

RD AN No. 4657 (1980-E, 4280-B, and 4287-B)  
June 4, 2012

TO: State Directors, Rural Development

ATTN: Business Programs Directors

SUBJECT: Business and Industry Guaranteed and Direct Loan,  
Biorefinery Assistance Program, and  
Rural Energy for America Program  
Adequate Consideration

**PURPOSE/INTENDED OUTCOME:**

The purpose of this Administrative Notice (AN) is to provide guidance to State Offices concerning when adequate consideration must be received for subordinations, release of collateral, or modification of terms.

**COMPARISON WITH PREVIOUS AN:**

This AN replaces RD AN No. 4567 (1980-E, 4280-B, and 4287-B), dated April 12, 2011, which expires on April 30, 2012.

**NATURE OF SERVICING REQUEST:**

Adequate consideration must be addressed when responding to a request for (1) the release of collateral or guarantors, (2) the Agency to take lesser lien position (i.e., subordination), or (3) the sale of collateral (e.g., sale of a parcel of land or equipment), etc. This list is not comprehensive. Any action which involves the exchange, subordination, or release of collateral should be evaluated under this AN.

All of Rural Energy for America Program (REAP) guaranteed loans are to be serviced in accordance with RD Instruction 4280-B, section 4280.152.

**EXPIRATION DATE:**  
June 30, 2013

**FILING INSTRUCTIONS:**  
Preceding Instructions 1980-E, 4280-B,  
and 4287-B

**IMPLEMENTATION RESPONSIBILITIES:**

In order to respond to these requests, initially you must determine Rural Development, Business Programs' (Business Programs) interest in the collateral.

- a) Owner Interest – Business Programs may have just an owner's interest in the collateral. This could arise when Business Programs is the successful bidder at a foreclosure sale on a Business and Industry (B&I) direct loan.
- b) Lender Interest – Business Programs may have just a lender's interest in the collateral. This could arise when Business Programs has an outstanding direct or guaranteed loan (in which it has not repurchased any holder's interest).
- c) Combination Interest – Business Programs may have both an owner's and lender's interest in the collateral. This could arise when Business Programs has repurchased a holder's interest in an outstanding B&I guaranteed loan.

Based on your evaluation of Business Programs' interest in the collateral, you should apply the relevant section below.

**Owner Interest:**

To the extent the Agency repurchases all or part of the guaranteed loan from a Holder (or Holders) or the Lender, the Agency owns an interest in the loan. This interest would be covered by the Comptroller General opinion at 19 Com Gen 48 which provides:

“Government officers are not authorized to modify the terms of a contract by a supplemental or substitute agreement if such modification is prejudicial to the interest of the United States, nor to give away the money, property, or any claim of the Government.”

Therefore, the Agency will not modify its interest in the loan, including modifying loan covenants, releasing personal or corporate guarantees or other collateral, or subordinating its lien position without receiving new consideration that will adequately secure the loan. (Past consideration does not meet this requirement.) New consideration that will adequately secure the loan encompasses some new benefit to the Agency either in the form of money, additional security, or some other benefit to the goals and objectives of the Agency.

**Lender Interest:**

Usually the Agency's interest will be that of a lender or guarantor. In those cases, the controlling statute is section 331 of the Consolidated Farm and Rural Development Act which provides the Agency several options. These provisions have been implemented into the following regulations:

**Direct Program:**

Debt Settlement (7 CFR 1956, subpart C),  
Release of Collateral (7 CFR 1951-E, section 1951.226), and  
Subordination (7 CFR 1951-E, section 1951.222).

**Guaranteed Program:**

Release of Collateral, B&I (7 CFR, 4287-B, section 4287.113),  
Biorefinery Assistance Program (BAP (7 CFR, 4287-D, section 4287.307(f)), and  
REAP (7 CFR, 4280-B, section 4280.152(c)),

Subordination, B&I (7 CFR, 4287-B, section 4287.123),  
BAP (7 CFR, 4287-D, section 4287.307(g)), and  
REAP (7 CFR, 4280-B, section 4280.152(d)).

When the Agency has just a lender's interest in the collateral, whether from the direct or guaranteed programs, then modifications to its interest in the collateral, including the release of collateral, borrowers, guarantors, or subordinations, must be in accordance with these regulations. These loans should never be under-collateralized at the time a servicing or loanmaking decision is made. Please adequately document your case files whenever making these servicing decisions.

When considering loan servicing actions for guaranteed loans involving subordinations and the release of collateral, you should:

1. review the regulatory requirements that are set forth in the regulations that are pertinent to the servicing action being considered;
2. obtain current financial statements on the borrower and guarantors, less than 60 days old, and have them reviewed by the lender;
- 3a. for B&I and REAP, obtain a current independent appraisal on all actions exceeding \$100,000 of collateral. The appraisal will be on all collateral that secures the guaranteed loan in accordance with RD Instruction 4279-B, section 4279.144. You should use this appraisal to document that the remaining collateral is adequate to secure the loan. The borrower must pay for the appraisal;
- 3b. for the BAP, obtain current appraisals on the collateral on all transactions exceeding \$250,000. The appraisal must meet the requirements of RD Instruction 4279-C, section 4279.244. The appraisal should provide documentation that the remaining collateral is adequate to secure the loan. The borrower must pay for the appraisal;

4. ensure that guaranteed loan to discounted value ratio is no less than 1:1 upon completion of the servicing action; and
5. ensure that the borrowers' and guarantors' obligations and ability to repay the guaranteed loan before the servicing action remains unchanged after the completion of the servicing action.

The lender should evaluate all of this information to ensure that the guaranteed loan remains adequately secured as cited above.

### **Combination Interest**

As previously mentioned, with the guaranteed program there will be occasions when the Agency has both a lender and an owner interest (e.g., the Agency has repurchased the holder's interest in an outstanding loan). In this situation, you must consider the request of a lender without regard to the Agency's owner interest. There could also be instances in which the Agency's lender and the owner interests are in conflict. In this case, you should forward the request to the National Office using RD Instruction 4287-B, Appendix A, with your recommendation for consideration by this office.

If there are questions, please call David Lewis, Chief, Business and Industry Division, Servicing Branch, at (202) 690-0797.

*(Signed by John C. Padalino)*

John C. Padalino  
Acting Administrator  
Rural Business-Cooperative Service