

Practical Tips for Lenders:

Navigating the Gauntlet of Government-Guaranteed Loans



Government-guaranteed loan programs can provide a great avenue for lenders to enhance credit.

Government-guaranteed loans have long assisted lenders by bolstering private credit structures where lenders may otherwise hesitate to extend credit. For instance, in 2011 the United States Department of Agriculture's Rural Development Program alone provided nearly \$900 million in funding through various loan programs in Washington state. Lenders also often turn to the Small Business Administration's ("SBA") guaranteed loan programs to bolster credit, including SBA's 7(a) Loan Program or 504 Loan Program. The primary benefit of these programs

is that the government's guarantee is an "obligation supported by the full faith and credit of the United States" and is "incontestable" by the agency, except in limited circumstances involving fraud or misrepresentation.

While these government-guaranteed loan programs can provide substantial benefit to lenders, they also can involve rigorous application processes that can perplex even the most sophisticated lenders. Federal agencies often require a tremendous amount of documentation, and the process can drag on for months

(or even years) as the lender and agency attempt to make sure everything is properly in place.

With that in mind, below are a few practical tips to avoid some of the pitfalls inherent in the government-guaranteed loan application process:

1. Select a government-guaranteed loan program suitable to the purposes of the loan.

Agencies offer a wide variety of guaranteed loan programs, and each program is designed to provide a greater societal benefit in some specific way. The purposes of these programs range from rural economic development, to assisting small businesses in low-income markets, to biorefinery assistance.

With such an assortment of programs available, it is important that lenders locate a loan program that is best suited to their specific loan. This can require a fair amount of research, particularly because these loan programs are constantly evolving. Once a lender has selected a specific program, it is also important to document in clear and concrete ways how the lender's loan will advance the purposes of the specific program selected. This will usually require working closely with the borrower to determine the borrower's long-term plan, as well as working with local community leaders to determine how the loan will benefit the public policy underlying the loan guarantee program.

2. Thoroughly examine the specific requirements of the selected loan program.

Once a lender has selected a specific loan program and can establish a concrete connection between the loan and the public policy underlying the program, then the lender should become familiar with the

specific loan documentation requirements for that program. This includes reviewing agency regulations, administrative notices and other agency guidance regarding the application process. For instance, the lender should determine what loan covenants the agency requires (or prohibits) in the lender's loan documents, what limitations the agency places on the lender's credit structure, what financial information the agency requires from the borrower, and what level of tangible net equity the borrower must establish.

Depending on the loan program, this process could require significant research, as the regulations and administrative guidance are constantly changing. While obtaining information from the local agency office is a good idea, it is also important that the lender not accept all information obtained from the agency at face value. Some of the information a lender obtains may be slightly outdated or simply conflict with currently applicable authorities. Many of these particular requirements may not prevent the agency from issuing the guarantee altogether, but they may cause considerable delays in the application process.

3. Communication is the key.

It is important to maintain regular communication with the borrower and the agency throughout the guarantee application process. Typically, government-guaranteed loan programs require the lender to submit an initial application for guarantee, the agency will then issue a conditional commitment in which the agency commits to issue a final guarantee if the lender can satisfy certain specified conditions. Depending on the loan, the process between the issuance of the conditional commitment and the final guarantee can be challenging. This can cause problems for the lender and borrower, and potentially jeopardize issuance of the final guarantee.

For instance, a conditional commitment typically requires the lender and borrower to each provide the agency with various certifications about the borrower's financial circumstances. Although the regulations do not specifically require lenders to update these certifications, it may be wise for lenders to do so, as agencies have attempted to revoke guarantees after issuance when lenders have failed to provide updated certifications. Providing the agency with updated information helps lenders avoid this issue altogether. After all, it would be difficult for an agency to claim that it was misled by a lender's certification, when the lender made sure that the agency was fully aware of all of the circumstances relating to that certification.

In other words, lenders can avoid potential legal disputes down the road by carefully communicating throughout the application process about the borrower's condition.

4. Do not disburse loan proceeds until the final guarantee is in place.


Lenders should condition any disbursement of loan proceeds on the agency's final issuance of the guarantee, and lenders should

refrain from disbursing any loan proceeds until the agency has issued its final guarantee. The myriad conditions the lender must satisfy in the conditional commitment provide the agency with multiple grounds to decline to issue the final guarantee if the lender does not comply. In contrast, once the final guarantee is issued, then it becomes incontestable except for instances in which the lender knowingly engaged in fraud or misrepresentation. In addition, for construction loans, agencies will not typically issue a final guarantee until construction is completed, which may require lenders to request additional collateral from borrowers prior to guarantee issuance.

Waiting to disburse loan proceeds thus ensures that if the agency fails to issue a guarantee, the lender will not be saddled with an under-secured loan, or a loan that does not meet its standard loan underwriting criteria. In addition, this will help ensure that the borrower remains highly motivated to cooperate with the lender in obtaining any information or additional documents the agency may request prior to guarantee issuance.

5. Lenders should know their post-issuance rights.

Once the agency has issued its guarantee, the agency may only challenge the enforceability of the guarantee based on fraud or misrepresentation. In addition, in the event that the lender suffers a loss and must seek payment from the agency, the agency may reduce its payout if there has been negligent servicing of the loan. Lenders should be aware that even if an agency attempts to assert fraud, misrepresentation or negligent servicing, the lender is not without remedies. Regulations provide the lender with an administrative appeal process, which includes the right to mediation or informal meetings with the agency, as well as the right to appeal administrative decisions to a court of law.

Government-guaranteed loan programs can provide a great avenue for lenders to enhance credit. Although the application process can be daunting, paying close attention to detail and communicating regularly with the agency will help lenders navigate the process confidently and successfully. 



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