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Memo To: USDA/RD
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Subject: Comments on USDA/RD Proposed Rule Published in Federal Register on September 14, 2007 Vol. 72, No. 178

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Horizon Bank is very familiar with the USDA/RD Business & Industry and Community Facilities guaranteed loan programs. During 2002 - 2007 we were involved in the origination of ten USDA/RD Business & Industry and Community Facilities guaranteed loans totaling $24,295,000. Nine of these loans were USDA/RD Business & Industry (B&I) guaranteed loans totaling $21,295,000 (88% of total) and one loan was a USDA/RD Community Facilities (CF) guaranteed loan for $3,000,000 (12% of total). None of these loans has had a payment default or loss.

**Horizon Bank believes that USDA/RD should modify the following proposed rules it published in the Federal Register on September 14, 2007, Vol. 72, No. 178 because they may have a very detrimental effect on the USDA/RD B&I and CF guaranteed loan programs.**

1. **USDA/RD should continue its current regulation, that establish, "the unguaranteed portion of the loan will neither be paid first nor given any preference or priority over the guaranteed portion". The "first loss" proposed change would kill the B&I and CF guaranteed loan programs.**

   If the "first loss" proposed change is adopted by USDA/RD, most current lenders in the B&I and CF guaranteed loan programs will likely not participate in these programs in the future, which would kill the B&I and CF guaranteed loan programs.

   The USDA/RD proposed rule that states "the guaranteed portion would be paid first and be given preference and priority over the unguaranteed portion" (first loss) will likely kill the B&I and CF guaranteed loan programs. If this provision is adopted the lender would absorb the "first loss" on each loan. This is not the current guarantee method where USDA/RD and the lender share losses on a "Pari Passu" basis. This provision is not consistent with the current program as indicated.

On page 52636, in the Conditions of Guarantee paragraph, it states that "the guaranteed portion would be paid first and be given preference and priority over the unguaranteed portion." Later in this same section it goes on to state that "these provisions are consistent with those found in the current programs." This statement is incorrect because this provision is not consistent with the current program. Page 52658 in the Basic Guarantee and Loan Provisions (5001.30-b-1) also states that "the guaranteed portion would be paid first and be given preference and priority over the unguaranteed portion." In other words, the new regulations propose to eliminate the concept of "Pari Passu".

2. **USDA/RD should continue its current regulation that does not limit refinancing of loans to a minority portion of the B&I guaranteed loan** (except the portion of the loan refinancing loans with the lender making the new USDA B&I guaranteed loan).

The "refinancing" proposed change for the B&I guaranteed loan program, will adversely impact many otherwise good credit worthy rural businesses that need to refinance existing loan(s) to improve cash flow to make their rural business more viable or that need to refinance loan(s) that are ballooning with a loan that makes their rural business more viable.

Five of the B&I guaranteed loans we were involved in originating during 2002-2007 totaling $10,510,000 (49% of the B&I loans) involved refinancing of over 50% of existing loans. These loans were primarely for rural businesses that needed to refinance existing loans to improve cash flow to make their rural business more viable or for rural businesses that needed to refinance loans that were ballooning with a loan that made their rural business more viable. None of these loans has had a payment default or loss to the best of our knowledge.

This "refinancing" proposed rule change is a very adverse change that should be deleted. This provision is not consistent with the current B&I guaranteed loan program regulations as indicated. Currently, the B&I guaranteed loan program regulations do not limit refinancing of loans to a minority portion of the guaranteed loan (except the portion of the loan refinancing loans with the lender making the new USDA B&I guaranteed loan).

Page 52621 in the Business and Industry Guaranteed Loan paragraph states that "refinancing of loans (other than USDA direct loans) will be limited to a minority portion of the guaranteed loan." Page 53643 in the Business and Industry (5001.103) paragraph also states that "refinancing of loans (other than USDA direct loans) will be limited to a minority portion of the guaranteed loan."

3. **USDA/RD should modify its proposed "cash equity" requirement to "have GAAP balance sheet equity of 10 percent for existing business or 20 percent for new business"**(replacing its outdated tangible equity requirement).

The wording of the "cash equity requirement" proposed change for the B&I guaranteed loan program loans pertaining to "have cash equity of 10 percent for existing business or 20 percent for new business" is not clear.

It appears that this proposed change is to conform the "balance sheet equity" requirement to the terms utilized by most private sector lenders. The URSA/RD comment that most private sector lenders do not normally require "tangible balance sheet equity" is correct. Most private sector lenders also do not normally require "cash balance sheet equity”. Most private sector lenders normally require “balance sheet equity” as defined by GAAP. We are not aware that GAAP even has a “cash balance sheet equity” term.

Page 52648 in Tangible Balance Sheet Equity Versus Cash Equity paragraph states that “Under the current B&I guaranteed loan program, one of the eligibility criteria for projects is based on meeting certain tangible balance sheet equity requirements. The new rule proposes to use, instead, cash equity. The Agency proposes this change because of difficulties in applying the tangible balance sheet equity criteria, and because the private sector is moving away from the use of tangible balance sheet equity as a qualifying factor.” (Page 52628 in the Financial Conditions paragraph also mentions this proposed cash equity requirement.)

**4. USDA/RD should continue its current B&I guaranteed loan regulation regarding “audited financial statements”, whereby, USDA/RD may require annual audited financial statements after the B&I guaranteed loan closes.**

The proposed regulation for B&I guaranteed loans pertaining to “audited financial statements for loans over $1 million” is unclear. If the intention of this proposed regulation is to require applicants for loans over $1 million to have audited financial statements for prior years, it will adversely impact many otherwise, good credit worthy potential rural businesses that need B&I guaranteed loans.

**5. USDA/RD should modify the wording of its proposed regulation regarding “debt service coverage” for B&I guaranteed loans to “loans for 100% refinancing should be able to demonstrate a historical debt service coverage ratio of 1.0 or higher for the refinanced loan and loans other than for 100% refinancing should be able to demonstrate a proforma debt service coverage ratio of 1.0 or higher once fully operational” for the project to be eligible. This rule should also provide for mitigating circumstances in case the ratio is not met.**

The USDA/RD proposed new regulation wording for B&I guaranteed loans pertaining to “debt service coverage ratio of 1.0 or higher” is unclear. One could read into it that historical cash flow must provide debt service coverage of 1.0 even though proceeds of the new B&I guaranteed loan will be utilized to expand the business resulting in additional cash flow available for debt service, which is not logical.