

RD AN No. 4532 (4279-A)
August 5, 2010

TO: State Directors, Rural Development
ATTN: Business Programs Directors
SUBJECT: Business and Industry Guaranteed Loan Program
Financing with Bonds

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to provide guidance on how bonds can be used to fund loans through the Business and Industry (B&I) Guaranteed Loan Program.

COMPARISON WITH PREVIOUS AN:

This is a new AN. There is an expired unnumbered letter on this subject.

IMPLEMENTATION RESPONSIBILITIES:

The purpose of this AN is to clarify the Agency policy concerning bond financing under the B&I program.

As background, a bond is a debt security in which the issuer owes the holders a debt and is obligated to repay the principal and interest following a predetermined schedule. Other stipulations may also be attached to the bond issue, such as the obligation for the issuer to provide certain information to the bondholder or limitations on the behavior of the issuer. Bonds are generally issued for a fixed term longer than 1 year. A bond is similar to a loan although terminology used is different. The issuer is equivalent to the borrower and the bondholder

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August 31, 2011

FILING INSTRUCTIONS:
Preceding RD Instruction 4279-A

to the lender. Bonds enable the issuer to finance long-term investments with external funds. When bonds are issued, there may be a trustee involved. A trustee is typically an entity designated by the issuer as the custodian of funds and is sometimes the official representative of bondholders. Trustees are appointed to ensure compliance with the bond documents and often represent bondholders in enforcing their contract with the issuer. However, as delineated later in this AN, the typical trustee arrangement does not work with the B&I Guaranteed Loan Program. There are three primary types of bonds: corporate bonds, municipal bonds and government bonds. With the B&I Guaranteed Loan Program, certain corporate, municipal and government bonds may be guaranteed, provided that they are taxable.

Corporate bonds are debts issued by industrial, financial, and service companies to finance capital investment and operating cashflow. Corporate bonds are debt obligations, or IOUs, issued by private and public corporations. Companies use the funds they raise from selling bonds for a variety of purposes, from building facilities to purchasing equipment to expanding the business. When a bondholder buys a bond, they are lending money to the corporation that issued it. The corporation promises to return the principal and interest on a predetermined schedule. The interest payments received from corporate bonds are taxable. Unlike stocks, bonds do not give a bondholder an ownership interest in the issuing corporation. To be eligible to be guaranteed under the B&I program, the bond must be an amortizing bond, on which payments must include principal and interest, and must be in accordance with RD Instruction 4279-B, section 4279.126(a)-(e).

The B&I Guaranteed Loan Program may also be used to guarantee certain types of municipal and government bonds, as long as the bonds are taxable. The bond issuer must obtain the services and opinion of a recognized bond counsel experienced in municipal financing who must present a legal opinion stating that the bonds are legal, valid and binding obligations of the issuer and that the issuer has adhered to all applicable laws.

Due to the potential conflict of interest of having a lender being in an ownership position, convertible bonds are not eligible to be guaranteed. A convertible bond gives the bondholder an opportunity to convert the bond into an ownership interest under predetermined circumstances.

The following scenarios have arisen:

Scenario #1: Lender (bondholder) buys all the bonds. Lender (bondholder) can sell bonds on secondary market and retain required percentage. Preferably, there would be one bond. At most, there could be up to 11 bonds using the multi-note system, in accordance with RD Instruction 4279-B, section 4279.75(b); up to 10 bonds for the guaranteed portion and one bond for the unguaranteed portion. Under this scenario, the lender (bondholder) is clearly identified. There is no question that the lender/bondholder is responsible for servicing the loan/bond. There would be no trustee in this scenario. This scenario would comply with the B&I Guaranteed Loan Program regulations.

Scenario #2: The same scenario as #1, except the lender (bondholder) is the trustee. The non-lender bondholders have no control over the trustee other than being able to make demand for payment or repurchase of their guaranteed interest under applicable regulations. This scenario would comply with the B&I Guaranteed Loan Program regulations.

Scenario #3: The same scenario as #1, except there is a third-party trustee. There would have to be a signed agreement between the lender (bondholder) and the trustee, giving the trustee the authority to act on behalf of the lender for routine servicing. The trustee must be fully under the control of the lender. As under Scenario #2, the bondholders would receive payments from the trustee, but would have no control over the trustee. The trustee must have the necessary servicing experience. The lender (bondholder) is still the ultimate party responsible for servicing the B&I loan. This scenario would comply with the B&I Guaranteed Loan Program regulations.

Scenarios that would not comply with the B&I Guaranteed Loan Program regulations include: (1) when the lender (bondholder) does not initially purchase all of the bonds; (2) when there are more than 11 bonds issued, which would conflict with our governing regulations (see Scenario #1); and (3) when the trustee is not fully under the control of the lender (bondholder). With regard to item 3, some examples of when the trustee would not be fully under the control of the lender (bondholder) would be if the non-lender bondholders can direct the trustee to take servicing actions, such as accelerating the bond, or the non-lender bondholders can replace the trustee. The non-lender bondholders cannot have any more rights than “holders” under program regulations. None of the scenarios in this paragraph would comply with the B&I Guaranteed Loan Program regulations.

In all projects involving a B&I guaranteed loan, the lender (bondholder) must retain 5 percent of the loan or bond in accordance with RD Instruction 4279-A, section 4279.77. In some cases, there may be two series of bonds issued; one for the guaranteed portion and one for the unguaranteed portion.

Each of these deals will have a bond purchase agreement between the issuer (borrower) and the bondholder (lender). The bond purchase agreement will contain similar language to what is contained in a loan agreement. This includes the financial covenants listed in RD Instruction 4279-B, section 4279.161(b)(11). Please ensure the lender (bondholder) is familiar with Agency requirements. The bond purchase agreement must not conflict with the B&I regulations. Additionally, a signed Form RD 4279-4, “Lender’s Agreement,” is required. Bond Purchase Agreements should be reviewed by the regional Office of the General Counsel for legal sufficiency.

The lender (bondholder) services a bond just as if it were a loan. If the lender (bondholder) wishes to sell the guaranteed portion on the secondary market under the single note option, it would use Form RD 4279-6, "Assignment Guarantee Agreement," just as it would for any other B&I loan. Corporate bonds should not be taken as collateral as they are debt instruments and have no value in the event of liquidation. Corporate bonds must be secured with collateral similar to the collateral taken when making a loan. As always, the loan must be in compliance with all of the provisions of RD Instructions 4279-A and B.

The Office of the General Counsel (OGC) Regional Attorney will be responsible for reviewing bond documents for legal compliance and sufficiency but all bond documents should also be sent to the National Office of the General Counsel as well. It is the responsibility of the State Office to review the documents for program compliance, particularly with RD Instruction 4279-B, section 4279.161(b)(8).

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

(Signed by Judith A. Canales)

JUDITH A. CANALES
Administrator
Business and Cooperative Programs