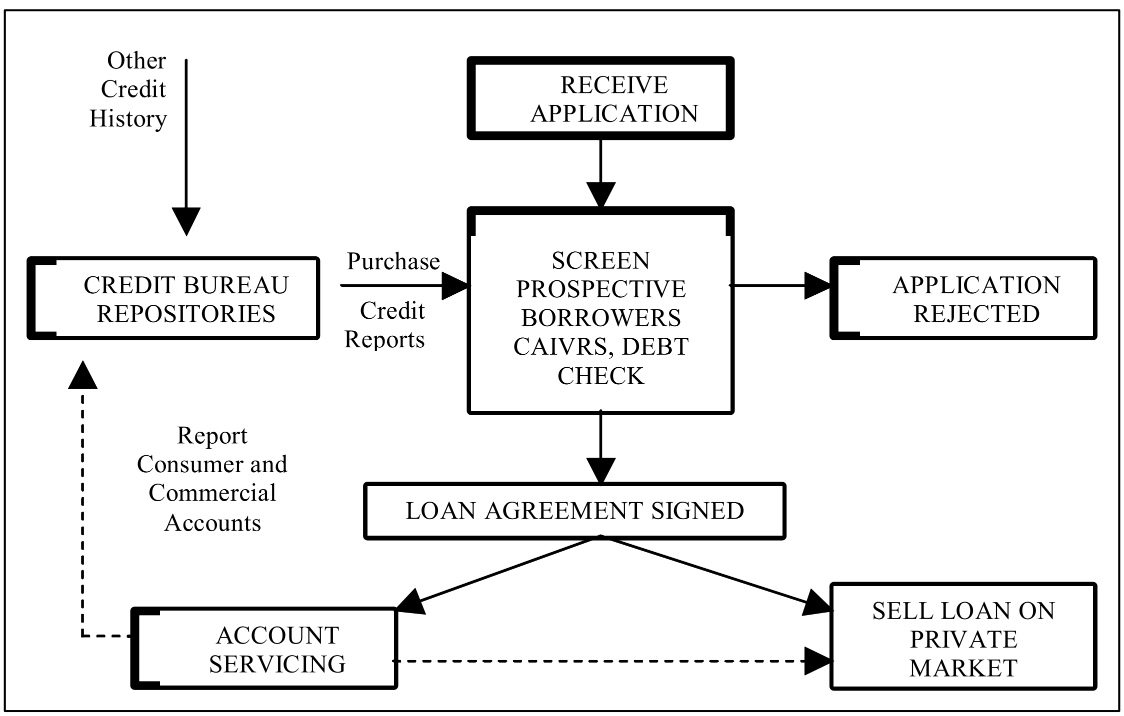
Extending Credit

This Chapter details how Federal agencies and lenders participating in guaranteed loan programs (guaranteed loan lenders) should manage, process, evaluate, and document loan applications and awards for loan assistance. See Chapter 5 "Management of Guaranteed Loan Lenders and Servicers" for information on how Federal agencies should manage lenders and servicers that participate in Federally insured guaranteed loan programs. See also Office of Management and Budget (OMB) Circular No. A-129, "Policies for Federal Credit Programs and Non-Tax Receivables," which may be found online at *www.whitehouse.gov/omb* or *www.fms.treas.gov* .

Credit Extension



When extending credit through a Government loan program, agencies and guaranteed loan lenders must ensure that applications are processed and that credit is analyzed in accordance with all statutory and regulatory requirements. Lenders and agencies need to assess and document their loan applicants' eligibility for the specific type of credit offered. Except where required by statute, an agency will not extend credit to individuals or entities who could obtain credit from private sector sources. Further, except in limited circumstances, no agency or guaranteed loan lender may extend credit to an individual or entity that is delinquent on a Federal non-tax debt, until the delinquency is resolved and proof of the resolution is presented by the debtor. Where permitted by law, individuals who owe delinquent child support obligations are likewise barred from obtaining Federal loan assistance. Federal credit granting agency personnel should work with their agency counsel to determine whether the eligibility requirements may be extended to principals of entities in commercial transactions.

The Application

Federal credit granting agencies and private sector lenders in guaranteed loan programs shall determine whether applicants comply with statutory, regulatory, and administrative eligibility requirements for loan assistance. Lenders and agencies should use the application process as a first step in their effort to evaluate an applicant’s request for credit and to determine eligibility for the credit being sought by the applicant. The application form itself is a critical piece of documentation for capturing key information about the applicant(s), co-applicant(s) and guarantor(s), including:

- full name and any "also/known/as" (AKA);
- taxpayer identification numbers (TINs) (Social Security Numbers [SSNs] for individuals or Employer Identification Numbers [EINs] for all other entities). An agency must require a loan applicant to provide the applicant’s TIN for any program under which the agency makes, guarantees, or insures loans. <u>See</u> 31 U.S.C. 7701(b). Applicants must be asked to identify all prior TINs that were used in other Federal Government applications;
- address(es) and telephone number(s);

- any personal information, such as number in household, required by the program in accordance with provisions of the Privacy Act of 1974, as amended;

- name(s), address(es), and telephone number(s) of applicant's and co-applicant's employer(s);

- all relevant financial information, such as income, assets, payments, and liabilities; and

- collateral information, including collateral location, estimated value and description.

The application form will also contain the following:

- a statement signed by each applicant attesting to the accuracy of the information provided. The statement will describe any penalties the Federal Government imposes on those who knowingly provide false information on a Federal credit or financial assistance application;

- a "Certification of Non-Delinquency" signed by each applicant stating that he/she/it is not delinquent on a Federal Government debt, including any tax debt, and does not own any property that is subject to a judgment lien securing a debt to the Government. If the applicant is unable to make such certification, the applicant should be asked to explain any delinquencies or defaults and informed that the applicant must resolve the delinquency or default, and present evidence of that fact to the agency, before the application process can proceed. ***The agency shall stop processing on the application until such evidence is presented***.

Pursuant to the Debt Collection Improvement Act of 1996 (DCIA), persons owing outstanding delinquent non-tax debt to the United States may not obtain Federal loan assistance until the delinquency is resolved. The DCIA eligibility requirement does not apply to disaster loans, or if the requirement is waived by the head of the lending agency. Otherwise, the DCIA eligibility requirement applies to all Federal direct, guaranteed and insured loans regardless of whether creditworthiness is an eligibility requirement. An agency is not required to grant a loan merely because the DCIA does not render an applicant ineligible (for example, in the case of a delinquent tax debt or if the delinquent debt has been resolved but evidences bad credit history);

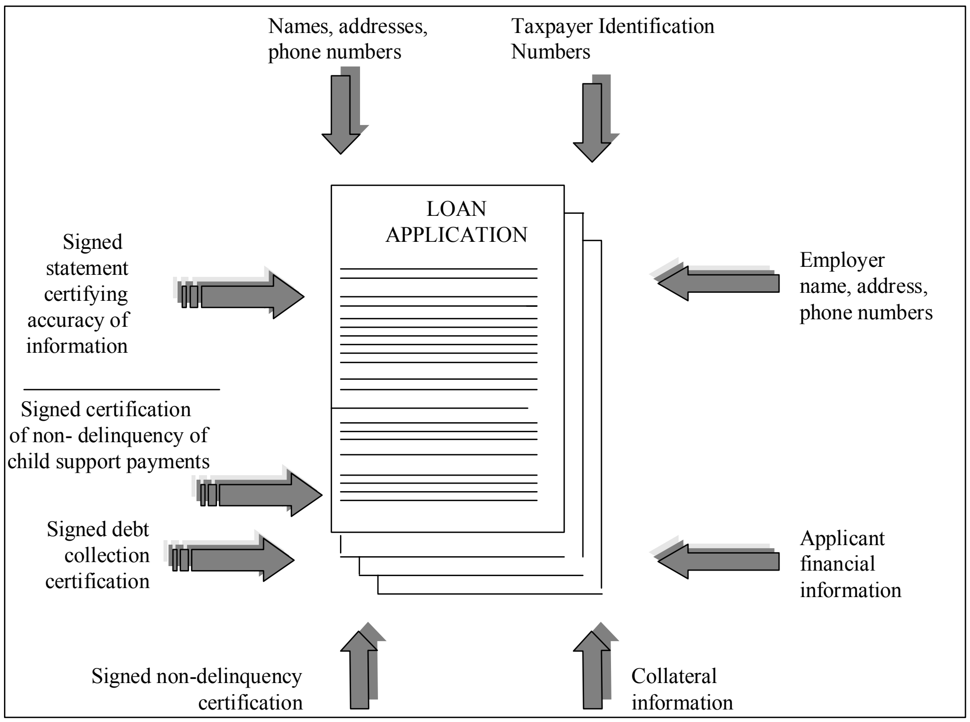
- to the extent allowed by law, a statement that each applicant does not owe delinquent child support obligations. As permitted by law, lenders and agencies shall deny Federal loan assistance to individuals who owe delinquent child support obligations that have been submitted to the Department of the Treasury (Treasury) for collection through the offset of Federal tax refund and other payments. See Executive Order 13109, "Supporting Families: Collecting Delinquent Child Support Obligations." An agency that is authorized to deny a loan pursuant to Executive Order 13109 must provide the loan applicant with a review process described in "Minimum Due Process Guidelines: Denial of Federal Financial Assistance" issued by the Attorney General. The Executive Order and due process guidelines may be found on the web site of Treasury's Financial Management Service (FMS) at *www.fms.treas.gov*;

- a statement requiring the applicant(s) to affirm that he/she has been unable to obtain credit from private sector sources (where it is consistent with statutory, regulatory and administrative eligibility requirements); and

- a "Debt Collection Certification Statement" signed by the applicant, detailing the consequences of delinquency (for example, credit bureau reporting, tax refund offset, etc.) and certifying that the Federal Government's debt collection policies have been discussed with the applicant at the time of application.

<u>All</u> applicants and co-applicants must be required to sign and date the completed application form.

<u>The Application</u>



Application and Origination Fees

The agency should assess a non-refundable application fee that, at a minimum, covers the costs of obtaining credit reports, appraisals, and supplemental data, where applicable. The application fee should be collected at the time the applicant(s) completes and submits the application form. The amount of the application fee should be reviewed on a regular basis and adjusted accordingly.

In addition, the agency should charge an origination or funding fee which covers the costs of making the loan, including an amount sufficient to cover as much of the estimated losses as possible, based on past performance of the portfolio. The agency should reassess and adjust, as necessary, the amount of the origination or funding fee at least annually, where permitted by statute.

The agency must inform the applicant at the time of application of any application, origination or funding fees. The agency must collect the origination or funding fee at the time of application, upon loan approval, or at the time the loan funds are disbursed as agency regulations require.

Verifying Information Provided by the Applicant

After receiving the completed application form and making an initial determination based on the application alone that the applicant is eligible for the credit being sought, the agency and/or its lender, as appropriate, should verify the information provided by the applicant by:

- matching the applicant's name and social security number against the Internal Revenue Services's delinquent tax files to determine if the applicant has a Federal tax liability. Applicants with such liablity are ineligible until the liability is satisfied;

- using, as appropriate, the Department of Housing and Urban Development's Credit Alert Interactive Voice Response System (CAIVRS), the Debt Check program operated by FMS, and other databases including internal agency information systems, to determine if the applicant is delinquent or has defaulted on a Federal Government loan or has an outstanding Federal judgment;

- obtaining and using credit reports available through the General Services Administration's (GSA) Federal Supply Schedule for Business Information Services. The credit report will also be used to conduct the credit analysis and determine the applicant's creditworthiness (see "Conducting the Credit Analysis" in this chapter); and

- requesting verification of the applicant's employment and income, credit history, and bank deposits from the appropriate sources. Requests for verification of this information should carry an expiration date. Information should be reverified if more than 90 days old at the time of loan approval, 120 days old at closing, or at any time prior to closing if there is reason to believe that changes have occurred since the original verification. These time limits may be extended 30 days based upon market conditions in effect at the time of application. All information received during the origination and underwriting process becomes part of the permanent loan file.

Credit Scoring

Credit scoring is a specific standardized, statistical method of rating applicants by assigning points to certain attributes and criteria of the applicant. For example: low consumer debt and no delinquencies -- 5 points; high consumer debt with 3 delinquencies -- 2 points; or, as a second example, occupancy in the same residence for 5 years -- 10 points; occupancy in the same residence for 2 years -- 3 points. In this example, a higher score would indicate greater financial stability and responsibility and, presumably, represent a lower credit risk.

Criteria used in a credit scoring system must be relevant to an applicant's ability to repay and must be uniformly applied to all applicants to ensure agency/lender impartiality in its credit analysis. In developing a credit scoring system, an agency must be able to demonstrate that there is a positive statistical relationship between specific criteria, such as length of time at the same residence, and its applicants' creditworthiness. Where creditworthiness is a criterion for loan approval, agencies and private sector lenders shall determine if applicants have the ability to repay the loan and a satisfactory history of repaying debt.

Credit scoring may be used to determine whether an applicant meets baseline creditworthiness requirements prior to conducting a full credit analysis. Credit scoring should not be used as a substitute for conducting such analysis, nor as the only means for determining creditworthiness.

Using Credit Reports

Agencies and guaranteed loan lenders shall use reports originating from credit bureau repositories as a screening tool. Credit reports and supplementary data sources, such as financial statements and tax returns, should be used to verify or determine employment, income, assets and credit history. In addition to using a credit report to verify information supplied by the applicant and where creditworthiness is a criterion for loan approval, the agency shall also use it to answer two key questions: (1) does the applicant have the ability to repay the loan or credit award in question; **and** (2) does the applicant have a satisfactory history of repaying debt? Guaranteed loan lenders and agencies need to determine what type(s) of credit report(s) will best help them answer these questions and order the appropriate report. Through the GSA's Federal Supply Schedule for Business Information Services, Federal agencies have access to a number of different types of reports, with different types of information.

Depending upon the type obtained, the credit report will reveal:

- the type of credit history that has been established, including whether the applicant has met the terms of established credit accounts;
- whether there have been any recent inquiries about the applicant's credit status; and
- whether there are any outstanding liens against the applicant's property.

The credit report will contain information on amounts owed to, and the status of accounts held by, private sector companies, as well as Government agencies, and public record information, such as judgments, liens and bankruptcies. The agency needs to evaluate all of the information in the credit report in terms of the following questions:

- **How long has credit been established?** A six month credit history may be acceptable if the applicant just graduated from college, but may be a cause of concern if the applicant has indicated that he/she has a well-established credit history.

C **Are the credit accounts being paid as agreed?** The answer to this question will indicate whether the applicant is able to handle the debts he/she incurs, identify potential problem accounts, and identify outstanding delinquent amounts owed to the United States or delinquent child support obligations that need to be resolved before additional Federal loan assistance may be approved.

C **Who is responsible for a given account?** Applicant? Co-applicant? Information on the credit report will tell the agency who is liable for paying a given account. The agency should follow-up with the applicant on any accounts which show up on the credit report, but which the applicant did not reveal.

C **At the time of application, is there any bad credit? Has there been in the past? And, if so, what were the circumstances -- medical problems, death, divorce, unemployment?** If past due accounts have been brought current, the applicant may be trying to reestablish a good credit rating. Repeated one or two month delinquencies may indicate a cash flow problem -- or someone who knows how to "play the system" so that the delinquencies never look so serious as to affect the applicant's ability to obtain new credit.

Agency personnel should exercise judgment when reading an applicant's credit report and should not hesitate to ask the applicant to clarify or explain any items of concern to the agency. (See **Appendix 1** for a key to reading credit reports.)

Credit Ratings

A credit rating may assist the agency in determining the creditworthiness of the applicant. The rating is based upon the applicant's financial condition, experience, and credit history. Under a credit rating system, each application is independently evaluated using specific standards and acceptable deviations from those standards developed by the agency. Ratios, in particular income ratios, are often used to determine a credit rating. Income ratios, which indicate the relationship between expenses and income, are used to assess an applicant's ability to make additional payments or absorb future expenses.

To develop and apply a credit rating system, an agency must:

- determine, based on past credit experience, what it considers to be an acceptable level of risk for its loans;
- establish standards, including acceptable ratio levels, that it can apply to relevant financial information obtained from the applicant;
- calculate all applicable ratios; and
- apply the appropriate standards to a loan application for a specific type of credit to determine the credit rating.

If the agency determines that an applicant has an unacceptable credit rating, it must decide if there are compensating factors which may mitigate the poor rating. Such factors would include the applicant's:

- demonstrated ability for increased annual earnings, based upon employment history;
- long-term employment prospect; and
- conservative use of credit or minimal amount of debt.

Conducting the Credit Analysis

Using the information on the credit report, the verified application information, and the results of the credit rating, the agency should conduct a credit analysis to determine an applicant's creditworthiness, that is, the applicant’s ability and willingness to repay the loan.

A credit analysis for a ***consumer applicant*** will consider the following:

- employment history for the past 2 years;
- current and potential income and benefits;
- financial statements including current assets, financial obligations, and liabilities;
- income tax returns for the past 2 years;
- credit rating;
- repayment history of prior debts;
- guarantees and collateral, ensuring that they are not pledged to other debts;
- value of any pledged collateral; and
- homeownership status and residential stability.

A credit analysis for a ***commercial entity*** will consider the following:

- financial condition, as documented by annual and interim financial statements such as the balance sheet, income statement, and cash-flow statements. The agency should use audited statements whenever possible and not require documentation that is cost prohibitive for the applicant to obtain;
- any income tax returns for the past 2 years;
- ratios, such as total liability to total equity, net income to interest expense, current assets to current liabilities, net income to assets, and net income to equity;
- profit margin;
- amount and type of working capital;
- evaluation of the actual or potential market for the commodity or service being offered and the entity's marketing strategy for expanding or creating that market;
- company ownership (e.g., sole proprietor, partnership, corporation);
- managerial ability and/or experience of key company personnel;
- guarantees and collateral, ensuring that they are not pledged or attached to other debts; and
- credit rating.

Generally, an agency should give particular attention to a company's cash flow since it will be the source of the debt repayment. The agency should also consider whether debts owed to the United States by officers, directors, major shareholders and partners render the commercial entity ineligible for loan assistance under the DCIA. See 31 C.F.R. 285.13(c)(2).

The agency should conduct comparable credit analyses on any co-borrower(s) and guarantor(s) listed on the application form. The agency must document and maintain the appropriate credit analyses in the applicant's file.

Appraisal of Real Property

For many types of loans, the Federal Government can reduce its risk of default and potential losses through well managed collateral requirements. Appraisals of real property serving as collateral for a direct or guaranteed loan (or property required for grant agreements and procurement contracts) must be conducted in accordance with the following guidelines:

- agencies should require an independent, unbiased appraisal of property used as collateral. The appraisal should be consistent with the "Uniform Standards of Professional Appraisal Practice" (USPAP), as promulgated by the Appraisal Standards Board of the Appraisal Foundation, and any additional requirements established by the agency; and

- the appraiser should be qualified in accordance with the applicable State and Federal regulatory requirements. Lenders and/or agencies shall determine whether an appraisal must be performed by a State licensed or certified appraiser based on the size of the loan and/or complexity of the appraisal. For non-business loans over $100,000 and for business loans over $250,000, lenders and agencies should ensure that a State licensed or certified appraiser prepares the appraisal. Agencies may also require the services of a State licensed or certified appraiser for smaller direct or guaranteed loan transactions. The services of a State licensed or certified appraiser are not required for loans with no cash out and for those transactions where the collateral is not a major factor in the decision to extend credit.

The appraisal will establish the fair market value of the property and serve as the basis for the agency's decision as to the maximum loan it will make on the property. The property should be appraised close to the commitment date of the lender. The property should be reappraised if the appraisal is more than 6 months old.

Major elements addressed on the appraisal include:

C **neighborhood analysis**, including data related to the economic background of the region, city and neighborhood;

C **site analysis**, including data related to the size and shape of the property, the types of buildings on the property, front footage and parking;

C **improvement analysis.** A **lot** is considered "improved" if it contains a structure. The **improvement analysis** focuses on the structure or other dwelling(s), such as floor plans, energy efficiency, and age; and

C **property condition and appraiser comments.** The appraiser must express an opinion about the condition of the property.

The “Subject Property Section” of the appraisal provides a complete description of the property and its surroundings. A map, floor plan, and photographs of the property reflecting the property’s “curb appeal” should also be attached.

The appraiser uses the sales price of similar properties and estimated replacement costs to estimate the property's market value. This estimate will be documented in the report's valuation section.

In some credit programs, the primary purpose of the loan is to finance the acquisition of an asset, such as a single family home, which then serves as collateral for the loan. Lenders and Federal agencies should ensure that borrowers assume an equity interest in such assets to reduce defaults and losses. Federal agencies should explicitly define the components of the loan-to-value ratio (LTV) for both direct and guaranteed loan programs. Lenders and agencies will review and approve the appraisal report containing the estimated market value in order to determine the maximum available loan on the property (loan-to-value ratio). The approved appraisal report will be placed in the permanent loan file.

Unless exempted or otherwise authorized by law, agencies should establish:

- a maximum acceptable LTV ratio. This could be in the range of 80 to 95%. Financing should be limited by not offering terms (including the financing of closing costs) that result in a LTV equal to or greater than 100 percent. Further, the loan maturity should be shorter than the estimated useful economic life of the collateral;

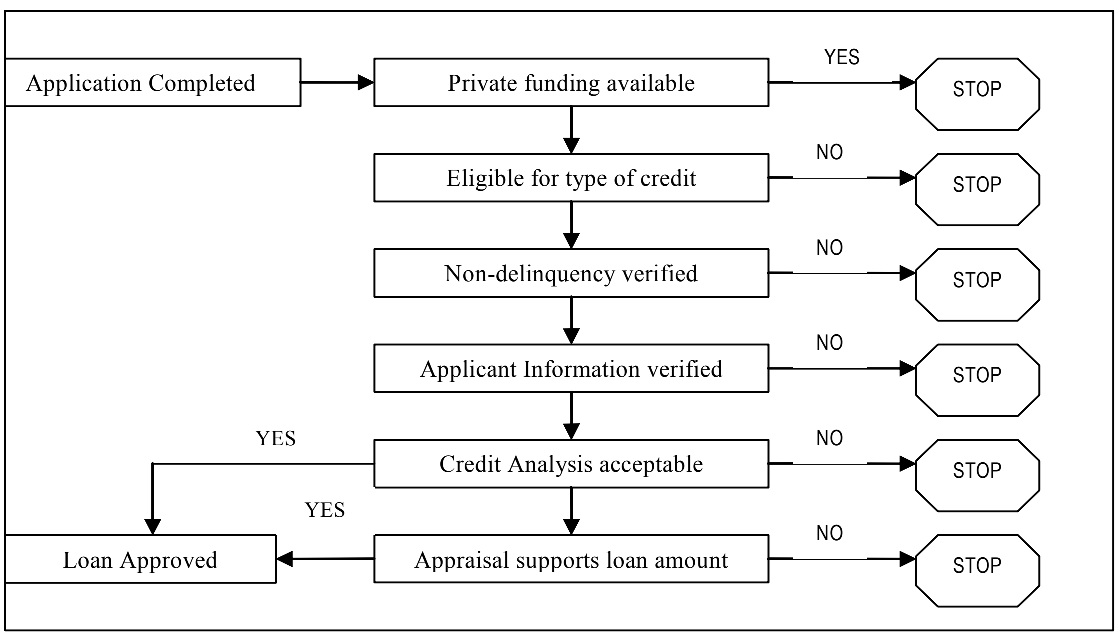
- limitations on the proportion of up-front fees or transaction related expenses that a borrower can finance;

- an acceptable minimum down-payment amount; and

- a process for assessing higher loan premiums on loans with higher loan-to-value ratios.

Loan Closing

Processing a Loan to Loan Closing



Loan closing occurs after the completion of the processing of a loan which results in loan approval. At loan closing, the agency or lender will collect any loan documents or monies due. The agency is responsible for ensuring that all legal documents including the promissory note, collateral documents (such as security agreement, mortgage, and/or deeds of trust), loan agreement, certification of non-delinquency, and debt collection certification statement, are signed by both the borrower(s) and co-borrower(s).

Where appropriate, the loan documents will state the terms of repayment, including:

- the frequency, due dates, and amount of principal and interest payments. Generally, loan payments should be monthly unless the borrower’s projected cash flow would make monthly installments inappropriate;
- the amount of escrow payments, if required;
- the length of the loan - loan maturity should be shorter than the useful economic life of the asset being financed;
- the acceptable means of repayment, i.e., checks, money orders, credit cards, pre-authorized debit or electronic payment via the internet (see, for example, www.Pay.gov);
- an explicit statement of borrower's rights and remedies;
- any special exemptions, such as cases of possible forbearance or deferment;
- Federal delinquent debt collection policies and procedures;
- agency policies regarding the assessment of late charges on delinquent payments. Amounts and/or rates to be assessed should also be provided, when possible; and
- agency policies regarding the acceleration of the debt in the event of a delinquency.

Non-Loan Screening

Where financial responsibility is a factor, an agency should screen its potential contractors and grant applicants, in accordance with all statutory and regulatory requirements. Standards in Part 9 of the Federal Acquisition Regulations (FAR) apply to the screening of contractors. As part of the application process, the agency must obtain the following information from contractors and grant applicants:

- taxpayer identification number(s); and
- certification of non-delinquent status. The applicant will certify that he/she is not delinquent on a Federal Government debt, including tax debt. Agencies should include the certification statement on the application form.

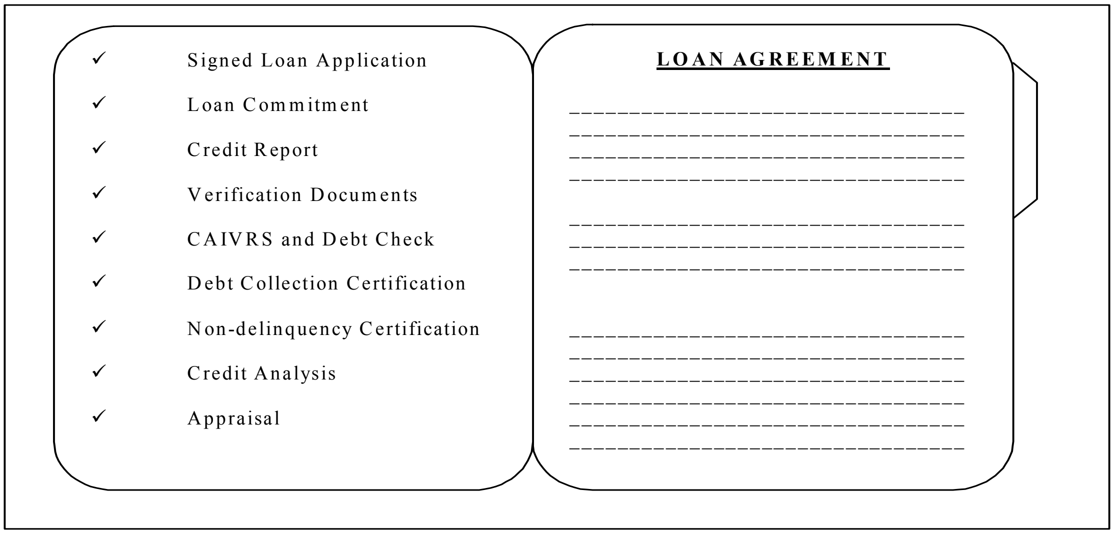
Processing of contractor agreements and grant applications shall be suspended when applicants are delinquent on Federal tax or non-tax debts, including judgment liens against property for a debt to the Federal Government. Processing should continue only when the debtor satisfactorily resolves the debt(s) (e.g., pays in full or negotiates a new repayment plan).

Agencies shall obtain and use credit reports to verify the information provided by contractors and grant applicants, assess financial condition, and ascertain other financial agreements, if any, between the applicant and the Federal Government. The agency should also check the "List of Contractors Indebted to the United States" (Army Hold-Up List), published by the Defense Finance and Accounting Service as part of its contractor eligibility evaluation and verification process.

When an applicant is listed as debarred or suspended in the "List of Parties Excluded from Federal Procurement or Non-procurement Programs," the agency will not make an award except as authorized under agency regulations implementing Executive Order 12549 or FAR 9.4.

Credit Extension Documentation

Credit Extension Documentation



Loan origination files should contain loan applications, credit bureau reports, credit analyses, loan closing documents, and other documents necessary to conform to private sector standards for that type of loan. Accurate and complete documentation is critical to providing proper servicing of the loan, pursuing collection of delinquent debt, and, in the case of guaranteed loans, processing claim payments.

At loan origination, the agency or lender will start building the loan file with the following documents, as applicable:

C original signed loan application including the certification by the borrower of non-delinquency of Federal debts; certification by the borrower that he/she sought private sector financing and was denied or a copy of the application form for private sector financing with the letter denying the loan; and certification by the borrower of the accuracy of the information provided on the loan application;

- supporting papers including credit approval documentation (credit report(s) and agency analysis of credit information, along with records of subsequent approval action); and an appraisal of the property along with supporting documentation;
- statement that the borrower has not been suspended, debarred, or voluntarily excluded from procurement or non-procurement dealings with the Federal Government;
- signed certificate that the borrower was informed of the Federal Government's debt collection policies and procedures;
- financial and market analyses for commercial loans;
- copies of all related audits for previous five (5) years for commercial loans;
- insurance documents;
- copy of the loan commitment and the terms and conditions of the loan, including a complete payment schedule for principal and interest;
- original copy of the accepted loan commitment signed by the applicant(s);
- all original internal review documents required for financial and legal findings (all letters, memoranda, legal opinions and requisitions for disbursement concerning negotiations and closure of the loan, including summary of written, telephone, and electronic mail contacts between lending officials and applicant);
- evidence of necessary public record filings securing loan collateral including current Uniform Commercial Code filings and searches; and
- list of scheduled reports required by the agency, including financial statements from the borrower.

Lenders and agencies should use a manual or automated checklist to ensure that they have fully documented their credit extension activities. (See **Appendix 2**). While much of this information may be contained in an automated system, lenders and agencies may still need to maintain all original documentation to support possible future legal action.

Questions regarding this chapter can be directed to the Agency Enterprise Solutions Division, Federal Finance, Financial Management Service at 202-874-6875.