals of the Loan Note Guarantee and note properly endorsed to the Agency, or the original of the Assignment Guarantee Agreement which has been properly assigned to the Agency without recourse including all rights, title, and interest in the loan.

(iii) A copy of any written response to the demand provided to the holder by the lender.

(3) The amount due the holder from the Agency includes unpaid principal, unpaid interest to the date of demand, and interest which has accrued from the date of demand to the proposed payment date.

(i) For verification purposes, the lender must furnish upon Agency request a current statement, certified by a bank officer, of the unpaid principal and interest owed by the borrower and the amount due the holder.

(ii) Any discrepancy between the amount claimed by the holder and the information submitted by the lender must be resolved by the lender and the holder before payment will be approved by the Agency. The Agency will not participate in resolution of any such discrepancy.

(iii) The Loan Note Guarantee does not cover the note interest to the holder on the guarantee loan accruing after 90 days from the date of the demand letter to the lender requesting the repurchase. However, if for any reason not attributable to the holder and the lender, the Agency cannot make payment within 30 days of the holder's demand to the Agency, the holder will be entitled to interest to the date of the payment.

(4) Repurchase by the Agency does not change, alter, or modify any of the lender's obligations to the Agency specified in the Lender's Agreement, the Loan Note Guarantee or Contract of Guarantee, nor does the purchase waive any of the Agency's rights against the lender.

(5) The Agency has the right to set-off all lender's rights which have been passed along to the Agency from the holder representing the Agency's obligation to the lender under the Loan Note Guarantee.

(6) Within 180 days of the Agency's repurchase, the lender will reimburse the Agency the amount of repurchase, with accrued interest through one of the following ways:

(i) By liquidating the loan security and paying the Agency its pro-rata share of liquidation proceeds; or

(ii) Paying the Agency the full amount paid to the holder plus any accrued interest.

(iii) Purchasing the guaranteed portion from the Government on a non-recourse basis if the Agency determines that selling the portion of the loan that it holds is in the Government's best interest;

(iv) The lender has submitted a written request to the Agency to repurchase the guaranteed portion from the Agency on a non-recourse basis and has received written approval from the Agency.

(7) [Reserved]

(8) If the lender does not reimburse the Agency within 180 days, the lender will be liable for the repurchase amount and any expenses incurred by the Agency to maintain the loan in its portfolio or liquidate the security. While the Agency holds the guaranteed portion of the loan, the lender will transmit to the Agency any payment received from the borrower, including the pro-rata share of liquidation or other proceeds.

(9) If the borrower files bankruptcy or pays the account current while the repurchase by the Government is being processed, the Agency may hold the loan as long as it determines it to be in the Government's interest.

(10) The Agency will revoke, in writing, the Preferred or Certified Lender status, as applicable, of any lender that does not repurchase a loan from the secondary market when requested by the holder in writing.

(11) If a lender does not repurchase a loan from the holder the lender shall provide documentation to the Agency that they were physically or financially unable to repurchase the guaranteed portion from the holder when the request was made or otherwise provide justification to the Agency as to why they did not complete the repurchase. The Agency will review this documentation and if the failure to repurchase is not justified, as determined by the Agency, the lender will be provided with no additional loan guarantees.

(d) Repurchase for servicing.

(1) If due to loan default or imminent loan restructuring, the lender determines that its repurchase is necessary to adequately service the loan, the lender may repurchase the guaranteed portion of the loan from the holder, with the written approval of the Agency.

(2) The lender will not repurchase from the holder for arbitrage purposes.

(3) The holder will sell the guaranteed portion of the loan to the lender for an amount equal to the unpaid principal and interest, less lender's servicing fee.

§ 1980.145 Restructuring guaranteed loans.

(a) General.

(1) Lender submissions.

(i) Standard eligible lenders.

(A) Standard eligible lenders must obtain prior written approval of the Agency for all restructuring actions.

(B) Standard eligible lenders must provide the items in paragraph (a)(2) and (e) of this section to the Agency for approval.

(C) If the lender's proposal for servicing is not agreed to by the Agency, the Agency approval official will notify the lender in writing within 14 days of the lender's request.

(ii) CLP lenders.

(A) CLP lenders must obtain prior written approval of the Agency only for debt write down under this section.

(B) For debt write down, all calculations required in paragraph (e) of this section will be submitted to the Agency.

(C) For restructuring other than write down, CLP lenders will provide FSA with a certification that each requirement of this section has been

met, a narrative outlining the circumstances surrounding the need for restructuring, and copies of any applicable calculations.

(iii) PLP lenders will restructure loans in accordance with their agreement with the Agency at the time of the PLP certification.

(iv) All lenders will submit copies of any restructured notes or lines of credit to the Agency.

(2) Requirements. For any restructuring action, the following conditions apply:

(i) The borrower meets the eligibility criteria of § 1980.120 except the borrower may have had prior debt forgiveness. In addition, borrowers applying for restructuring of guaranteed loans will not be required to complete borrower training unless such training has been required as part of a previous loan but has not yet been satisfactorily completed.

(ii) The borrower's ability to make the amended payment is documented by the following:

(A) A feasible plan.

(B) Current financial statements from all liable parties.

(C) Verification of nonfarm income.

(D) Verification of all debts of $1,000 or more.

(E) Applicable credit reports.

(F) Financial history (and production history for standard eligible lenders) for the past 3 years to support the cash flow projections.

(iii) A final loss claim may be reduced, adjusted, or rejected as a result of negligent servicing after the concurrence with a restructuring action under this section.

(3) Balloon payments are prohibited; however, the loan can be restructured with unequal installments, provided the current year and any typical year plan demonstrates that these installments can be repaid without further restructuring.

(4) The lender may capitalize the outstanding interest when restructuring the loan in accordance with the following:

(i) As a result of the capitalization of interest, a rescheduled or reamortized note or line of credit agreement may increase the amount of principal which the borrower is required to pay. However, in no case will such principal amount exceed the statutory loan limits contained in § 1980.122.

(ii) When accrued interest causes the loan amount to exceed the statutory loan limits, rescheduling or reamortization may be approved without capitalization of the amount that exceeds the limit. Noncapitalized interest may be scheduled for repayment over the term of the rescheduled note.

(iii) Only interest that has accrued at the rate indicated on the borrower's original promissory notes may be capitalized. Late payment fees or default interest penalties that have accrued due to the borrower's failure to make payments as agreed are not covered under the guarantee and may not be capitalized.

(iv) If any of the guaranteed loan or line of credit agreements previously executed prohibit the capitalization of interest, the Agency will provide the lender with a modification form to waive the restriction for capitalization of interest resulting from restructuring a Farm Loan Programs loan and not exceeding statutory limits. If the documents do not prohibit the capitalization of interest, the new loan principal and the guaranteed portion, if greater than the original loan amounts, will be identified on the appropriate Agency modification form. Any modification will be attached to the original Loan Note Guarantee or Contract of Guarantee as an addendum.

(v) Approved capitalized interest will be treated as part of the principal and interest that accrues thereon, in the event that a loss should occur.

(5) The lender and Government's security position will not be adversely affected because of the restructuring. New security instruments may be taken if needed, but a loan does not have to be fully secured in order to be restructured.

(6) Any holder agrees in writing to any changes in the original loan terms, including the approval of interest assistance. If the holder does not agree, the lender must repurchase the loan from the holder for any loan restructuring to occur.

(7) After a guaranteed loan is restructured, the lender must provide the Agency with a copy of the restructured promissory note.

(b) Consolidation. The following conditions also apply to consolidation:

(1) Only OL loans or lines of credit may be consolidated.

(2) Existing lines of credit may only be consolidated with a new line of credit if the terms (to make advances as well as final maturity date) of the new line of credit are within the terms of the existing line of credit. OL loan note guaranteed loans may only be consolidated with other OL loan note guarantees.

(3) Guaranteed loans made prior to October 1, 1991, cannot be consolidated with those loans made on or after October 1, 1991.

(4) OL loans and lines of credit secured by real estate or with an outstanding Interest Assistance Agreement, or Shared Appreciation Agreement cannot be consolidated.

(5) A new note or line of credit agreement will be taken. The new note or line of credit agreement must describe the note or line of credit agreement being consolidated and must state that the indebtedness evidenced by the note or line of credit agreement is not satisfied. The original note or line of credit agreement must be retained for identification purposes.

(6) The interest rate for a consolidated OL loan is the negotiated rate agreed upon by the lender and the borrower at the time of the action, subject to the loan limitations for each type of loan.

(7) A new Contract of Guarantee or Loan Note Guarantee will be provided.

(c) Rescheduling and reamortization. The following conditions also apply when rescheduling or reamortizing a guaranteed loan:

(1) Payments will be rescheduled or reamortized within the following terms:

(i) FO and existing SW loans will be reamortized over the remaining term of the note or over a period not to exceed 40 years from the date of the original note.

(ii) OL loan notes must be rescheduled over a period not to exceed 15 years from the date of the action. An OL line of credit must be rescheduled over a period not to exceed 7 years from the date of the action or 10 years from the date of the original note, whichever is less. Advances cannot be made against a line of credit loan that has had any portion of the loan rescheduled.

(2) The interest rate for a rescheduled or reamortized loan is the negotiated rate agreed upon by the lender and the borrower at the time of the action, subject to the loan limitations for each type of loan. If the rescheduled or reamortized loan has an outstanding Interest Assistance Agreement, any change of the interest rate must occur on the anniversary date of the existing Interest Assistance Agreement.

(3) A new note is not necessary when rescheduling or reamortization occurs. However, if a new note is not taken, the existing note or line of credit agreement must be modified by attaching an ''allonge'' or other legally effective amendment, evidencing the revised repayment schedule and any interest rate change. If a new note is taken, the new note must reference the old note and state that the indebtedness evidenced by the old note or line of credit agreement is not satisfied. The original note or line of credit agreement must be retained for record keeping purposes.

(d) Deferrals. The following conditions also apply to deferrals:

(1) Payments may be deferred up to 5 years, but in no case extended beyond the final due date of the note.

(2) Principal may be deferred either in whole or in part. Payment of a reasonable portion of accruing interest as indicated by the borrower's cash flow projections is required for multi-year deferrals.

(3) There are reasonable prospects that the borrower will be able to resume full payments at the end of the deferral period.

(e) Debt writedown. The following conditions also apply to debt writedowns:

(1) A lender may only writedown a delinquent guaranteed loan or line of credit in an amount sufficient to permit the borrower to develop a feasible plan of operation.

(2) The lender will request other creditors to negotiate their debts before a writedown is considered.

(3) The borrower cannot develop a feasible plan after consideration is given to rescheduling, reamortization and deferral under this section.

(4) The present value of the loan to be written down will be equal to or exceed the net recovery value of the loan security.

(5) The loan will be restructured with regular payments at terms no shorter than 5 years for a line of credit and OL loan note and no shorter than 20 years for an FO loan.

(6) No further advances may be made on a line of credit that is written down.

(7) Loans may not be written down with interest assistance. If a borrower's loan presently on interest assistance requires a writedown, the writedown will be considered without interest assistance. If approved, the existing Interest Assistance Agreement will be terminated.

(8) The writedown is based on writing down the shorter-term loans first.

(9) When a lender requests approval of a writedown for a borrower with multiple loans, the security for all of the loans will be cross-collateralized and continue to serve as security for the loan that is written down. If a borrower has multiple loans and one loan is written off entirely through debt writedown, the security for that loan will not be released and will remain as security for the other written down debt. Additional security instruments will be taken if required to cross-collateralize security or maintain lien priority.

(10) The writedown will be evidenced by an allonge or amendment to the existing note or line of credit reflecting the writedown.

(11) The borrower executes an Agency Shared Appreciation Agreement for loans which are written down and secured by real estate.

(i) The lender will attach the original agreement to the restructured loan document.

(ii) The lender will provide the Agency a copy of the executed agreement, and

(iii) Security instruments must ensure future collection of any appreciation under the agreement.

(12) The lender will prepare and submit the following to the Agency:

(i) A current appraisal of all property securing the loan in accordance with § 1980.127.

(ii) A completed report of loss on the appropriate Agency form for the proposed writedown loss claim.

(iii) Detailed writedown calculations.

(iv) The amount of writedown is calculated as follows:

(A) Calculate the present value.

(B) Determine the net recovery value.

(C) If the net recovery value exceeds the present value, writedown is unavailable; liquidation becomes the next servicing consideration. If the present value equals or exceeds the net recovery value, the debt may be written down to the present value.

(v) The lender will make any adjustments in the calculations, as requested by the Agency.

§ 1980.146 Other servicing procedures.

(a) Additional loans and advances.

(1) Notwithstanding any provision of this section, the PLP lender may make additional loans or advances in accordance with its agreement with the Agency at the time of PLP certification.

(2) Lenders must not make additional loans without prior written approval of the Agency, except as provided for in the borrower's Loan or Line of Credit Agreement.

(3) In cases of a Guarantee line of credit, lenders may make an emergency advance when a line of credit has reached its ceiling provided the following conditions have been met:

(i) The loan funds to be advanced are for authorized operating loan purposes;

(ii) The financial benefit to the lender and the Government from the advance will exceed the amount of the advance; and

(iii) The loss of crops or livestock is imminent unless the advance is made.

(4) Protective advances are covered by § 1980.149.

(b) Release of liability upon withdrawal. An individual who is obligated on a guaranteed loan may be released from liability by a lender with the written consent of the Agency provided the following conditions have been met:

(1) The individual to be released has withdrawn from the operation;

(2) A divorce decree and final property settlement does not hold the withdrawing party responsible for the loan payments;

(3) The withdrawing party's interest in the security is conveyed to the individual or entity with whom the loan will be continued;

(4) Either the ratio of the amount of debt to the value of the remaining security is less than or equal to .75, or the withdrawing party has no income or assets from which collection can be made; and

(5) Withdrawal of the individual does not result in legal dissolution of the entity to which the loans are made. Individually liable members of a full partnership may not be released from liability.

(c) Release of liability after liquidation. After a final loss claim has been paid on the borrower's account, the lender may release the borrower or guarantor from liability if;

(1) The Agency agrees to the release in writing;

(2) The lender documents its consideration of the following factors concerning the borrower or guarantors:

(i) Potential income,

(ii) Inheritance prospects,

(iii) If collateral has been properly accounted for,

(iv) The availability of other income or assets which are not security for the guaranteed debt,

(v) The possibility that assets have been concealed or improperly transferred,

(vi) The effect of other guarantors on the loan,

(vii) Cash consideration or other collateral in exchange for the release of liability.

(3) The lender will execute its own release of liability documents.

(d) Interest rate changes.

(1) The lender may change the interest rate on a performing (nondelinquent) loan only with the borrower's consent.

(2) To change a fixed rate of interest to a variable rate of interest or vice versa, the lender and the borrower must execute a legally effective amendment or allonge to the existing note.

(3) If a new note is taken it will be attached to and refer to the original note.

(4) The lender will inform the Agency of the rate change.

§ 1980.147 Servicing Shared Appreciation Agreements.

(a) Lender responsibilities. The lender is responsible for:

(1) Monitoring the borrower's compliance with the Shared Appreciation Agreement;

(2) Notifying the borrower of the amount of recapture due; and,

(3) Reimbursing the Agency for its pro-rata share of recapture due.

(b) Recapture.

(1) *Triggering recapture.*—Recapture of any appreciation of real estate security will take place at the end of the term of the Agreement, or sooner, if the following occurs:

(i) On the conveyance of the real estate security (or a portion thereof) by the borrower.

(A) If only a portion of the real estate is conveyed, recapture will only be triggered against the portion conveyed. Partial releases will be handled in accordance with § 1980.141(b) of this subpart.

(B) Transfer of title to the spouse of the borrower on the death of such borrower, will not be treated as a conveyance under the agreement.

(ii) On the repayment of the loans; or

(iii) If the borrower ceases farming operations.

(2) *Figuring recapture.* (i) The amount of recapture will be based on the difference between the value of the security at the time recapture is triggered and the value of the security at the time of writedown as shown on the Shared Appreciation Agreement.

(ii) Security values will be determined through appraisals obtained by the lender and meeting the requirements of § 1980.127.

(iii) All appraisal fees will be paid by the lender.

(iv) The amount of recapture will not exceed the amount of writedown shown on the Shared Appreciation Agreement.

(v) If recapture is triggered within 4 years of the date of the Shared Appreciation Agreement, the lender shall recapture 75 percent of any positive appreciation in the market value of the property securing the loan or line of credit agreement.

(vi) If recapture is triggered after 4 years from the date of the Shared Appreciation Agreement, the lender shall recapture 50 percent of any positive appreciation in the market value of the property securing the loan or line of credit agreement.

(3) *Servicing recapture debt.* (i) If recapture is triggered under the Shared Appreciation Agreement and the borrower is unable to pay the recapture in a lump sum, the lender may:

(A) Reamortize the recapture debt with the consent of the Agency, provided the lender can document the borrower's ability to repay the reamortized debt plus other obligations. In such case, the recapture debt will not be covered by the Loan Note Guarantee or Contract of Guarantee;

(B) Pay the Agency its pro rate share of the recapture due. In such case, the recapture debt of the borrower will be covered by the Loan Note Guarantee or Contract of Guarantee; or

(C) Service the account in accordance with § 1980.149.

(ii) If recapture is triggered, and the borrower is able, but unwilling to pay the recapture, in a lump sum, the lender will service the account in accordance with § 1980.149.

(4) *Paying the Agency.* Any shared appreciation recaptured by the lender will be shared on a pro-rata basis between the lender and the Agency.

§ 1980.148 Bankruptcy.

(a) Lender responsibilities. The lender must protect the guaranteed loan debt and all collateral securing the loan in bankruptcy proceedings. The lender's responsibilities include, but are not limited to:

(1) Filing a proof of claim where required and all the necessary papers and pleadings;

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

(3) Protecting the collateral and resisting any adverse changes that may be made to the collateral securing the guaranteed loan;

(4) Seeking a dismissal of the bankruptcy proceeding when the operation as proposed by the borrower to the bankruptcy court is not feasible;

(5) When permitted by the Bankruptcy Code, requesting a modification of any plan or reorganization if it appears additional recoveries are likely.

(6) Monitor confirmed plans under Chapters 11, 12 and 13 of the bankruptcy code to determine borrower compliance. If the borrower fails to comply, the lender will seek a dismissal of the plan by the court; and

(7) Keeping the Agency regularly informed in writing on all aspects of the proceedings.

(i) The lender will submit a Default Status Report when the borrower defaults and every 60 days until the default is resolved or a final loss claim is paid.

(ii) The Default Status Report will be used to inform the Agency of the bankruptcy filing, the plan confirmation date, the plan's effective date, when the reorganization plan is complete, and when the borrower is not in compliance with the reorganization plan.

(b) Bankruptcy expenses.

(1) Reorganization bankruptcy.

(i) Lender's in-house expenses are not covered by the guarantee in a reorganization bankruptcy.

(ii) Other expenses, such as legal fees and appraisals, incurred by the lender as a direct result of the borrower's chapter 11, 12, or 13 reorganization are covered under the guarantee.

(2) Liquidation bankruptcy.

(i) Reasonable and customary liquidation expenses may be deducted from the proceeds of the collateral in liquidation bankruptcy cases.

(ii) In-house expenses are not considered customary liquidation expenses, may not be deducted from collateral proceeds, and are not covered by the guarantee.

(c) Estimated loss claims in reorganization bankruptcies.

(1) At confirmation. The lender may submit an estimated loss claim upon confirmation of the plan in accordance with the following:

(i) The estimated loss payment will cover the guaranteed percentage of the principal and accrued interest written off, plus any allowable costs incurred as of the effective date of the plan.

(ii) The lender will submit supporting documentation for the loss claim.

(iii) The estimated loss payment may be revised as consistent with a court-approved plan.

(iv) Protective advances. Protective advances made and approved in accordance with § 1980.149 may be included in an estimated loss claim associated with a reorganization bankruptcy, if:

(A) They were incurred in connection with the initiation of liquidation action prior to the bankruptcy filing; or

(B) The advance is required to provide repairs, insurance, etc. to protect the collateral as a result of delays in the case, or failure of the borrower to maintain the security.

(2) Interest only losses. The lender may submit an estimated loss claim for interest only after confirmation of the plan in accordance with the following:

(i) The loss claims may cover interest losses sustained as a result of a court-ordered, permanent interest rate reduction.

(ii) The loss claims will be processed annually on the anniversary date of the effective date of the bankruptcy plan.

(iii) If the borrower performs under the terms of the plan, annual interest reduction loss claims will be submitted on or near the same date, beyond the period of the reorganization plan.

(3) Actual loss.

(i) Once the reorganization plan is complete, the lender will provide the Agency with documentation of the actual loss sustained.

(ii) If the actual loss sustained is greater than the prior estimated loss payment, the lender may submit a revised estimated loss claim to obtain payment of the additional amount owed by the Agency under the guarantee.

(iii) If the actual loss is less than the prior estimated loss, the lender will reimburse the Agency for the overpayment plus interest at the note rate from the date of the payment of the estimated loss.

(4) Payment to holder. In reorganization bankruptcy if a holder makes demand upon the Agency, the Agency will pay the holder interest to the plan's effective date. Accruing interest thereafter, will be based upon the provisions of the reorganization plan.

(d) Liquidation bankruptcy.

(1) Upon receipt of notification that a borrower has filed for protection under Chapter 7 of the bankruptcy code, or a liquidation plan under Chapter 11, the lender shall proceed according to the liquidation procedures of this subpart.

(2) If the property is abandoned by the trustee, the lender will conduct the liquidation according to § 1980.149.

(3) Proceeds received from partial sale of collateral during bankruptcy may be used by the lender to pay reasonable costs, such as freight, labor and sales commissions, associated with the partial sale. Reasonable use of proceeds for this purpose must be documented with the final loss claim in accordance with § 1980.149 (a)(vi).

§ 1980.149 Liquidation.

(a) Mediation. When it has been determined that a default cannot be cured throughany of the servicing options available or if the lender does not wish to utilize any of the authorities provided in this subpart, the lender must:

(1) Participate in mediation according to the rules and regulations of any State which has a mandatory farmer-creditor mediation program.

(2) Consider private mediation services in those states which do not have a mandatory farmer-creditor mediation program.

(3) The lender must not agree to any proposals to rewrite the terms of a guaranteed loan which do not comply with this subpart.

(4) Any agreements reached as a result of mediation involving defaults and or loan restructuring must have written concurrence from the agency before they are implemented.

(b) Liquidation plan. If a default cannot be cured after considering servicing options and mediation, the lender will proceed with liquidation of the collateral in accordance with the following:

(1) Within 30 days of the decision to liquidate, all lenders will submit a written plan to the Agency which includes:

(i) Documentation of the lender's ownership of the guaranteed loan promissory note and related security instruments;

(ii) A current balance sheet from all liable parties, or in liquidation bankruptcies, a copy of the bankruptcy schedules or discharge notice; and

(iii) A proposed method of maximizing the collection of debt which includes specific plans to collect any remaining loan balances on the guaranteed loan after loan collateral has been liquidated, including possibilities for judgment.

(A) If the borrower has converted loan security, the lender will determine whether litigation is cost effective. The lender must address, in the liquidation plan, whether civil or criminal action will be pursued. If the lender does not pursue the recovery, the reason must be documented when an estimated loss claim is submitted.

(B) Any proposal to release the borrower from liability will be addressed in the liquidation plan.

(iv) An independent appraisal report on all collateral securing the loan which reflects the current market value and potential liquidation value. The appraisal will meet the requirements of § 1980.127. If the bankruptcy trustee is handling the liquidation, the lender should submit the trustee's determination of value.

(v) An estimate of time necessary to complete the liquidation.

(vi) If the liquidation period is expected to exceed 90 days and the lender owns any of the guaranteed portion of the loan, the lender will submit an estimated loss claim.

(vii) An estimate of reasonable liquidation expenses.

(viii) An estimate of any protective advances.

(c) Agency approval of plan.

(1) A lender's liquidation plan, and any revisions of the plan, must be approved by the Agency.

(2) If the Agency fails to approve the liquidation plan or request that the lender make revisions to the plan within 30 days, the lender may assume the plan is approved, make protective advances and begin liquidation actions at their discretion after waiting the 60 days from determining the eligibility of borrower for interest assistance.

(3) At its option, the Agency may liquidate the guaranteed loan as follows:

(i) The lender will transfer to the Agency all rights and interests necessary to allow the Agency to liquidate the loan upon Agency request. The Agency will not pay the lender for any loss until after the collateral is liquidated and the final loss is determined.

(ii) If the Agency conducts the liquidation, interest accrual will cease on the date the Agency notifies the lender in writing that it assumes responsibility for the liquidation.

(iii) The Agency will keep the lender informed of its progress in liquidating the account.

(d) Estimated loss claims. An estimated loss claim will be submitted by the lender with the liquidation plan. The estimated loss will be based on the following:

(1) The Agency will pay the lender the guaranteed percentage of the total outstanding debt, less the fair market value of the remaining security, any unaccounted for security, and estimated liquidation expenses. The market value will be determined by an appraisal meeting the requirements of § 1980.127.

(2) The lender will apply the estimated loss payment to the outstanding principal balance owed on the guaranteed debt and will credit the principal balance with the calculated lender's loss on the unguaranteed percentage of the loan. The lender must then discontinue interest accrual on the defaulted loan at the time the estimated loss claim is paid by the Agency.

(e) Protective advances.

(1) Written authorization from the Agency is required for all protective advances in excess of $3,000 for CLP lenders, $500 for standard eligible lenders. The dollar amount of protective advances for PLP lenders will be specified when PLP status is awarded and attached to the Lender's Agreement.

(2) The lender may claim recovery for the guaranteed portion of any loss of monies advanced as protective advances allowable under this subpart. This includes any accrued interest resulting from the protective advances.

(3) Payment for protective advances is made by the Agency when the final loss claim is approved, except in bankruptcy actions.

(4) Protective advances are used only when the borrower is in liquidation, liquidation is imminent, or when the lender has taken title to real property in a liquidation action.

(5) Attorney fees are not a protective advance.

(6) Protective advances may only be made when the lender can demonstrate the advance is in the best interest of the lender and the Government.

(7) Protective advances must constitute a debt of the borrower to the

lender and be secured by the security instrument.

(8) Protective advances must not be made in lieu of additional loans.

(f) Unapproved loans or advances. The amount of any payments made by the borrower on unapproved loans or advances outside of the guarantee will be deducted from any loss claim submitted by the lender on the guaranteed loan, if that loan or advance was paid prior to the guaranteed loan.

(g) Acceleration.

(1) If the borrower is not in bankruptcy, the lender shall send the borrower notice that the loan is in default and the entire debt has been determined due and payable immediately after other servicing options have been exhausted.

(2) The loan cannot be accelerated until after the borrower has been considered for Interest Assistance.

(3) The lender will submit a copy of the acceleration notice or other document to the Agency.

(h) Foreclosure.

(1) The lender is responsible for determining who the necessary parties are to any foreclosure action or who should be named on a deed of conveyance taken in lieu of foreclosure.

(2) When the property is liquidated, the lender will apply the net proceeds to the guaranteed loan debt.

(3) When it is necessary to enter a bid at a foreclosure sale, the lender may bid that amount that they determine is reasonable to protect their and the Government's interest. At a minimum, the lender will bid the lesser of the net recovery value or the unpaid guaranteed loan balance.

(i) Final loss claims.

(1) Lenders may submit a final loss claim when the security has been liquidated and all proceeds have been received and applied to the account.

(2) If a lender acquires title to property either through voluntary conveyance or foreclosure proceeding, the lender may choose to submit a final loss claim, if applicable, at the point title is obtained or at the time the lender disposes of the property. Maintenance expenses incurred for the property while it is owned by the lender will be through use of protective advances.

(3) The lender will make its records available to the Agency for its investigation into the propriety of any loss payment.

(4) All lenders will submit the following documents with a final loss claim:

(i) An accounting of the use of loan funds.

(ii) An accounting of the disposition of loan security and its sales proceeds.

(iii) A copy of the loan ledger indicating loan advances, interest rate changes, protective advances, and application of payments, rental proceeds, and security proceeds, including a running outstanding balance total.

(iv) Documentation, as requested by the Agency, concerning the lender's compliance with the requirements of this subpart.

(5) The Agency will notify the lender of any discrepancies in the final loss claim or, approve or reject the claim within 40 days.

(6) The Agency will reduce a final loss claim based on their calculation of the dollar amount of loss caused by the lender's negligent servicing of the account.

(7) The final loss will be the remaining outstanding balance after application of the estimated loss payment and the application of proceeds from the liquidation of the security. The final loss will include any interest accrual on the principal that remained after application of the estimated loss.

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

(j) Future Recovery. The lender will remit any recoveries made on the account after the Agency's payment of a final loss claim to the Agency in proportion to the percentage of guarantee in accordance with the Lender's Agreement until the account is paid in full or otherwise satisfied.

(k) Overpayments. The lender will repay any final loss overpayment determined by the Agency upon request.

(l) Electronic funds transfer. The lender will designate one or more financial institutions or other authorized agents to which any Agency payments will be made. The lender will provide the Agency information as necessary for the lender to receive electronic funds transfer payments through each institution or agency designated.

37. Section 1980.151 is added to read as follows:

§ 1980.151 Borrower training

(a) Requirements. (1) Borrowers with farm loans guaranteed by the Agency must obtain training in production and financial management concepts unless waived by the Agency in accordance with this section. Failure to complete the training as agreed will cause the borrower to be ineligible for future Agency benefits including future direct and guaranteed loans, primary loan servicing of direct loans, Interest Assistance renewals, and restructuring of guaranteed loans.

(2) A decision that the loan applicant needs such training will not be used as a basis for rejecting the request for assistance.

(3) In the case of an entity loan applicant, any entity member holding a majority interest in the operation or who is operating the farm must agree to complete the training on behalf of the entity or qualify for a waiver. However, if one entity member is solely responsible for financial or production management, then only that entity member will be required to complete the training in that area for the entity or qualify for a partial waiver. If the financial and production functions of the farming operation are shared, the knowledge and skills of the individual with the responsibility of production or financial management, or both, of the operation will be considered in the aggregate for granting a waiver or requiring that training be completed.

(4) When production training is required, a borrower must complete course work covering production management in crop or livestock enterprises which constitute twenty percent of the cash farm income for the coming production cycle, as determined by the Agency, and set out in the training agreement.

(5) Borrowers who are adding a new enterprise must agree to complete any required production training in that enterprise unless a waiver is granted.

(6) All required training must be completed within two years after the borrower signs the training agreement. The lender may recommend to the Agency a 1-year extension to this deadline where the borrower is unable to complete the training due to circumstances beyond the borrower's control.

(b) Waiver. (1) Lenders may request a waiver from the production or financial management, or both, training requirements on behalf of the loan applicant.

(2) CLP and PLP lenders may certify that loan applicants meet the criteria for waiver without submitting supporting documentation. Standard eligible lender requests must include evidence that the loan applicant meets one of the following conditions:

(i) The loan applicant has successfully completed an equivalent training program.

(ii) The loan applicant has demonstrated adequate knowledge and ability in the subject areas covered under this training program. For waiver

under this paragraph, standard eligible lenders must submit a brief narrative describing the loan applicant's past production or financial management performance specifically related to satisfaction of the course objectives.

(iii) Lenders do not need to submit supporting evidence for a waiver if the loan applicant has previously received a waiver or satisfied the borrower training requirements needed.

(c) Fees. Training fees must be included in the plan of operation as a farm operating expense. Payment of training fees is an authorized use of operating loan funds.

(d) Choosing vendor. The loan applicant is responsible for selecting and contacting the vendors necessary to complete the training required under this section.

(e) Vendor reporting. (1) The vendor will provide the lender and the Agency with periodic progress reports, as determined by the Agency. These reports are not intended to reflect a grade or score, but to indicate whether the borrower is attending sessions and honestly endeavoring to complete the training program.

(2) Upon completion of the training, the vendor will provide the lender and the Agency with an evaluation which specifically addresses the borrower's improvement toward meeting the training goals. The instructor will also assign the borrower a recommended score according to the following criteria:

Score

1—The borrower attended classroom sessions as agreed, satisfactorily completed all assignments, and demonstrated an understanding of the course material.

2——The borrower attended classroom sessions as agreed and attempted to complete all assignments; however, the borrower does not demonstrate an understanding of the course material.

3——The borrower did not attend classroom sessions as agreed or did not attempt to complete assignments. In general, the borrower did not make a good faith effort to complete the training.

(i) Borrowers receiving a score of 1 will have met the requirements of the agreement.

(ii) Borrowers receiving a score of 2 will have met the requirements of the agreement. However, since these borrowers do not adequately understand the course material, the lender will develop a plan outlining the additional supervision the borrower will require to accomplish the objectives of the guaranteed loan program.

(iii) Borrowers receiving a score of 3 will not have met the requirements of the agreement for training.

38. Section 1980.160 is added to read as follows.

§ 1980.160 Sale, assignment and participation.

(a) The following general requirements apply to selling, assigning or participating guaranteed loans.

(1) The lender may sell, assign or participate all or part of the guaranteed portion of the loan to one or more holders at or after loan closing only if, the loan is not in default. However, a line of credit can be participated, but not sold or assigned.

(2) The lender will provide the Agency with copies of all appropriate forms used in the sale or assignment.

(3) The guaranteed portion of the loan may not be sold or assigned by the lender until the loan has been fully disbursed to the borrower. A line of credit may be participated prior to being fully advanced.

(4) The lender is not permitted to sell, assign or participate any amount of the guaranteed or unguaranteed portion of loan to the loan applicant or borrower or members of their immediate families, their officers, directors, stockholders, other owners, or any parent, subsidiary, or affiliate.

(5) Upon the lender's sale or assignment of the guaranteed portion of the loan, or participation of the line of credit, the lender will remain bound to all obligations indicated in the Loan Note Guarantee, Lender's Agreement, the Agency program regulations, and to future program regulations not inconsistent with the provisions of the Lenders Agreement. The lender retains all rights under the security instruments for the protection of the lender and the United States.

(b) Effect of sale or assignment on holder.

(1) Upon the lender's sale or assignment of the guaranteed portion of the loan, the holder will assume all rights of the Loan Note Guarantee pertaining to the portion of the loan purchased.

(2) The lender will send the holder the borrower's executed note attached to the Loan Note Guarantee.

(3) The holder, upon written notice to the lender and the Agency, may assign the unpaid guaranteed portion of the loan. The holder must sell the guaranteed portion back to the original lender if necessary for liquidation of the account.

(4) The Loan Note Guarantee or Assignment Guarantee Agreement in the holder's possession does not cover:

(i) Interest accruing 90 days after the holder has demanded repurchase by the lender.

(ii) Interest accruing 90 days after the lender or the Agency has requested the holder to surrender evidence of debt repurchase, if the holder has not previously demanded repurchase.

(c) Participations.

(1) In a participation, the lender sells an interest in a loan but retains the note, the collateral securing the note, and all responsibility for loan servicing and liquidation.

(2) The lender must retain at least 10 percent of the total guaranteed loan amount from the unguaranteed portion of the loan in its portfolio, except when the loan guarantee exceeds 90 percent, the lender must retain the total unguaranteed portion.

(3) Participation with a lender by any entity does not make that entity a holder or a lender as defined in this subpart.

(d) Premiums, fees, and penalties. Negotiations concerning premiums, fees, and additional payments for loans, etc. are to take place between the holder and the lender.

The Agency will participate in such negotiations only as a provider of information.

§ 1980.174 through 1980.175 [Removed and reserved]

39. Sections 1980.174 through 1980.175 are removed and reserved.

§ 1980.180 [Removed and reserved]

40. Section 1980.180 is removed and reserved.

§ 1980.185 [Removed and reserved].

41. Section 1980.185 is removed and reserved.

§ 1980.190 through 1980.191 [Removed and reserved]

42. Sections 1980.190 through 1980.191 are removed and reserved.

Exhibits A, C, E, F, and G [Removed]

43. In subpart B, Exhibits A and C are removed and reserved and Exhibits E, F, and G are removed.

Signed in Washington, D.C., on September 21, 1998.

August Schumacher, Jr.,

Under Secretary for Farm and Foreign Agricultural Services.

Inga Smulkstys,

Acting Under Secretary for Rural Development.

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