

# **Appendix J**

## **Model Loan Liquidation Procedures**

## **APPENDIX J**

### **LOAN LIQUIDATION**

#### **CHAPTER 1**

##### **PURPOSE AND ORGANIZATION**

###### **1. What is the Purpose of this Liquidation Manual?**

The purpose of this Manual is to provide you with guidelines for liquidation activities of Agency personnel and Participating lenders.

###### **2. what is the Scope of Liquidation Activities?**

Loan liquidation personnel handle problem accounts, which require enforced collection measures or other actions to protect the interests of the Agency. Liquidation personnel take all necessary and appropriate steps in connection with the administration and collection of loans classified as "In Liquidation" typically, these steps include:

- a. Workouts;
- b. Recovery from collateral; and
- c. Pursuit of guarantors and other obligors.

###### **3. How is this Manual Organized?**

- a. This Manual is organized to provide you with both the references to regulations and the policy you need to know to perform your job in loan liquidation.
- b. Chapter 3 contains general guidelines for liquidation activities, including definitions and delegations of authority.
- c. The remaining chapters of this Manual deal with various individual topics, which are part of the liquidation process.

###### **4. What are the Sources of Authority and Guidance for Liquidation Activity?**

- a. As a loan liquidation official you must be aware that all liquidation activities you take must conform to:
  - (1) Agency regulations;
  - (2) The Agency policy and procedures; and

(3) The Agency's, "Loan Guaranty Agreement (Deferred Participation)."

b. What do you need to know about the regulations?

(1) From time to time, Agency publishes changes to the Regulations to implement new legislation or to clarify or modify existing regulations. These changes are published in Public Notice.

(2) The subsections of the Regulations, which pertain to loan liquidation, are provided in Chapter 2 of this Manual.

c. What do you need to know about the Agency's "Loan Guaranty Agreement (Deferred Participation)?"

The Agency Loan Guaranty Agreement is the Agency's contract of guaranty with the lenders in the program.

## **5. What will this Manual Provide?**

This Manual will provide the policy for procedures and administration of all loans classified "in liquidation" status. This would include loans serviced by either the Agency or the participating lenders.

## **6. When Should You Refer to the Loan Servicing Manual?**

You should be fully familiar with the regulations and polices contained in the Servicing manual. You will use the Servicing Manual for liquidation matters whenever the situation is not covered by this manual or when the "servicing" approach is more appropriate.

## CHAPTER 2

### REGULATIONS AND OTHER AUTHORITIES

#### 1. Who services the loan after Agency honors its guarantee?

Generally, after Agency honors its guarantee, the Lender must continue to hold the Loan Instruments and service and liquidate the loan. The Lender must execute a Certificate of interest showing Agency's percentage of the loan, and must submit a liquidation plan to Agency for each loan to be liquidated. If Agency elects to service or liquidate the loan, the Lender must assign the Loan Instruments to Agency. A Certificate of Interest is a document that specifies the interest in a given loan.

#### 2. Suspension or revocation of eligibility to participate.

Agency may suspend or revoke the eligibility of a Lender to participate in the program because of a violation of Agency regulations, a breach of any agreement with Agency, a change of circumstance resulting in the Lender's inability to meet operational requirements, or a failure to engage in prudent lending practices. Proceedings for such purposes will be conducted in accordance with the provisions of part 134 of this chapter. A suspension or revocation will not invalidate a guarantee previously provided by Agency.

#### 3. What are Agency's policies concerning liquidation of collateral?

##### (a) Liquidation policy.

Agency or the Lender may liquidate collateral securing a loan if the loan is in default or there is no reasonable prospect that the loan can be repaid within a reasonable period.

##### (b) Disposal of collateral and assets acquired through foreclosure or conveyance.

Agency or the Lender may sell real and personal property (including contracts and claims) pledged to secure a loan that is in default in accordance with the provisions of the related security instrument.

##### (1) Competitive bids or negotiated sales.

Generally, Agency will offer loan collateral and acquired assets for public sale through competitive bids at auctions or sealed bid sales.

The Lender may use negotiated sales if consistent with its usual practice for similar non-Agency assets.

(2) Lease of acquired property.

Normally, neither Agency nor a Lender will rent or lease acquired property or grant options to purchase. Agency and the Lender will consider proposals for a lease if it appears a property cannot be sold advantageously and the lease may be terminated on reasonable notice upon receipt of a favorable purchase offer.

(c) Recoveries and security interests shared.

Agency and the Lender will share pro rata (in accordance with their respective interests in a loan) all loan payments or recoveries, all reasonable expenses (including advances for the care, preservation, and maintenance of collateral securing the loan and the payment of senior lien holders), and any security interest or guarantee (excluding Agency's guarantee) which the Lender or Agency may hold or receive in connection with a loan.

(d) Guarantors.

Guarantors of financial assistance have no rights of contribution against the Agency. The Agency is not deemed to be a co-guarantor with any other guarantors.

#### 4. Definitions.

Definitions for the terms used in this manual are contained in the By-Laws of the association.

**Authorization** is Agency's written agreement providing the terms and conditions under which Agency will make or guarantee business loans. It is not a contract to make a loan.

**Borrower** is the obligor of an Agency business loan.

**Close Relative** is a spouse; a parent; or a child or sibling, or the spouse of any such person.

**Lender** is an institution that has executed a participation agreement with Agency under the guaranteed loan program.

**Loan Instruments** are the Authorization, note, instruments of hypothecation, and all other agreements and documents related to a loan.

**Preference** is any arrangement giving a Lender or a preferred position compared to Agency relating to the making, servicing, or liquidation of a business loan with respect to such things as repayment, collateral, guarantees, control, maintenance of a compensating balance, purchase of a Certificate of deposit or acceptance of a separate or companion loan, without Agency's consent.

**Service Provider** is an entity that contracts with a Lender to perform management, marketing, legal or other services.

## **5. What ethical requirements apply to participants?**

Lenders, ("Participants"), must act ethically and exhibit good character. Ethical indiscretion of an Associate of a Participant or a member of a will be attributed to the Participant. A Participant must promptly notify Agency if it obtains information concerning the unethical behavior of an Associate. The following are examples of such unethical behavior. A Participant may not:

- (a) Self-deal;
- (b) Have a real or apparent conflict of interest with a small business with which it is dealing (including any of its Associates or an Associate's Close Relatives) or Agency;
- (c) Own an equity interest in a business that has received or is applying to receive Agency financing (during the term of the loan or within 6 months prior to the loan application);
- (d) Be incarcerated, on parole, or on probation.
- (e) Knowingly misrepresent or make a false statement to Agency.
- (f) Engage in conduct reflecting a lack of business integrity or honesty;
- (g) Be a convicted felon, or have an adverse final civil judgment (in a case involving fraud, breach of trust, or other conduct) that would cause the public to question the Participant's business integrity, taking into consideration such factors as the magnitude, repetition, harm caused, and remoteness in time of the activity or activities in question;
- (h) Accept funding from any source that restricts, prioritizes, or conditions the types of small businesses that the Participant may assist under an Agency program or that imposes any conditions or requirements upon recipients of Agency assistance inconsistent with Agency's loan programs or regulations.

- (I) Fail to disclose to Agency all relationships between the small business and its Associates (including Close Relatives of Associates), the Participant, and/or the lenders financing the Project of which it is aware or should be aware.
- (j) Fail to disclose to Agency whether the loan will:
  - (1) Reduce the exposure of a Participant or an Associate of a Participant in a position to sustain a loss.
  - (2) Directly or indirectly finance the purchase of real estate, personal property or services (including insurance) from the Participant or an Associate of the Participant.
  - (3) Repay or refinance a debt due a Participant or an Associate of a Participant; or
  - (4) Require the small business, or an Associate (including Close Relatives of Associates), to invest in the Participant (except for institutions, which require an investment from all members as a condition of membership, such as a Production Credit Association).
- (k) Issue a real estate forward commitment to a builder or developer; or
  - (l) Engage in any activity, which taints its objective judgment in evaluating the loan.

## **6. Requirements for all participating lenders.**

A Lender must:

- (a) Have a continuing ability to evaluate, process, close, disburse, service and liquidate small business loans;
- (b) Be open to the public for the making of such loans (not be a financing subsidiary, engaged primarily in financing the operations of an affiliate);
- (c) Have continuing good character and reputation, and otherwise meet and maintain the ethical requirements of the Regulations; and
- (d) Be supervised and examined by a State or Agency regulatory authority, satisfactory to Agency.

## **7. Preferences.**

An agreement to participate under the Act may not establish any Preferences in favor of the Participant.

## **8. Other services Lenders may provide Borrowers.**

Subject to Regulations, Lenders, their Associates or the designees of either may provide services to and contract for goods with a Borrower only after full disbursement of the loan to the small business or to an account not controlled by the Lender, its Associate, or the designee. A Lender, an Associate, or a designee providing such services must do so under a written contract with the small business, based on time and hourly charges, and must maintain time and billing records for examination by Agency. Fees cannot exceed those charged by established professional consultants providing similar services.

## **9. When does Agency honor its guarantee?**

- (a) Agency, in its sole discretion, may purchase a guaranteed portion of a loan at any time. A Lender may demand in writing that Agency honor its guarantee if the Borrower is in default on any installment for more than 60 calendar days (or less if Agency agrees) and the default has not been cured. If a Borrower cures a default before a Lender requests purchase by Agency, the Lender's right to request purchase on that default lapses.
- (b) Purchase by Agency of the guaranteed portion does not waive any of Agency's rights to recover money paid on the guarantee, based upon the Lender's negligence, misconduct, or violation of this part, including those actions listed in the Regulations, the Loan Guarantee Agreement or the Loan Instruments.

## **130. What interest rate applies after Agency purchases its guaranteed portion?**

When Agency purchases the guaranteed portion of a fixed interest rate loan, the rate of interest remains as stated in the note. On loans with a fluctuating interest rate, the interest rate that the Borrower owes will be at the rate in effect at the time of the earliest uncured payment default, or the rate in effect at the time of purchase (where no default has occurred).

## **11. How much accrued interest does Agency pay to the Lender or Registered Holder when Agency purchases the guaranteed portion?**

- (a) Rate of interest.

If Agency purchases the guaranteed portion from a Lender or from a Registered Holder (if sold in the Secondary Market), it will pay accrued interest at:

- (1) The rate in the note if it is a fixed rate loan; or

(2) The rate in effect on the date of the earliest uncured payment default, or of Agency's purchase (if there has been no default).

(b) Payment to Lender.

If the Lender submits a complete purchase request to Agency within 120 days of the earliest uncured payment default, Agency will pay accrued interest to the Lender from the last interest paid-to-date up to the date of payment. If the Lender requests Agency to purchase after 120 days from the date of the earliest uncured payment default date, Agency will pay only 120 days of interest.

(c) Payment to Registered Holder.

Agency will pay a Registered Holder all accrued interest up to the date of payment.

(d) Extension of the 120-day period.

Before the 120 days expire, the Agency field office may extend the period if the Lender and Agency agree that the Borrower can cure the default within a reasonable and definite period of time or that the benefits from doing so otherwise will exceed the costs of Agency paying additional interest. If the 120 days have passed, only the Director or designee can extend the period.

**15. What is the "earliest uncured payment default"?**

The earliest uncured payment default is the date of the earliest failure by a Borrower to pay a regular installment of principal and/or interest when due. Payments made by the Borrower before a Lender makes its request to Agency to purchase are applied to the earliest uncured payment default. If the installment is paid in full, the earliest uncured payment default date will advance to the next unpaid installment date. If a Borrower makes any payment after the Lender makes its request to Agency to purchase, the earliest uncured payment default date does not change because the Lender has already exercised its right to request purchase.

**13. When is Agency released from liability on its guarantee?**

(a) Agency is released from liability on a loan guarantee (in whole or in part, within Agency's exclusive discretion), if any of the events below occur:

(1) The Lender has failed to comply materially with any of the provisions of these regulations, the Loan Guarantee Agreement, or the Authorization.

- (2) The Lender has failed to make, close, service, or liquidate a loan in a prudent manner.
  - (3) The Lender's improper action or inaction has placed Agency at risk.
  - (4) The Lender has failed to disclose a material fact to Agency regarding a guaranteed loan in a timely manner;
  - (5) The Lender has misrepresented a material fact to Agency regarding a guaranteed loan;
  - (6) Agency has received a written request from the Lender to terminate the guarantee;
  - (7) The Lender has not paid the guarantee fee within the period required under Agency rules and regulations;
  - (8) The Lender has failed to request that Agency purchase a guarantee within 120 days after maturity of the loan;
  - (9) The Lender has failed to use required Agency forms or exact electronic copies; or
  - (10) The Borrower has paid the loan in full.
- (b) If Agency determines, after purchasing its guaranteed portion of a loan, that any of the events set forth in paragraph (a) of this section occurred in connection with that loan, Agency is entitled to recover any money paid on the guarantee plus interest from the Lender responsible for those events.
- (c) If the Lender's loan documentation indicates that one or more of the events in paragraph (a) of this section may have occurred, Agency may undertake such investigation as it deems necessary to determine whether to honor or deny the guarantee, and may withhold a decision on whether to honor the guarantee until the completion of such investigation.
- (d) Any information provided to Agency prior to Lender's request for Agency to honor its guarantee shall not prejudice Agency's right to deny liability for a guarantee if one or more of the events listed in paragraph (a) of this section occur.
- (e) Unless Agency provides written notice to the contrary, the Lender remains responsible for all loan servicing and liquidation actions until Agency honors its guarantee in full.

## CHAPTER 3

### CORRESPONDENCE, REPORTS, AND CONTROL SYSTEMS

#### 1. Correspondence.

All correspondence received in field offices must be handled in a professional, business like manner. Prompt response is essential.

- a. Who handles routine correspondence?

The assigned official responsible for the loan account handles routine correspondence.

- b. What are the time frames for response?

As a guideline, you should respond to correspondence within 10 business days, or less.

- c. What information must you retain and where?

- (1) Specific loan accounts.

You must place copies of all correspondence and documented telephone calls on substantial matters for specific loan accounts in the related loan file.

- (2) General subject matters.

You must place copies in an official subject file (e.g. general policy and procedural correspondence from Headquarters)

#### 2. what is an Agency's Modification or Administrative Action?

The term "Modification or Administrative Action", refers to an action to modify the authorization and loan agreement or other actions which are necessary to help the borrower respond to a business growth opportunity or to respond to a problem. It also refers to actions that Agency may take that would affect the loan (e.g., change the status of loan from regular servicing to "in-liquidation," to transfer the loan from one lender to another, etc.)

All actions require approval under the rule of two authority. (See paragraph 2, chapter 4)

Modifications or administrative actions on specific loans are taken by the completion of an Agency Form \_\_\_\_, "Modification or administrative action" or the Agency modification stamp format. The result is a "Modification action."

a. Agency Modification Form.

Agency "Modification or administrative action" is available as a pre-printed form or on-line from the Agency computer software. The report must contain all the essential information pertinent to the issue being considered, such as status of the loan, collateral, guarantors, and comments of the recommending official originating the report.

(1) The recommending official comments should include:

- (a) Summary of the request;
- (b) Evaluation of supporting documentation; and
- (c) Recommendation for approval or denial.

(2) The approving official must:

- (a) Take final action to approve or deny the request; and
- (b) Document the reason for his/her decision if it is not already clearly stated in the recommendation.

**NOTE: Documentation by the approving official is not necessary when the recommendation is clear and concise, is the basis of the approving official's determination, and it is so stated on the action by the approving official.**

b. Modification stamp format.

You may accomplish routine or uncomplicated changes in the authorization and loan agreement by using an Agency Modification stamp:

(1) The Agency stamp "Modification or administrative action - stamp", is an approved stamp format which can be affixed to incoming borrower/lender/ correspondence to reflect Agency action. You may use the Agency stamp in those cases where you are not required to distribute the action to other offices or commands.

(2) You should limit its use to less complicated requests where the incoming letter (and any enclosures) satisfactorily describes the action requested and provides sufficient information to allow final action.

- (3) In some cases, you may use the modification stamp for administrative actions that are not in response to bank or borrower requests (e.g., internal notification to other areas of the Agency).
- (4) You must consecutively number these actions with other modification actions, and each action must reflect the signature of the recommending and approving officials.

c. Authority for action.

You must cite on the Agency modification form/stamp the applicable Manual chapter and paragraph number that provides authority for the action. If you take more than one action with an Agency modification form/stamp, you must cite each action with the applicable chapter and paragraph numbers.

d. Filing of the action.

You must file the modification action (with related documents such as a credit memo, etc.) with other modification actions in the borrower's loan file.

e. Actions requiring approval by another office.

- (1) You must use an Agency modification form, (rather than a stamp action), to recommend loan-servicing action on specific cases, which require approval at an office other than the originating office. The proposed action and the signatures and titles of the recommending/approving officials must be on the report. It is essential that the report contain all the pertinent information necessary to make an informed decision. (This section applies when a loan is transferred to another field office or other location).
- (2) The originating office will forward the action to the next with a copy retained by the originating office, pending final action. The report must include the comments and recommendation of the highest supervisory official using the rule of two on an Agency modification form at each office and of counsel (on legal issues).

**NOTE: This process will be the same for actions that must be sent to Headquarters for a final decision.**

- (1) The office taking final action will do so on the form, or if needed, by separate letter. The office taking final action will retain a copy and return the original action to the originating office.
- (2) When the action taken requires notice to lender//borrower, the originating office must:

- (a) Give such advice by separate letter; and
- (b) File a copy of the letter in the correspondence section of the loan folder.

**NOTE:** Various Agency automated computer systems may be valuable in making efficient use of your time in preparing modification actions.

### **3. Transferring Loans Between Field Offices.**

From time to time, you may need to request another office to accept responsibility for further action on a loan (e.g. borrower moves outside your jurisdiction). Another Agency office should not refuse to accept a valid transfer of a loan, or refuse to perform a reasonable task for another field office. Any loss attributed under any transferred account will be attributed to the transferring office.

### **4. Liquidation Litigation Tracking System (LLTS).**

- a. The LLTS provides a variety of computerized information screens. It is used to monitor the status of liquidation and litigation cases. The LLTS provides a chronological record of liquidation and litigation actions taken. It also contains detailed collateral and guarantor information.
- b. When a problem loan is classified "in liquidation," a liquidation plan must be developed. Key elements of the plan must be entered into LLTS within 30 days following receipt of the loan. Periodic updates must be made as the loan progresses.

### **5. What are the Requirements of the Liquidation Plan?**

The Agency/**participating** lender must use the standardized "Lender Liquidation Plan Format" which Agency has developed.

### **6. How is a Liquidation Plan Approved?**

- a. Via Agency Modification Form.

### **7. Reserved for Loan Liquidation Tracking**

To track the progress of those loans in liquidation, it is recommended that a computerized tracking system be designed. This system tracks all actions and the timing of those actions in the computer with tickler notifications being designed that will notify the employee of any delays in certain planned steps in the liquidation process.

**8. Operation and Oversight of Loan Liquidation Tracking System, (LLTS)**

- a. The supervisory official must review the Agency and lender-serviced accounts using LLTS every calendar quarter on:
  - (1) All Collateral Purchased accounts and liquidation accounts that have been in liquidation 180 days or more;
  - (2) A random sample of 25 percent of all liquidation accounts less than 180 days;

The review may be conducted either electronically or face-to-face with the assigned liquidation official. If drift appears in the random review, a more detailed review is required.

- b. The supervisory official must post all comments to LLTS.

**9. What are the Supervisor's Objectives When Conducting the LLTS Portfolio Review? The supervisor objectives are to:**

- a. Track the activity and general progress of the loan account.
- b. Ensure that an effective liquidation plan is established and followed
- c. Ensure that the liquidation loan officer is taking every action necessary to protect the Agency.
- d. Avoid any unwarranted delays; and
- e. Provide guidance for future actions.

**10. What Should the Supervisor Determine at the LLTS Portfolio Review? The supervisor should determine that:**

- a. An acceptable liquidation plan has been established and entered into LLTS; or
- b. General comments from a Modification action are entered into LLTS;
- c. All required factual information has been obtained; and
- d. The supervisor has entered all directional comments into LLTS to document the review.

**141. What Loan Accounting Information should be available through computers?**

- a. Certified statements of account;
- b. Transcripts of account;
- c. Confirmation of loan payoff amounts; and
- d. Other types verification support.

**172. Safekeeping and Control of the Collateral Records?**

- a. A designated staff should be assigned the responsibility for the safekeeping and control of collateral records, (hereafter referred to as “Cashier.”
- b. All original notes, debentures, and other like loan documents will be given to and held by the cashier.
- c. The cashier will release documents requested in accordance with established cashier control procedures.

**CHAPTER 4**

**GENERAL GUIDELINES FOR  
LIQUIDATION ACTIVITIES**

**1. Definitions.**

**Appraisal.**

A "current appraisal" is one made within the past 120 days, or not more than 1 year if justified in a modification action.

**Approving official.**

Approving official refers to an Agency staff member who has met the requirements outlined in the delegations of authority, as published in a Public Notice. (This is often the line supervisor.)

**Claim amount.**

The net outstanding principal balance that would be remaining after the proposed compromise offer is applied to the current principal balance.

**Cram down.**

An approval of a bankruptcy, Court ordered reorganization, over the objection of a creditor, when the courts find that the plan is in the best interest of all other creditors and does not unfairly treat the objecting creditors.

**Colpur.**

Colpur is collateral purchased or property acquired by Agency or its **participating** lenders through loan liquidation.

**Cost of money to the Government.**

Cost of money to the Government is the interest yield equivalent to that being paid on government securities for similar maturities.

**Evidence of Debt.**

References to borrowers' loans and accounts include:

- (1) Notes;
- (2) Receivables;
- (3) Judgments; and
- (4) Other evidence of debt payable to the Agency.

**Drift.**

Drift is when there is serious delay in managing a loan (by Agency/lender) without good documented reason noted in the Loan Liquidation Tracking System, (LLTS).

**Field office.**

The term field office is used to indicate district offices, branch offices, commercial loan servicing centers, or any designated office outside of the main headquarters of the Agency.

**Liquidation officer.**

The generic term "liquidation officer" refers to the Agency staff member who performs the basic tasks discussed in this Manual.

**Obligor/debtor.**

The terms "obligor" or "debtor" include:

- (1) Borrower;
- (2) Co-borrower;
- (3) Guarantor(s);
- (4) Assumptor(s);
- (5) Judgment debtor(s); and
- (6) Any other party who has liability for a loan account.

**Present value.**

Present value is the current worth of future sums of money. This concept is used in many phases of liquidation decision-making.

**Recommending official.**

Recommending Official refers to an Agency staff member who has met the requirements outlined in the delegations of authority as published as in a Public Notice and in the Agency Regulations. (This is often referred to as the liquidation officer.)

## **Supervisory attorney.**

Supervisory attorney is the:

- (1) Designated counsel in charged of the legal aspects of the loan program.
- (2) Senior litigation counsel where separate legal staffs are designated for loan liquidation is made.

## **2. What are the Agency's Delegations of Authority?**

- a. The Delegations of authority are published as a Public Notice in the Agency Regulations.
- b. What are the limitations on authority to the field?

- (1) Exceptions to policy.

Instances where circumstances require or suggest an action, which is not in full compliance with the mandatory parts of the Manual, are "exceptions to policy." Final authority to approve exceptions lies with the Director or designee. The Agency's Modification Form, (Modification or Administrative Action), must include comments and recommendations of the field office.

- (2) Rule of Two.

- (a) All actions taken under delegated authority must reflect both the recommending official and the approving official. This process is called the "Rule of Two."
- (b) Accounts classified as in litigation, must include comments by both counsel and the approving official.
- (c) Final approval, on credit issues where the account is classified in litigation is the responsibility of the approving official (e.g. designated supervisor).
- (d) Removing the loan from "in litigation" is the responsibility of counsel.

- (3) What happens if your recommendation for action is not approved by the deciding official?

- (a) If the approving official does not approve your recommendation for action, he/she must add comments and recommendations to your modification action and refer the loan to the second level of authority. That next level of authority must indicate the final action taken and the basis for the decision.
- (b) If the position taken at the second level of authority is contrary to the differing recommendations of both you (the recommending official) and the first approving official, the matter will go forward to the next level of authority until it reaches the point of concurrence in a prior recommendation.

(4) Example:

- (a) You are a liquidation specialist and you recommend a workout in a Modification Action.
- (b) Your approving official is the Supervisor of liquidation. If the chief of liquidation approves your Modification Action, the action is final and the workout is approved.
- (c) If the Supervisor of liquidation declines the action, he or she must refer the action to the next higher of authority. If the next higher level of authority concurs with your recommendation or with the Supervisor of Liquidation, the action is final. For example, if the next higher authority concurs with your recommendation to approve the workout, the workout is approved. However, if the next higher authority concurs with the Supervisor of liquidation's decision to decline the workout, the workout is declined.
- (d) If the next higher authority does not uphold your recommendation or the supervisor of liquidation's decision and recommends yet another action, the action must then be referred to the next level of authority for final action.

**NOTE: Regardless of title, all officials must have appropriate delegation of authority from the Director.**

(5) What can't be approved under the rule of two?

According to the delegations of authority published in the Agency Regulations, no Agency employee has the authority to:

- (a) Take action on any loan, which is in "litigation" status without legal review and concurrence;
- (b) Deny liability of the Agency under the terms of a participation or guaranty agreement; or
- (c) Authorize suit for recovery from a **participating** lender under any alleged violation of a participation or guaranty agreement.

### **3. What Do You Do When You Receive a Written Proposal by an Obligor or Debtor?**

You must formally act on all written requests in compliance with the rule of two.

- a. What do you do if you receive an oral proposal?
  - (1) If the request is grossly lacking in merit or supporting documentation, then you may deny the request without a recommendation; or
  - (2) If the request has merit, you must request a written proposal with supporting documentation.
- b. What do you do if the obligor, debtor, or participating lender requests a reconsideration or an appeal?
  - (1) Handle it in the same manner as the original written proposal; then
  - (2) You must submit the request to the next level of authority.

### **4. What are the Field Offices' Performance Goals for Loans in Liquidation, Litigation, and Colpur Status?**

Goals should be set for the timely completion of liquidation cases. Suggested goals are as follows:

- a. Complete loans in liquidation in 12 months, unless you cannot accomplish this for good cause;
- b. Complete loans in litigation in 18 months, unless you cannot accomplish this for good cause, such as delay caused by legal such as awaiting a court's determination; and
- c. Dispose acquired assets (Colpur) within 12 months of acquisition, unless you cannot accomplish this for good cause, such as the necessity for remediation efforts to clean up hazardous waste.

## **5. Management Reviews.**

- a. The Director of the Agency will designate a supervisor to perform a Management Review every 60 days to review office caseloads of more than 180 days in liquidation status.
  - (1) The purpose is to:
    - (a) Ensure compliance with goals;
    - (b) Set new priorities; and
    - (c) Allocate resources and review related issues.
  - (2) The Director's designee must take the lead in promoting a teamwork approach to recoveries. Since liquidation and legal staff have separate areas of responsibility and authority, it is vital that a cooperative attitude exist.
- b. The Director's designee must ensure that the required meetings take place and discuss any recommendations with affected personnel.
  - (1) The purpose of the periodic review is:
    - (a) To provide for the effective management of resources; and
    - (b) To emphasize the importance of recovery processes.
  - (2) The reviews are not meant to substitute for the existing in-depth portfolio reviews by liquidation supervisors.
- c. For lender oversight and managerial reviews, see Chapter 8, "Lender-Serviced Liquidations."

## **6. Placing a Loan "In Liquidation" or "In Litigation" Status.**

You must prepare a Modification action. At a minimum, your report must provide full justification for the action.

- a. When must a loan be placed "in liquidation" status?

A loan must be placed "in liquidation" when:

- (1) Foreclosure action by a prior lien holder or a lawsuit has been instituted against the borrower or obligor with respect to any substantial collateral securing the loan or guaranty and the Agency's interest may be adversely affected.

- (2) The borrower has filed a voluntary petition or any involuntary petition has been filed against the borrower under the bankruptcy code and there is evidence that borrower has assets pledged as collateral, which this Agency must protect, and the loan is delinquent;
- (3) A receiver has been appointed, an assignment for the benefit of creditors has been made, or other legal actions have been taken for the purpose of liquidating the collateral or obligor's assets; or
- (4) All or a valuable part of the collateral has been abandoned by the obligor.

b. When should a loan be placed "in liquidation" status?

A loan should be placed in liquidation when:

- (1) All reasonable alternatives to collect the debt have been exhausted;
- (2) The borrower cannot, or will not, repay the debt on reasonable terms;
- (3) The collateral is clearly in serious danger of dissipating; or
- (4) Any other circumstances, which may substantially and adversely affect the Agency's position (lawsuit by a junior lien holder, etc.).

c. When must a loan be placed "in litigation" status?

An account must be referred to the field office counsel and classified as "in litigation" when:

- (1) There are insolvency proceedings, such as bankruptcy, receivership, and assignment for the benefit of creditors involving the obligor and there is evidence that collateral of significant value exists and loan is delinquent;
- (2) A lawsuit has been instituted against a borrower, which may have a substantially adverse effect on the Agency's position;
- (3) The Agency has been named a party defendant in a suit involving a borrower which may substantially harm the Agency's position; or
- (4) The Agency must pursue judgment or otherwise enforce its liens through litigation.

d. When should you place a loan "in litigation" status?

An account should be referred to the field office counsel when:

- (1) There are insolvency proceedings, such as bankruptcy, receivership, or assignment for the benefit of creditors involving the borrower. Discuss with counsel, as there may be assets of limited value or borrower may be current with loan payments; or
- (2) There is a need for legal action to effect further recovery or to protect the position of Agency.

e. Can you recommend placing a loan "in litigation" status without placing the loan "in liquidation" status?

A loan can be placed in litigation without being in liquidation. A loan is to be placed "in litigation" by use of a Modification Action.

**NOTE: The recommending official may recommend classifying a loan "in liquidation" and "in litigation" on the same Modification Action.**

f. When and how to remove a loan from "in litigation" status?

When the litigation matter is complete or a determination is made that further legal effort would not be warranted or justified, counsel will prepare and approve a Modification Action authorizing removal of the loan from an "in litigation" status and transferring it to liquidation or regular servicing for appropriate action.

g. When and how to remove a loan from "in liquidation" status?

An account can be returned to servicing by use of a Modification action when the situation that classified a loan as "in liquidation" has been resolved or has been restructured/re-amortized by:

- (1) A workout plan;
- (2) A term compromise agreement;
- (3) A judgment has been obtained; and
- (4) At least three monthly payments have been made, as agreed.

## **7. Placing/Removing a Loan In or Out of Liquidation/Litigation Status.**

- a. When a liquidation case is identified as needing legal action, you must transfer it to litigation status with the concurrence of counsel.
- b. Counsel will proceed with appropriate action, subject to approval by liquidation personnel, in regard to credit matters.

- c. After transfer to litigation, the loan becomes the responsibility of the legal division. The account will be monitored according to the newly established 18-month litigation time frame.
- d. Under the "Rule of Two" for litigation cases:
  - (1) For purely credit matters (such as settlements and releases of claims for consideration):
    - (a) The recommending official for these actions will be a liquidation official; and
    - (b) The approving official will be an official outside of the legal division (e.g. the liquidation supervisor).

**NOTE: Comments of counsel are required.**

- (2) For foreclosure actions, a loan officer/liquidation staff must:
  - (a) Arrange and conduct the sale in accordance with all legal requirements prescribed by Agency counsel;
  - (b) Provide all necessary assistance including arranging for and paying for appraisals, title reports, environmental reports, and auctioneers; and
  - (c) Be responsible for preparing protective bids, providing for the care and preservation of collateral, and attending sales as needed.
- (3) When litigation is completed or a determination is reached that further legal effort would be unproductive:
  - (a) Counsel will prepare a Modification Action authorizing removal of the loan from litigation status and transfer it back to liquidation for appropriate action; and
  - (b) If a workout or restructuring plan is approved while a loan is in liquidation status, the account will be removed from liquidation once three regular payments have been received in accordance with the terms of the plan even though a debtor/borrower might remain under the technical jurisdiction of a Bankruptcy Court.

## **8. Risk Management Database and Loan Underwriting Characteristics.**

- a. A Risk Management Database should be designed and established by the Agency to capture information on loans going into default. This would apply to all loans transferred into liquidation status no matter when they were approved. This involves having available, at loan origination, certain

underwriting characteristics for each loan the Agency makes or guarantees, plus additional data on loans that go into default. The specified data must be available at the time of loan approval and must be entered into an Agency's database when a loan is placed in liquidation.

- b. The Agency and its participating lenders, guarantors and re-guarantors must obtain loan origination data on the specified underwriting characteristics for each business loan the Agency makes or guarantees. This loan origination data will be supplemented by additional information on collateral for loans that go into default, and Agency staff must enter all required data into Agency's when a loan is placed in liquidation.
- c. Servicing/liquidation supervisors must verify the entry of this data and its accuracy as part of their regular supervisory reviews. Also, the Director's designee must monitor compliance during their regular 60-day reviews.
- d. The risk management database should include:
  - (1) A credit history indicator at time of application;
  - (2) The current ratio and the debt to tangible net worth ratio at the time of loan approval;
  - (3) A collateral analysis at the time of loan approval showing loan to value ratios for both fair market and liquidation valuations; and
  - (4) The net realizable value of loan collateral at default.
- e. Processing personnel must ensure that all information needed to compute the ratios is collected on every business loan, and servicing/liquidation personnel must input this data for loans that go into liquidation.
- f. For valid comparisons, ratios must be computed using the same method for each loan.
  - (1) The Agency should distribute to each participant written instructions on what elements and how those elements are calculated so that a uniform approach is used for information going into the Risk Management Database.
  - (2) Lenders must be aware that the information required to calculate the specified ratios must be in the loan file for each Agency guaranteed loan they originate.
  - (3) For lender serviced loans that go into liquidation, the lender should calculate all ratios as of the time of application and provide these ratios to Agency along with the specified information on loan collateral as an attachment to the liquidation plan.

- (4) The liquidation plan must be submitted by the lender to the Agency when required according to the type of lender and loan program involved, and must be entered by Agency staff into the Agency's database when received from the lender.

## **9. Which Modification Actions Must Agency Counsel Review?**

- a. Legal counsel must review all Modification actions involving the following activities (exception are noted in the corresponding categories):
  - (1) Exceptions to policy;
  - (2) Conflict of interest/preference;
  - (3) Acquisition of environmentally impaired property;
  - (4) Transfer of a loan to another lender;
  - (5) Subordinations (review includes the Modification action and other documents deemed necessary);
  - (6) Assumptions (review includes the Modification action and other documents deemed necessary);
  - (7) Release or substitution of collateral;
  - (8) Release or substitution of obligors;
  - (9) Workouts;
  - (10) Purchase under the Agency guaranty, including "repairs" and denials of liability;
  - (11) Deeds in lieu of foreclosure;
  - (12) Review of liquidation plans (for issues regarding legal compliance, e.g., legal expenses);
  - (13) Payment of attorneys' fees;
  - (14) Transfers of a loan into litigation;
  - (15) Transfers of a loan out of litigation;
  - (16) All Modification actions on a loan in litigation status;
  - (17) Purchase and/or payment of prior liens;
  - (18) Payment of real estate taxes;
  - (19) Compromise actions;
  - (20) All charge-offs;
  - (21) Any other document or Modification actions with issues regarding legal compliance; and
  - (22) Substantive revisions to the loan authorization.
- b. Counsel must refer all purely credit issues or administrative aspects to the Liquidation/Servicing Division.
- c. For lender-serviced loans, the lender is responsible for the preparation and legal review of all documentation.
- d. For loans, the lender is responsible for preparing all documents. The Agency counsel must review all prepared documentation.

## **10. What Other Modification Actions Does Agency Counsel Typically Review?**

Besides the Modification actions listed above which counsel must review in each instance, the following are examples of other Modification actions which counsel should review:

- a. Transfers into liquidation status;
- b. Protective bids at foreclosure sales;
- c. Assignment for the benefit of creditors;
- d. Alterations in the terms of any loan instrument;
- e. Disposal of COLPUR; (Collateral Purchased)
- f. Transfers to servicing from liquidation; and
- g. Abandonment of collateral.

## **11. Who has Authority to Liquidate Agency Loans?**

The following people have authority to liquidate Agency loans:

- a. Delegated Agency employees per existing delegation of authority as published in the Agency Regulations; and
- b. Participating lenders with an executed Agency Guaranty or Re-Guaranty Agreement.

## **12. How Do You Handle Conflicts of Interest?**

You must become fully familiar with Agency Rules and Regulations.

- a. Conflicts of interest can arise between one's official and personal duties. Some possible conflicts of official duties involve:
  - (1) Agency employees and their close relatives;
  - (2) Participating lenders' employees and their close relatives; and
  - (3) Certified development companies' employees and their close relatives.
- b. Special care should be taken in situations involving:
  - (1) An associate of the participant (see chapter 2, "Regulations and Other Authorities," for a definition);
  - (2) Close relatives of an employee (see chapter 2, "Regulations and Other Authorities," for a definition);
  - (3) Loans to Agency employees and their close relatives;
  - (4) Loans to participant's associates;
  - (5) Employee/associate bidding on collateral being liquidated; and

(6) Purchases of collateral or "Colpur" by close relatives of the participating lender's associates.

c. Loans to Agency employees and their close relatives.

If an Agency employee or a close relative of an Agency employee is an obligor on a loan, all significant actions affecting their liability must be referred to the Agency Director.

(1) Significant actions affecting their liability include:

- (a) Charge-offs;
- (b) Compromises;
- (c) Releases of an obligor;
- (d) Substantial workout of payments; and
- (e) Substantial release of collateral.

d. Loans to participant associates.

If an associate of a participant is an obligor on a loan, you must refer all significant actions affecting their liability to the Agency Director or designee for final action.

e. Can an employee/associate bid or purchase at a sale?

(1) No. An Agency employee, close relative, or members of the household must not bid or purchase for their own interest, either directly or through an agent at any Agency-related sale of collateral or "Colpur."

(2) Associates of the participating lender, close relative, or members of the household of the participant's associates must not bid or purchase on their own accord or through agents at any Agency-related sale of collateral or "Colpur."

#### **14. What is Agency's Policy on the Sale of a Loan?**

A cash sale for not less than the total amount due and transfer of the note and related loan documents, without recourse, may be approved with the written consent of the participant, where appropriate. As a matter of policy, a reasonable effort should be made to notify the borrower of the sale of a loan.

## **15. What is Agency's Policy on Certain Litigation Matters?**

When it appears that legal action by the Agency is required to effect further recovery or to protect the position of Agency, the matter must be referred to field office counsel.

It is not contemplated that all matters requiring counsel's comments, opinions, or actions will be classified as "in litigation."

Litigation instituted against Agency or the Director. An original process or notice of litigation served upon or received by an Agency employee must be brought to the attention of counsel immediately.

**CHAPTER 5**  
**PROBLEM LOANS AND WORKOUT SITUATIONS**

**1. What is Agency's Policy Regarding Workouts of Loans Classified "In Liquidation?"**

- a. Agency's mandate is to foster and assist small business.
- b. You should work with the borrower to structure a workout whenever feasible.
- c. Be creative, since the alternative of liquidating the collateral usually results in reduced net recovery for Agency.

**2. How Do You Determine if a Workout Should Be Considered?**

Analyze the loan based on the following four questions:

- a. Is the borrower cooperative and acting in good faith?
- b. Will restructuring the repayment plan help the borrower pay the debt?
- c. Can the borrower's cash flow support the workout plan? and
- d. Is a workout in the best interest of both the borrower and the Agency?

**3. Is it Necessary to View the Collateral Before Considering a Workout on a Problem Loan?**

Not necessarily. An up-to-date review of the existing collateral versus additional unencumbered assets must be completed, but you are not required to personally view the collateral.

You should personally view the assets if you feel it will be beneficial. If additional collateral is to be taken as consideration for a workout, you must be aware that the Agency's lien could be invalidated if the borrower files bankruptcy within the preference period. (Consult with counsel for further clarification.)

**4. What Types of Relief are Available to the Borrower?**

- a. Reinstatement of maturity;
- b. Deferment of payment;
- c. Postponement of any liquidation action;
- d. Extension of maturity; or
- e. Re-amortization or rescheduled accounts.

**5. What Type of Legal Review and Formal Documentation is required?**

- a. For Agency-serviced loans:

(1) Counsel must review the loan documents to ensure that all existing liens remain intact and any newly pledged collateral is properly secured. Documents to review include:

- (a) Security agreements;
- (b) UCC lien filings;
- (c) Mortgages; and
- (d) Any other existing collateral documents.

(2) Counsel must prepare and/or review documentation necessary to protect the Agency's interests. Typical documentation may include:

- (a) A new note;
- (b) A renewal note;
- (c) A modification to the note; or
- (d) An amendment to the original note.

- b. For lender-serviced loans, the lender is responsible for the preparation and review of these documents.
- c. In some instances, it may be necessary to obtain consent of the guarantor(s). Counsel must determine if notice or consent is required and must determine the consequences, if any, of noncompliance by Agency.
- d. For any additional items that counsel must review, see paragraph 9, "Which Modification Actions Must Agency Counsel Review?" in Chapter 4, "General Guidelines for Liquidation Activities."

## **6. What Interest Rate Adjustments May Be Made in a Workout Situation?**

- a. The rate is negotiable with the lender, but may not exceed the maximum rate allowed by Agency under the particular loan program.

## **7. What Determines the "Cost of Money to the Government?"**

Usually, the Government's cost of money is equal to the interest rate payable on Treasury issues with similar maturities.

## **8. Special Handling of Loans Where Borrower is willing but Unable to Pay (Hardship Case).**

Often, when the business fails, the individuals are in dire financial straits. There may be, from time to time, a case where they would pay but are unable to financially. In those instances, you should consider the following.

a. A hardship delay.

- (1) An Agency Modification must be prepared recommending postponement of collection action for up to 1 year because of the financial hardship circumstances;
- (2) Further delays may be considered based on the specific circumstances of the case; and
- (3) Further delays may only be considered if it appears that the obligor's financial condition may substantially improve in the near term.

b. Is the primary residence at risk?

If the primary residence is at risk, you may consider a creative repayment plan payable over time. The end product should reflect a reasonable return to Agency where the individual(s) retain their residence. You should be able to resolve most cases with proper handling.

c. Other specialized approaches.

- (1) Special circumstances require innovative approaches. You may have a local economy or marketplace with unique problems that impair your enforcement of collection.

For example:

- (a) A property may be located in a market that is saturated with similar hard to sell properties;
  - (b) You may have taken a deed in lieu of foreclosure as part of a settlement agreement in exchange for a life estate interest; or
  - (c) You may find some other locally unique problem.
- (2) As with the hardship situation, the best course of action may be to delay collection in hopes that the market, economy, or individual's situation improves. A recommendation must be made on an Agency Modification to the approving official.

- (a) You should consider recommending (by Modification action) to:

- (i) Reduce future installments to \$1.00 for a period of no more than 1 year from the date of the next installment due date to provide relief to the borrower;

**NOTE: The \$1.00 installment is established so that the borrower is reminded regularly of their debt to the Agency while not placing any additional burden at this time on the hardship.**

(ii) Reestablish the original payment amount to commence at the end of this relief period (to maintain proper follow up of the account); and

(iii) Reclassify the loan to "Servicing" status.

(b) This will ensure that:

(i) An annual review of the obligor's financial condition is completed to determine if subsequent annual suspensions (and reviews) of the payment installment are appropriate;

(ii) The account will not be accidentally referred to a collection Agency; and

(iii) That timely follow up will take place.

## **CHAPTER 6**

### **AGENCY-SERVICED LIQUIDATIONS**

This chapter deals with possession, control and protection of collateral when it is determined that a workout is not possible and the loan is Agency serviced. It is important that you document all your findings and actions in the designated computer tracking system or if one has not been developed, a paper documentation must be done.

#### **1. What is Agency's Policy for Agency-Serviced Liquidations?**

- a. You must direct your efforts toward maximizing recovery in a minimum amount of time.
- b. You must promptly proceed to locate, identify, assess, and protect all pledged real and personal property.

#### **2. What Initial Steps Should Be Taken if a Workout is Not Possible?**

- a. Review the loan documents;
- b. Identify all collateral and lien positions;
- c. Identify the status of taxes;
- d. Identify the status of hazard insurance;
- e. Make a field visit to view collateral;
- f. Assess the collateral value;
- g. Determine the need for care and preservation of the collateral; and
- h. Assess potential environmental issues.

#### **3. What Loan Documents Must be Reviewed?**

You must begin with an in-depth review of all available loan documents. Review both the loan file and the collateral file (e.g., notes, deeds of trust, Recordings, etc.). This will allow you to be fully familiar with the business assets, obligors, and guarantors, along with any peculiar items and changes that have occurred since the loan was made. In addition, you must determine the exact status of real and personal property taxes, hazard insurance, and prior liens including open-end provisions, since any of these factors may have an adverse impact on the Agency's collateral position.

#### **4. How Do You Verify What Collateral Actually Remains or is Available?**

- a. The loan file is a valuable source of information relative to collateral issues. The loan authorization contains the original requirements and the Modification actions will reveal any adjustments made. It is very important to be thorough.

- b. Collect data through discussions with borrower and any other sources familiar with the borrower.
- c. You must search the public records for all liens of record, including judgments, special assessments and other liens.
- d. Obtain lien searches, real estate property reports, business information reports and any other investigative search that is available and warranted.
- e. Determine if any tax liens or other governmental liens have been filed.
- f. Visit the business premises.
- g. Obtain an appraisal of the assets.

(1) A formal appraisal is justified and valuable when determining how to dispose of the assets.

(2) If collateral is nominal, the loan officer's opinion of value should suffice. (See Chapter 16 on "Appraisals".)

**NOTE:** You must obtain an appraisal on any assets, regardless of value, that may be deeded to Agency in exchange for a credit to an obligor's debt (deed-in-lieu).

#### **5. Mandatory Field Visit Requirements.**

- a. Agency personnel must make site visits following the guidelines for lenders. (See paragraph 8, "What Steps Should Agency Take after Being Notified of an Adverse Event?" in the subparagraph b., "Site Visits - 'Lender - Serviced Loans'" in Chapter 8, "Lender-Serviced Liquidations")
- b. In addition, if a site visit was not made within the previous 120 days, one must be made prior to the sale or computation of a protective bid for substantial collateral (real or personal).
- c. Hiring a contract appraiser or evaluator is permitted if field office staff is inadequate. The cost must be charged to the loan as a recoverable expense.
- d. You must attend all sales of Agency related collateral, unless visit is waived by an Agency Modification Action for good cause.

## **6. What Should You be Looking for During the Visit?**

You should:

- a. View the business assets to verify what remains versus what was supposed to exist.
- b. Identify, if possible, additional assets to pursue.
- c. Determine whether the collateral requires special protection and the related costs of care and preservation of collateral (CPC); and
- d. Assess what sale technique would be most effective.

## **7. How Should the Field Visit and Inspection of Collateral be Documented?**

- a. A memorandum report must be prepared covering the inspection of collateral and detailing any major discrepancies with what should have existed based on review of the file.

This report should contain:

- (1) Determination of collateral value;
  - (2) Review of Agency's lien position on collateral;
  - (3) Specific identification and description of all worthwhile assets including serial numbers;
  - (4) Results of review of loan documents and borrower's records, including books of account and other financial documents;
  - (5) Considerations on the care and preservation of collateral (CPC); and
  - (6) Analysis of use of loan proceeds to compare with assets currently on site.
- b. If there is any evidence that pledged items worth more than \$5,000 are missing or have been sold, concealed or otherwise disposed of with intent to defraud the Agency, you should contact the proper authorities for a possible investigation.
  - c. Photographs and/or videotaping provide excellent supplements to the written report and should be used whenever possible.
  - d. A written evaluation of the collateral should be included in the field visit report, either a formal appraisal or loan officer's estimate as appropriate.
  - e. The report must be reviewed by the approving official and comments are to be entered (by the approving official) into the computer or a detail written record made and filed in the loan case file.

## **8. Is it Best to Sell the Assets at the Location or Remove Them to Storage?**

Once you have determined what collateral exists, viewed it and estimated the liquidation sale value, you should decide whether to conduct the sale of assets at the borrower's premises.

You should consider:

- a. The costs of care and preservation of collateral (e.g., moving and storage fees, sale commission, advertising, utilities, etc.).

- b. Landlord storage costs.

The landlord will usually allow a sale to take place on the premises for a reasonable storage fee or possibly no charge at all. Most of the time, the landlord is more interested in getting the space back to be able to obtain another lease.

- c. Landlord Waiver.

If you have a "Waiver of Landlord Lien," you have specific rights as to possession of the collateral. If you do NOT have the waiver, you should consult with counsel as to landlord rights in your specific state.

- d. Environmental considerations. See paragraph 15.b. of this chapter, "What is Agency's environmental evaluation policy?"
- e. Any other factors which may affect your sale (e.g., location, available parking, security, etc.).

## **9. Repossession of Collateral.**

- a. When is possession obtained?

- (1) The Agency must take control of the collateral in order to proceed to sale.

- (2) Remember that when you are taking collateral into the Agency's custody you are responsible for taking prudent care and protecting the assets.

- (3) This responsibility is not to be taken lightly as it could have an impact on personal guarantors and collection of any deficiency.

- (4) The liquidation officer should not take possession until he/she:

- (a) Has a clear plan of action;
- (b) Knows the property has worthwhile value;
- (c) Coordinates with counsel as to legal aspects; and
- (d) Determines what contractor assistance is advisable.

b. How do you obtain possession?

Possession may be taken:

- (1) Pursuant to the legal recordings of the collateral, through peaceful repossession;
- (2) With the assistance from the landlord;
- (3) Directly from the borrower in a cooperative effort; or
- (4) Through enforced debt collection.

If the debtor refuses entry and/or possession, counsel will take the necessary steps to permit entry for the purpose of determining the need for and particulars of enforced collection.

## **10. When Don't You Take Possession of Collateral?**

a. Do not take possession in the following cases.

- (1) From an "employee of the borrower," deal with the borrower/owner directly and obtain his/her cooperation whenever possible.
- (2) Of "income producing property" whose value is dependent on income generated or anything that is alive or growing until after arrangements have been made to contract with a competent professional to handle/manage the assets. A back up plan must also be in place.
- (3) Of property which **MAY** be contaminated by hazardous waste or materials. (See paragraph 15. b., "What is Agency's environmental evaluation policy?")
- (4) Of any individual's personal effects not specifically identified as Agency collateral.

b. If you encounter a belligerent borrower, back off. It is the Agency's policy to abandon or proceed judicially, depending on the value and circumstances, if any threat of violence is perceived. No amount of collateral is worth exposing an employee to danger.

**NOTE:** Cash should be taken with great caution. If cash is taken, an itemized inventory by denomination of all paper and coins must be made and witnessed by at least two other people. The cash taken must be converted to a cashiers, check or money order and applied to the borrowers account as soon as possible.

### **11. What is a Typical Sequence of Events When the Borrower and Landlord Cooperate and Peaceful Possession Will be Taken?**

- a. Check for hazardous materials or waste;
- b. Take the keys;
- c. Allow the borrower and employees to take personal belongings;
- d. Change the locks;
- e. Take physical inventory;
- f. Pick up accounts receivable;
- g. Arrange for utilities;
- h. Post the property as necessary;
- i. Notify police and key neighbors if deemed necessary;
- j. Check insurance coverage;
- k. Provide for any special maintenance required for equipment;
- l. Determine security needs; and
- m. Ensure that competent management is in place if needed.

### **12. Selling Collateral After Taking Possession.**

See Chapter 7, "Agency's Methods of Recovery from Collateral."

### **13. Release/Subordination of Agency Lien.**

Recommendations for release and/or subordination of Agency lien on loans "in liquidation" will only be considered if they clearly are in the Agency's best interest. Release/subordination should be used to effect maximum recovery. Each action will be considered based on its effect on the value of the collateral and the ability to obtain greater overall recovery on the loan.

- a. Request for release of lien by borrower.

Generally liquidation by the borrower in a piecemeal fashion is not in the Agency's best interest. The borrower finds buyers for attractive assets leaving the rest for public auction. In a few instances, however, it may be beneficial. The recommending official must ensure that any sales/releases are for good value and will not adversely affect any subsequent foreclosure sale. Use Agency Modification Action for approval.

b. Other Requests for release of lien.

- (1) Upon receipt of a request for release of property from an Agency lien, the recommending official should assess the facts, obtain participant approval, and ensure that Agency approval will not constitute waiver of lien.
- (2) You may recommend release of collateral subject to the following.
  - (a) Real and/or personal property may be released for a reasonable amount based on Agency's estimate of value. If the offer is for less than the estimated value, or the amount to be applied on the loan is less than the proceeds from sale, the basis for release must be clear and the loan file must be fully documented.
  - (b) Proceeds from release must be applied to collections from the liquidation process.
  - (c) The equity or value of any new property taken in substitution for a release must be comparable to what is released. The new asset must be pledged as collateral even though taken subject to a purchase money or prior lien.
  - (d) The Agency must not consent to a sale of property in which it holds a security interest or mortgage lien if such action may constitute a waiver of lien or security interest. Consult with counsel.

**NOTE:** When a personal residence is the only worthwhile asset and there are no other prospects for recovery, (e.g., income), you may reach an agreement on release of the house for consideration. Consult with counsel to ensure that the obligor/guarantor remains liable for the deficiency. You should strive to obtain a sum over and above the release amount and settle/compromise the entire Agency claim. This will complete the case and is generally the preferred course of action.

c. Subordination to another debt.

Subordination to another debt must be preceded by a careful analysis and full documentation. Few instances are appropriate, but some may be in the best interests of the Agency.

These may include:

- (1) Construction completion where the only way to complete the project and ensure recovery is through additional financing;
- (2) Short term working capital needs;
- (3) Hazardous waste workouts where subordination to a loan for cleanup would be preferable to abandonment;
- (4) Special purpose facilities; or
- (5) Other instances where the facts clearly show the subordination would be in Agency's best interest.

d. Process Agency Modification.

Process an Agency Modification, with comments of counsel, for approval of release or subordination requests. Once approved, ask counsel to prepare and/or review the appropriate documents.

**154. Environmental Considerations.**

The liquidation officer must be aware of the substantial liability issues concerning hazardous materials and contaminated property. The clean-up costs of a contaminated site can be very costly and the stigma could adversely effect the collateral value. Ownership and/or management of contaminated property can result in liability for clean-up, site restoration, and potential third party claims that arise from the contamination.

a. What are the effects on collateral?

When a site is designated as contaminated by Agency or State environmental agencies, a lien may be filed to cover the costs of cleanup and restoration. The property value will be reduced by the lien amount. The Agency's liability for clean-up costs may be affected by the degree of control that the Agency exercises over a borrower and its collateral if hazardous wastes exist. Coordination with and approval of counsel is important.

b. What is Agency's environmental evaluation policy?

- (1) You/lender must conduct a preliminary assessment of risk at the beginning of liquidation. You must complete the "Environmental Questionnaire" on all loans supported by real estate, generally excluding residential real estate, with worthwhile equity for Agency in the property. This questionnaire is located in the Processing Manual.
- (2) If there is any possibility that hazardous materials may exist, or there is a potential for contamination of property, a professional environmental audit, Phase I audit, must be obtained.

- (3) In no event will Agency take ownership or control (i.e., operational control effecting the environmental decisions of the company) of any property of a firm identified in a "frequently polluting industry" prior to conclusive completion of the necessary level of environmental assessment. (See Processing Manual). In this situation, you must conduct at least a Phase I audit. Every effort must be made to sell this type of collateral rather than taking ownership and control.

## **16. What is a "Preliminary Assessment of Risk?"**

It is the evaluation you perform if there is any evidence that there may be environmental concerns with a property.

- a. What is a Phase I Audit?

A Phase I audit will be performed by a reputable private firm and as a minimum should include the following;

- (1) Inspection of site and adjacent properties;
- (2) Review of historical site property records;
- (3) Review of regulatory agencies' records;
- (4) Personal interviews with individuals knowledgeable with the site operations; and
- (5) The report provided by the auditors will indicate if any areas of concern were detected, and will advise if a Phase II audit is required.

- b. What is a Phase II Audit?

- (1) This type of assessment is required if it is known that significant contamination exists, or a Phase I recommends it. The report is in much more detail as to specific problem areas already identified.

At a minimum the following items should be included in the Phase II Audit;

- (a) Taking physical samples for testing. (e.g., testing for presence of asbestos, PCB's or radon, soil and groundwater sampling and testing, leak analysis for underground storage tanks);
  - (b) Hydrological investigation of site vicinity; and
  - (c) Determination of the extent of contamination and costs of clean-up.
- (2) When contamination is identified how do you analyze the level of concern?

You should take into consideration your own knowledge and experience, any professional assessments received and their recommendations, and projected costs of clean-up and restoration. This will allow you to make a prudent judgment on how to proceed. As it may pertain, see paragraphs 22 and 23, in this chapter, "When may Collateral be Abandoned?" and "If Collateral is Abandoned..."

**c. What are the limitations on the requirements for a Phase I or II Audit?**

- (1) The approving official may waive the requirements for a Phase I or II audit on a case-by-case basis.
- (2) Some cases where waiving of an audit may be appropriate are:
  - (a) The Agency has no knowledge that environmental risks exist and the property is not on the list of frequently polluting industries;
  - (b) Phase I audit has recently been conducted by Agency; or
  - (c) Equity in the property is so limited that the Agency is not planning to take possession in any event.

**17. What are the Agency Guidelines for Qualifying Environmental Auditors?**

Environmental audits must be performed by a firm that is impartial, has no interest in the property or transaction and has demonstrated expertise in its field. Care must be taken to ensure that the firm hired has no relationship with the property sellers or their representatives. In order to establish their level of expertise and the absence of any conflict of interest, the firm must satisfy Agency as to all the following topics:

- a. How long the contractor has been performing environmental assessments of real property;
- b. Details concerning certification or approval of the contractor pursuant to an official Agency, State or local program or policy to conduct environmental assessments;
- c. Identity, training, and relevant experience of all employees who will work on the project;
- d. Details concerning any membership of the contractor in any organization whose purpose relates to the performance of environmental assessments;
- e. If the assessment will be performed in accordance with generally recognized standards, provide a description of the standards;

- f. The nature of any previous environmental inspections the contractor has performed for the seller or purchaser of the subject property;
- g. A description of any affiliation the contractor now has, or has ever had, with the seller or purchaser of the subject property;
- h. A description of any liability insurance the contractor has to cover claims in the event it fails to discover adverse environmental conditions in its inspection; and is the contractor willing to indemnify Agency for any costs stemming from any negligent failure to detect contamination; and
- i. A certification by the signing individual, under penalty for false statements, that the above information is true and correct.

Questions concerning these matters should be formally asked of all auditors whose assessments will be relied upon to determine the degree of environmental risk associated with real estate collateral, and a copy of their response placed in the loan file.

#### **18. Accounts Receivable (A/R) Guidelines.**

- a. You must identify and pursue pledged A/R in a timely and aggressive manner.
- b. The A/R must be promptly evaluated and collected (or abandoned, if appropriate).
- c. You must directly, or through others:
  - (1) Perform a review of the receivables to the extent of available books and records;
  - (2) Determine potential collect ability;
  - (3) Determine costs of collection;
  - (4) Provide notice to the individual account debtors; and,
  - (5) Ensure proper controls are in place and records maintained.

#### **19. How do You Handle Collection of A/R?**

- a. Collection by Agency.
  - (1) You must take possession of the accounts receivable ledger and all supporting documents, (e.g., invoices, orders, receipts, etc.) These supporting documents will be necessary if litigation is required on any of the accounts.
  - (2) Notice to the borrower's debtors.

Notice must be given to all A/R debtors in writing. This will notify debtors that Agency is holder of the debt by way of its security interest in the borrower's accounts receivable. The letter should be prepared with input from counsel and mailed on Agency letterhead. See Appendix 21 for a sample A/R collection letter.

(3) Supplemental A/R file.

You should set up a supplemental A/R file to collect correspondence and the ledger information. There will probably be many follow up letters and copies are to be kept in the file. Place A/R file with the original loan file.

(4) The A/R record of debt and payments.

As part of the A/R collection file you should keep a listing of all accounts owing and payments made. Give a copy of the listing to the collateral cashier to ensure prompt identification, recording, and application of payments received.

(5) Attempt to get the borrower to help resolve disputed claims.

(6) Consider discounting the receivables that are not collected after several attempts.

(7) Abandon un-collectible accounts (Agency Modification required).

(8) You should notify the obligors of any remaining A/R once Agency ceases collection efforts. Advise them that they may collect as they wish and remit the proceeds less collection costs to Agency. This notice must be in writing and will help negate any defenses that obligors might raise in a suit for the deficiency balance.

(9) Close the A/R supplemental file and place it in the original docket file.

b. Collection by borrower.

Borrower collection can be risky for the obvious reason that funds could be diverted. On the other hand, the borrower will be held liable for any deficiency and has a vested interest in collecting the most available. The borrower also can best handle any disputed claims. Analyze the situation carefully, but in the final analysis the basic question that must be answered is "Do you trust the borrower?"

## **20. May Pledged Accounts Receivable be Sold?**

Yes, if the sale is in the best interest of the business. There are, however, concerns that the purchaser may use questionable or excessively aggressive collection methods, which could reflect adversely on Agency. Therefore, care must be taken to ensure that Agency does not put itself in such a position.

The sale of A/Rs may be held in one of the following manners:

- a. You may sell the A/Rs to the purchaser of a going concern who is a bona fide owner/operator. The A/R's will have their greatest value to the new business owner/operator. You must use an Agency Modification for approval.
- b. You may recommend approval of a sale of A/Rs by another party in interest, (e. g., borrower, court, participant). This does not expose the Agency to potential criticism for collection methods, which may be used by the participant. Use an Agency Modification for approval.
- c. All other sales of A/R must be sent through channels to Headquarters for approval.

## **21. Guidelines for Handling Shares of Voting Stock.**

- a. Shares of voting stock held as collateral and registered in the name of the Agency's nominee may be voted at stockholders' meetings to protect Agency's interest as a creditor. Care should be exercised, however, since management control may make Agency liable for hazardous waste cleanup. You must consult with counsel.
- b. The line supervisor may, after documented conversation with counsel:
  - (1) Determine how the shares are to be voted; and
  - (2) Effect the execution of proxies if necessary.
- c. Stock must not be voted in favor of the election of any employee of the Agency as a director of the issuing corporation without the approval of Agency Director or designee.
- d. An Agency Modification is required for this entire process, and it may be used as the vehicle to document the conversation with counsel.

## **22. When May Collateral be Abandoned?**

You should abandon collateral when the cost to dispose of the collateral exceeds potential recovery to Agency. This may be appropriate where:

- a. The collateral is of nominal value and costs of sale outweigh the anticipated selling price; or
- b. There is environmental contamination and the clean-up costs exceed the property value.

A cost/benefit analysis must be done on each individual case considered for abandonment. Any recommendation to abandon collateral must be presented on Agency Modification to the approving official who has final authority. When there are issues regarding legal compliance, you must obtain counsel's approval before recommending abandonment.

### **23. If Collateral is Abandoned are Liens or Mortgages Released?**

No. Liens will not be released except when consideration is received. Liens on abandoned personal property will remain in effect. However, they will be allowed to lapse at the next re-filing date unless the Agency Modification approving the abandonment specifically requires them to be re-filed.

Real estate mortgages should only be released with appropriate consideration, which must be approved via Agency Modification.

## CHAPTER 7

### THE AGENCY'S METHODS OF RECOVERY FROM COLLATERAL

#### 1. What is Agency's Policy for Recovery from Collateral?

- a. Take action promptly and in the manner most advantageous to the Agency when:
  - (1) The loan is in default; or
  - (2) There is no reasonable prospect of borrower repaying the loan;
- b. Maximize recovery in the sale of collateral in the minimum amount of time; and
- c. Pursue aggressive marketing of the collateral in order to avoid acquiring assets.

**NOTE: When feasible, you are strongly encouraged to upgrade any legally required advertising for a recorded lien sale, or for a judicial or summary foreclosure on real estate, to meet Agency's requirements for a "comprehensive public sale."**

#### 2. What Should You Take Into Consideration When Taking Action on a Liquidation Account?

- a. Statutory authority;
- b. Applicable State, Provincial or City law;
- c. Appropriate operating procedures; and
- d. Agency objectives.

#### 3. What are the Basic Methods in Achieving Recovery?

- a. Voluntary sale by borrower.

The owner of real estate or personal property may be able to sell its assets and apply the proceeds to the loan debt.

(1) The obligor must have:

- (a) Possession of collateral;
- (b) Clear title to the property free of all liens;

- (c) Agreement with existing lien holders that they are willing to cooperate in the sale and transfer of title; and
- (d) A current appraisal no older than 1 year, which can be obtained by the Agency.

You should be aware that experience shows only a small percentage of cases will work in this type of sale. A degree of direct supervision is required, which far exceeds that needed when assets are sold by a professional auctioneer.

In addition, the borrower may sell the "good" items leaving the Agency without sufficient collateral to hold a public auction.

- (2) The release of Agency's lien can be for cash, or a down payment of cash with a note receivable, which you must secure with the asset involved. Conduct a lien search prior to any arrangement.

b. Deed in lieu of foreclosure.

The Agency may accept a deed or bill of sale in lieu of taking foreclosure action. The liquidation officer must conduct a thorough evaluation, as this procedure carries certain risks.

You will need the following information to assist you in making a recommendation:

- (1) Clear title from the owner;
- (2) A written agreement between Agency and all obligors on an agreed amount of credit to be applied to the loan balance;
- (3) A recent appraisal or other reliable indication of value must be available to support the amount credited;
- (4) An assessment of possible pollution problems (See paragraph 15, "Environmental Considerations" in Chapter 6, "Agency-Serviced Liquidations");
- (5) A determination as to whether the sale complies with all laws pertaining to such sales.
- (6) A current lien search;
- (7) A review from counsel of whether State law will adversely affect Agency's right to collect the balance of the loan from any obligors; and

(8) The Modification action recommending this approach must contain documentation that a forced sale would not generate a larger return.

c. Foreclosure of deed of trust.

"Trust Deeds" or "Deeds of Trust" are used in some states to effect a lien on real estate. There is a trustee named, usually an attorney, who is willing to serve in that capacity. If the owner does not pay as agreed, the trustee, as requested by Agency or lender, will advertise, and publicly sell the property and apply the proceeds of the sale to the debt.

#### 4. Foreclosure of Mortgages.

The property owner conveys, depending on local law, either a lien on the realty or the title to the realty to Agency or the lender. The mortgage will be canceled or released when the debt is paid. The Agency/lender may sell the property at public sale and apply the proceeds to the debt if the borrower fails to pay. There are certain areas, which require judicial foreclosure of real property mortgages, while others permit summary, non-judicial foreclosure sales.

a. Judicial sale.

There are some areas, which do not permit non-judicial foreclosure sales of real property. The Agency must prove the debt and security held and allow all parties an opportunity to be heard in court before the foreclosure can be held.

When you cannot obtain peaceful possession of personal property in some jurisdictions, the court action for possession of the property may result in a judicial sale.

(1) Judicial foreclosures may be handled as follows:

- (a) The Agency may initiate action for a judicial foreclosure; or
- (b) The Agency, as a mortgage holder, may be named a party defendant in a foreclosure action by another lien-holder.

The DOJ, which represents Agency, will attempt to confine its litigation to the Agency courts. The lender may bring the foreclosure action in State or Agency court.

(2) The following are types of judicial sales.

(a) Receivership sale.

A receiver, who functions much like a bankruptcy trustee, will take possession of and protect the property. The court will

order the receiver to sell the property publicly or privately on terms directed by the Court.

(b) Bankruptcy sale.

A bankruptcy trustee, may sell both real and personal property, which will be free and clear of liens.

This sale can be:

- i. Negotiated;
- ii. Offered publicly by the trustee in the courtroom;
- iii. A sealed bid; or
- iv. An on-site public auction.

(c) Sale by debtor-in-possession.

The debtor-in-possession or the trustee in a debt arrangement under the Bankruptcy Code may sell collateral by negotiation or some form of public offering. The sale will be preceded by a hearing and court order.

Confirmation of the court is usually required and the liens will move from the property and attach to the proceeds of the sale.

b. Quasi-judicial sale.

This is a process allowing the debtor to:

- (1) Appear before an entry-level court official; and
- (2) Contest the creditor's right to proceed with the sale of their property.

Counsel will normally handle this procedure as it varies from State to State.

## **5. What Type of Sales are Acceptable and How are they Handled?**

The Agency's regulations provide for the sale of loan collateral in accordance with the pertinent security instruments generally by public sale through competitive bidding at an auction sale or a sealed bid sale.

- a. Voluntary sale by borrower. See earlier paragraph.
- b. Public auction.

- (1) Public auctions are conducted in accordance with applicable statutes and are considered to be legally correct.

- (2) The normal procedure involves publication of a notice of sale, usually in a local newspaper, followed by the public auction.
- (3) You should upgrade the legal required advertising to meet Agency's requirements for a comprehensive public sale whenever possible.

c. Comprehensive public sale.

- (1) Whenever possible, you are strongly encouraged to offer collateral at a comprehensive public sale.
- (2) To meet the requirements of a comprehensive public sale you should consider using additional promotion by:
  - (a) Display advertising;
  - (b) Brochures;
  - (c) Purchasing updated mailing lists;
  - (d) Advertising in trade journals;
  - (e) Including descriptive information and photographs in Agency's Internet listing of acquired assets; and
  - (f) Any other sales support activity that would be used in a well-conducted public sale.
- (3) Whenever possible, you should attempt to arrange with the trustee, sheriff, marshal, receiver, or bankruptcy trustee to allow a professional auctioneer, realtor or other sales professional to assist in promoting and conducting the foreclosure sale.

d. Private sales.

- (1) The UCC authorizes creditors to use either public or private sale for personal property collateral, as may be commercially reasonable, but does not set forth detailed procedures to use for a private sale.
- (2) You should use procedures, which provide protection against a sale being held invalid or a loss of liability of the obligors. Coordinate with the borrower whenever possible. The two important items to remember are "notice" and "commercially reasonableness."
- (3) The approving official has authority to approve a private sale of personal property collateral consistent with the UCC, or for real property collateral, if fully justified in the Modification action.
- (4) A current appraisal (within 120 days is preferred, but no more than 1 year as justified in the Modification) must be available with the value

documented on the Modification action recommending the private sale. This is especially important in the event that a deficiency balance will remain for which remaining obligors will be pursued.

- (5) The lender may be authorized to conduct private sales in any amount if such actions are:
  - (a) In accordance with applicable laws;
  - (b) The regular practice on their non-Agency loans; and
  - (c) The Agency has given prior written concurrence.
- (6) The approving official has delegated authority to approve the Modification action authorizing the above sales.

e. Sealed bid sales.

- (1) You may offer collateral using advertised sealed bids.
- (2) The Agency's requirement that you conduct a comprehensive public sale whenever possible mandates that you promote the sealed bid sale properly.
- (3) You may consider sealed bid sales where the number of potential bidders is perceived to be limited. Realize that this process requires you to handle all aspects of the sale, which entails:
  - (a) Developing prospects;
  - (b) Writing ads;
  - (c) Working with advertisers;
  - (d) Arranging for payment of expenses;
  - (e) Controlling the bids; and
  - (f) Answering inquiries.
- (4) You must first prepare the:
  - (a) Invitation to bid;
  - (b) Terms and conditions for submitting bids; and
  - (c) Bid form.

f. Sealed bidders auction.

You may conduct a sealed bidders auction using the following basic steps:

- (1) Solicit your sealed bid;
- (2) A prearranged formula for selecting the bidding finalists is done;
- (3) The sealed bid deposits of the finalist are retained; and

(4) An open public auction is held among the high bidders.

Should this method fail, you are then free to negotiate with interested parties.

## **6. Is "Term Financing" Available?**

Yes. But you must fully justify accepting term financing in a modification action since the Agency's general policy is to sell collateral for cash. Occasionally, it may be appropriate to offer terms for the sale of real estate. When offering terms for personal property, a compelling reason must be present.

## **7. How Would a Term Sale be Handled?**

- a. The advertising must reflect that:
  - (1) Financing is available to persons who qualify within a specific time period prior to the sale;
  - (2) Financial statements are required;
  - (3) Bank references are needed;
  - (4) The applicant must be of good character;
  - (5) The credit criteria for determining financial responsibility will be the same as if the Agency were processing a new business loan;
  - (6) The net present value of a term bid must exceed a cash bid by at least "10 percent"; and
  - (7) Certification must be made by individuals purchasing on terms that they are not more than 60 days delinquent on any required child support payments.
- b. The amount of the credit bid should be limited to not more than 80 percent of the successful bid. Purchaser should pay at least 20 percent in cash or certified funds at time of sale.
- c. The terms, rates, security positions, and other factors allowable for Colpur are also applicable for term financing in auction or sealed bid situations.

## **8. What Is a Protective Bid?**

- a. A protective bid is:
  - (1) The amount of Agency or lender's bid at a sale; and
  - (2) Established based on the current appraisal less related expenses associated with the foreclosure sale.
- b. It is Agency's policy to bid a fair value at foreclosure sales conducted by Agency.

**NOTE: The Agency personnel normally will NOT make known the amount of the Agency's protective bid, appraised value or liquidation value. However, you are free to discuss a range of acceptable value with the selling agent.**

## **9. Are Protective Bids Always Required?**

- a. No. There are times when the value is nominal and the related expenses such as moving, storing, reselling, etc., exceed the appraised value. A protective bid is not required, and the sale can be advertised as an absolute auction. However, an Agency Modification must be prepared justifying your action.
- b. The key to establishing a need for a protective bid rests on the quality of the appraisal. You will find the appraisal is one of the most important tools of liquidation.

## **10. How Do You Prepare a Protective Bid?**

Your baseline for determining the bid should normally be the liquidation value. The Agency will base protective bids on the "sound liquidating value" of the collateral. The protective bid must be approved by Modification action. The following items must be subtracted when establishing a protective bid:

- a. Anticipated costs of acquisition and resale;
- b. Special considerations described below:
  - (1) All prior liens, charges, and claims against the collateral, which will have to be paid by the successful bidder;
  - (2) Consideration to be paid to governmental agencies for release of a junior tax lien;
  - (3) Expenses of protection, maintenance, and preparation prior to resale;
  - (4) Depreciation, vandalism, or other foreseeable decline in value prior to resale; and
  - (5) Costs of resale, including advertising, commissions, and administrative expense.

## **11. What is a Bid in Excess of Sound Liquidating Value?**

- a. This is a bid, which is higher than the liquidating value. The bid should not be in excess of the related Agency indebtedness due on the account. There must be no legal avenues of recovery other than the collateral (i.e., obligors who are bankrupt, deceased, or otherwise not worth pursuing). The basic reason for establishing a bid in this manner would be for future negotiating purposes.

- b. When a liquidation officer establishes a bid, which is greater than the appraised value, justification must be documented on a Modification action.

## **12. Sales By Prior Lien holders - Are Protective Bids Needed?**

- a. You should normally prepare a protective bid:
  - (1) To keep the prior lien holder from bidding in at only a nominal figure; or
  - (2) For use in exercising a right of redemption where that is available to the Agency.
- b. If you choose not to enter a bid, it may:
  - (1) Permit a prior lien holder or third party to acquire the collateral at a fraction of its value; and
  - (2) Open the way to an unduly large deficiency judgment by the prior lien holder and reduce Agency's ability to recover from the guarantors.
- c. The Agency's right of redemption may, in some cases, be exercised only by paying the prior lien holder.
- d. You should attempt to use additional advertising and employ the services of a professional sales agent, after discussing with the prior lien holder. This would be done at our expense.

## **13. Are there Exceptions to Establishing a Protective Bid?**

Yes.

- a. Some jurisdictions require a lien holder to bid a minimum percentage of the market value of the collateral being sold. You should still compute a protective bid amount based on guidelines in this chapter.
- b. A bid would not be necessary when:
  - (1) The value of the collateral is nominal (e.g., less than \$5,000); or
  - (2) Related cost of the sale (e.g., repairs, environmental clean up, legal, taxes, etc.) exceeds the value of the collateral.

## **14. What Tolerance Range is Allowed in Protective Bids?**

A reasonable range is usually 10 percent. This should cover any unanticipated events, which may unfold at the sale.

## 15. When Do You Offer Collateral in Bulk or Piecemeal?

- a. There are times when it will be beneficial to offer collateral in bulk, in piecemeal or a combination of the two.
- b. You should be aware that some jurisdictions:
  - (1) Prohibit bulk sales (this is now rare);
  - (2) Require that sales of real estate and personal property be separate;
  - (3) Require a parcel or piecemeal offering; or
  - (4) Allow the property owner to direct or designate the order in which parcels or classes of property are to be sold until enough collateral is sold to repay the obligation.

## 16. Types of Bidding:

- a. Bulk.
  - (1) Bidding should ordinarily commence at a certain figure and proceed as necessary, up to the authorized protective bid.
  - (2) You need to also be aware of the legal implications of bulk sales:
    - (a) Acquiring property for less than its "true value;"
    - (b) Meeting the commercially reasonable requirements; or
    - (c) Bulk sales statutes.
- b. Bulk then piecemeal.
  - (1) Your bidding strategy can become more flexible by:
    - (a) Bidding just in bulk;
    - (b) Bidding just on certain parcels; or
    - (c) Bidding on both bulk and certain parcels.
  - (2) The bulk bidder should be given the opportunity to increase his bulk bid prior to starting the piecemeal bidding.
  - (3) The collateral will be sold by whichever manner of bidding brings the most recovery to Agency.
  - (4) Having the bulk bidding first is mandatory whenever there is any possibility of the collateral being sold bulk.
  - (5) You must be aware of the various possibilities, which may result from piecemeal or bulk bidding. You may find that advertising

bulk and then piecemeal can hurt your sale. Potential buyers who are interested in one or a few items may not be willing to spend their time when the possibility exists that everything can go to a bulk bidder.

c. Piecemeal.

Piecemeal bidding may be more beneficial for Agency. A typical example would be machine shop in rented premises. The Agency would not want to acquire all of the collateral and may choose to bid on only the major pieces.

You will find the decision to offer in bulk, in bulk and then piecemeal, or just piecemeal will depend on the type of collateral you are selling, the jurisdiction in which you are selling or just the local protocol.

**CHAPTER 8**  
**LENDER-SERVICED LIQUIDATIONS**

**1. What is Agency's Policy on Lender Liquidations?**

- a. It is Agency's policy that the lender must:
- (1) Service and liquidate a loan when they have asked Agency to honor its guaranty;
  - (2) Execute an Agency Form \_\_\_\_, "Participation Certificate," showing Agency's guaranty percentage of the loan;
  - (3) Submit a liquidation plan;
  - (4) Maximize recovery in the sale of collateral in the minimum amount of time; and
  - (5) Avoid acquiring assets whenever possible through the aggressive marketing of loan collateral.

**NOTE:** Whenever feasible, you are strongly encouraged to upgrade the legal required advertising for a UCC sale, or for a judicial or summary foreclosure on real estate, to meet Agency's requirements for a "comprehensive public sale."

- b. If Agency chooses to service or liquidate the loan:
- (1) The lender must assign the loan instruments to the Agency;
  - (2) You must complete an Agency Modification justifying this action; and
  - (3) The Agency must execute an Agency Form \_\_\_\_, "Certificate of Interest", showing lender's percentage of the loan.

**2. Lender Oversight and Managerial Reviews.**

- a. During the managerial reviews, lenders who are not adequately liquidating loans must be identified; and
- b. Lenders with chronic problems and lenders who do not take suggested corrective actions must be identified.

The Agency designee must:

- (1) Promptly contact the lenders;
- (2) Must meet with the appropriate officials of those institutions to discuss Agency liquidation procedures and expectations under the

Agency regulations, Agency policy and procedures, the Guaranty Agreement, any supplemental guaranty agreements and the authorization and loan agreement; and,

- (3) Annually, the Agency designee must provide a summary report to Headquarters on lender liquidation deficiencies within 60 days of the end of each fiscal year.

### **3. What Lender Programs do the Procedures in this Chapter Apply to?**

The liquidation procedures outlined in this chapter apply to all loan programs of the Agency.

### **4. What Should the Lender Do When it Appears a Borrower May Not Repay Its Loan?**

When the lender determines that there is no longer any reasonable possibility that a borrower will be able to repay the Agency guaranteed loan in an orderly manner, it should immediately contact the Agency to begin the process for enforcing recovery. No two liquidations are the same. Therefore, the following paragraphs should assist the lender in reaching a resolution.

### **5. When Must a Lender Notify the Agency Servicing Office of an Adverse Event?**

The participating lender must notify the Agency office servicing the loan when there is an adverse event. The notice should be by telephone, followed with a fax and/or written confirmation. If a servicing center is servicing the loan, it will take appropriate action and forward the loan file to a local field office, if appropriate.

### **6. What are Adverse Events?**

Adverse events include, but are not limited to:

- a. Foreclosure or other legal action.

The institution of a foreclosure action or other legal action against the borrower or other obligor, which adversely impacts Agency's interest in any worthwhile collateral securing a loan or guaranty.

- b. Bankruptcy.

The borrower, a significant obligor, or a person in possession of collateral has filed a voluntary petition or an involuntary petition has been filed against the borrower under any chapter of the Bankruptcy law.

- c. Receiver appointed or other legal action.

A receiver has been appointed, an assignment for the benefit of creditors has been made, or other legal action has been taken to liquidate collateral or to force a change in management or ownership.

- d. Abandonment.

Substantial collateral has been abandoned by the borrower.

- e. Dissipation of collateral.

Substantial collateral is being, or is in danger of being dissipated.

- f. Other.

Any other circumstance, which may substantially and adversely affect the joint position of the lender and Agency.

**7. How do You Handle an Adverse Event if the First Notice is a Liquidation Plan?**

If the first notice you receive from the lender is the lender's proposed liquidation plan, you or the line supervisor **must** contact the lender as soon as possible following receipt of the plan to ascertain the essential facts. During the conversation, you (or the line supervisor) must:

- a. Make certain that the lender will make the required field visit; or
- b. Advise the lender that no action, including making demand on the borrower, is to be taken without Agency's written approval.

**8. What Steps Should Agency Take After Being Notified of an Adverse Event?**

- a. Discuss requirement of field visit to the borrower.

Once you know about any event, which creates an "in liquidation" situation, the lender must visit the borrower's business premises. If the lender does not make the field visit within the time frame noted below, the lender must document the reason for not doing so, and you must establish with the lender a new deadline for the visit with an Agency Modification.

If it is a lender-serviced loan, the lender must perform the field visit and must document their findings in the borrower's loan file.

- b. Site Visits - "Lender Serviced Loans."
- (1) Lenders must make site visits and prepare a comprehensive and detailed report containing an inventory of assets and an assessment of their condition.
- (a) This action must be performed:
- i. Within 60 days of an un-remedied default in payment; or
  - ii. As soon as possible after default if there are assets of significant value that could be removed or depleted.
- (b) Whether a payment default exists, a site visit must be conducted within 15 days of an event which would cause a loan to be placed into liquidation status, including:
- i. Business shutdown or abandonment;
  - ii. Foreclosure or other adverse action affecting significant collateral;
  - iii. Bankruptcy or receivership; or
  - iv. Any reason to believe collateral is being lost or its value diminished.
- (2) The recommending official/approving official (e.g., loan officer/line supervisor) will review:
- (a) The site visit reports at the time of guaranty purchase; and
  - (b) The quality and appropriateness of real estate appraisals, personal property appraisals, and any environmental surveys.
- (3) Alternative to site visits by lender.
- (a) Lenders may engage third party inventory/appraisal contractors to perform the same duties provided the costs are reasonable in relation to the services provided;
  - (b) Minimum review standards are outlined in subparagraph 8.c., "Minimum collateral evaluation and appraisal standards," in Chapter 8, "Lender-Serviced Liquidation;"
  - (c) If the lender's information conforms in all respects to the Agency standards, Agency personnel will not need to make a site visit, nor will one be necessary prior to the computation of a protective bid for sale purposes.

**c. Minimum collateral evaluation and appraisal standards.**

- (1) A meaningful collateral inspection by lenders and/or Agency is both a comprehensive inventory and a valuation of the collateral. The following is necessary to provide a meaningful inspection of personal property collateral.
  - (a) Specific description and identification including serial numbers;
  - (b) Photographs or videotapes of larger or more significant pieces to establish condition, identity, and pictorial evidence;
  - (c) Establishment of individual liquidation values;
  - (d) Evaluation of inventory (especially of retail items).
- (2) This can either be done by videotaping or by actual count. The latter is only necessary if there is sufficient value in the inventory to warrant consideration of sale, and it is needed to verify or establish the value of the inventory on the basis of retail price or cost.
- (3) Retail inventory firms are generally economical and efficient and can provide an accurate accounting of goods.
- (4) A timely and comprehensive inspection may improve the overall recovery on loans where chattels have been overlooked or ignored.
- (5) A thorough review includes an analysis of the use of loan proceeds to compare with assets currently on site.
  - (a) Any differences should be addressed in discussions with the borrower;
  - (b) The focus is to evaluate early and effectively in a manner appropriate for the collateral involved. (For instance, if a borrower is a small rural store with little or no appreciable inventory, the cost of having a contractor evaluate and dispose of this asset might well prove counterproductive. On the other hand, if one is working with a retail store where inventory is the only significant source of recovery, it is very important to have a quick and reliable measure so liquidation personnel can have the data necessary to formulate liquidation and disposal methods and alternatives;)
  - (c) If at all possible, site visits should include a review of the borrower's books and records to determine whether any

funds were inappropriately taken out of the company or used for unauthorized purposes;

- (d) In reviews of defaulted loans, frequently it has been found that unauthorized use of funds has occurred but gone undetected, because books and records were not reviewed;
- (e) In addition, you must make a preliminary review of security instruments and document the amount and condition of the collateral before you prepare the Agency Modification establishing any protective bid in the event of foreclosure sale.

- d. Order lien searches as appropriate.

Lenders must first determine their exact lien position prior to taking any steps in the foreclosure process.

- e. Order appraisals as appropriate.

If it is determined that an appraisal is needed, the appraisal must be no older than 1 year to be classified as current. (See Chapter 16, "Appraisals.")

- f. Determine if any environmental issues exist.

The lender must be alert for possible environmental problems. (See paragraph 15, "Environmental Considerations," in Chapter 6, "Agency-Serviced Liquidations.")

- g. Consider potential for workout.

If the borrower is still operating, assess the potential for workout or restructure of the account. (See Chapter 5, "Problem Loans and Workout Situations.")

- h. Coordinate liquidation with the lender.

If the borrower has ceased operations or enforced collection is necessary, you should discuss plans for liquidation with the lender. You should reach a tentative agreement with the lender regarding the steps to be taken.

- i. Consider whether to transfer into litigation.

You must discuss with counsel any questions regarding the possibility of placing a loan into litigation.

**9. What Should the Lender and Agency do if Immediate On-Site Action is Necessary?**

- a. If the needed action is "routine" (e. g., changing locks on a vacated building, ordering a lien search, or obtaining an appraisal) then you may give approval to act.
- b. If the needed action is "non-routine," you should call and clear the matter with your line supervisor and counsel, when necessary. Once cleared, you may take (or give approval to take) the action. This information is to be documented either in the field visit report or the liquidation plan as well as documented on an Agency Modification.

**10. What are the Factors to Consider in Determining that a Lender Should Not Liquidate a Loan?**

- a. Competing liens or loans held by lender. If: the Agency and the participating lender have competing liens against any of the borrower's assets; or the lender has a non-Agency loan to the same borrower or its principals; then: the lender must not be allowed to handle the liquidation, unless:
  - (a) Any disputes are resolved prior to the commencement of such action; and
  - (b) There is a written agreement as to the distribution of funds expected to be realized.

In such cases, you must verify that the lender has properly distributed all funds received. (See Chapter 7, "Agency's Methods of Recovery from Collateral.")

- b. Lender's past performance.

If a lender's past efforts at liquidation were unsatisfactory (poor results, excessive costs, poor responsiveness), Agency should not allow the lender to liquidate until the problems are likely resolved.

**NOTE: You must complete an Agency Modification justifying this action.**

**11. What Happens When the Lender Liquidates a Loan?**

The following steps must be taken:

- a. Employment of a public auction firm.

If the lender hires an auctioneer for purposes of meeting the "commercially reasonable" test, the following information must be obtained.

- (1) The liquidation plan must state that Agency will be made whole if acts or omissions by the auctioneer cause Agency loss. There must be sufficient protection afforded the lender against misconduct or negligence of the auctioneer. This can be ensured through proper liability insurance and bonding that is either required and/or customary and reasonable. (See Chapter 15, "Contracting With Auction Firms.")
- (2) The lender may require the auction firm to provide a bond in the amount of the anticipated sale proceeds. This will generally only cover personal property as proceeds from sale of real estate are usually controlled by the trustee or other selling agent.
- (3) The lender may use the requirements of Agency in hiring an auction firm as outlined in Chapter 15, "Contracting with Auction Firms."

b. Submission of a liquidation plan to Agency by the lender.

- (1) A standardized liquidation plan format (see Appendix 15-i) has been developed to ensure that liquidation instruction and policies provided to lenders are consistent.
- (2) The lender must attach to the plan the "Underwriting Characteristics" of the loan. (Refer to Chapter 4, "General Guidelines for Liquidation Activities," paragraph 8, "Risk Management Data Base, Loan Underwriting Characteristics," for additional information.)
- (3) The standardized liquidation format has been developed for use by ALL lenders.
- (4) The lender must submit a liquidation plan to Agency for approval in advance of liquidating the collateral;
- (5) The lender must use the Agency's standardized lender liquidation plan format.
- (6) You may customize this plan to fit local law and procedures as long as the essential data is captured;
- (7) Major deviations must be approved in advance by Headquarters

c. Control of sale proceeds.

The auctioneer or other selling agent must be required to deposit the gross proceeds from the sale of the collateral or Colpur in an escrow account pending payment of authorized expenses/fees and maintain a detailed

accounting of the sale. The escrow account should be, if possible, an interest bearing account and identified as being for the benefit of the specific Agency related loan.

- d. Other.

Any other circumstance, which may substantially and adversely affect the joint position of the lender and Agency.

## **12. The Lender's Liquidation Plan is Reviewed and Approved as Follows.**

- a. The recommending official must promptly review the liquidation plan making appropriate recommendations to the approving official;
- b. Counsel must review for reasonableness of legal fees and the legal procedures to be undertaken.;
- c. The approving official must document the approval of the liquidation plan in LLTS within 30 business days following approval;
- d. The approving official may approve the plan in LLTS or by use of a Modification action.

## **13. What if the Lender Requests a Change to the Liquidation Plan?**

It is not unusual for liquidation plans to be changed as events unfold. The lender must obtain the Agency's approval before proceeding with major changes in the plan and expenses.

- a. Procedure.

When possible, the lender should submit a written proposal to the Agency. The Agency will then evaluate the proposal and approve any change with a Modification action.

- b. Urgency versus documentation.

Sometimes situations require swift or even immediate action to protect the interests of the Government. You and the lender should discuss the situation and possible steps to take. Once you reach a general agreement, you must brief the line supervisor (and counsel, if appropriate). You must obtain verbal approval from the approving official before you relay consent to the participant. Document agreed changes should be implemented as soon as practical with a Modification action.

**14. What if Agency Requests a Change to the Liquidation Plan?**

When the liquidation plan is submitted to Agency for approval, the lender must adhere to changes requested by Agency.

**15. What are the Agency Liquidation Officer's Responsibilities for Follow-Through?**

You must maintain a close working relationship with the lender throughout the course of the liquidation. A summary of all contacts, attempted contacts, and reviews must be entered into the LLTS chronological record.

a. Ongoing contact.

The lender must provide copies of significant documentation such as letters, sales notices, and reports as they occur. Such material should be reviewed by the liquidation officer (and counsel, if appropriate), handled as deemed necessary and placed in the loan file. In addition, the lender or its counsel must provide Agency counsel and you with copies of all pleadings.

b. 90 Day reviews.

You must make telephone, written, or face-to-face contact with the lender handling the liquidation of the account at least once every calendar quarter.

c. Supervisory review.

The supervisory official must review the lender-serviced accounts using LLTS every calendar quarter on:

- (1) All liquidation accounts that have been in liquidation 180 days or more;
- (2) Colpur accounts (see Chapter 11, "Collateral Purchased by Agency and Lender."); and
- (3) A random sample of 25 percent of all liquidation accounts under 180 days.

The review may be conducted either electronically or face-to-face with the assigned liquidation official. If drift appears in the random review, a more detailed review is required.

d. Field visits.

Field visits to the borrower's premises and to the lender's office should be made from time to time during the liquidation process.

- e. Attendance at sales.
  - (1) An Agency loan officer need not attend public sales conducted by the lender, particularly if:
    - (a) An Agency representative has viewed, within the past 120 days, the collateral to be offered for sale; or
    - (b) The Agency determines that such attendance would not be necessary to protect Agency's position.
  - (2) A representative of the lender must be in attendance at sales of worthwhile assets.
  - (3) In such cases, the lender must send the Agency a report of the events, which took place at the sale. Also, the lender must send the Agency a copy of the auctioneer's (or other selling agent's) accounting. **Repeated failure of the participant to furnish the required documentation may be justification to revoke the Agency Agreement of the participant.**
- f. Monitoring expenses and recoveries.

You must ensure that liquidating lenders keep expenses in line with the agreed upon liquidation plan. You must also ensure that they properly apply recoveries from the liquidation process, especially when there are competing liens or non-Agency loans involved.

#### **16. How Does the Agency and the Lender Handle Insurance?**

The Agency usually does not purchase or continue premiums on insurance during liquidation of the collateral. However, banks usually do purchase or maintain hazard insurance on the collateral as well as public liability coverage and may ask Agency to share in the premium expense. (See Chapter 22, "Insurance Property, Life and Public Liability.")

#### **17. May Lenders Who are Liquidating Agency Loans Use Private/Negotiated Sales?**

Yes. Lenders who are liquidating Agency loans may use private/negotiated sales if:

- a. It is practiced in similar sales of non-Agency assets; and
- b. The sales were disclosed in their liquidation plan or subsequent amendments to the plan.

The use of private/negotiated sales are subject to certain conditions, which are described in the following paragraphs.

**18. What are the Main Requirements for a Private/Negotiated Sale Prior to an Actual Foreclosure?**

The requirements for the lender to use private/negotiated sales are:

- a. The real estate or personal property must be free and clear of all liens or the lien holders must cooperate in the sale and transfer of title; preferably within 120 days and
- b. A current appraisal no older than 1 year must exist, (See Chapter 7, "Agency's Methods of Recovery from Collateral.")

**19. What are the Limitations on the Lender's Use of Private/Negotiated Sales?**

Lenders conducting the liquidation may conduct private/negotiated sales as follows.

- a. Private UCC sales.

The uniform commercial code (UCC) provides means for conducting private sales of collateral by secured parties in the event of default. The liquidating lender may conduct private UCC sales of collateral without limits as to size/amount, provided:

- (1) The approach used is similar to the means used by the lender in its liquidation of non-Agency loans;
- (2) The sale is deemed to be commercially reasonable under the circumstances;
- (3) The sale satisfies the provisions of the Bulk Sales Act; and
- (4) The expected net recovery at least equals the net amount estimated to be realized from a public sale.

- b. Sales of a "going" business in its entirety.

A favorable aspect of private/negotiated sales is that they can provide a means to sell the collateral as an operating entity. This may result in a larger recovery, depending on the circumstances. Accordingly, the approving official may authorize the liquidation lender to conduct private/negotiated "going" business sales of collateral in its entirety, without regard to loan size or estimated recovery amount, provided the prerequisites indicated in the prior subparagraph, "Private UCC Sales" are met.

- c. Sales to existing owners.

Private sales of collateral may not be made to existing owners under any circumstances.

- d. Costs of sale.

Reasonable costs of advertising, labor, and fees are permissible on all sales of collateral, even if those costs are not specifically described in the liquidation plan.

- e. Term sales.

- (1) Private sales on terms are subject to the same requirements as other terms sales of collateral or Colpur. Use Agency documents if possible, practical and agreeable to the lender.

- (2) Before purchase of an Agency guaranty, a lender-financed sale of assets (seller carry-back and/or take-back) on a loan it is liquidating does not require Agency's approval, and will reduce the loan balance by the amount of the sale.

- (3) After purchase, a lender may sell assets (through a note receivable) on a loan it is liquidating with Agency's prior written approval.

- (4) See paragraph 6, "Is 'Term Financing' Available?" in Chapter 7, "Methods of Recovery from Collateral" and in Chapter 11, "Collateral Purchased by AGENCY and Lender" starting with paragraph 19, "When Can You Sell on Terms?"

**20. Can a Lender Sell Colpur at a Private or Negotiated Sale?**

Yes. A lender may conduct private or negotiated sales on Colpur accounts regardless of the dollar amount involved. (See Chapter 11, "Collateral Purchased (Colpur) by Agency and Lender.")

**21. What are the Limitations and Restrictions on the Lender's Handling of Liquidations?**

The Agency's limitations and restrictions on the lenders handling of the liquidation of AGENCY guaranteed loans are essentially incorporated in three requirements as follows.

- a. The Agency must give its consent to the general liquidation plan at the outset (including anticipated litigation) and whenever significant modifications to the plan are needed;

- b. The lender must follow procedures which:
  - (1) Are consistent with generally accepted practices used by prudent lenders; and
  - (2) Are required by this Manual, Agency's rules and regulations, and Agency's loan documents.

In this regard, the Agency expects that the participant will use the same degree of prudence it uses when it liquidates its non-Agency loans.

- c. Prior written consent must be obtained from Agency in certain circumstances.

## **22. When Must the Lender Obtain the Agency's Prior Written Consent?**

The lender handling the liquidation of a loan must obtain Agency's prior written consent in the event of any of the following.

- a. Restrictions on sales to associates of participants.

Associates of participants must not bid or purchase directly or through agents on their own account at any Agency related sale. This includes sales of collateral or Colpur conducted by either the Agency or the lender. Written permission from the AGENCY is required to sell any Agency related collateral or Colpur to a close relative who is not a member of the household of participant's associates. (See Chapter 4, "General Guidelines for Liquidation Activities" for definitions and procedures.)

- b. Legal fees.

The Agency counsel must review proposed litigation and make a decision on the proper forum to bring an action.

Legal fees must not exceed more than 10 percent of the amount agreed to by AGENCY in the liquidation plan, as amended. If legal fees exceed the amount of recovery through liquidation on the loan, no payment of those fees may be made unless fully justified and approved by Agency Modification.

- c. Protective bids.

A protective bid is:

- (1) The amount of lender's bid at sale; or
- (2) Established based on the current appraisal and related expenses associated with the foreclosure sale.

The Agency must concur with the lender's recommendation for a protective bid and to subsequent changes of more than 10 percent if a protective bid is entered. For more information related to protective bids, see Chapter 7, "Agency's Methods of Recovery from Collateral."

d. Compromise of debt.

Lenders must not unilaterally compromise an Agency account.

e. Release of an obligor.

Lenders must not unilaterally release any obligor on an Agency loan. (See Chapter 10, "Special Programs" for any exceptions.)

f. Variances from lender's usual procedures.

When the proposed actions vary from either the lender's or the Agency's usual liquidation procedures, you must document the circumstances. A Modification action with counsel's comments is required.

g. Matters covered by the guaranty agreement.

The Agency, "Loan Guaranty Agreement," (with the participant) specifies certain matters, which require agreement between the Agency and the lender. The following actions must be approved by Agency if not contained in the lender's liquidation plan.

- (1) Accelerate the maturity of the note. (If the need for immediate action exists, an Agency Modification stamped letter from the participant is sufficient for this action);
- (2) Make or consent to any substantial alteration in the terms of the Note or related loan instruments;
- (3) Approve any release, substitution, or exchanges of collateral, except where the value released does not exceed 20 percent of the original loan amount;
- (4) Sell, assign, or transfer the note or related loan instruments;
- (5) Sue upon the note or related loan instruments;
- (6) Waive any claim against a borrower, guarantor, standby creditor, or other obligor (see Chapter 10, "Special Programs");
- (7) Purchase, pay installments on, or pay in full a prior lien. (See Chapter 9, "Purchasing Agency's Guaranty" in Loan Servicing Manual.)

**23. How Should a Disagreement with the Lender be Resolved?**

- a. An impasse will be handled as an exception to policy;
- b. The approving official and or the district director must make a personal effort to reach an agreement with the participant before the matter is forwarded to Headquarters

**24. How Must You Apply the Proceeds from Liquidation?**

When you are satisfied as to the amount of the expenses and the division of the recovery, the net proceeds (lender's out-of-pocket liquidation expenses can be paid first) from the liquidation process must be applied as follows.

- a. When the Agency guaranty has NOT been purchased, the participant will be allowed to recover up to 120 days of interest from liquidation proceeds, using the interest rate in effect at payment default. All other proceeds received from liquidation must be applied by the lender to the principal balance of the loan. The Agency will then pay only its portion of the principal balance outstanding with no accrued interest at the time of the guaranty purchase. (See Loan Servicing Manual, Chapter 9, "Purchasing Agency's Guaranty.")
- b. When the Agency guaranty HAS been purchased, the participant must apply the net proceeds first to principal, then to interest, unless directed otherwise by Agency. The lender must then remit Agency's share of the net proceeds to the appropriate field office, together with an itemized accounting of all income and expenses.

**25. What Must You do When the Above Information is Received?**

When you receive the itemized accounting of all income and expenses, you must:

- a. Review the material and determine whether everything conforms to the liquidation plan: and,
- b. Instruct the cashier to forward the funds and Agency to the appropriate fiscal office for application on the account.

**26. How Can Loans Be Canceled or Charged-Off?**

An account, which has been serviced/liquidated by the lender, can be canceled or charged off in several ways.

- a. Cancellation of the Agency guaranty.

The approving official may approve cancellation of the Agency guaranty in instances where Agency has not honored its guaranty and will not be requested to do so. You must send a copy of the Agency Modification approving cancellation to the fiscal office.

b. Charge off of the loan.

If the Agency has honored its guaranty and there is no expectation of further worthwhile recovery, you may charge off the loan with counsel's approval. You must review the liquidation actions by the lender to ensure that the liquidation plan was followed and that no observable harm to Agency resulted from the lender's actions. The Agency Modification recommending charge off must include a statement of this finding. (See Chapter 18, "Charge Off Procedures.")

**CHAPTER 9**  
**MISCELLANEOUS ISSUES REGARDING**  
**PARTICIPATION LOANS**

**1. How Do You Handle a Lender's Request to Change the Lender's Participation in a Loan?**

- a. Prior to purchase by AGENCY of its guaranteed share.

The Agency may authorize an increase in the lender's participation when requested by the lender before the Agency purchases the guaranteed share of the loan. This action requires a Modification action, with a copy to the fiscal office.

- b. After the guaranty has been purchased.

If the Agency authorizes a lender's request to increase its share after the Agency has purchased its guaranty, then:

- (1) A new Agency Form, "Participation Certificate," must be exchanged for the old one; and,
- (2) The lender must provide the funds necessary to repurchase its increased share.

Copies of both the Agency Modification and the lender's check must be sent to OFO.

- c. Decrease in lender's share (unguaranteed portion).

No authority has been delegated to field offices to decrease the participant's share except as indicated in paragraph 2, "Proposals to Purchase the Unguaranteed Portion (Lender's Share) are an Exception to Policy."

**2. How is the Agency Guaranty Terminated or Canceled?**

The Agency guaranty may terminate or be canceled by letter of request from the participant, nonpayment of guaranty fees, or at loan maturity.

- a. Letter of request from participant.

A participant may request in writing that the Agency's guaranty be canceled. You may cancel the participation agreement as of the day the

request was received. Use an Agency Modification to accomplish the cancellation. You must send a copy of the completed Agency Modification to the fiscal office.

- b. Nonpayment of guaranty fees.

The Agency Guaranty Agreement provides for automatic termination of the Agency guaranty if the required guaranty fee is not paid on a timely basis.

- c. Loan maturity.

- (1) The Agency's obligation to purchase expires automatically 120 days after the maturity date of all loans;
- (2) The approving official may approve a lender's request made before the maturity date to extend the purchase deadline;
- (3) A Modification action is required.

**3. What Must You Advise the Lender When the Agency Guaranty Has Been or Will Be Canceled?**

You must write to a participant to advise or acknowledge when a guaranty has been or will be canceled. You must advise the participant in the letter that:

- a. The Agency does not waive any preexisting causes of action against the participant or borrower; and
- b. The Agency does not waive any defenses against preexisting causes of action.

**4. Are Lender Reports and Fee Requirements Associated with Servicing Still Necessary During Liquidation?**

Various routine reports by lenders and some fee requirements may continue to be necessary during the liquidation of a loan, especially when purchase of the guaranty was not accomplished prior to liquidation. Most of these requirements are covered in the Servicing Manual.

**5. How do you handle the purchase of Agency's guaranteed share of a loan if the loan is now in liquidation?**

- a. In general.

A loan may be classified as "in liquidation" before the Agency has purchased its guaranteed share. If so, you should give immediate consideration to purchasing the guaranty using the help of the servicing

personnel, if available. You should be guided by the requirements in Chapter 9, "Purchasing Agency's Guaranty" in the Servicing Manual.

- b. Special considerations relating to Colpur.

The acquisition of Colpur, by any means, mandates a purchase of the Agency guaranty **unless** the servicing office documents by use of a Modification action that reasons may exist to deny liability. You should begin the guaranty purchase process as soon as it appears that collateral will be acquired.

**6. What possible misunderstanding of remaining liability exists if colpur is acquired before the purchase is completed?**

There are two common areas of misunderstanding that may develop when the lender acquires Colpur prior to Agency's purchase of its guaranty. They are as follows.

- a. The Agency's guaranty runs to the loan account only. Since the acquisition of collateral usually acts as a credit against the loan (just like a loan payment), the amount of Agency's obligation to the lender is reduced by the amount bid at the sale less expenses;
- b. Colpur is an owned asset of the lender(s) and accrues no interest.

**NOTE: Do not overlook these accounting issues when you discuss liquidation plans with participating lenders.**

**7. Is a Grace Period Allowed for Crediting a Borrower's Account When Collateral Purchased?**

Yes. In some situations, events may be moving faster than the ability of the lender to assemble and submit the necessary documentation to support the purchase request. In those instances, the Agency will allow a grace period of no more than 30 days before deductions will be made to the amount paid the lender.

You must describe the events causing the delay in purchase in both:

- a. The Agency Modification authorizing the purchase; and,
- b. The Agency, "Collateral Purchase Report," (see Appendix 3) setting up the Colpur account.

**8. When Should the Agency Consider Invoking its Unilateral Purchase Privilege?**

The field office should consider invoking the "Agency Purchase Privilege" contained in the Agency's Guaranty Agreement if:

- c. The lender will NOT voluntarily request purchase;
- d. The lender will NOT transfer servicing of the loan;
- e. The interests of Agency are being adversely affected by unsatisfactory administration by the lender; and
- f. Liquidation action appears necessary and a strong possibility of a conflict of interests exists (e. g., separate, direct lending by the participant to borrower, an affiliate, a guarantor, or other obligor).

## CHAPTER 10

### COLLATERAL PURCHASED (COLPUR) BY AGENCY AND LENDER

#### 1. What is Colpur?

Colpur is collateral purchased or acquired by Agency or its participating lender through Agency liquidation.

#### 2. What is Agency's Policy?

The Agency's policy is to dispose of collateral purchased in such a manner as to realize the maximum recovery in the minimum amount of time.

#### 3. What is the Agency's Policy on Obtaining and Retaining Colpur?

While the Agency will continue to emphasize avoiding the acquisition of assets, it recognizes that acquiring some Colpur may be necessary to protect Agency's position.

- a. You should take all possible steps to keep Colpur levels down without compromising the financial considerations used to govern its acquisition and sale.
- b. You should take all reasonable efforts to sell collateral at the earliest possible time to obtain a reasonable price and thus avoid the acquisition of Colpur.
- c. You should be aware of the importance of:
  - (1) Accurate appraisals;
  - (2) Market and environmental factors;
  - (3) The necessity of realistic bid computations; and
  - (4) The fact that real property should NOT be acquired or held for speculation.
- d. The Agency's goal is to sell Colpur within 12 months of acquisition.
- e. All Colpur should be disposed of within 12 months of acquisition if an advantageous recovery can be obtained. In cases where this is not possible, the Director or his/her designee must review and approve a disposition plan.

- f. Factors that might necessitate an extension of the time for disposal include:
  - (1) Legal problems precluding a sale or preventing a sale at a realistic price;
  - (2) Environmental concerns (property undergoing remediation);
  - (3) Seasonal factors (e.g., selling beach property in mid-winter); and
  - (4) Eviction procedures in progress.
- g. There are legitimate instances where a short delay will result in a significant increase in recovery. However, to merely "wait for the market to improve" is NOT a good reason to postpone a sale and may be unwarranted speculation.

**4. In Whose Name Should the Colpur Property Be Titled When Serviced by Agency?**

Title should be placed in the name of the Director of the Agency.

**5. In Whose Name Should the Colpur Property Be Titled When Serviced by the Lender?**

If Colpur can be disposed of in a short time period (normally 120 days), title should be placed in the name of the Agency. If the sale will take longer, the lender must consult with Agency to consider transfer of the property to Agency's name if significant tax savings could be realized. The value of the property and tax rates must be considered.

a. Date purchased.

You must use the date the Agency/lender is the successful bidder at the sale, or the date of the written conveyance agreement (if applicable).

b. Redemption period.

In certain areas a period in which a borrower may redeem ownership may apply.

c. Purchase price.

- (1) In the case of a public sale, the term "Purchase Price" will mean the Agency's or participant's bid price or amount of consideration set by the court having jurisdiction;
- (2) In the case of a voluntary conveyance, the purchase price must be the consideration set forth in the conveyance agreement.

- a. Liquidation values.

The report should contain an itemized list of the Colpur by class, type, and/or separate tracts or lots with the detailed liquidation values.

- b. Reporting sale of Colpur.

Records are to be kept on whether the transaction was a partial or final sale of the Colpur, and if it was for cash or terms.

**6. How is Colpur to be sold by Agency, the Participating Lender, or another Mortgagee, or Lender?**

- a. For Agency-serviced loans you are strongly encouraged to offer acquired assets (Colpur) for public sale through competitive bids at auctions or sealed bid sales. Lenders may use negotiated sales if consistent with their usual practice for similar non-Agency assets.

- b. Colpur acquired through foreclosure.

- (1) Properties obtained through either judicial or non-judicial (summary) foreclosure procedures consistent with State law may be disposed of by negotiated sale immediately after Agency acquires them.

- (2) The line supervisor is authorized to:

- (a) Approve an auction or other type of public sale;
- (b) Approve a negotiated sale;
- (c) Approve the listing with a qualified broker for the property to be sold in a commercially reasonable manner appropriate to the type of asset and consistent with prevailing local practices; and
- (d) Approve suitable advertising for a negotiated or other sale by Agency staff.

- (3) You must justify all negotiated sales or listing prices with a recent appraisal (preferably within 120 days, but no older than a year) of the property or other reliable indication of value (such as an opinion by a qualified broker in situations where prices can be readily ascertained because of similar property sales in an active market).

- (4) Professional appraisals continue to be preferred. However, experienced brokers may be able to provide equally reliable

information faster and at less cost. Residential values may be established through use of comparable sales information.

- (5) You should use net present value (NPV) calculations in setting or accepting any sales price, taking into account care and preservation expenses as well as other holding costs. The commercial reasonableness of any procedure should always be weighed.
  - (6) Whenever possible, in order to avoid the acquisition of an asset (Colpur), the minimum legal requirements for a foreclosure sale conducted by Agency or a participating lender should be supplemented by display or other advertising to obtain maximum exposure for the property to obtain the best price.
- c. Colpur acquired through a deed in lieu of foreclosure.
- (1) This type of Colpur must continue to be exposed to a comprehensive public sale as defined in Chapter 7, "Agency's Methods of Recovery from Collateral." However, if a property has a market value of less than \$25,000, the line supervisor may use acceptable methods of sale as outlined in the previous subparagraph 8.b., "Colpur Acquired Through Foreclosure."

## **9. What are the Responsibilities and Liabilities of Ownership?**

Maintain condition of property to:

- a. Prevent deterioration;
- b. Prevent vandalism;
- c. Avoid a potential "attractive nuisance";
- d. Prevent personal injury; and
- e. Clean up contamination.

## **10. What Special Attention is Given Colpur Accounts?**

All Colpur accounts over 180 days must be reviewed every 60 days by the approving official to ensure that a reasonable disposal plan is being pursued.

## **11. Is There a Dollar Limit for Expenses?**

If Agency's aggregate share of all advances and expenses on any one Colpur is more than the lesser of \$50,000 or 75 percent of the liquidation value of the property, they must be approved by the district director.

**NOTE:** This limitation does not apply to direct selling costs or the purchase of a prior lien.

**12. How Often Must You Obtain Updated Appraisals on Colpur?**

You must obtain an updated appraisal annually unless justified by a Modification action.

**NOTE:**An appraiser cannot appraise the same piece of Colpur more than two consecutive times, unless justified in a Modification action.

**13. Can You Ever Use an Appraisal Older than 1 Year?**

Only in rare circumstances should an appraisal older than 1 year be used and must be documented by a Modification action.

**14. When is Using an Appraisal Older than 1 Year an Exception to Policy?**

The use of an appraisal over 1 year old in the case of a private sale of collateral or Colpur is an exception to policy and requires Headquarters approval.

- a. You should perform a site visit at least annually; and,
- b. You should prepare a field visit report, which should be forwarded to the approving official and then be placed in the loan file.

**15. What are the Restrictions on a Negotiated Sale of Colpur Property?**

- a. The selling price must be supported by an appraisal not more than 1 year old; preferably, one performed within the past 120 days;
- b. The property must have been offered at least once at a comprehensive public sale unless it was acquired through a foreclosure sale consistent with state law or is valued at less than \$25,000.

**16. What Procedures Should be Followed with Real Estate Brokers When an Account is:**

**a. Agency-serviced?**

- (1) The property must have been subjected to a comprehensive public sale unless it was acquired through a foreclosure sale consistent with state law; or is valued at less than \$25,000;
- (2) The property may be listed on a nonexclusive or exclusive basis with a real estate broker as authorized by a Modification action.

**b. Lender-serviced?**

- (1) The property may be listed with a real estate broker on a nonexclusive or exclusive basis in accordance with the procedures it uses for non-Agency property; and

- (2) The asking price should be supported by a current appraisal or other reliable indication of value.

**17. What are the General Requirements When Using a Real Estate Broker?**

- a. A predetermined “asking price” will be established;
- b. The listing broker must be local to the property being sold, except where the property must be marketed more extensively, and have experience in the type of property being marketed;
- c. All agreements with brokers must be in writing and signed by both parties;
- d. If possible, Agency should reserve the right to sell to customers obtained through its own sources;
- e. The commission to be paid to the broker must be no greater than the rate customarily paid in the area;
- f. The listing broker must be properly licensed and should be a member of a multiple listing service; and
- g. A commission must not be paid unless:
  - (1) The broker negotiates a sale satisfactory to Agency;
  - (2) Title is actually conveyed; and
  - (3) Consideration is paid to Agency in accordance with the sales contract.
- h. No commission will be paid directly or indirectly to:
  - (1) Any employee of Agency;
  - (2) Any employee of the participating lender; and
  - (3) Their close relatives or associates.
- i. The Agency must pay only one commission;
- j. The listing should allow for termination by Agency at its option or should be for a specific limited time (typically 90 days); and
- k. Each Agency office must use a number of qualified brokers on a rotating basis.

**18. What Must a Purchase Offer Contain, and How Do You Process it?**

- a. All offers must:

- (1) Be in writing from offeror or authorized agent;
  - (2) Provide written proof of Agency; and
  - (3) Not be disclosed to other prospective purchasers or their agents.
- b. A good faith deposit of 5 percent must be submitted in the form of cash or certified funds.
  - c. Be approved by a Modification action, which must reflect:
    - (1) The results of all sales efforts;
    - (2) Current value of the property; and
    - (3) Identity of the purchaser.
  - d. A letter of acceptance must be sent to the potential purchaser.

**19. When Can You Sell on Terms?**

- a. Colpur should be sold for cash unless it is more advantageous to Agency to sell on terms.
- b. What terms are acceptable?
  - (1) Down payment of at least 20 percent (may be adjusted to be competitive with the local market);
  - (2) Balance payable in equal monthly payments;
  - (3) Monthly payment must exceed accruing interest;
  - (4) Interest rate should be based on prevailing rates in the area:
    - (a) A rate may be established below market rate (but not less than the cost of money to the Government except in unusual situations). See definition in Chapter 4, "General Guidelines for Liquidation Activities;"
    - (b) The interest rate must not exceed the state statutory rate of interest;
  - (5) Maturity should not exceed 15 years (balloon payment allowed at maturity); and
  - (6) The net present value of any term offer must be compared with any cash offers. The net present value of a term offer must exceed a cash offer by at least "10 percent." If it does not, take the cash offer.

**20. Is a First Lien Position Required on the Property Financed by Agency?**

Yes. The note must be secured by a first lien on the Colpur being financed.

**21. What Type of Property can Be Sold on Terms?**

a. Residential Colpur:

- (1) Should almost always be for cash as numerous sources of financing for this type of property is available;
- (2) A term sale with interest near market rate can be authorized based on the mortgage market in your area; and
- (3) A Modification action must be prepared justifying both the term sale and any lower interest rate.

b. Commercial real estate:

- (1) A term sale with interest rate below market can be authorized; and
- (2) A Modification action must be prepared justifying both the term sale and the lower interest rate.

c. Personal property Colpur:

- (1) Sales of personal property must be for cash; and
- (2) Sales to the buyer of the premises housing the personal property may be on terms:
  - (a) Terms may be offered if related to the remaining life of the asset but must not exceed 5 years; and
  - (b) The monthly payment must cover actual accruing interest and depreciation.

**22. what are the credit requirements of a potential bidder?**

a. Financial responsibility: credit must be cleared before the sale, not after.

b. Character.

c. All sale advertisements must state that for term sales:

- (1) Potential buyers must be approved prior to the sale;
- (2) A deadline for receipt of the required documentation to allow time for credit review;
- (3) Purchaser must provide hazard and public liability insurance; (see Chapter 22, "Insurance");

- (4) Purchaser must execute Agency Form 1261, "Statements Required By Laws & Executive Orders" (see Servicing Manual for additional information) and
- (5) Certification must be made that purchaser (and principals of a borrower who own 50 percent or more of the voting interest of the business) is not delinquent more than 60 days under the terms of any administrative order, court order, or repayment agreement that requires payment of child support.

Principals may be sole proprietors, partners, shareholders of a corporation, or members and/or managers of a limited liability company.

**25. Preparing a Plan to Dispose of Colpur Property.**

An Agency Modification should be used to outline the disposal plan. The Agency Modification should cover:

- a. Method of sale with possible alternatives;
- b. Minimum acceptable price; and
- c. Any other needed information.

**26. What Should You Consider When Establishing a "Minimum Acceptable Bid"?**

- a. Fair market value of the property;
- b. Protective bid analysis;
- c. Any other pertinent justification;
- d. Usable value of the property to be sold; and
- e. Your acceptable minimal bid must include a 10 percent plus or minus tolerance.

**NOTE:** The Agency personnel normally will NOT make known the amount of the Agency's minimum acceptable sales price, appraised value, or liquidating value of Colpur. However, you are free to discuss a range of acceptable value with the selling agent.

**27. Restrictions for Purchase of Colpur.**

- a. Restrictions on the borrower.

The Agency does NOT favor selling acquired nonresidential property for less than the full amount due to:

- (6) The borrower from whom it was acquired; or
- (7) The principals responsible for its management.

**NOTE:** The amount due the Agency includes the total Agency investment in the property plus the deficiency and any interest accrued.

- b. Restrictions on Agency employees.

Employees of Agency and close relatives of any must not bid or purchase directly or indirectly at any Agency related sale.

- c. Restrictions on the lender.

Associates of participants must not bid or purchase for their own account, directly or indirectly, at any Agency related sale. The Agency must give written permission to sell any Agency related collateral or Colpur to close relatives of participant's associates (See paragraph 2, "How Do You Handle Conflicts of Interests?" in Chapter 4, "General Guidelines for Liquidation Activities.")

## **28. Are There Exceptions to Selling Colpur to the Borrower?**

- a. Nonresidential Colpur can be sold to the borrower for less than the full amount due when:

- (1) A comprehensive public sale has been held;
- (2) You have exhausted all other sales efforts; and
- (3) The sale is for cash.

- b. **Residential Colpur**, which was and is proposed to continue to be a primary and only residence, may be sold back to an obligor who will continue to be the occupant. The requirements for such a sale are:

- (1) The property is sold for a fair market value; and
- (2) The sale is normally for cash.

**NOTE:** Your documentation supporting a sale of this type must show why the action is not detrimental to the interests of the Agency.

## **29. How is Title to Colpur Conveyed to the Purchaser?**

- a. Agency-serviced Colpur.

- (1) Counsel is to prepare and/or review the conveyance of title to the real property or review the title/escrow company's documentation related to the transfer of the property.

The Deed will usually be by quitclaim, bargain and sale deed, without warranty, or a special warranty, if circumstances justify.

**NOTE: The Agency, based on its tax-exempt status, is not liable for documentary stamp taxes with respect to its instruments of conveyance. The agreement must state that all required revenue or documentary stamps must be paid for by the purchaser.**

(2) Counsel is to prepare the bill of sale for conveying personal property without representation or warranty. The instrument of conveyance to the purchaser should include the removal date of personal property and a statement that purchaser will not be permitted to resell the items purchased on the premises. Further, any damage to the premises by removal of the personal property items is the responsibility of the purchaser.

b. Lender-serviced Colpur.

- (1) When the Colpur is in the name of Agency and sold by the lender, conveyance should be handled in the same manner as when Agency is doing the servicing;
- (2) When the Colpur is in the name of the lender, it will convey property in the same manner it handles its non-Agency accounts.

c. Recording requirements.

- (1) You must have all instruments securing the note recorded in the appropriate office of public records in accordance with local requirements;
- (2) You must place contracts of sale on record if required by law or custom or if advantageous to the Agency.

d. Handling of note receivables if purchaser defaults.

You should follow the same procedures for classifying a regular Agency loan. (See Servicing Manual")

### **310. Can Colpur be Leased?**

- a. A lease of real property Colpur must be predicated on your inability to sell the property. If you can justify the advantage to Agency, a lease can be executed for periods up to 1 year;
- b. Personal property must NOT be rented;
- c. Lender's request to lease Colpur must be handled by these same considerations;
- d. All leases must be prepared by Counsel.

**321. Terms and Conditions of a Lease.**

- a. A lease or lease purchase must be designed for the protection of the Agency.
- b. You must make an inspection and inventory, jointly with lessee, before and after the period covered by the lease
- c. The lease must have a provision for:
  - (1) The return of the property to Agency in the same condition (less fair wear and tear only);
  - (2) Reimbursement to Agency for missing items or those returned in unsatisfactory condition; and
  - (3) The lessee to obtain, at his/her expense, casualty and public liability insurance;
- d. The lease should permit the lessor to cancel the lease in the event of sale or redemption of the property prior to the expiration of the policy;
- e. You should not rent Colpur to the borrower from whom it was acquired or to any of the principals responsible for the borrower's management unless:
  - (1) Unusual circumstances exist;
  - (2) It is to the Agency's advantage; and
  - (3) A comparable or more desirable proposal cannot be obtained.

You should support this with an Agency Modification.

- f. You must make at least semiannual inspections of the leased property to determine its condition and the compliance to the lease and prepare a report summarizing your findings.

**332. Profit from Sale of Colpur.**

You should protect the Agency against possible allegations of unconscionable profit. This can be accomplished by the use of a professional auctioneer to assist in advertising and conducting foreclosure sales. Sale of property must be advertised as widely as possible under the circumstances. The benefit you will receive is that the property may be sold at the foreclosure, preventing it from becoming Colpur in the first place.

- a. Unconscionable profit.

There is legal precedent, which requires a lender to apply Colpur profit to the debt if the period of time the property was actually held by the lender was short and the profit large. The courts found the "profit" was really "equity" which had not been properly developed by the lender in its foreclosure efforts.

- b. Determination of Colpur profit or commercially reasonable recover.

The amount of funds to be credited to the loan account may be approved by the line supervisor acting on the recommendation of the liquidation loan officer. Counsel's concurrence is required.

c. Compromise of obligor.

Corrective credits to the loan account should occur in conjunction with a compromise with the obligor(s) of the overall indebtedness. The account must be adjusted to reflect the appropriate credit even if a compromise is not possible.

d. Funds in excess of loan balance.

Any overage may be retained by Agency, paid into the registry of the court having jurisdiction, or handled in such manner as determined to be the most equitable under the circumstances. A Modification action is required with comments of Counsel.

e. Documentation and justification of profit.

- (1) When the profit on a sale of Colpur exceeds 10 percent of the purchase price (20 percent if more than 1 year since acquisition), a Modification action is required.
- (2) The Modification action must document the:
  - (a) Circumstances that caused the increase in value;
  - (b) Whether the value may have existed at the time of acquisition; and
  - (c) Distribution of the profit to the general fund, to the loan account, to the court, to junior creditors or to the obligor(s), and justify it.
- (3) If you can justify the profit as a result of special events or circumstances, which occurred after the acquisition, the profit may properly belong in the AGENCY general fund.

**NOTE:** It is not the intention of the Agency to take advantage of a borrower's situation or to make an unreasonable profit on Colpur to the detriment of the debtor(s). The burden of proof is on the Agency since the Agency is typically in control of the marketing efforts and is well aware of the values prior to foreclosure.

### 343. Abandonment of Colpur.

a. Personal property.

For personal property, you must prepare a Modification action recommending abandonment. This decision should be based on the

limited value and the fact that the cost of selling would exceed estimated recovery.

b. Real estate.

For real estate titled in the Agency's name, you cannot abandon it. You must fully detail in those rare instances where the value of the property has fallen to the point that no purchase can be generated.

**NOTE:** The responsibilities and liabilities of the Agency continue as long as the title is held (e.g., unsightly display, potential hazards).

c. Sales efforts.

There are times that you as a loan officer must become more innovative in disposing of assets. When you have exhausted all of these efforts, an "exception to policy" plan, documented by a Modification action must be prepared. This action must summarize all of the innovative sales efforts attempted as well as any potential liability faced by the Agency.

d. Potential liability.

- (1) When possible, you should assess a property's potential liability to the Agency at the time the protective bid is computed. Occasions arise where the liability was not known or unforeseen changes occur after Agency has acquired the asset;
- (2) You should annually update the Colpur account to review potential liability.

e. Hazardous waste.

The presence of any hazardous waste may have significant ramifications with respect to the value and ability to sell real or personal property. You should be aware, it is not necessarily the case that Agency is liable for cleanup of hazardous waste on property in which the Agency holds title. Relevant statutes, regulations and case law must be carefully reviewed in each instance by Counsel. You should notify Counsel of all communications you receive from Agency, State, or local environmental agencies. Additionally, Counsel should be advised of any instance where it is suspected or alleged that hazardous waste is located on property titled in the Agency's name.

**NOTE:** The prohibitions of abandoning real property remain applicable even if hazardous waste is discovered.

- f. Documentation and forms, which are needed for abandonment action on personal property:
  - (1) A Modification action must be prepared by the recommending official reflecting:
    - (a) The value of the property;
    - (b) The sales effort; and
    - (c) The reason for abandonment.
  - (2) Justification must be outlined in the Modification action as to why the property should be abandoned;
  - (3) A Modification action must be forwarded to the approving official for final action with comments of counsel;
  - (4) The "Date of Sale" will be the approval date of the Agency Modification authorizing the abandonment; and
  - (5) The word "Abandoned" will be inserted in the "Gross Sale Price" column.

**35. Options to Purchase.**

The Agency or the participating lender must not grant an option to purchase; to do so will be treated as an exception to policy.

## CHAPTER 12

### GUIDELINES FOR PERSONAL GUARANTIES

#### 1. What is a Personal Guaranty?

A personal guaranty is the obligation to pay the entire indebtedness (unless the guaranty is limited).

#### 2. What Form is Used for a Personal Guaranty?

You will use the Agency designated form 148," (see Appendix 1). This form is executed in connection with loans made by or in participation with the Agency.

#### 3. Circumstances of Default?

Although not all inclusive, the following circumstances are considered defaults:

- a. Failure to maintain payments as required by the promissory note and authorization and loan agreement;
- b. Failure to pay taxes on personal or real property securing the loan;
- c. Failure to pay withholding taxes;
- d. Cancellation of hazard or life insurance policies;
- e. Abandonment of collateral;
- f. Any other condition which could impact the Agency's collateral position;  
or
- g. Breach of any agreement or covenant.

#### 4. When Do You Notify a Guarantor of Default?

When Agency becomes aware of a default (e.g., as noted above), you should consult with counsel to determine if written notification of the default to a guarantor is appropriate.

#### 5. What Requirements are There for Notifying a Husband and Wife When Both are Liable?

When written notification is necessary, you should send it by regular and certified mail Return receipt requested both jointly and separately.

## **6. When Must You Send a Demand for Payment in Full to All Guarantors?**

You must send it when:

- a. The note has been accelerated;
- b. When the approving official has determined that any of the "automatic in liquidation" situations exist (see Servicing Manual");
- c. When liquidation action has been authorized; and
- d. Consult with counsel.

## **7. Steps to Take to Review the Guarantor's Financial Condition.**

When you receive a loan classified "in liquidation" you must review the financial condition of each guarantor. This review is made to determine the possible recovery from each guarantor.

### **a. What type of review is needed?**

You should analyze and compare the most recent and historical financial information available (e.g., financial statements, tax returns, etc.).

### **b. What outside services are available to determine guarantor's financial condition?**

- (1) Local credit bureau;
- (2) Special reporting services such as:
  - (a) Current assets and income report;
  - (b) Single property check;
  - (c) Skip tracing services;
  - (d) UCC lien search; and
  - (e) State corporation commission file search.

### **c. What do you do if a substantial adverse change in guarantors financial condition is identified?**

If your review reflects a substantial change in a guarantor's financial condition, you should obtain full details.

#### **(1) What are common adverse changes?**

- (a) Disposal of assets; and
- (b) Creation of fictitious debts.

**(2) Whom should you refer these matters to if you determine the Agency will suffer a loss?**

You must report it to the designated investigation unit within the Agency.

**8. What Do You Do When the Guarantor is Deceased?**

- a. Ascertain the status of life insurance;
- b. Consult with counsel to determine the necessity of filing a probate claim; and
- c. Consult with counsel prior to releasing a claim on a loan in liquidation status with claims against the estate.

**9. What Notices Might the Agency Receive Which Would Indicate a Guarantor Might Be Insolvent?**

- a. Foreclosure notice by a lien holder;
- b. Bankruptcy filing; or
- c. Receivership notification.

**10. What Action Should the Agency Take when Notices of Foreclosure, Bankruptcy, or Receivership Against the Guarantors are Received?**

- a. The liquidation loan officer should determine:
  - (1) The value of any assets involved;
  - (2) The amount of any prior liens in order to make decision on paying off balance;
  - (3) The overall strength of the business;
  - (4) The strength of remaining guarantors; and
  - (5) The chances of the loan payments continuing.
- b. The liquidation loan officer must notify counsel to determine what action must be taken to protect the Agency's position.

**11. Will an Account Always Be Liquidated When an Adverse Action Occurs With Guarantor?**

No. You should give consideration to the overall financial stability of the business. If you anticipate full payment from the business, monitoring the guarantor's situation will be satisfactory.

## 12. When Can You Release a Personal Guarantor?

You may release a personal guarantor when:

- a. The loan is fully paid;
- b. The full amount due from a limited guarantor is paid;
- c. A compromise offer has been approved; or
- d. The release is part of a workout, sale, or reorganization of the firm and:
  - (1) Substitution of guarantors and collateral of equal or better value is made; or
  - (2) The release is in the best interests of the Government.

**NOTE:** The liquidation officer must consult with counsel to ensure that no legal rights of the Agency against the borrower, guarantors, or any other party will be adversely affected by the release.

## 13. What Do You Do if the Guarantor is Missing?

A missing guarantor can normally be traced using any of the following methods:

- a. The Skip Trace Service Report available from Equifax;
- b. Various on-line skip trace databases;
- c. Contact with the Internal Revenue Service;
- d. Nearby places of business;
- e. Obligor's other creditors;
- f. Consumer credit services;
- g. Local participating lenders;
- h. Obligor's neighbors, relatives, former employers;
- i. United States Post Office;
- j. Utility companies;
- k. Local unions;
- l. Department of Veterans Affairs;
- m. State motor vehicle records;
- n. Other licensing or taxing authorities; or
- o. Life insurance companies.

## 14. When Do You Take Action Against a Guarantor?

Generally, the business assets are usually considered to be the primary source of recovery and are ordinarily liquidated prior to taking action against a guarantor. Never the less, collateral can be liquidated in any order determined to be in the best interest of the Agency.

## 15. What Actions Can the Agency Take Against the Guarantors?

Actions, which can be taken, are:

- a. A suit can be brought against the guarantor or action against non-business collateral securing the guaranty.

Where immediate action is deemed necessary, you must justify by a Modification action. Such reasons may include:

- (1) Lack of cooperation;
  - (2) Failure to supply financial information;
  - (3) Refusing to assist in the liquidation of business assets;
  - (4) Possible dissipation of assets; or
  - (5) Foreclosure actions by other lien holders.
- b. Agency can process a compromise offer from a guarantor prior to the sale of the business collateral when:
    - (1) The deficiency balance has been determined; and
    - (2) It is advantageous to the Agency.

## CHAPTER 13

### DENIAL OF LIABILITY SUIT AGAINST PARTICIPANT

#### 1. Who Has the Authority Within the Agency to Deny Liability?

Usually, the authority to deny payment of a guaranty is reserved to the head or very senior member of an Agency and therefore we recommend that this authority be reserved to the Director of the Agency.

#### 2. What Reasons Justify a Decision by the Agency to Deny Liability Under its Loan Guaranty?

##### a. Regulations:

"When is Agency released from liability on its guarantee?

**Agency is released from liability on a loan guarantee (in whole or in part, within Agency's exclusive discretion), if any of the events below occur:**

- (1) The Lender has failed to comply materially with any of the provisions of these regulations, the Loan Guarantee Agreement, or the Authorization;
- (2) The Lender has failed to make, close, service, or liquidate a loan in a prudent manner;
- (3) The Lender's improper action or inaction has placed Agency at risk;
- (4) The Lender has failed to disclose a material fact to Agency regarding a guaranteed loan in a timely manner;
- (5) The Lender has misrepresented a material fact to Agency regarding a guaranteed loan;
- (6) Agency has received a written request from the Lender to terminate the guarantee;
- (7) The Lender has not paid the guarantee fee within the period required under Agency rules and regulations;
- (8) The Lender has failed to request that Agency purchase a guarantee within 120 days after maturity of the loan;
- (9) The Lender has failed to use required Agency forms or exact electronic copies; or
- (10) The Borrower has paid the loan in full.

- (b) If Agency determines, after purchasing its guaranteed portion of a loan, that any of the events set forth in paragraph (a) of this section occurred in connection with that loan, Agency is entitled to recover any money paid on the guarantee plus interest from the Lender responsible for those events.
- (c) If the Lender's loan documentation indicates that one or more of the events in paragraph (a) of this section may have occurred, Agency may undertake such investigation as it deems necessary to determine whether to honor or deny the guarantee, and may withhold a decision on whether to honor the guarantee until the completion of such investigation.
- (d) Any information provided to Agency prior to Lender's request for Agency to honor its guarantee shall not prejudice Agency's right to deny liability for a guarantee if one or more of the events listed in paragraph (a) of this section occur.
- (e) Unless Agency provides written notice to the contrary, the Lender remains responsible for all loan servicing and liquidation actions until Agency honors its guarantee in full.

### **3. Evaluating a Denial of Liability.**

The decision to deny liability on the Agency loan guaranty requires a thorough review of the facts involved. The decision by Agency to deny liability carries with it the right to defend Agency's position in a court of law.

Before pursuing a recommendation of denial, you must do the following.

- a. Determine that you have sufficient evidence of the wrongdoing by the lender under any one of the reasons for denial stated in the regulations above.
- b. Keep in mind that there does not need to be a monetary loss associated with the lender's actions or inactions in order to sustain a denial of liability. However, if Agency has not been harmed financially, this should be an important factor in the decision whether to deny liability.
- c. All options must be explored to resolve the problem prior to processing a denial of liability. Examples are:
  - (1) Lender corrects deficiencies;
  - (2) Evaluate if a repair is appropriate;

- (3) Ask lender to voluntarily release Agency from liability on the guaranty; and
- (4) Be aware of the ruling by the Comptroller General that Agency cannot honor its guaranty when it is aware of the lender's negligence, fraud, or misrepresentation.

Examples include:

- (a) The lender did not perfect the security interest required in the authorization and loan agreement;
- (b) The lender did not disburse loan per use of proceeds in authorization and loan agreement;
- (c) The lender did not properly execute the mortgage/deed of trust, rendering document unenforceable;
- (d) The lender disbursed funds despite knowledge of adverse change in financial condition of borrower;
- (e) The lender released guarantor or compromised the loan without the consent of Agency;
- (f) The lender conferred a preference on itself to the detriment of the Agency loan;
- (g) The lender did not service loan in a manner consistent with prudent lending practices;
- (h) The lender committed fraud or misrepresentation to Agency when recommending approval of the loan; or
- (i) The lender failed to provide timely notice of default which caused serious harm to Agency, including repetitive failure to report the delinquent status of an Agency loan on Agency required Forms or format.

#### **4. Are There Alternatives to a Full Denial of Liability?**

Yes. The recommendation of a denial of liability should NOT be an automatic response to a problem. The Agency can attempt to reach an amicable adjustment (reduction of the guaranty), or "repair," with the participant as a resolution. Also, sometimes the participant will voluntarily cancel the guaranty.

##### **a. Pre-purchase loan adjustments to the guaranty (repairs).**

- (1) Where the issue involves negligence and a sum certain, the field office must discuss the matter with the lender before it can recommend denial. During such discussions, the Agency representatives should explain to the participant the problems, which must be overcome before purchase can be recommended. At the same time, they should seek an insight into the participant's point of view regarding the matter. The Agency must explore every possibility for an amicable and reasonable resolution.

- (2) If you or the participant suggests an adjustment to the guaranty (i.e. a decrease in the Agency's guaranty), the servicing office may purchase on the adjusted basis without referral to Headquarters if the adjustment reasonably approximates the anticipated attributable loss. Any such repair must be authorized by an AGENCY Form Modification. The Agency Form Modification must fully document the findings made in the pre-purchase review and contain the comments and concurrence of counsel.

**b. Voluntary release by participant.**

- (1) In some cases, the lender can be induced to release Agency from any further liability under the guaranty. A voluntary cancellation of the guaranty by the lender is preferable to a denial by Agency. Therefore, the Agency should request a letter of release before a denial action is initiated.
- (2) When Agency responds to a letter requesting release, the Agency must advise the lender that Agency's release does not waive any of its preexisting rights or defenses in the event that release is not ultimately consummated.

**5. How Do You Determine the Amount of Loss Attributable to the Lender?**

Any denial action based on monetary loss must include an estimate of the loss attributable to the lender's actions or inaction. The basis for the estimate may range from a formal appraisal figure to an educated approximation, depending on the circumstances. Appraisal costs incurred "for this purpose" are a non-recoverable program expense and, as such, are not chargeable to the borrower. In the Agency Form Modification, use the most exact loss figure available and explain how it was determined.

**6. How Do You Handle a Situation of Likely Loss?**

**a. Indeterminable loss prior to purchase.**

Where a substantial, but not total, attributable loss is likely and the Agency has NOT purchased its guaranty, consider encouraging the participant to continue servicing through final liquidation. Agree to negotiate the guaranty adjustments once the actual loss is determined.

**b. Loss established subsequent to purchase.**

Where a substantial attributable loss is likely and the Agency has purchased the guaranty, Agency will rely upon its right to recover damages to the extent of the Agency's resulting loss and any other

damages or penalties deemed appropriate. The amount of loss attributable to the lender can be determined while the loan is:

- (1) In servicing;
  - (2) In liquidation; or
  - (3) When it is finalized, liquidated, or otherwise terminated.
- c. Once the amount of attributable loss is determined, you must request the lender to reimburse Agency for the attributable loss. (Supported by an Agency Form Modification.) If this step fails, and further negotiations appear futile, the field office must prepare an Agency Form Modification setting forth the facts in the matter and recommending appropriate action. Refer the action through channels to the Office of Borrower and Lender Servicing in Headquarters.

## **7. What are the Field Office's Reporting Requirements When it Recommends Denial?**

- a. The field office must prepare a detailed Agency Form Modification whenever there is serious doubt as to the Agency's legal obligation to honor a demand for purchase.
- b. The report must:
  - (1) Be objective;
  - (2) Be complete, with attachments and exhibits, so that a final determination will be possible after it is reviewed; and
  - (3) Reflect all aspects of the situation, including but not limited to:
    - (a) A clear identification of lender's failure(s);
    - (b) The findings from a review of the documents and lien searches;
    - (c) An estimate of anticipated attributable loss;
    - (d) Details of efforts by Agency and the lender to correct the deficiency(ies);
    - (e) Establishment of the fact that lender cannot or will not correct the deficiency(ies); and
    - (f) Comments of each reviewing official, including opinion of district counsel as to the grounds for denial and likelihood for success in court should a resulting denial be contested.

**NOTE:** If district counsel determines that Agency is not legally obligated to purchase the loan, in whole or in part, this decision cannot be overruled at the field level. The issue and the loan file must be referred to the Director for final action based upon legal review.

- c. The package must include the original and one copy of the Agency Form Modification and must be accompanied by the loan file.
- d. Routing.
  - (1) The full report must be forwarded to the Headquarters. The report to Headquarters must carry the recommendations and signatures of the:
    - (a) Recommending official (liquidation loan officer);
    - (b) Supervisory attorney;
    - (c) Line supervisor (approving official);
    - (d) District counsel; and
    - (e) District director.
  - (2) During this process, reviewing officials should not hesitate to reopen discussions with the lender (e.g., higher bank level, bank attorney) if clarification is needed or if a release or settlement appears possible.

#### **8. Who Has the Authority Within the Agency to Decide to Sue a Participant?**

Usually, no authority is delegated below the Agency Director to sue a participant. The Agency will, throughout its purchase procedures, retain the right to sue the participant in the event that the participant is later found to have breached the guaranty or participation agreement under which the loan was made. These rights include, but are not limited to, the right to recover the amount paid to lender and/or damages for:

- a. The lender's failure to close, disburse, or service the loan in a reasonably prudent manner;
- b. The lender's noncompliance with Agency rules and regulations or the terms and conditions set forth in the Agency loan documents; and
- c. Fraud, misrepresentation, or negligence.

**NOTE:** The reporting procedures and other considerations for suit against participants are essentially the same as those used for denial actions. However, counsel must consider and comment on all litigative probabilities to ensure that court action would, if taken, have a high likelihood of success.

## CHAPTER 14

### CONTRACTING WITH AUCTION FIRMS

#### 1. What is Agency Policy on the Sale of Collateral and of Collateral Purchased (Colpur)?

- a. The Agency's policy is to offer loan collateral and Colpur for public sale through competitive bids at a "public auction" or "sealed bid sale" unless the property has been acquired through a foreclosure proceeding consistent with State law.
- b. The lender may use negotiated sales if this is their normal practice for non-Agency collateral.

#### 2. What is Agency Policy for Hiring Auctioneers for AGENCY Serviced Loans?

The Agency must hire only qualified professional auctioneers with good experience and a satisfactory commercial track record to handle its sales.

#### 3. Why are the Services of an Auction Firm Needed?

The Agency's defense is strengthened by using a capable and clearly qualified firm should the Agency be challenged as to whether a sale was commercially reasonable.

#### 4. What Qualifications Must an Auction Firm Have Before Being Hired by Agency?

They should have:

- a. Documented financial strength;
- b. Available full-time staff;
- c. Ability to be bonded;
- d. An insurance policy covering certain liabilities;
- e. Ability to attract well-financed bidders;
- f. Good experience in the type of property being sold;
- g. Facility for storage and conducting sales;
- h. Proper security; and
- i. Equipment moving capabilities.

**5. How Do You Authorize the Use of an Auction Firm?**

- a. You must prepare a Modification action outlining the auction firm to be hired and the expenses associated; or
- b. The information can be outlined in the Liquidation plan, which requires recommending official, and approving official's signature.

You must document any changes from the requirements outlined in the Master Auctioneer's Agreement.

**6. What is the Minimum Number of Qualified Auctioneers that a Field Office Must Maintain and Use for an Agency Liquidation?**

- a. All field offices must use the services of at least two auctioneers when annual commissions are more than \$50,000.
- b. Field offices must utilize the services of at least three auctioneers when annual commissions are more than \$100,000.
- c. It is strongly encouraged that, as the need for auctions increases, the field offices proportionally increase the number of auctioneers it uses based on the requirements noted above.

**7. What is a Master Auctioneer Agreement?**

This is an agreement between Agency and each auction firm determined to be qualified to sell collateral or Colpur.

**8. What are the Requirements Maintaining an Auctioneer File for Agency-Serviced Loans?**

- a. Each office is required to maintain a file of all the auctioneers approved, as well as declined with the supporting documentation.
- b. This file must include the Master Auctioneer Agreements.
- c. The file must contain an Agency Auctioneer Log, for each auctioneer used. You may develop your own computer generated log if it addresses all of the elements in the current form or supply this form to your auctioneers for them to complete and return to the field office. Once you have reviewed the information submitted by the auction firm, it can be placed in the appropriate auctioneer file with no further documentation needed.
- d. All supporting documentation for each auction will be maintained in the borrower's loan file.

**9. What is an Auctioneer Contract?**

- a. This is a contract, which must be completed for each sale assigned to the particular auction firm.
- b. The contract is between Agency and the auction firm.
- c. The contract must be filed in the borrower's loan file.

**10. What are the Auctioneer Responsibilities in Connection With a Sale?**

- a. Attract bidders by proper marketing;
- b. Know the market;
- c. Prepare and present the property for sale;
- d. Conduct and control bidding;
- e. Collect funds;
- f. Oversee removal of sale items;
- g. Provide prompt and full accounting to Agency;
- h. Submit detailed sale report; and
- i. Consult with loan officer on all matters affecting maximum recovery on property to be sold.

**11. What Information Must Be in an Auctioneer's Sale Report?**

- a. Listing of items or lots sold;
- b. Name of successful bidder and bidder number with amount paid;
- c. Original invoices for each expense paid; and
- d. Signed report listing total amount of sale, expenses, commissions (and how computed), and net amount of funds submitted to Agency.

**12. What are the Responsibilities of the Liquidation Staff in Connection With the Auction Sales?**

- a. Review brochures and advertising;
- b. Refer interested buyers to auction firm;
- c. Insure proper viewing time of collateral prior to sale;
- d. Determine need for cleaning, painting, etc., of property;
- e. Monitor sale;
- f. Determine need for and develop a protective bid;
- g. Determine auction firm has systems in place for removal and check out of items sold; and
- h. Prepare a sale report.

### **13. What are the Requirements for Bonding?**

- a. The auctioneer is not required to obtain a bond:
  - (1) If anticipated sale proceeds are not expected to be more than \$50,000; or
  - (2) If the amount is more than \$50,000 is paid directly to Agency from the auction proceeds; and
  - (3) The firm has a documented track record of at least 3 years of experience with Agency or a participating lender.
  
- b. If the auction company does not have the 3-year track record with Agency, a bond in the amount required by State law or \$50,000, whichever is greater, IS REQUIRED on all sales regardless of anticipated sale proceeds.

## CHAPTER 15

### APPRAISALS

#### 1. What is Agency's Practice on Obtaining Appraisals?

It is Agency's practice to obtain pre-foreclosure appraisals on collateral when the:

- a. Loan is placed in liquidation status, and it appears that collateral will be disposed of to achieve recovery;
- b. Collateral is believed to have significant value;
- c. Collateral is of special purpose in nature; or
- d. Possibility exists that suit will be brought against the remaining obligors for a deficiency balance.

#### 2. Why is an Appraisal Needed?

An appraisal must be obtained to make sound liquidation decisions such as:

- a. Determining the method of liquidation;
- b. Granting a request by a borrower for release of collateral; and
- c. Establishing the need for protective bids.

#### 3. When Must an Appraisal Be Done?

- a. Negotiated private sales must be supported by at least one appraisal made by a fee appraiser within the past year.
- b. A new appraisal must be completed if the existing appraisal is more than 1 year old.

#### 4. When is Using an Appraisal Over 1 Year Old Considered an Exception to Policy?

The use of an appraisal over 1 year old, in the case of a private sale of collateral or Colpur, is an exception to policy and requires Headquarters approval.

(See Chapter 7, "Agency's Method of Recovery from Collateral," and Chapter 11, "Collateral Purchased (Colpur) by Agency and Lender.")

#### 5. How Many Fee Appraisers Should Your Office Obtain?

Whenever possible, you should obtain more than one appraiser. When fees paid to appraisers will be more than \$25,000 a year, you should obtain the services of at least two appraisers.

## **6. From What Groups Can You Select a Fee Appraiser?**

- a. Local professional appraisal organizations;
- b. Local auctioneers; and
- c. State certified or licensed appraisers.

The Agency encourages the use of state licensed or certified appraisers whenever it is practical and appropriate.

## **7. How is the Employment of a Fee Appraiser Documented?**

Employment of a fee appraiser should be documented by a:

- a. Contract for Appraisal Report; and
- b. A Modification action outlining all information regarding the:
  - (1) Proposed appraisal;
  - (2) Fee to be charged;
  - (3) Type of report; and
  - (4) Values, which will be provided, e.g., piecemeal, going business.

## **8. Is a Pre-Payment Review Necessary?**

Yes. You should review the:

- a. Bill for comparison with prevailing local rates; and
- b. Report for content and quality.

The signature authorizing payment will document that work was performed in a satisfactory manner.

## **9. What is the Procedure for Paying Appraisal Expenses?**

## **10. What Other Services can Be Obtained by Using the Same Basic Criteria as with Fee Appraisers?**

You may obtain other related services on a fee basis, which could include:

- a. Architects;
- b. Project engineers;
- c. Surveyors;
- d. Hazardous waste assessment firms; and
- e. Environmental audit services.

### **11. What Type of Collateral Could Be Valued Using a "Desk Estimate?"**

- a. When you are working on a servicing or liquidation matter involving equipment of a general-purpose type, a "desk estimate" may be acceptable.
- b. Collateral identified as "general purpose type" could be:
  - (1) Automotive equipment;
  - (2) Office equipment; and
  - (3) Any general-purpose property with values available from general references, catalogues, or common knowledge.

**NOTE:** A desk estimate should be the Agency's last choice. A liquidation officer along with the Agency assumes a lot of responsibility by performing this evaluation, if the Agency is challenged on the value. For this reason, only senior liquidation officers must be used to perform such evaluations.

### **12. What Steps Should Be Taken to Complete a Desk Estimate?**

- a. The following information should be prepared:
  - (1) A Modification action stating the reasons for the desk estimate rather than an actual appraisal;
  - (2) A columnar listing of major items of collateral;
  - (3) A statement as to the condition of each item of collateral; and
  - (4) A column to the right of the listing for the values to be placed.
- b. This information should be provided to the senior liquidation loan officer to insert the reasonable values based on their background knowledge and the information at hand.

### **13. Should the Liquidation Loan Officer Perform the Desk Appraisal and Handle the Sale or Develop the Protective Bid?**

No. However, if the liquidation loan officer must perform the evaluation and conduct the sales activities, the line supervisor must review the liquidation loan officer's work to minimize potential conflict of interest problems.

#### **14. How Should You Handle Potential Dispute Situations?**

If you have an irate or non-cooperative borrower, an appraisal should always be obtained from an appraiser who can qualify as an expert witness.

## CHAPTER 16

### COMPROMISE ACTIONS

#### 1. What is the Authority to Compromise?

Some guaranty programs allow for compromise of the debt owed. Such compromises are usually based on the lack of ability for the borrower to perform on the debt owed but when the borrower does have the ability to perform on a lower amount of debt.

#### 2. What is the General Settlement Policy?

##### a. Terms "compromise" or "settlement."

The terms "compromise" or "settlement" can be used interchangeably or together to mean the resolution of a debt for less than the amount due through mutual agreement between debtor and Agency.

##### b. Obligor does not have the ability to make full payment.

When it is known that the obligor does not have the ability to make full payment, it may be appropriate to settle for less than the full amount due. However, when the liability of the obligor is clear and the lender and the guarantor can collect fully without protracted litigation (or large unrecoverable expenses) there is little basis to settle for less than what is owed.

##### c. Compromised/settlement amount.

It must bear a reasonable relationship to the estimated net present value of the projected amount of recovery available through enforced collection.

##### d. Factors in assessing debtors ability to pay.

- (1) Health and life expectancy;
- (2) Local economic conditions;
- (3) Present and potential income;
- (4) Equity in pledged or reachable assets;
- (5) Possibility of assets being improperly transferred or concealed by debtor; and
- (6) Applicable exemptions available to debtor under State and Agency law.

e. Debtor assistance.

Active cooperation by the debtor may have substantially enhanced recovery. This should be recognized in the settlement analysis.

f. Benefits to others.

A compromise proposal, which may also benefit junior lien-holders, is permissible when the benefits to the Agency are significant and there are no better alternatives.

g. Prompt action.

- (1) You need to initiate the compromise process within 3 months after a deficiency has been established.
- (2) The Agency Form Modification is to be completed promptly after receipt of the required materials necessary for consideration of the offer.

h. Documented recovery efforts.

The file must show that efforts to realize recovery on the assets and to compromise have been made.

i. Charge off.

The charge off of an account having substantial equity in reachable assets is NOT an acceptable alternative.

### **3. Compromise Attempt.**

The Agency must attempt to reach a compromise settlement with obligors prior to commencement of foreclosure actions against their personal residences.

### **4. Fraud or Misrepresentation.**

An offer in compromise cannot be accepted if the Agency has knowledge of fraud, substantial misrepresentation, or financial dishonesty on the part of the offeror.

## 5. "Rule of Two" Authority.

- a. Loan officers must justify and explain compromise actions using standard the Agency Form Modification format with appropriate supporting documentation indicating the benefit to the borrower and/or to the Agency. Legal involvement is required as indicated.

- (1) The following information should be reviewed in evaluating a compromise request:
  - (a) Reports from credit reporting bureaus; and
  - (b) Current Assets and Income Report.
- (2) You need the Dwelling Property Report:
  - (a) Discussions with the lender, local realtors, appraisers, and county assessors; and,
  - (b) Viewing the assets by the liquidation officer.

A copy of the value verification documentation should be part of the compromise package.

- (3) You need the analysis comparing the original balance sheet (submitted with loan application) and the statements now submitted with the compromise offer, with an explanation as to the disposition of any significant assets, which are no longer on the current statements. Major changes should be discussed in detail along with any suspicious transfers of assets.
- (4) You may need appraisals where the value of a significant asset is in question and the difference(s) in value may affect decisions to be made on the compromise. (See Chapter 16, "Appraisals.")
- (5) You must assess the obligors' ability to pay.
- (6) You need comparisons of the new financial information with the previously submitted data in the loan file. Especially review the original personal financial statement submitted with the loan application and compare it with the one now being submitted. Make direct comparisons between major assets owned at that time and the assets now owned. Likewise, review the liabilities owed then with what is now owed. The obligors need to be contacted for clarification of any major unexplained differences between these statements.

## 9. Assessing Obligor's "Ability to Pay."

The adequacy of a compromise offer must begin with an evaluation of the assets of the obligor(s). The starting point is ordinarily the net present value of the forced sale value of such assets (not the loan balance). This value combined with the prognosis of the obligors' earning power form the basis for determining the adequacy of the offer. The review must balance the right of the Government to collect the amount owed and the obligation to treat all obligors with dignity and fairness.

The following is a list of areas for consideration in assessing the obligor's ability to pay.

a. Forced sale equivalent (liquidation value).

- (1) The basis for this value is normally the amount recoverable from the sale of the assets within a limited period of time (auction type sale). Also to be considered is the time and expense needed for the Agency to gain control of the asset. In the absence of other available criteria, the following general guidelines should be used as a percentage of market value. An additional deduction of 5 - 10 percent for other expenses should also be considered to establish a realistic forced sale equivalent.

Real Property:

Commercial.....	75%
Residential.....	80%
Unimproved Land.....	50%

Business Assets:

Machinery/Equipment.....	50%
Accounts Receivable/Inventory.....	20%
Furniture/Fixtures.....	10%
Leasehold Improvements.....	5%

- (2) Consideration should be given to the time and monies involved with enforced collection to establish a discounted forced sales figure. The forced sale equivalent value needs to be adjusted for the following types of expenses.

Court costs, filing fees;

- (a) Prior liens, taxes, assessments;  
(b) Costs of sale (auctioneer's fees, advertising, looting, and clean up costs);

- (c) Time of Agency employees (financial, legal, clerical, and administrative);
- (d) U.S. Attorney costs (professional, administrative, out of pocket); .....
- (e) Possibility of protested litigation or of bankruptcy and related expenses;
- (f) Time mandated by any redemption periods and the cost (depreciation, vandalism, insurance risks) that may result from such delays;
- (g) Care and protection expenses pending resale;
- (h) Extraordinary expenses of eviction, repairs to property, vandalism;
- (i) Costs necessary to bring property to marketable condition;
- (j) Transportation/travel costs; and
- (k) Discount reflecting the present value of future net recovery.

b. Non-reachable assets and income.

There may be items, which are utilizable to the obligor(s) and have substantial value but are beyond the reach of the Agency. The facts of the situation should enter into the Agency's assessment of the obligor's good faith.

c. Jointly owned property.

Special problems are encountered when the obligor shares ownership with another of an asset. This, by itself, is not sufficient reason to disregard the asset as having no value. The situation must be closely examined to determine (even to the extent of hiring appraisers and consultants) if the potential value of the property warrants further action.

d. Individual asset valuations.

Each worthwhile asset owned by the obligor needs to be assessed. Estimating the values of these assets is not an exact science but the Agency needs to have a uniformity of approach.

(1) Cash.

You should only be concerned with cash in amounts substantially in excess of basic living expenses as determined from the AGENCY 770. Special accounts (IRA's, Keoghs, trust accounts) should be valued net of early withdrawal penalties and other costs.

(2) Cash surrender value (CSV) of life insurance.

You should determine the net amount receivable under the terms of the policy. Loans outstanding and other costs may also have to be subtracted out. The policy must often be surrendered in order to receive the CSV. The loan value should be used for analysis if surrendering the policy would leave the family with inadequate protection. This approach is to be used even if the Agency is acknowledged as assignee in the insurance company's home office.

(3) Accounts/notes receivable.

The size, age, and collect ability of these assets need to be examined to determine their worth. Typically they have little forced sale value. Ordinarily only large receivables should receive much attention.

(4) Furniture, fixtures, and other personal effects.

These are normally not worth very much. Efforts spent in other areas will yield much better results. You will assign a nominal value to the contents of a modest home for compromise situations. If such assets are subject to an Agency lien, the lien may be realized for nominal value or the assets may be abandoned if no such release is possible.

(5) Jewelry, paintings, antiques, and collections.

When items in these categories have been assigned substantial value, they should be given special attention. Outside sources may have to be utilized to determine meaningful values on these specialty items.

(6) Automobiles.

Automobiles have a ready market and various published books give a handy reference as to value. Gross compromise value "rule of thumb" is 80 percent of loan value. Of course prior encumbrances must be deducted to determine the net compromise value.

(7) Securities.

The value of stocks and bonds in publicly traded firms are easily ascertained and can quickly be converted to cash. Ownership interest in firms with closely held corporate stock and in unincorporated firms presents much greater valuation problems. Each situation is considered using the best judgment available. If

substantial potential worth is apparent, obtain a valuation analysis by a chartered financial analyst or some other qualified person.

(8) Other assets.

Common carrier rights, copyrights, liquor licenses, patents, inheritances, and trusts are the types of assets that can be worthless or have substantial value. Confer with counsel regarding local laws and their effect on these assets. The establishment of values for these assets must rely on a reasonable assessment of the circumstances in each case.

(9) Real estate.

This is often the asset having the largest value on the balance sheet. For income producing or commercial properties, it is desirable to use a member of a recognized appraisal organization.

e. Determinations regarding applicable liabilities/liens.

Once an evaluation of assets has been made, attention should be shifted to the liability section of the balance sheet. Large new obligations should be reviewed to determine how they came about and how they are secured.

(1) Debts with senior liens.

Debts with senior lien positions decrease our equity in the property. If the debt is legitimate and properly perfected it may well eliminate any interest the Agency has in the asset. Junior liens may represent a potential purchaser of the property.

(2) Unsecured debts.

Unsecured debts do not affect our interest in assets when the Agency is properly perfected but they are an impediment to the obligor's ability to pay. They could lead to a filing of bankruptcy.

(3) Debts to relatives/close associates.

Particular attention should be shown to large recent debts of this nature. The debt may encumber assets that would otherwise be available to Agency. You must verify that such debts are real and were created at "arms length." A written explanation detailing consideration given for the debt, value of security, and date pledged should be made.

f. Evaluation of income.

The primary basis for a compromise settlement is the present value of the net realizable equity. However, consideration must be given to the income (present and prospective) of the obligor(s). The concern is not income needed for ordinary living expenses, but that, which is significantly in excess of what is needed. There are no hard and fast rules; rather it is the good judgment of the recommending and reviewing officials, which will decide each case on its own merits.

(1) Trust income.

Substantial income arising from trusts or other fixed source when combined with regular income providing cash flow substantially in excess of normal living expenses are to be reflected in compromise considerations. A copy of the trust must to be obtained and reviewed to make a determination as to its availability.

(2) Lottery and other prizes.

No weight will be given to this possibility in evaluating income potential.

g. Term settlements.

A cash settlement is the preferred method in compromising a debt. This is not always possible and individual circumstances may dictate a term offer to be most appropriate. Items to consider on term settlements are as follows.

(1) Time limits.

Terms should not exceed 5 years. No balloon is permitted on settlements based solely on the potential earnings of the obligors. Where based on the value of residential real estate, a balloon is permitted. You must be sure to properly secure the collateral used in a term settlement.

(2) Present value.

The present value of a proposed term settlement should always be calculated using a discount rate reflecting interest rate, term, and recovery prospects. A cash amount within 10 percent of the present value should be obtained from the obligor if possible. If both cash and terms are offered and the term offer does not exceed the cash by 10 percent, take the cash offer.

(3) Reinstatement of original debt.

A provision for the automatic reversion to the entire original claim upon failure to reasonably satisfy the repayment requirement must be included in each term compromise settlement. This is also the time to include any allowable local remedies such as confession of judgment, which can be included in the settlement agreement.

(4) Interest rate on term settlements.

There is no requirement that term settlements bear interest. The reviewing official has the authority to set a reasonable interest rate. When interest is included in the settlement agreement, payments must exceed interest accruals.

(5) Hardship Term Arrangements.

Special consideration may be given to the acceptance of a term compromise with a delayed first payment of up to a year when:

- (a) The only worthwhile equity is in residence;
- (b) The family depends on retirement benefits, welfare payments, or other limited income for sustenance; or
- (c) The obligor-residents are in poor health, have limited life expectancy, or low earnings potential.