

PART 1904 - BORROWER CASE CLASSIFICATION

Subpart C - Classification of Community Programs Loans

§1904.101 Introduction.

(a) Office of Management and Budget Circular A-129 requires all Federal Agencies which have loan programs to implement a loan classification system. The objectives of the system are to:

- (1) assess the quality of the Agency's loan portfolio;
- (2) estimate loan losses to the Government in the Agency's accounting records and financial statements;
- (3) assess the need for special loan servicing; and
- (4) improve the management of the loan programs.

(b) Community Programs (CP) borrowers may have several loans for completely separate projects and/or facility types. Therefore, a classification code will be assigned to each individual loan.

§1904.102 District Director responsibilities.

(a) Each District Director is responsible for classification of CP accounts, including Collection Only (CO), Bankruptcy Action Pending (BAP), Court Action Pending (CAP), and Foreclosure Action Pending (FAP) accounts. All accounts will be classified initially by the Finance Office in accordance with §1904.105 of this subpart.

(b) Account classification activities are to be carried out between June 1 and September 30 of each year. To the extent possible, classification should be done as borrower financial situations are reviewed in connection with loan processing, subordinations, loan rescheduling, graduation reviews, problem case reviews, liquidations, or other loan servicing actions. This will minimize the time required to classify accounts.

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General
Borrower Case Classification

§1904.103 State Office responsibilities.

As a component of supervisory visits and evaluation reviews, State Office personnel will:

- (a) Monitor completion of classifications. It should be assured that the initial Finance Office report has been reviewed for completeness and that any appropriate changes in classifications have been made when the codes are entered through the Automated Discrepancy Processing System (ADPS). After the first year, it should be verified that new loans are classified and subsequent reports are checked for completeness and appropriate changes to classifications and/or estimated loss amounts.
- (b) Assess validity of the classifications. This should be done in conjunction with all Problem Case Reviews, reviews of other loan servicing actions, and reviews of loan making activities. A reasonable number of additional borrower files will also be selected for review of classification validity.

§1904.104 Classification categories.

(a) Some degree of risk is inherent in all loans, especially Rural Development loans. The classification categories defined below reflect the servicing official's judgment of the degree of risk involved for a particular loan. Evaluation should include the same factors reviewed when approving a loan or analyzing quarterly or annual reports; for example, the number of users, user fees, past due accounts, operating costs, and the level of reserve and other restricted accounts.

(1) Commercial. These are Rural Development's highest quality CP accounts. The financial condition of the borrower is strong enough to enable it to absorb the normal costs of routine repairs, replacement, and possibly modest capital improvements. There is ample security for the loan and sufficient cash flow to meet operation and maintenance costs and service debts. The account is of such quality that a commercial lender would likely see the loan as a profitable investment. Borrowers subject to refinancing requirements will be requested to graduate such loans in accordance with Subpart F of Part 1951 of this Chapter. Classification code - 1.

(2) Standard. These loan accounts are fully acceptable by Rural Development standards. Risk and potential servicing costs are higher than would be acceptable to other lenders, but the loan is adequately secured. Repayment ability is adequate and there is a high probability that the loan will be repaid as scheduled and in full. Classification code - 2.

(3) Substandard. Loans in this category have adequate though marginal security, but financial difficulties are involved. Repayment ability is marginal or loan payments are sometimes delinquent. The borrower requires special counseling and servicing. In spite of the financial weaknesses it is estimated that in the event of liquidation, the loan would be adequately secured and there may be no loss on the account to the Government. Classification code - 3.

(4) Doubtful. The loan is not adequately secured. Repayment ability is presently inadequate, but there is some potential for improvement and eventual repayment of the loan. However, under present circumstances liquidation is likely to occur, and the potential for loss to the Government is high. Loans in this category require intensive loan servicing. Classification code - 4; estimated loss amount must be entered.

(5) Loss. The financial conditions relating to the loan have deteriorated to the point where repayment cannot be anticipated. There is inadequate security. Some form of liquidation is imminent or in process and will not likely produce adequate funds to cover the loan balance, liquidation costs, and protective advances. Classification code - 5; estimated loss amount must be entered.

(b) For both the Doubtful and Loss categories, loan security is inadequate at the time of the review, and the Government would incur a loss as a result of liquidation. The essential difference between the two classifications is the magnitude of the shortfall in repayment ability. For loans classified as "Doubtful," there is some chance of financial recovery and eventual repayment. For loans classified as "Loss," liquidation involving a loss is considered to be inevitable in the near future.

(c) Loan classification is an internal administrative function and does not directly affect the borrower. If borrowers classified as "Commercial" cannot obtain credit from other lenders, the commercial classification will not be changed unless the borrower's financial situation changes. Classifications are not appealable.

§1904.105 Implementation procedures.

Due to the wide variety of types of projects and of security taken for CP loans, it is not feasible to use ratios or similar methods to classify loans. Instead, the servicing official must select the appropriate classification category based on personal knowledge of the borrower's situation and review of current financial information.

(a) The report issued by the Finance Office will be Report Code 836b, "Classification of Community Program Loans." The initial report will show all loans which are on or ahead of schedule as a "2" (Standard), and all loans which are behind schedule as a "3" (Substandard).

(b) Subsequent reports provided by the Finance Office will show the latest loan classification code and estimated loss amount, if any, previously entered for each loan.

(c) Following receipt of the initial and all subsequent reports from the Finance Office, the District Director will assure that:

(1) All appropriate CP loans appear on the report.

(2) Any necessary changes in classification are made by updating the appropriate field(s) in the Automated Field Management System.

(3) For accounts classified as "Doubtful" or "Loss," a notation is made in the running record of the basis for the classification and the method used to calculate the estimated loss amount.

(d) An estimated loss amount must be entered for loans classified as "Doubtful" or "Loss," but is not to be entered for any other category. Estimated loss amounts will be based on analysis of the remaining balance of the loan, cash on hand, and other assets on which Rural Development has a lien. The estimated loss amount would normally be the amount expected to be realized from those sources less the balance of Rural Development loan(s) and anticipated liquidation costs. A new appraisal will not be required unless necessary due to other servicing actions being taken in connection with the loan.

(e) A copy of each report will be maintained in operational files. Except as noted in §1904.105(c)(3) above, documentation in individual case files is not required.

§1904.106 - 1904.150 [Reserved]