

RD AN No. 4620 (4279-B and 4280-B)
January 3, 2012

TO: State Directors, Rural Development
ATTN: Business Programs Directors
SUBJECT: Business and Industry, Biorefinery Assistance, and Rural Energy
for America Guaranteed Loan Programs
Collateral Discounting

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide guidance concerning acceptable discounting of collateral for Business and Industry (B&I), Biorefinery Assistance (BAP), and Rural Energy for America Program (REAP) guaranteed loans.

COMPARISON WITH PREVIOUS AN:

This replaces RD AN No. 4478 (4279-B) dated November 10, 2009, which expired November 30, 2010.

IMPLEMENTATION RESPONSIBILITIES:

In accordance with RD Instruction 4279-B, section 4279.131(b), RD Instruction 4280-B, section 4280.139(b), and 7 CFR 4279 subpart C, section 4279.234(b)(4), collateral must have documented value sufficient to protect the interest of the lender and the Agency. Subject to the discussion below, the discounted collateral value will be at least equal to the loan amount, and lenders will discount collateral consistent with sound loan-to-value policy.

Office of Management and Budget Circular A-129 states, in part, that financing should be limited by not offering terms (including the financing of closing costs) that result in a loan-to-value equal to or greater than 100 percent. RD Instruction 4279-B, section 4279.131(b), requires a loan-to-discounted value not to exceed 100 percent, except as outlined in section 4279.131(b)(2). Section 4279.131(b)(2) allows loan-to-value coverage to be discounted accordingly for those businesses with a documented successful financial history where cash-flow and profitability are strong. It is the position of the Agency that a business will only be

EXPIRATION DATE:
December 31, 2012

FILING INSTRUCTIONS:
Preceding RD Instructions 4279-B
and 4280-B

considered “successful” in accordance with section 4279.131(b)(2) when that business has been profitable in all of the years for which financial statements are required to be submitted with the application. New businesses do not meet this requirement.

RD Instruction 4280-B, section 4280.139, states that collateral must have documented, sufficient value to protect the interests of the lender and the Agency. For REAP guaranteed loans, the discounted collateral value will normally be at least equal to the loan amount. Section 4279.234 (b)(4) requires that collateral have documented value sufficient to protect the interest of the lender and the Agency, and the discounted collateral value must be at least equal to the loan amount. Lenders will discount collateral consistent with sound loan-to-value policy.

The type, quality, and location of collateral are relevant factors used to assess collateral adequacy and appropriate levels of discounting. Factors to be considered in the discounted value of collateral should include the type and marketability of the collateral and alternative uses of the collateral. That is, specialized buildings or equipment will be discounted greater than multi-purpose facilities or equipment. General guidelines typically include discounting general-use real estate and improvements to 70 – 80 percent of market value, machinery and equipment to 50 – 70 percent of market value, raw inventory and finished inventory to 50 – 60 percent of book value, and receivables (less than 90 days old) to 50 – 60 percent of book value. Typically, work (inventory) in process and receivables older than 90 days are discounted to \$0 value. Individual cases, local markets, audits of inventory and receivables, and other economic factors will impact discounted collateral values. If discounting of collateral is more generous than the ranges above, the file should clearly document your reasoning. Additionally, if your discounting is more generous than what the lender used in its credit analysis, that reasoning should also be documented in the file.

If you have any questions, please contact the B&I Division at (202) 690-4103 or the Energy Division at (202) 720-1400.

(Signed by JUDITH A. CANALES)

JUDITH A. CANALES
Administrator
Business and Cooperative Programs