

USDA's Business and Industry Guaranteed Loan Program

Abstract

This *Insights* report provides an overview of the U.S. Department of Agriculture (USDA) Business and Industry (B&I) Guaranteed Loan Program and discusses considerations that banks¹ should weigh when using the program. The B&I program guarantees a portion of loans made by banks and other approved lenders to eligible businesses located in rural areas. This guarantee helps creditworthy businesses in rural areas obtain financing on reasonable terms, with the intent of saving and growing jobs in rural America. The loan guarantees, if properly structured and managed, also help banks manage risk and comply with legal lending limits and capital requirements. Loans guaranteed through the program may be eligible for Community Reinvestment Act (CRA) consideration.

I. What Is the B&I Guaranteed Loan Program and How Does It Work?

The B&I program is administered by the Rural Business Cooperative Service (RBCS), an agency within the USDA's Rural Development mission area. The purpose of the B&I program is to develop businesses and industries that will grow employment and improve the economic and environmental climate of rural communities. This purpose is achieved by bolstering the existing private credit structure through the guarantee of quality loans² that will provide lasting community benefits.

The program provides guarantees of up to 60, 70, or 80 percent—depending on loan size—on loans made by private lenders to eligible rural borrowers.³ Loans eligible for B&I program guarantees are generally limited to a maximum of \$10 million per

¹ This report generally uses the term “banks” to refer to national banks and federal savings associations.

² The guarantee authority is not intended to be used for marginal or substandard loans or for the relief of lenders having such loans.

³ The maximum percentage for subsequent guarantees will be based on the cumulative amount of outstanding principal and interest of any existing B&I program guaranteed loans and the new loan request. See 7 CFR 4279.119(b)(1). As an exception, the administrator of the RBCS may, at his or her discretion, permit guarantees of up to 90 percent on loans of \$5 million or less if (1) the project to be financed is a high-priority project as defined in 7 CFR 4279.2(a), or (2) the lender documents, to the satisfaction of the RBCS, that the loan will not be made and the project will not be completed due to the bank's legal or regulatory lending limit if the higher guarantee percentage is not approved. See 7 CFR 4279.119(b).

borrower, although in some circumstances larger loan amounts may be approved.⁴ The RBCS will only guarantee loans that are sound and have a reasonable assurance of repayment.⁵ Applications for loan guarantees will be accepted and processed without regard to the availability of credit from any other source.⁶

Demand for the program can exceed the supply of available funds in any given year. In fiscal year 2018, a budget authority of \$35 million was expected to result in \$864 million in loan guarantees.⁷ Applications for loan guarantees are given a priority scoring,⁸ based on criteria discussed later in this report, that is used to compare pending applications. A high-priority project⁹ is defined as one that scores more than half of the points available under the scoring criteria. A minimum of 5 percent of the guarantee authority is reserved for local and regional food enterprise development, including the construction of food processing, aggregation, and distribution facilities, as well as food hubs.¹⁰

Table 1: Maximum Percentage of Guarantee by Loan Size

| Loan size | Maximum guarantee |
|--|-------------------|
| \$5 million or less | 80% |
| More than \$5 million and up to \$10 million | 70% |
| More than \$10 million | 60% |

Eligible Lenders

Institutions under the supervision of and subject to credit examination by a federal or state regulatory agency, including federally or state-chartered banks and Farm Credit System banks, are eligible to participate in the B&I program. Credit unions are eligible if they are subject to examination and supervision by a state agency or the National Credit Union Administration. Other non-supervised lenders, such as non-depository community development financial institutions, community development corporations, insurance companies, and mortgage companies with successful commercial lending experience, may apply to the USDA to become a guaranteed lender for a three-year period. Non-regulated lenders must reapply at the end of the three years to maintain eligibility.¹¹ All lenders must execute a [lender’s agreement](#) with the USDA to participate in the program.¹²

⁴ The administrator of the RBCS may, at her or his discretion, grant an exception to the \$10 million limit for loans up to \$25 million under certain circumstances. See 7 CFR 4279.119(a)(1). The Secretary of Agriculture may approve guaranteed loans in excess of \$25 million, up to \$40 million, for rural cooperative organizations that process value-added agricultural commodities in accordance with 7 CFR 4279.113(j)(1). See 7 CFR 4279.119(a)(2).

⁵ 7 CFR 4279.131.

⁶ The B&I program does not have a “credit elsewhere” test. See 7 CFR 4279.108(d).

⁷ The budget authority for the B&I program reflects the subsidy cost to the federal government to support the loan level. The subsidy cost for the B&I program depends on a number of factors, including default rates, the prevailing interest rates, whether the interest rate is subsidized by the federal government, and whether there are fees. In addition to the subsidy cost, the B&I program has an administrative cost component. See www.obpa.usda.gov/budsum/fy19budsum.pdf.

⁸ 7 CFR 4279.166.

⁹ 7 CFR 4279.2(a).

¹⁰ 79 Fed. Reg. 24393–24394 (April 30, 2014). The requirement is in effect through fiscal year 2018.

¹¹ 7 CFR 4279.29(b).

¹² 7 CFR 4279.29.

Eligible Borrowers

The B&I program provides guarantees for loans made to businesses that save or create jobs in rural areas. Borrowers may be individuals, partnerships, cooperatives, for-profit or nonprofit corporations, Indian tribes, or public bodies.¹³ Individual borrowers must be citizens of the United States or reside in the United States after being legally admitted for permanent residence.¹⁴ Private entity borrowers¹⁵ must demonstrate that loan funds will remain in the United States and that the facility being financed will primarily create new or save existing jobs for rural U.S. residents.¹⁶

The program is open to new and existing businesses. Eligible business activities include manufacturing, sales (retail and wholesale), providing services, and other activities that will provide employment and improve the economic or environmental climate. Existing businesses must have a minimum of 10 percent tangible balance sheet equity.¹⁷ For new businesses, a minimum of 20 percent tangible balance sheet equity is required.¹⁸ For energy projects, the minimum tangible balance sheet equity requirement ranges from 25 percent to 40 percent.¹⁹ There are no size standards for businesses and no minimum owner occupancy requirements for borrowers acquiring or refinancing real estate.

Eligible Areas

Generally, projects being financed must be located in eligible rural areas.²⁰ A rural area²¹ is generally defined as any area other than (1) a city or town that has a population of greater than 50,000 inhabitants or (2) any urbanized area contiguous and adjacent to such a city or town.²² Projects located within the boundaries of a federally recognized Indian tribe's reservation or within tribal trust lands may be eligible under certain circumstances.²³ The USDA offers an [online tool](#) to help borrowers determine whether the properties where the projects are located are eligible.

There are two exceptions that allow guarantees on projects located on properties outside of rural areas. Under the first exception, cooperative facilities in non-rural areas may be eligible for loan guarantees if they have a primary purpose of value-added processing for agricultural producers that are located within 80 miles of the facility, the primary benefit of the loan will be to provide employment for rural residents, the principal amount of the loan does not exceed \$25 million, and there is funding availability in the fiscal year

¹³ 7 CFR 4279.108(a).

¹⁴ 7 CFR 4279.108(b).

¹⁵ Corporations or other types of non-public-body borrowers.

¹⁶ 7 CFR 4279.108(b).

¹⁷ 7 CFR 4279.131(d)(1). Tangible assets are calculated by subtracting intangible assets from total assets. Tangible balance sheet equity is not a generally accepted accounting principles (GAAP) concept but is calculated from GAAP-based financial statements. The USDA provides a [Tangible Balance Sheet Equity Calculator](#).

¹⁸ Ibid.

¹⁹ Ibid.

²⁰ 7 CFR 4279.108(c).

²¹ 7 CFR 4279.108.

²² 7 CFR 4279.108(c)(1). The Food, Conservation, and Energy Act of 2008 (2008 Farm Bill) allowed for flexibility in this default definition. Section 6018(a) of the 2008 Farm Bill amended section 343(a)(13) of the Consolidated Farm and Rural Development Act with new subparagraphs (D) and (E) that provide administrative exception authority to the Under Secretary for Rural Development. The exceptions fall into two categories. First, there is statutory language limiting exclusion of whole municipalities when there are areas that appear as narrow "strings" of development at the outskirts of urbanized areas, often extending along highways. Second, there is statutory language retaining eligibility for areas that remain "rural in character." USDA Rural Development, *Report on the Definition of "Rural,"* February 2013. <https://www.rd.usda.gov/files/RDRuralDefinitionReportFeb2013.pdf>

²³ RD Instruction 4279-B.

for non-rural cooperative projects.²⁴ The second exception applies to projects located in urban areas if they process, distribute, aggregate, store, and/or market agricultural food products to support community development and farm and ranch income and a significant amount of that food product is both produced and sold locally or regionally.²⁵

Eligible Business Purposes

The B&I program may guarantee loans used for a wide variety of business activities,²⁶ including but not limited to the following:

- Purchase and development of land, buildings, and associated infrastructure for commercial or industrial properties.
- Business acquisitions, provided that jobs will be created or saved.
- Leasehold improvements.²⁷
- Constructing or equipping facilities for lease to private businesses engaged in commercial or industrial operations.
- Purchase of machinery and equipment.
- Startup costs, working capital, inventory, and supplies in the form of a permanent working capital term loan.
- Debt refinancing, when it is determined that the project is viable and that refinancing is necessary to improve cash flow and create or save jobs.

Loan funds can also be used for recreation and tourist facilities, educational facilities, certain community facility projects, pollution control, and some energy projects.

Cooperatives have been important economic development partners with the USDA. The B&I program guarantees qualifying loans to individual farmers or ranchers to purchase cooperative stock in a farmer or rancher cooperative established to process an agricultural commodity. The cooperative may use the proceeds from the stock sale to recapitalize, develop a new processing facility or product line, or expand an existing production facility.²⁸ Similarly, the USDA may guarantee loans for the purchase of preferred stock or similar equity²⁹ issued by a cooperative organization or for a fund that invests primarily in cooperative organizations, provided that the guarantee significantly benefits one or more entities eligible for assistance under the B&I program.³⁰ Loans used to purchase stock in businesses formed by employees through an employee stock ownership plan or worker cooperative are also eligible for loan guarantees.³¹

²⁴ 7 CFR 4279.113(j)(2).

²⁵ 7 CFR 4279.113(y)(2).

²⁶ 7 CFR 4279.113.

²⁷ The lease cannot contain reverter clauses or other restrictive clauses that would impair the use or value of the property as security for the loan. See 7 CFR 4279.113(c).

²⁸ 7 CFR 4279.115.

²⁹ “Similar equity” means any special class of stock that is available for purchase by non-members or members and lacks voting and other governance rights. See 7 CFR 4279.115(b)(1).

³⁰ 7 CFR 4279.115(b).

³¹ 7 CFR 4279.115(c).

The B&I program may be used to guarantee a leverage loan³² in a new markets tax credit (NMTC) transaction.³³ An investor fund entity that pools a leverage loan and an investment that was established for a single specific NMTC investment may be an eligible borrower. One hundred percent of the guaranteed loan funds must be invested in one or more NMTC community development entities (CDE), and the funds must then be lent by the CDE to a qualified active low-income community business (QALICB).³⁴ The QALICB must meet the B&I program's requirements for eligible borrowers.³⁵ Banks considering using B&I program guarantees in NMTC transactions should consult the USDA and appropriate tax and legal professionals for guidance.

Ineligible uses include, but are not limited to, the following:

- Lines of credit.
- Projects in excess of \$1 million in which 50 or more jobs would be relocated.
- Owner-occupied housing.
- Racetracks or gambling facilities.
- Charitable and fraternal organizations.
- Lending institutions.

II. How Are Loans Structured?

The lender is primarily responsible for determining credit quality and must address all of the elements of credit quality in a comprehensive, well-written credit analysis, including capacity (sufficient cash flow to service the debt), collateral (assets to secure the loan), conditions (borrower, economy, and industry), capital (equity/net worth), and character (integrity of management).

The B&I program is subject to the National Environmental Policy Act and other federal guidelines designed to ensure that federally supported projects do not harm the environment. Lenders are responsible, through consultation with the prospective borrower, for understanding the potential environmental impacts of the project being financed and developing proposals that minimize the potential to adversely affect the environment. The level and complexity of environmental review will depend on the scope of the project.

Collateral

The lender must ensure that the collateral for the loan has a documented value sufficient to protect the interests of the lender and the RBCS.³⁶ The discounted collateral value³⁷ must be at least equal to the loan amount. The entire loan must be secured by the same security with equal lien priority for the guaranteed and unguaranteed portions of the loan.³⁸

³² For more information on leverage loans and the New Markets Tax Credit Program, see OCC, *Community Developments Insights*, "New Markets Tax Credits: Unlocking Investment Potential," June 2013.

³³ New Markets Tax Credit Program, 7 CFR 4279.116, as amended, 82 Fed. Reg. 26335 (June 7, 2017).

³⁴ 7 CFR 4279.116(b)(1)(iii).

³⁵ 7 CFR 4279.108.

³⁶ 7 CFR 4279.131(b).

³⁷ The lender must discount collateral consistent with the sound loan-to-discounted value policy outlined in 7 CFR 4279.131(b)(1).

³⁸ 7 CFR 4279.131(b)(5).

Term and Rates

A loan's maturity is determined by the use of the proceeds, the useful life of the assets being financed and those used as collateral, and the borrower's ability to repay the loan. Loan terms are also subject to program maximums that vary with the purpose of the loan.

Table 2: Loan Proceeds and Terms

| Loan proceeds | Maximum term |
|-------------------------|---|
| Real estate | 30 years |
| Machinery and equipment | Not to exceed to useful life of the machinery and equipment, or 15 years, whichever is less |
| Working capital | 7 years |
| Cooperative stock | 7 years |

The interest rate on the loan may be fixed or variable, and is negotiated between the lender and the borrower. It is permissible to have different interest rates on the guaranteed and unguaranteed portions of the loan, provided that the rate of the guaranteed portion of the loan does not exceed the rate of the unguaranteed portion. Interest rates on guaranteed loans cannot be higher than those rates customarily charged to borrowers without guarantees.³⁹ Interest rates are subject to RBCS review and approval.

Fees

A guarantee fee is charged when the guarantee is issued. The fee is charged to the lender and may be passed on to the borrower as an eligible use of guaranteed loan proceeds. The amount of the guarantee fee⁴⁰ is set annually by the RBCS and published in the *Federal Register*. In fiscal year 2018, the fee was set at 3 percent.⁴¹ Under some circumstances, such as for loans of \$5 million or less to businesses that support value-added agriculture, promote access to healthy foods, or are high-impact businesses⁴² in distressed rural areas, the RBCS may charge a reduced guarantee fee if requested by the lender.

The lender pays an annual renewal fee,⁴³ which is required to maintain the enforceability of the guarantee. The renewal fee rate is set annually by the RBCS and published in the *Federal Register*, and the rate that is in effect at the time the loan is obligated remains in effect for the life of the guarantee of the loan. In fiscal year 2017, the fee was set at 0.5 percent.⁴⁴

Other fees can be negotiated between the borrower and lender. The lender may establish charges and fees for the loan provided they are similar to those normally charged to other applicants for the same type of loan in the ordinary course of business. The fees are an eligible use of loan proceeds.

Lenders may charge prepayment penalties.

³⁹ The interest rate on the guaranteed portion of the loan may be higher than the unguaranteed portions in situations where a fixed rate on the guaranteed portion becomes a higher rate than the variable rate on the unguaranteed portion due to the normal fluctuation in the approved variable interest rate.

⁴⁰ The amount of the guarantee fee is determined by multiplying the total loan amount by the guarantee fee rate by the percentage of the guarantee.

⁴¹ 83 Fed. Reg. 1013 (January 9, 2018).

⁴² A high-impact business development investment is a business investment that scores at least 25 points in the loan priority scoring under 7 CFR 4279.166(b)(4).

⁴³ The amount of the annual renewal fee is determined by multiplying the outstanding principal loan balance as of December 31 of each year by the annual renewal fee rate by the percentage of the guarantee.

⁴⁴ 83 Fed. Reg. 1013 (January 9, 2018).

III. How Do Lenders Apply for a Guaranty?

Application Process

The B&I program is a lender-driven program. Banks use their own documents, security instruments, and commercial underwriting requirements. Subject to the limitations previously discussed, banks set their own interest rates and terms, and service their own loans. Local USDA Rural Development personnel can assist through the entire process, enabling banks to focus on and enhance customer relationships.

Banks new to the B&I program are encouraged to contact their state USDA Rural Development office to learn more about the program. Lenders approved to participate in the program will execute a lender's agreement with the RBCS. If a valid lender's agreement exists, it is not necessary to execute a new agreement for each new loan guarantee.

After agreeing to finance the proposal, the lender may apply for a guarantee from the RBCS. Applications are submitted to the [USDA Rural Development's network of state and area offices](#). The appropriate state or area office is based on the location of the project to be financed.

Although it is not required, the RBCS encourages lenders to submit a preapplication for each loan guarantee request. The preapplication is used to screen potential loans for program eligibility and reduce the amount of time needed for a formal application. A limited amount of information is submitted in the preapplication process, but the lender can receive agency comments before submitting a full application.

Applicants for loans exceeding \$600,000 submit a standard application package. Applicants for loans of \$600,000 or less may submit an abbreviated loan package, provided the RBCS determines that there is not a significant increased risk of default on the loan. According to program regulations, upon receipt of a complete application a lender can expect a response on its guarantee request within 60 days, unless (1) approval is prevented by a lack of guarantee authority, (2) there are delays resulting from public comment requirements of the environmental assessment, or (3) delays are due to outstanding U.S. Department of Labor clearance issues.⁴⁵ Response times can vary based on the complexity and scope of the proposed project.

A loan priority scoring system is used to compare each application to other pending applications. Loans are evaluated according to multiple criteria, including the population of the area in which the business will be located, the level of distress of that area, the interest rate of the loan, the leveraging of B&I program funds, the impact the business will have in creating jobs and community benefits, and the project's consistency with community economic development strategies and state strategic plans. A high-priority project is defined as one that scores more than half of the available points in the scoring criteria.⁴⁶

If the application meets the program qualifications, a conditional loan guarantee commitment is issued. This conditional commitment includes a list of conditions that must be met by the lender and borrower before the guarantee can be issued. These conditions generally include standard financial performance requirements, such as placement of liens on collateral, successful USDA staff inspections of the project site, and occupancy permits. Some loans may require additional conditions. In cases where the project being funded involves construction, the conditional commitment typically

⁴⁵ 7 CFR 4279.168.

⁴⁶ 7 CFR 4279(2)(a).

includes the requirement that the facility be operational. In some situations, the lender may negotiate with the RBCS to receive the guarantee on the loan before the facility is constructed.

IV. How Are Loans Managed?

Secondary Market

USDA-guaranteed portions of loans or parts thereof are actively traded in the secondary market through a network of broker-dealers. In addition, under the Federal Agricultural Mortgage Corporation's ([Farmer Mac](#)) [USDA Guaranteed Loan Purchase](#) (also known as Farmer Mac 2), the lender sells the guaranteed portion of the loan to Farmer Mac. Banks can manage liquidity issues by selling these loan portions, which enable them to recycle funds for new loans or other purposes. The principal and interest of the guaranteed portions of B&I program loans purchased in the secondary market are unconditionally guaranteed by the full faith and credit of the U.S. government. The originating lender is responsible for servicing the loan.⁴⁷

Loan Servicing

The lender is responsible for servicing the entire B&I program loan (both the guaranteed and unguaranteed portions) in a prudent manner. These responsibilities are fully described in the lender's agreement governing the B&I program guarantee and in RD Instruction 4287-B. Generally, the B&I program loan servicing requirements are standard, but lenders should review these documents and discuss requirements with the relevant Rural Development field office staff.

In addition to servicing the loan, lenders must meet all reporting and other communications requirements of the B&I Guaranteed Loan Program.⁴⁸

Borrowers are required to submit annual financial statements,⁴⁹ which the lender must submit to the RBCS within 120 days of the end of the borrower's fiscal year. The lender must analyze the financial statements and provide the RBCS with a written summary of the lender's analysis and conclusions, including trends, strengths, weaknesses, extraordinary transactions, and other indications of the borrower's financial condition. Spreadsheets of the new financial statements must be included. Lenders are required to provide an annual report of the number of workers employed by the borrower.⁵⁰

⁴⁷ The lender may contract for services but is ultimately responsible for underwriting, loan origination, loan servicing, and compliance with all USDA regulations. See 7 CFR 4287.107.

⁴⁸ [Business and Industry Loan Program Frequently Asked Questions](#).

⁴⁹ 7 CFR 4279.137.

⁵⁰ [Business and Industry Loan Program Frequently Asked Questions](#).

Reporting Requirements

The following are specific reporting requirements from the lender to the USDA:⁵¹

- Semiannually—by June 30 and December 31: Report on the loan’s status and remaining balance (use Form RD 1980-41).
- Annually—120 days after the borrower’s fiscal year-end: Provide financial statements and analysis.
- If the loan is sold on the secondary market, provide the USDA with a copy of an executed Form RD 4279-6, “Assignment.”
- Report whenever the lender’s risk rating of the loan changes.
- Report whenever the loan is more than 30 days delinquent (use Form RD 1980-44).
- Report whenever the lender becomes aware that the borrower is in violation of any loan covenant or security agreement.

In executing the servicing responsibilities, lenders should be aware that the USDA’s prior written concurrence is needed for the following activities:

- Advancing additional loans to the borrower (even if they are unguaranteed loans).
- Subordination of lien position.
- Modification of any loan instrument.
- Release of collateral, if the value is more than 20 percent of the original loan amount.
- Restructuring of rates, term, or debt repayment.
- Release of any borrower or guarantor from liability.
- Any protective advance⁵² made to preserve and protect collateral that, cumulatively with other such advances, exceeds regulatory limits.
- Any liquidation action.

Borrower Default

When the lender is considering options to address a default, the prospects for providing a permanent cure without adversely affecting the risk to the RBCS and the lender are the B&I program’s paramount objectives.

In the event of default or third-party actions that the borrower cannot or will not cure or eliminate within a reasonable period of time, liquidation may be considered. If the lender concludes that liquidation is necessary, it must request the RBCS’ concurrence.⁵³ The lender liquidates the loan and must submit to the RBCS its proposed method of liquidation, in writing, within 30 days after a decision to liquidate. Upon RBCS approval of the liquidation plan, the lender commences liquidation. Instructions for loan liquidation are included in the B&I Loan Guarantee Program Servicing Instructions (RD Instruction 4287-B).

V. What Are Program Risks?

The B&I program generally provides a 60 percent to 80 percent federal guarantee on business loans, depending on the size of the loan. Table 1 illustrates how the B&I program decreases a bank’s exposure when lending to businesses. If a loan defaults, the bank, after the liquidation of collateral, receives from the RBCS the remaining unpaid

⁵¹ 7 CFR 4287.107.

⁵² 7 CFR 4287.156.

⁵³ 7 CFR 4287.157 (d).

principal and interest of the guaranteed portion of the loan on a pro rata basis. In this hypothetical example, a \$5 million loan with an 80 percent guarantee exposes the bank to a maximum of 20 percent of the loss on the loan (\$1 million).

Table 3: Hypothetical Small Business Expansion Plan

| Item | Amount |
|--|------------------|
| Total project cost | \$5 million |
| Owner equity injection (otherwise meets tangible equity requirement*) | \$0 |
| Loan amount | \$5 million |
| B&I guaranteed amount (80 percent) | \$4 million |
| Unguaranteed amount | \$1 million |
| <hr/> | |
| Loan interest rate | 5% |
| Guaranteed portion sold at premium | 6% |
| Lender servicing spread | 1% |
| <hr/> | |
| Premium (6% of \$4 million) | \$240,000 |
| Servicing spread on the guaranteed portion (1% of \$4 million) | \$40,000 |
| Lender's interest income on the unguaranteed portion (5% of \$1 million) | \$50,000 |
| Revenue in year 1 of the loan | \$330,000 |

Source: OCC analysis

*Tangible balance sheet equity is discussed under "Eligible Borrowers" on page 3.

Although the loan guarantee significantly reduces credit risk to the lender by guaranteeing up to 80 percent of a loan, the lender remains exposed to credit risk on the nonguaranteed portion. Lenders must exercise appropriate due diligence and maintain appropriate controls and ongoing monitoring to protect against this credit risk and the operational risk associated with the administration of this program.⁵⁴ Banks should use sound procedures in underwriting loans made under these programs. Lenders using the B&I program may use their own credit review and financial analysis, so long as they meet the requirements for the complete written analysis in the USDA instructions.

Lenders must also take appropriate measures for the monitoring and prevention of fraud and misrepresentation.⁵⁵ This includes executing necessary verification procedures, such as verification of borrower equity and business site inspections. Such measures are necessary to comply with both program requirements and prudent lending practices.

Banks must comply with the operational requirements of the B&I program to ensure that guarantees are honored in the case of default.⁵⁶ Failure to comply with the program's governing regulations can result in guarantee claims being partially or fully denied. For example, the RBCS must be notified when a loan exceeds 30 days delinquency and the delinquency cannot be cured within an additional 30 days, or when a borrower is otherwise in default of covenants in the loan agreement. Ultimately, the quality of the lender's management of operational risk (adherence to RBCS operational requirements) and legal compliance risk association with the B&I program may have a direct impact on the integrity of the loan guarantees and, therefore, on the transaction's credit risk profile.

⁵⁴ Comptroller's Handbook, "Commercial Real Estate Lending," August 2013.

⁵⁵ 7 CFR 4279.72.

⁵⁶ 7 CFR 4279.72.

Common Mistakes by Lenders Making B&I Program Loans

- Failing to disclose a material fact to Rural Development regarding a guaranteed loan in a timely manner.
- Failing to obtain or maintain liens on collateral or protect the collateral securing the guaranteed loan.
- Failing to service the loan in a manner consistent with prudent lending practices.

Some lenders are apprehensive about whether their loan guarantee claims will be honored if the loans go into default. Lenders can minimize this risk by carefully following procedures for documenting and servicing loans. The RBCS recommends lenders work closely with their state or area office throughout the process. Table 4, covering FYs 2014–2016, shows loan approvals, loans for which a guarantee was sought, and loans where a guarantee was either partially or fully denied.

Table 4: B&I Guaranteed Loan Program Performance

| Number of loans | FY 2014 | FY 2015 | FY 2016 |
|--|---------|---------|---------|
| Number of loans submitted for the B&I program | 401 | 414 | 439 |
| Number of loans approved for the B&I program | 349 | 369 | 379 |
| Number of loans for which banks sought to claim guarantee | 12 | 19 | 15 |
| Number of loans for which a guarantee was partially denied | 0 | 0 | 1 |
| Number of loans for which a guarantee was fully denied | 0 | 0 | 0 |

As has been previously discussed, the RBCS will typically offer a conditional commitment before closing, with the guarantee issued only after the requirements are met. These conditions often include standard financial requirements (such as executing liens on collateral), but may also include borrower performance requirements (such as requiring that a new facility be operational). Loans to borrowers starting new business endeavors or involved in construction activities are mostly likely to include these performance conditions, as the USDA personnel involved with the transaction seek to ensure that the business is viable before removing the conditions of the guarantee. Lenders should carefully review the conditions of the guarantee with RBCS staff before loan closing to ensure that all parties share the same expectations and comfort level with the terms of the guarantee.

For cases in which the project being funded involves construction, the conditional commitment typically includes the requirement that the facility be operational. For these projects, the lender might provide interim construction financing, which would not be guaranteed under the B&I program. Once the facility is operational and other conditions included in the conditional commitment are met, the lender would offer permanent financing that would receive the RBCS guarantee under the B&I program.

VI. What Are Regulatory Considerations?

Legal Lending Limits and Capital Requirements

Some community banks with smaller legal lending limits may find the B&I program useful for expanding their commercial lending business because the federally guaranteed portion of a loan does not count toward a bank's legal lending limit.⁵⁷ The amount

⁵⁷ 12 USC 84(c)(5) and 12 CFR 32.3(c)(4).

applied against the bank's legal lending limit is the unguaranteed portion of the loan. For instance, if a bank's legal lending limit is \$1 million, the bank may make up to a \$5 million B&I program loan if it has an 80 percent guarantee, because the guaranteed portion (80 percent, or up to \$4 million) is not included in the limit. It is only once the guarantee is in place that the percentage of the loan can be excluded from the legal lending limit.⁵⁸ Banks should exercise sound judgment and employ prudent risk management principles regardless of the level of the guarantee.

The federal guarantee may lower a loan's risk-weighting for capital purposes. Under the B&I program, the portion of the loan guaranteed by the RBCS may receive a significantly lower risk weight than the unguaranteed portion of the loan.⁵⁹

CRA Consideration

B&I program loans have the potential to receive CRA consideration as either loans to small businesses or as community development loans, depending on the amount and purpose of the loans, the type and size of the institutions being examined, and whether the loans benefit the institutions' CRA assessment area(s) or the broader statewide or regional area that includes the institutions' assessment area(s). For example, the lending test applicable to evaluating large institutions includes an assessment of small business loans that meet the definition of "loans to small business" as defined in the instructions for preparing Consolidated Reports of Condition and Income.⁶⁰ B&I program loans in amounts greater than \$1 million may qualify as community development loans if they meet the CRA definition of community development.⁶¹ Institutions evaluated under the small and intermediate small bank tests also may receive CRA consideration for loans that finance small businesses. Further, intermediate small banks may opt to have business loans of any amount that meet the definition of community development considered as either business loans under the lending test or community development loans under the community development test.

Providing technical assistance on financial matters to a small business may qualify as a community development service. For example, banks may receive consideration for providing assistance to small businesses in preparing loan application packages for submission to local, state, or federal government agencies. For additional information and guidance on CRA, refer to the CRA regulations and the "Interagency Questions and Answers Regarding Community Reinvestment."⁶²

⁵⁸ Any interim construction financing provided by a bank that does not have a federal guarantee in place must be included in the legal lending limit and could result in legal lending limit violations if such amount is not properly monitored.

⁵⁹ The B&I program loan guarantees to the lender are conditional, based on the lender following certain program requirements. The government-guaranteed portion of a loan receives a 20 percent capital risk weighting, and the unguaranteed portion receives a risk weight appropriate for the loan exposure asset class, typically 100 percent. 78 Fed. Reg. 62018 (October 11, 2013).

⁶⁰ Loans to small businesses are defined as those with original amounts of \$1 million or less and that are reported as "loans secured by nonfarm or nonresidential real estate" or "commercial and industrial loans" in Part I of the Call Report Schedule RC-C.

⁶¹ OCC, *Community Developments Fact Sheet*, "CRA: Community Development Loans, Investments, and Services," March 2014.

⁶² 81 Fed. Reg. 48506 (July 25, 2016).

VII. Conclusion

The USDA's B&I program is designed to help participating lenders and borrowers improve the economic and environmental climate in rural communities. When properly administered, the loan guarantee can be a valuable tool for lenders financing rural enterprises.⁶³

David Black is the primary author of this update. Kristopher Rengert wrote an earlier version of this report. *Community Developments Insights* reports differ from OCC advisory letters, bulletins, and regulations in that they do not reflect agency policy and should not be considered as regulatory or supervisory guidance. Some of the information used in the preparation of this paper was obtained from publicly available sources that are considered reliable and believed to be current as of June 8, 2018. The use of this information, however, does not constitute an endorsement of its accuracy by the OCC.

⁶³ OCC, *Community Developments Investments*, "Associated Bank and the USDA: Helping a Company on the Verge of Recovery to Soar," November 2013.