



LOAN AGREEMENT REQUIREMENTS

Business & Industry (B&I) Guaranteed Loan Program

What is “the loan agreement”?

As it relates to the B&I program, a “loan agreement” is an agreement between the borrower and the lender establishing covenants that govern their relationship under the loan. It supplements the terms of the promissory note and the security instruments. (Note: USDA is not a party to this agreement.)

When is the loan agreement needed?

A draft loan agreement must be submitted to USDA as part of a complete application. The loan agreement is normally executed at loan closing, and a copy of it must be submitted to USDA prior to issuance of the B&I guarantee.

Is a specific loan agreement form required?

USDA does not mandate any specific form or format for the loan agreement. Many lenders have their own standard loan agreement formats, which they are free to use. However, USDA does require the agreement to contain certain *minimum covenants*, specifically:

Negative Covenants:

- Limitations on purchase or sale of equipment and fixed assets.
- Restriction on dividend payments.
- Limitations on compensation of officers and owners.
- Prohibition against assuming liabilities or obligations of others.
- Restrictions concerning consolidations, mergers, or other circumstances.
- Limitations on selling the business without the concurrence of the lender.

Financial Standards Covenants:

- Minimum working capital or current ratio requirement.
- Maximum debt-to-net worth ratio.

Financial Reporting Requirements:

- Type and frequency of submission of financial statements. (*Note: The borrower and all guarantors must provide financial statements prepared in accordance with Generally Accepted Accounting Principles (GAAP) at least annually. Nonprofits and public bodies must meet federal audit standards in their financial reporting.*)

Within this framework, USDA will normally leave it up to the lender to decide how restrictive or flexible the terms of the loan agreement should be. Sometimes a lender may even determine that there is no need to establish a minimum requirement on some of these covenants.

Example: On a long-term real estate loan, a lender may not be concerned about the debt-to-net-worth ratio over the life of the loan. In that case, the loan agreement need only indicate that the borrower does not need to maintain any specific ratio. Thus, the USDA-required covenant is addressed, even though the requirement is completely flexible.

An example of a very flexible, but still acceptable loan agreement is shown on the next page.

The following "Loan Agreement" is an example that satisfies the minimum criteria for a B&I guaranteed loan. It may be used as a guide; it is not a mandatory format. Lenders are responsible for satisfying themselves as to the sufficiency of their loan agreements.

LOAN AGREEMENT

This Loan Agreement is entered into this ____ (date), between ____ (Lender) and ____ (Borrower) and pertains to a Business & Industry (B&I) Guaranteed loan described as follows: _____.

The Lender agrees to fund this loan, and the Borrower hereby agrees to the following:

1. **Limitations on purchase or sale of equipment and fixed assets.** The borrower may not sell any equipment or fixed assets which serve as collateral for this loan except as set forth in the security instruments for this loan.
2. **Restriction on dividend payments.** Dividends may not be paid that would cause the borrower to be unable to meet all of its financial obligations.
3. **Limitations on compensation of officers and owners.** The borrower's owners and officers may be compensated only to the extent that this compensation does not materially jeopardize the financial strength of the company or cause the borrower to be unable to meet all of its financial obligations.
4. **Prohibition against assuming liabilities or obligations of others.** The borrower will not assume the liabilities or obligations of others without the prior written consent of the lender.
5. **Restrictions concerning consolidations, mergers, or other circumstances.** The borrower will not undertake any consolidations or mergers without the prior written consent of the lender.
6. **Limitations on selling the business.** The borrower will not sell the business without the prior written consent of the lender.
7. **Minimum working capital or current ratio requirement.** The borrower must maintain a minimum working capital position (or current ratio position) of _____. OR The lender is not establishing a minimum working capital position (or current ratio position).
8. **Maximum debt-to-net worth ratio.** The borrower must meet the tangible balance sheet equity standard specified in USDA's Conditional Commitment. Thereafter, the borrower must maintain a debt-to-net worth ratio of less than _____. OR Thereafter, the lender is not establishing a debt-to-net worth ratio standard.
9. **Type and frequency of submission of financial statements.** The borrower and all guarantors must provide financial statements at least annually, no later than 90 days after their fiscal year-end. The borrower's financial statements must be prepared by an independent Certified Public Accountant in accordance with Generally Accepted Accounting Principles and must be: (THE LENDER SHOULD SPECIFY THE REQUIRED FINANCIAL STATEMENT LEVEL)
 - Compiled
 - Reviewed
 - Audited (*Nonprofits & public borrowers must meet federal audit reporting standards.*)

Acknowledged and agreed to:

Borrower