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DECISION **THE COMPTROLLER GENERAL OF THE UNITED STATES** WASHINGTON, D.C. 20548

FILE: B-189712 **DATE:** September 23, 1981

MATTER OF: Farmers Home Administration-Loan Guarantee Program

DIGEST: 1. Loan guarantee by Farmers Home Administration (FmHA) initially charged against level of guarantee authority for particular fiscal year in which guarantee was first approved cannot, as general rule, continue to be charged against the authority for that year when entirely new borrower is substituted in subsequent fiscal year, since determination of whether to approve guaranteed loan to particular borrower is an individual one requiring specific eligibility determination by FmHA. However, if substituted borrower bears close and genuine relationship to original borrower, such as would exist between corporation and partnership controlled by same individuals, and loan purpose remains substantially unchanged, FmHA would have authority to charge loan guarantee to substitute borrower against ceiling for fiscal year in which original guarantee was approved.

2. Loan guarantee by FmHA initially charged against level of loan guarantee authority for particular fiscal year in which guarantee was first approved cannot continue to be charged against ceiling for that year when major changes to character of the project or loan terms occur during subsequent fiscal year. However, if less substantial changes are involved where the purpose and scope of the revised loan guarantee agreement are consistent with the purpose and scope of the original guarantee and the need for the project continues to exist, FmHa would have authority to charge amended loan guarantee against ceiling for fiscal year in which it was first approved.

3. Loan guarantee by FmHA initially charged against level of loan guarantee authority for particular fiscal year in which guarantee was first approved can continue to be charged against authority for that year if new guaranteed lender is substituted in subsequent fiscal year, provided the borrower, loan purpose, and loan term remain substantially unchanged. Although the guarantee is actually extended to the lender, the lender is merely a conduit through which FmHA provides assistance to an eligible borrower to achieve the statutory objectives. Therefore new lender can be designated without changing the essence of the agreement.

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4. FmHA's regulations as well as terms of relevant FmHA forms indicate that applications for loan guarantees are to be approved or disapproved in writing. Oral notification of loan guarantee approval thus would not be sufficient to create a valid guarantee.

This decision is in response to a request from the Acting Administrator of the Farmers Home Administration (FmHA), concerning several questions that have arisen in connection with FmHA's business and industrial guaranteed loan program. In essence, FmHA is concerned as to whether a commitment by FmHA to guarantee a loan by a private lender to an eligible borrower can still be counted against the authorized loan guarantee ceiling for the fiscal year in which the commitment was made, when changes affecting different aspects of the guarantee occur in a subsequent fiscal year.

Specifically, FmHA's written submission requests that we answer the following three questions:

"1. Whether guarantee authority reserved ('obligated') during a previous fiscal year must be lost irrevocably when the lender is changed during a subsequent fiscal year.

"2. Whether guarantee authority reserved during a previous fiscal year must be lost irrevocably when the borrower is changed during a subsequent fiscal year.

"3. Whether guarantee authority reserved during a previous fiscal year must be lost irrevocably when major changes to the character of the project or loan terms occur during a subsequent fiscal year."

Subsequently, in informal discussions with representatives from FmHA these questions were further amplified and clarified. Also, we were informally requested to address a fourth issue involving the extent to which a valid guarantee commitment can be viewed as having been created in a particular fiscal year on the basis of FmHA's oral rather than written notification to the lender. We conclude, with exceptions we shall discuss below, that each of the changes indicated by FmHA with respect to questions 2 and 3 would create a new guaranteed loan which must be charged against the guarantee ceiling for the fiscal year in which the change was made. On the other hand, the change indicated in question 1 would not create a new guarantee and could continue to be charged against the ceiling for the fiscal

year in which the guarantee was first approved. Further, with respect to the informal question, we conclude that oral notification does not create a valid guarantee commitment.

FmHA's business and industrial loan program, also known as the rural or industrial development loan program, is authorized, by section 310B of the Consolidated Farm and Rural Development Act, as amended, (Act) 7 U.S.C. § 1932(a), as follows:

> "The Secretary may also make and insure loans to public, private, or cooperative organizations organized for profit or nonprofit, to Indian tribes on Federal and State reservations or other federally recognized Indian tribal groups, or to individuals for the purposes of (1) improving, developing, or financing business, industry, and employment and improving the economic and environmental climate in rural communities, including pollution abatement and control, * * * Such loans, when originated, held, and serviced by other lenders, may be guaranteed by the Secretary under this section without regard to subsections (a) and (c) of section 1983 of this title. * * *"

The word "insure" as used in this subsection is specifically defined in 7 U.S.C. § 1991 as including "guarantee, which means to guarantee the payment of a loan originated, held, and serviced by a private financial agency or other lender approved by the Secretary * * *."

The rural development loan program established by 7 U.S.C. § 1932 is funded out of a special revolving fund -- the Rural Development Insurance Fund -- created under section 309A of the Act, 7 U.S.C. § 1929a. Maximum limitations on the amount of industrial development loans that can be made out of, or under, the fund in a particular fiscal year are set forth in section 346(b) of the Act, as amended, 7 U.S.C. § 1994(b), 1/ as follows:

1/Although guaranteed loans are included within the statutory definition of insured loans, this provision (7 U.S.C. § 1994 (b)) sets one limit for insured industrial development loans and a separate limit for guaranteed industrial development loans. In this context, the term "insured loan" refers to loans which are initially made by FmHA directly out of the revolving fund and are then promptly sold by FmHA with recourse in the secondary market. The term "guaranteed loan" refers to loans which from their inception are made, held, and serviced by a participating financing institution or other approved lender, with FmHA's assurance that upon default by the borrower it will assume up to 90 percent of the lender's loss on the loan.

"Loans for each of the fiscal years 1980, 1981, and 1982 are authorized to be insured, or made to be sold and insured, or guaranteed under the Rural Development Insurance Fund as follows:

* * * * *

(B) industrial development loans $1,500,000,000 of which $100,000,000 may be for insured loans and $1,400,000,000 may be for guaranteed loans with authority to transfer amounts between categories * * *."

Under 7 U.S.C. § 1994(a), Congress can impose additional limitations on the amount of guaranteed and insured industrial development loans that can be made in a particular fiscal year as follows:

"(a)* * *There shall be two amounts so established for each of such programs and for any maximum levels provided in appropriation Acts for the programs authorized under this chapter, one against which direct and insured loans shall be charged and the other against which guaranteed loans shall be charged, * * * "

For the 1980 and 1981 fiscal years, such limitations have been included in FmHA's annual appropriation. For example, the following provision is set forth in the Agriculture, Rural Development, and Related Agencies Appropriations Act, Fiscal Year 1981, Pub. L. No. 96-528, 94 Stat. 3095, 3106, December 15, 1980:

"For an additional amount to reimburse the rural development insurance fund for interest subsidies and losses sustained in prior years, but not previously reimbursed, in carrying out the provisions of the Consolidated Farm and Rural Development Act, as amended (7 U.S.C. 1988(a)), $143,282,000.

"For loans to be insured, or made to be sold and insured, under this fund in accordance with and subject to the provisions of 7 U.S.C. 1928 and 86 Stat. 661-664, as follows: Insured water and sewer facility loans, $750,000,000; guaranteed industrial development loans, $741,000,000; and insured community facility loans, $260,000,000."

Similar language setting a $1.1 billion overall limitation on the total amount of rural development loans for the 1980 fiscal year, including $10 million for insured loans and the remainder for guaranteed loans is contained in the Agriculture, Rural Development, and Related Agencies Appropriations Act, Fiscal Year 1980, Pub. L. No. 96-108, 93 Stat. 821, 831, November 9, 1979.

Although the language in the appropriation legislation for both the 1980 and 1981 fiscal years is written in a form that might appear to appropriate $1.1 billion and $741 million for guaranteed industrial development loans for the 1980 and 1981 fiscal years respectively, it is apparent that what was intended by the Congress was the imposition of ceilings on the total amounts of guaranteed rural development loans that could be made by FmHA in each fiscal year. 2/ It is the existence of precisely these limitations in FmHA's annual appropriation on the total amount of industrial development loans that can be guaranteed in a particular fiscal year that resulted in FmHA's request to us for a legal opinion as to the proper treatment of a guaranteed loan approved in a particular fiscal year which is modified in a subsequent fiscal year.

FmHA urges us to take the position that a guaranteed loan that has been modified should continue to count against the authorized guaranteed loan level for the year in which it was first approved rather than the level of the subsequent fiscal year in which the guarantee was changed.

Before considering the specific issues raised by FmHA, we believe it is necessary to clarify FmHA's use of the term "obligation" in referring to approved loan guarantees. Our office has taken the position that a loan guarantee is only a contingent liability that does not meet the criteria for a valid obligation under 31 U.S.C. § 200. Ordinarily, when a loan is guaranteed by the Federal Government, an obligation is only recorded if, and when, the borrower defaults--and a Federal outlay is necessarily required to honor the guarantee. This will not usually take place, if at all, in the same fiscal year in which the loan guarantee was initially approved. See GAO Audit Report "Legislation Needed to Establish Specific Loan Guarantee Limits for the Economic Development Administration", FGMSD-78-62, January 5, 1979. Thus, we have held that it is not necessarily required that funds be available in the underlying revolving fund, or elsewhere, before the agency may approve a loan guarantee so long as the guarantee itself is authorized and within whatever annual monetary limits Congress has placed on it. See 58 Comp. Gen. 138, 147 (1978).

2/As is explained at greater length hereafter, funds are not ordinarily appropriated for loan guarantees since no obligation or disbursement of Federal funds occurs when a loan guarantee is approved.

Based on informal discussions with FmHA representatives, it appears that FmHA's practices and procedures in connection with its guaranteed loan program are consistent with our interpretation that a loan guarantee approval does not result in an actual obligation of funds. Apparently, what FmHA actually does upon approval of a loan guarantee is "charge" the amount of the loan guarantee against the authorized ceiling for that year. Also, it may administratively reserve, or earmark, in its revolving fund a certain percentage of the total amount of the guarantee based on the estimated default rate for such loans.

The primary case cited by FmHA in its submission, B-189712, January 5, 1978, (57 Comp. Gen. 205) and most of the other related cases in this general area involved federal grants. The issue in these cases was the availability in a later fiscal year of appropriated funds that were obligated in a prior fiscal year where the underlying agreement that formed the basis for the obligation was modified in the later fiscal year, after the end of the period of availability of the funds.

Although the situation in the instant case is somewhat different—since, as explained above, it does not involve an actual obligation of appropriated funds—the same legal principles are involved. The applicable limitation on loan guarantees, which is set forth in an annual appropriation act, refers to the total amount of loan guarantees that can be approved in a particular fiscal year. The basic question in the "obligation" cases is whether an otherwise binding commitment of funds in a particular fiscal year remains valid if the purpose or the recipient of the funds is changed after the funds are no longer available for a new commitment. Similarly, the basic question here is whether a loan guarantee, once approved, remains a valid and binding commitment if a change affecting the purpose, recipient, or nature of the guarantee occurs after the period of loan guarantee authority expires.

With these considerations in mind, we shall address the specific questions raised by FmHA in its submission (as clarified in informal discussions with FmHA officials) although we have changed the order in which these questions are answered. The first question is whether a loan guarantee initially charged against a level of a loan guarantee authority for a particular fiscal year can continue to be charged against the authority for that year when the borrower is changed during a subsequent year. When the question is presented in this form, without further amplification, the answer is necessarily "no".

We have consistently held in the grant cases that, when the recipient of an original grant is unable to implement the grant as originally comtemplated and an alternate grantee is designated subsequent to the expiration of the period of availability for obligation of the grant funds, the award to the alternate grantee must be treated as a new obligation and is not properly chargeable to the appropriation current at the time the original grant was made. See 57 Comp. Gen. 205, supra; B-164031 (5), June 25, 1976; and other cases cited in those decisions. The rationale behind the general rule is set forth in B-114876, January 21, 1960, as follows:

> "The awards here involved are made to individuals based upon their personal qualifications. Whether the award is considered an agreement or a grant, it is a personal undertaking and where an alternate grantee is substituted for the original recipient, there is created an entirely new and separate undertaking. The alternate grantee is entitled to the award in his own right under the new agreement or grant and not on behalf of, on account of, or as an agent of, the original grantee. It seems clear that the award to an alternate grantee is not a continuation of the agreement with, or grant to, the original grantee executed under a prior fiscal year appropriation, but is a new obligation."

Similarly, in the case at hand, the determination of whether to approve a loan guarantee to a particular borrower is an individual one, necessarily requiring a specific determination by FmHA of the borrower's eligibility under the relevant statutory and regulatory provisions. Obviously, the determination by FmHA with respect to the eligibility of one borrower and the extent to which approval of a guaranteed loan to that borrower would achieve one of the legislative objectives of the rural development loan program, as set forth in 7 U.S.C. § 1932, would be of no value in making such a determination about an entirely different and unrelated borrower, even if a similar project was involved. Thus, adherence to the general rule, as set forth in B-114876, January 21, 1960, and similar cases, requires us to hold that when a loan guarantee is approved for a new borrower having no relationship to the original borrower it must be treated as an entirely new undertaking and must be charged against the authorized loan guarantee level in effect when it, as opposed to the original guarantee, is approved.

Although the above conclusion answers the question set forth in FmHA's written submission, there are exceptions to the general rule. FmHA's representatives informally advised us of some specific situations that may arise in which the originally approved borrower and the proposed substitute are linked in some way. One example is the situation in which the originally approved borrower — a corporation — is replaced with a substitute borrower — a partnership — (or the reverse). In this example, the individuals controlling both the corporation and the partnership are the same and the purpose of the loan presumably remains the same as well. In this or similar situations, the substituted borrower is not a new and independent entity that is separate and apart from the original borrower.

This distinction is significant. Our Office has held that "* * *it may be possible in certain situations to make an award to an alternate grantee after expiration of the period of availability for obligation where the alternate award amounts to a 'replacement grant' and is substantially identical in scope and purpose to the original grant." B-164031(5) June 25, 1976, supra.

Our decisions in two cases are especially relevant. In B-157179, September 30, 1970, we held that the unexpended balance of grant funds originally awarded to the University of Wisconsin could properly be used in a new fiscal year to support Northwestern University's completion of the unfinished project. Essentially, we took this position because the designated project director had tranferred from the University of Wisconsin to Northwestern University and was viewed as the only person capable of completing the project. Further we, found that the original grant was made in response to a bona fide need and that the need for completing the project continued to exist. Our decison analogized the circumstances of that case to the situation involving replacement contracts.

Concerning replacement contracts, we take the position that the funds obligated under a contract are, in the event of the contractor's default, generally available in a subsequent fiscal year "* * *for the purpose of engaging another contractor to complete the unfinished work, provided a need for the work, supplies, or services existed at the time of execution of the original contract and that it continued to exist up to the time of execution of the replacement contract.* * *" See 34 Comp. Gen. 239 (1954); and 60 Comp. Gen. ____ (B-198074, July 15, 1981).

The second relevant decision—57 Comp. Gen. 205, supra—was the one cited in FmHA's submission. In that case we considered whether to allow an alternate grantee to be substituted for the original grantee after the period of availability had expired where the original

grant application had been jointly filed by both. We held that, provided the original and revised grants were for the same needs and purposes and were of the same scope (which determination was left to the agency), replacement of the designated grantee by the other applicant did not require a new obligation because "* * *the alternative proposal amounts to a replacement grant rather than a new and separate undertaking."

In both these cases a genuine and tangible relationship existed between the original and substituted grantee. Also, in both cases the purpose and scope of the grants, as well as the need for the grant project, remained the same. In the situations suggested informally by FmHA, the original and substituted borrowers would have a similar, if not greater, connection with each other. For example, in the case of a change from a partnership to a corporate borrower, or the reverse, the names of the controlling individuals presumably would appear on both the original and revised applications. Similarly, we assume that the purpose and the scope of the project supported by the loan guarantee would remain substantially the same since the same individuals would be involved. Therefore, we would not object if FmHA charges a substitute loan guarantee against the authorized ceiling of the fiscal year for which the guarantee was initially approved, provided the substituted borrower bears a close and genuine relationship to the originally approved borrower (such as has been discussed herein) and the purpose for which the loan funds are to be used by the substitute borrower is substantially unchanged.

The next question is whether a loan guarantee can continue to be charged against the ceiling for the year in which it was approved "when major changes to the character of the project or loan terms occur during a subsequent fiscal year." Examples of such major changes are listed in the submission as including "major changes to the facility design, project's purpose, loan terms." As was true of the previous question, when the issue is characterized in this fashion the answer is clearly "no".

Our Office has consistently held that an agency has no authority to amend a grant so as to change its scope after the underlying appropriation has ceased to be available for obligation. For example in 39 Comp. Gen. 296, 298 (1959) we said the following:

"We cannot agree that authority to make one grant in a fiscal year necessarily carries with it authority to amend that grant where the amendment would alter the scope of the original grant and require additional funds. The execution of a grant based upon a proposal containing specific objectives, research methods to be followed, and estimates of project costs would ordinarily give rise to a definite and maxmium obligation of the United States. To enlarge such a grant beyond the scope of the original is to create an additional obligation and must be considered as giving rise to a new grant. * * *"

More recently, in 57 Comp. Gen. 459 (1978), we considered whether the Department of Agriculture could substitute one research grant project for another—to the same grantee. We held that although the grant as modified retained some aspects of the original proposal, the research objective and scope of the original grant was changed, creating a new obligation chargable to the appropriation of the year in which the substitution was made.

Applying these grant decisions to the area of loan guarantees, when a major change to the "character" of the project supported by the guarantee is made, the revised loan guarantee must be charged against the ceiling in effect when the revision is made. We believe that just as a significant change in the terms and conditions under which a grant was made would be viewed as creating a new grant, a significant change in the terms and conditions under which a loan guarantee was approved would create a new loan. 60 Comp. Gen. _____ (B-194153, May 13, 1981).

However, the answer to this question as FmHA submitted it does not, as before, completely resolve this issue. FmHA's representatives informally advised us that in some instances the only revisions to projects supported by FmHA loan guarantees were relatively minor ones (although no specific examples of such changes were stated). The question then becomes much more difficult to resolve definitively, since we have recognized the existence of exceptions to the general rule concerning modifications of the substantive terms of a grant. For example in B-74254 September 3, 1969, we did not object to

the amendment of an approved grant application after the period of availability of the grant allotments had expired, where the amendments involved changes in the use of the funds from construction to renovation or the reverse.

In 58 Comp. Gen. 676 (1979), we considered a similar question as to whether a proposed modification of a grant by ACTION in effect created a new grant where the change involved an enlargement of the area from which participants in the grant project were to be selected. We said the following in that decision:

> "Our earlier decisions concerning changes in grants after the period of availability of the grant funds for obligation has ended have identified three closely related areas of concern:
>
> "(1) whether a bona fide need for the grant project continues;
>
> "(2) whether the purpose of the grant will remain the same; and
>
> "(3) whether the revised grant will have the same scope as the original grant."

Thus, the test of whether a modification of the terms of the grant agreement constitutes an amendment to the original grant or a new and separate undertaking is substantially the same test as is used in determining whether an alternate grantee can be substituted for the original grantee. That is, the need for the project must continue to exist and the purpose and scope of the revised grant must be consistent with the purpose and scope of the original grant.

Application of this test to FmHA loan guarantees can only be accomplished, in our view, on a specific case-by-case basis, considering the specific circumstances of a loan and the type of modification involved. However, as stated above, the type of changes mentioned in FmHA's written submission, including "major changes to the facility design, project, purpose, [and] loan terms," would in our view be so significant as to change the scope of the guarantee and therefore would have to be viewed as a new and separate undertaking.

The final question in the submission involves the substitution of one lender for another in a subsequent fiscal year.

Based on the preceding discussion this question can be readily resolved. As stated above, the basic purpose of the FmHA rural development loan guarantee program is to provide assistance to eligible borrowers to enable them to accomplish one or more of the statutory objectives. In other words, although the guarantee is extended to the lender, it is clear that the purpose of doing so is not to provide a federal benefit to the lending institution but to induce the lender to make the loan to the borrower. In this sense, the lender is just a conduit or funding mechanism through which FmHA provides assistance to an eligible borrower so that the statutory objectives can be realized. Thus, the particular lender involved is of relatively little consequence. In this respect, the relevant statutory provisions do not contain any specific eligibility requirements for lenders. This is clearly distinguishable from the situations discussed above in which the proposed change in the borrower or scope of the project would necessarily have affected the very essence of the agreement.

Accordingly, provided the other relevant terms of the agreement, including the borrower, loan purpose, and loan terms remain substantially the same, we believe that a change in the lender can legitimately be viewed as an amendment of the original loan guarantee. Therefore, the loan can continue to be charged against the authorized loan guarantee level for the year in which the agreement was initially approved.

Informally, we were requested to consider a fourth question-- whether the notification of loan guarantee approval by FmHA has to be in writing in order to be effective within a particular year and therefore be charged against the loan guarantee ceiling for that year, or whether oral notification supported by an internal memorandum is sufficient. There are no statutory provisions in the legislation governing the rural development loan program or elsewhere, of which we are aware, that require loan guarantee approval to be in writing. Further, since a loan guarantee does not constitute an actual obligation of funds until the borrower has defaulted and the Government becomes legally "obligated" to make an expenditure in order to honor its guarantee, recording of guarantees is not required by 31 U.S.C. § 200, which requires, that obligations be supported by written documentation.

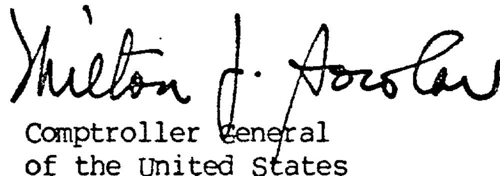
However, FmHA's regulations set forth in 7 C.F.R. § 1980.452, provide in pertinent part as follows:

> "FmHA will evaluate the application. FmHA will make a determination whether the borrower is eligible,

> the proposed loan is for an eligible purpose, and that there is reasonable assurance of repayment ability, sufficient collateral, and sufficient equity. If FmHA determines it is unable to guarantee the loan, the Lender will be informed in writing. Such notification will include the reasons for denial of the guarantee. If FmHA is able to guarantee the loan, it will provide the Lender and the applicant with Form FmHA 449-14, listing all requirements for such guarantees. ***"

In our view, this regulation clearly contemplates written notification to lenders of FmHA's decision to approve or disapprove the application for a guaranteed loan. Similarly, the terms and provisions set forth in the various forms and documents used by FmHA in approving loan guarantees (including Forms FmHA 449-35, FmHA 440-1, and FmHA 449-14) indicate that loan guarantee approval must necessarily be in writing to be effective. In B-187445, January 27, 1977, we concluded that similar provisions in the regulations and contract governing the guaranteed loan portion of the Small Business Administration required that "the approval of a guarantee must, at a minimum, be in writing in order to be valid." Also, see 54 Comp. Gen. 219 (1974). Accordingly, it is our view that under FmHA's current regulations, oral notification would not be sufficient to create a valid guarantee.

The questions presented to us by FmHA are answered in accordance with the foregoing.



Comptroller General
of the United States