Government Incentives for Businesses

Permanent Federal Credit and Loan Guarantee Programs

By Jeffrey A. Rosen, Patrick E. Groomes, and Michael W. Cohen

Within the last 18 months, the United States has experienced the most significant contraction in business credit since at least the Carter administration. Individual loans to small and medium-size enterprises by commercial banks have become more expensive, complex, and sometimes difficult to obtain.

As the financial crisis of late 2008 unfolded, much attention was understandably focused on the emergency programs of the U.S. Treasury and the Federal Reserve designed to stabilize banks and enable lending. Those new programs, such as the Troubled Assets Relief Program, or TARP, have commanded much public attention and focus on the government's role in the credit markets, in part because of their unprecedented size, cost, and restrictions on and oversight of the recipients.

Perhaps less well-recognized is that the federal government has for many years run an array of permanent credit programs, aimed at expanding the availability of credit on attractive terms to a wide variety of prospective borrowers. These programs provide support for the development of a wide variety of projects, including road and transportation infrastructure, electricity infrastructure, micro-credit lending businesses, and advanced transportation fuels. During the last several years, the Office of Management and Budget (OMB) conducted evaluations of at least 40 such federal credit and loan guarantee programs. These are found at the OMB website, *www.whitehouse.gov/omb/expectmore* (see the drop-down menu under "Topic or Type").

Some of this credit support is directed toward individuals, particularly with regard to housing and education loan programs. Several programs provide support to business enterprises that are engaged in activities federal policymakers have chosen to subsidize. Many of these programs, however, have broad applicability to a wide variety of business enterprises. Some of the business credit programs are themselves quite large, involving tens of billions of dollars in direct loans or loan guarantees, which significantly reduce the cost of debt financing for recipients. However, there usually is some cost involved in acquiring these loans or loan guarantees. Recipients generally are required to fund a "credit subsidy cost," which is a portion of the estimated cost incurred by the federal government arising from all defaults under a given program. The credit subsidy cost for any given loan or loan guarantee usually is determined based on the nominal value of the loan or loan guarantee. Under some programs, however, Congress has appropriated funds to cover a recipient's credit subsidy cost, thus further lowering the cost of debt financing under these programs.

Over the past several years, the programs discussed in this article have funded a $589 million loan for an expansion of the I-495 Capital Beltway in northern Virginia, a $266 million loan guarantee for the construction of five articulated barges, a $1.4 billion loan guarantee for the construction of three utility-scale solar power plants, an $8.33 billion loan guarantee for the construction of two nuclear power reactors, and a $4.1 million loan for rail cars and new locomotives.

This article provides an overview of the permanent credit programs, by issuing agency, that are available to businesses and what businesses must do to participate in them. It addresses neither programs for individuals, nor programs involving assistance for international activities such as exports or imports, nor the TARP programs. As each federal program is unique in its terms and conditions, the body of this article focuses on the general parameters and characteristics of these programs to illustrate the terms of the federal government's credit programs for business.

The authors are lawyers at Kirkland & Ellis LLP in Washington, D.C. Mr. Rosen previously served as the general counsel of the White House Office of Management and Budget during 2006–2009 and as the general counsel of the U.S. Department of Transportation during 2003–2006. Their respective e-mails are jeffrey.rosen@kirkland.com, patrick.groomes@kirkland.com, and michael.w.cohen@kirkland.com.

Department of Transportation (DOT)

Railroad Rehabilitation & Improvement Financing (RRIF) Program. The RRIF program is designed to finance development of railroad infrastructure and is administered by the Federal Railroad Administration (FRA) within DOT. RRIF was established by the Transportation Equity Act for the 21st Century in 1998 and expanded by the Safe Accountable, Flexible and Efficient Transportation Equity Act: A Legacy for Users in 2005. The enabling legislation authorizes the FRA to issue direct loans and loan guarantees for up to $35 billion in projects at any given time. Over the last 10 years, over 20 loan agreements, several in excess of $50 million, including a loan of $233 million, have been funded through this program.

Eligible entities for RRIF funds include railroads, joint ventures that include at least one railroad, and limited rail freight carriers with the purpose of creating a rail connection between a facility and a second rail carrier. RRIF funding may be used to acquire or improve intermodal or rail equipment and facilities, refinance outstanding debt incurred for the purposes listed above, and develop or establish new intermodal or railroad facilities. RRIF funds may not be used for railroad operating expenses.

RRIF funds may cover up to 100 percent of an eligible project's costs, and loans are permitted for terms of up to 25 years. Entities receiving RRIF assistance must pay the credit subsidy cost at the time of issuance of RRIF loans or loan guarantees. Applications are currently open for this program. Recent RRIF awards include a $31 million loan to the Iowa Interstate Railroad for the purchase of 12 new locomotives and a $4.6 million loan to the Nashville and Eastern Railroad for the purchase of new hopper cars and locomotives.

Shipyard Construction and Modernization. The Federal Ship Financing Guarantee Program was established by Title XI of the Merchant Marine Act of 1936 (Title XI). The Title XI program guarantees loans to finance a vessel or shipyard improvement project constructed in the United States. The Title XI program is administered by the Maritime Administration within DOT (MARAD).

Applicants to this program are limited to individuals or entities with the ability, experience, financial resources, and other qualifications necessary for the adequate operation and maintenance of an eligible vessel or shipyard. Vessels eligible for Title XI financing include commercial shipping vessels, offshore oil rigs and support vessels, and floating drydocks. Title XI further extends to technological improvements to such vessels, novel techniques and processes designed to improve shipbuilding, and related industrial production that advances U.S. shipbuilding.

A loan guarantee may be entered into up to one year after the commissioning of the project or vessel. Loan guarantees are limited to 87.5 percent of the actual cost of the project or vessel.

As of October 2009, the MARAD loan guarantee portfolio was approximately $2.5 billion. The current outlook for the program is unclear. From 1993 to 2003, over $5.6 billion in projects were guaranteed. However, $1.3 billion in defaults occurred related to those projects. This prompted a wholesale review of Title XI by the Government Accountability Office, and since then, budgetary requests for Title XI have dwindled. However, in 2009 loan guarantee activity resumed, with MARAD guaranteeing loans of $266 million for five articulated barges and $40 million for nine tank barges and 30 hopper barges.

Transportation Infrastructure Finance and Innovation Act Credit Program (TIFIA). The Transportation Infrastructure Finance and Innovation Act of 1998 created a federal credit program, TIFIA, to support transportation projects with secured direct loans, loan guarantees, and standby lines of credit. These funds may be used by a public-private partnership for road or rail infrastructure projects. As of October 2009, the active TIFIA portfolio included direct loans and loan guarantees comprising over $5.1 billion in credit.

Eligible projects for TIFIA are broadly defined as surface transportation projects, road and rail infrastructure and vehicles, or intermodal transfer facilities. A project must have a cost of $50 million or 33⅓ percent of the federal highway funds apportioned to the state in which the project is located for the most recent fiscal year. Any credit instrument issued must be repayable, at least in part, from tolls or user fees that are also used to secure project obligations.

Eligible applicants for TIFIA are state or local governments, public authorities, public-private partnerships, or any other legal entity that undertakes a project and is authorized by the secretary of transportation. Any applicant that is not a state or local government must have a proposed project sponsored by the applicable state or local government where the proposed project will be located. The extent of TIFIA credit support cannot exceed 33 percent of the reasonably anticipated eligible project costs.

The credit subsidy costs of TIFIA are payable by federal appropriations. Applications are currently open for this program. Recent projects funded by TIFIA include a $171 million loan for the Transbay Transit Center in San Francisco, a $589 million loan for the I-495 Capital Beltway High Occupancy Toll Lanes in northern Virginia, and a $341 million loan for the Port of Miami tunnel.

Department of Energy (DOE)

Title XVII Loan Guarantee Program (Title XVII). The Title XVII program provides loan guarantees to support renewable energy, transmission, advanced nuclear, and clean coal and carbon sequestration projects. Title XVII was established by the Energy Policy Act of 2005 (EPAct 2005) and later expanded by the American Recovery and Reinvestment Act of 2009 (ARRA). The original EPAct 2005 program and the ARRA expansion are similar. However, funding under the original EPAct 2005 focuses on “innovative” technologies, or technologies that are not yet in widespread commercial use, while funding under the ARRA expansion of EPAct 2005 focuses on technologies in commercial use. Renewable energy projects include wind, solar, biomass, geothermal, tidal, and ethanol. Title XVII grants authority to DOE to guarantee up to $100 billion in loans, including $18.5 billion for advanced nuclear projects.

Funds for the credit subsidy costs of the loan guarantees for commercial renewable projects issued under the ARRA expansion of EPAct 2005 are appropriated in the ARRA legislation. Credit subsidy costs for innovative project loan guarantees issued under the original EPAct 2005 are payable by the borrower and are determined on a project-by-project basis. The size of the loan guarantee is limited to no more than 80 percent of the costs of an eligible project.

While eligible projects for Title XVII are broadly defined in the enabling legislation, Title XVII is administered by DOE solicitations for a subset of specific technologies. Open solicitations currently seek commercial and innovative renewable energy projects. Eligible applicants for solicitations are usually the project sponsor or developer, and, in some instances, the lender. DOE has created a program under Title XVII where the lender for the project will be the applicant for the loan guarantee under certain solicitations. DOE created this program with the intent of streamlining the application process for obtaining funding under Title XVII.

Title XVII has recently issued conditional guarantees on loans of $1.4 billion to BrightSource Energy Inc. for the construction of three utility-scale concentrated solar power plants; $117 million to First Wind Holdings, LLC for a Hawaii wind power project; and $8.33 billion for the construction of two nuclear power reactors in Burke, Georgia.

Department of Agriculture (USDA)

Rural Energy for America Program (REAP). The REAP guaranteed loan program issues loan guarantees to promote commercial financing of renewable energy projects for agricultural producers and small businesses. REAP was created in the Farm Security and Rural Investment Act of 2002 and later expanded in the Food, Conservation and Energy Act of 2008 (the 2008 Farm Act), and is administered by the USDA’s Rural Development program. Eligible purposes for guaranteed loans include the purchase and installation of renewable energy facilities, biomass fuel systems, ethanol or biodiesel facilities, and energy efficiency improvements. Entities eligible for REAP are agricultural producers or rural small businesses.

The maximum loan eligible for a REAP guarantee cannot exceed 75 percent of the eligible project costs, up to $25 million. The maximum percentage of the loan guarantee ranges from 85 percent of the total loan for loans of up to $600,000 down to 60 percent for loans of $10 million or more.

Congress has appropriated funds to cover the credit subsidy costs of REAP loan guarantees in the following amounts: $60 million for 2010, $70 million for 2011, and $70 million for 2012. USDA issues solicitations for REAP guarantees each year.

Business & Industry (B&I) Loan Guarantee Program. USDA’s B&I loan guarantee program is a program that guarantees loans on private projects in rural areas with the goals of promoting employment; improving the economy or the environment; promoting the conservation, development, and use of water for aquaculture; and reducing reliance on nonrenewable energy resources by encouraging the development and construction of solar and other renewable energy systems.

Any business located in rural areas with a population of 50,000 or less may apply for a B&I loan guarantee. Loan proceeds may be used for a wide variety of operational and financial activities including those that fund acquisitions when the loan will keep the business from closing; expanded job opportunities, business conversion, enlargement, repair, modernization, or development; the purchase and development of land, easements, rights-of-way, buildings, or facilities; and the purchase of equipment, leasehold improvements, machinery, supplies, or inventory.

B&I guarantees are generally available for loans of up to $10 million, with an 80 percent guarantee on loans of up to $5 million and a 70 percent guarantee on loans between $5 million and $10 million. In certain instances, loans up to $25 million may be 60 percent guaranteed with USDA approval.

Biorefinery Assistance Program (Biorefinery Program). The Biorefinery Program was created in the 2008 Farm Act for the development of advanced biofuels in rural areas with a population of 50,000 or less. The Biorefinery Program is administered by USDA’s Rural Development program.

Any business may apply for the Biorefinery Program. Eligible projects are commercial-scale biorefineries that adopt technologies to produce an advanced biofuel. Advanced biofuels include renewable biomasses, such as cellulosic ethanol or butanol. The

Purposes for guaranteed loans include renewable energy facilities, biomass fuel systems, ethanol or biodiesel facilities, and energy efficiency improvements.

principal amount of the guaranteed loan may not exceed $250 million. The loan guarantee cannot exceed 80 percent of the loan amount, though this limit may be lowered by the secretary of agriculture.

The 2008 Farm Act created a mandatory appropriation for the Biorefinery Program of $245 million for 2010. In addition, the statute authorizes discretionary appropriations of $150 million, available until 2012.

Other USDA Programs. The USDA has several other specialized loan programs that target specific objectives for development in rural communities. These include programs that offer private grants, direct loans, and/or loan guarantees for improving and expanding telecommunications services; improving the generation, transmission, and distribution of electricity; improving rural telemedicine and distance learning services; and improving and expanding broadband in rural areas.

Small Business Administration (SBA)

The SBA caters to small businesses throughout the United States. While credit availability under all of its programs is limited to enterprises that do not exceed specified levels of market capitalization and net income, credit support may still be available to affiliates of larger enterprises based upon their individual circumstances. The SBA maintains two general credit programs and several additional programs with specified public policy objectives.

7(a) Loan Guarantee Program (7(a) Program). The 7(a) Program was created by the Small Business Act in 1953 and provides loan guarantees for small businesses to obtain financing. Eligible businesses qualify as small businesses based upon revenue and employee metrics. The majority of businesses are eligible for financial assistance from the SBA, the most notable exception being financial institutions engaged in lending or investment activity.

The 7(a) Program can guarantee up to 80 percent of a loan up to $150,000 or 70 percent of a loan between $150,000 and $2 million. The proceeds of a loan obtained under the 7(a) Program can be used for a wide variety of operational and financial activities including short- and long-term funding of capital investment, financing of working capital, the refinancing of business indebtedness, and the purchase of an existing business. The stated purpose of the loan is a significant factor in the maturity date of the loan guaranteed by the SBA.

Certified Development Company/504 (CDC/504). The CDC/504 loan program provides long-term financing through special entities seeking to foster economic development within a community, Certified Development Companies (CDCs). CDCs are nonprofit corporations that work with the SBA and private-sector lenders to provide financing to small businesses. Nationwide there are 270 CDCs, organized according to geographic location.

Eligible applicants for CDC/504 loans are small businesses as determined by the SBA regulations. Unlike the more flexible 7(a) Program, proceeds of a CDC/504 loan may only be used for fixed-asset projects, including land and land improvements, construction of facilities, or purchase of machinery and equipment.

CDC/504 loans, which are backed by an SBA-guaranteed debenture, must be for at least $25,000 and can constitute up to 50 percent of the cost of a project. The maximum amount available to finance a project depends both upon the number of jobs that will be created as a result of the project and the ability of the project to address specific public policy goals. However, the maximum amount of assistance is limited to $2 million for any one borrower.

Other SBA Programs. The SBA has established several other specialized loan programs that target specific objectives, including assisting U.S. companies that (1) generate export sales and need additional working capital to support these sales and (2) are planning, designing, or installing pollution control mechanisms.

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General Issues When Applying

When applying for federal loan and loan guarantee programs, it is crucial that applicants understand the limits of the program under which they are applying, the implementing agency's rules and regulations governing the program, and the guidelines for applications under that program. The federal government lacks the flexibility of traditional lenders. Federal agencies must evaluate applications within the parameters established by the enabling legislation and the regulations adopted by the implementing agency. The failure to follow these rules can result in ineligibility, prolonged review by the implementing agency, and, if an award is granted, challenge by third parties who were denied for failure to comply with the governing rules, regulations, and guidelines. Ultimately, this means higher costs to the applicant.

Furthermore, receipt of federal funds, including loans and loan guarantees, potentially may subject the recipient to a myriad of government rules and regulations, including wage laws, sourcing requirements, and accounting obligations. Therefore, before applying for any federal programs, applicants must consider whether they are willing to subject themselves to these requirements and the corresponding costs.

OMB Circular A-129 (2000). Any agency implementing a federal credit or loan guarantee program must follow the policies established by OMB. Circular A-129 issued by OMB sets standards for a federal agency issuing such credit instruments, including requirements on extending credit, managing guaranteed lenders, servicing credit and nontax receivables, and collecting delinquent debt. The provisions contained in Circular A-129 apply to all credit programs of the federal government. Standards on federal agencies extending credit include (1) applicant screening for program eligibility, creditworthiness, and other delinquencies on federal debt and (2) collateral requirements, including appraisal guidelines, loan-to-value ratios, and liquidation of real property standards.

Federal Credit Reform Act of 1990 (FCRA). All federal credit programs are required to support their subsidy costs pursuant to FCRA. Prior to the enactment of FCRA, loan guarantees were not reported on the books of the issuing federal agencies until default, making them an attractive proposition compared to loans and grants. FCRA remedies this by requiring an agency to account for the credit subsidy cost of any federal credit program, including loan guarantees. An appropriation must be made by Congress for these credit subsidy costs for a loan guarantee to be issued. In some circumstances, including portions of the Title XVII program, the borrower is required to pay the credit subsidy cost, which obviates the need for the congressional appropriation.

The federal government lacks the flexibility of traditional lenders.

Conclusion

In a time of difficult and limited access to business credit, an understanding of the opportunities available from permanent federal credit and loan guarantee programs will be invaluable to businesses of all sizes. These programs will provide incentives for businesses to expand transportation infrastructure and energy infrastructure and promote businesses in rural areas. However, most of these programs are not widely publicized and are relatively unknown. Businesses that wish to apply for these programs must identify an applicable federal credit or loan guarantee program and then navigate the often numerous regulations for that respective program.