

RD AN No. 4765 (1942-A) (3575-A)
May 20, 2014

TO: State Directors
Rural Development

ATTN: Community Programs Directors

FROM: Tony Hernandez /s/ *Tony Hernandez*
Administrator
Housing and Community Facilities Programs

SUBJECT: Prohibition on Financing Short-Term Debt on Community Facilities
Direct and Guaranteed Loans

PURPOSE/INTENDED OUTCOME:

The purpose of this Administrative Notice (AN) is to advise State Offices of the prohibition on financing short-term debt with a Community Facilities (CF) Direct and/or Guaranteed Loan. Also, this AN clarifies when debt financing is an eligible purpose under the Community Facilities Direct and Guaranteed Loan Programs in accordance with RD Instructions 1942-A Section 1942.17(d) (1) and 3575-A, section 3575.24, and this AN identifies the necessary supporting documentation.

COMPARISON WITH PREVIOUS AN:

This AN replaces RD AN No. 4682 (3575-A), dated August 16, 2012, which expired on October 31, 2013.

IMPLEMENTATION RESPONSIBILITIES:

The National Office has been receiving inquiries on whether short-term debt financing is an eligible loan purpose. Short-term financing may be referred to as working capital, an operating loan or short-term loan because scheduled repayment takes place in less than one year. This type of financing usually applies to money needed for day-to-day operations, such as purchasing inventory, supplies, paying wages of employees or paying the current portion of long term debt. A line of credit is an example of short-term debt financing. RD Instructions 1942-A and 3575-A do not authorize short-term debt financing or financing with working capital characteristics as an eligible loan purpose.

EXPIRATION DATE:
May 31, 2015

FILING INSTRUCTIONS:
Proceeding RD Instruction 1942-A; 3575-A

There are certain ancillary expenses that are permitted under the Community Facilities Direct and Guaranteed Loan Programs when they are a necessary part of a loan to finance eligible facilities. These expenses are listed in sections 1942.17(d)(1)(iv)(A) and 3575.24(b). They include reasonable fees and costs such as an origination fee, loan guarantee fee, legal, engineering and some other developmental fees.

Section 1942.17 (d)(1) (iv) (B) and Section 3575.24(b)(3)(ii) permit funds to be used to pay for interest on loans until the facility is self-supporting, but not for more than 3 years, and to pay for interest on loans secured by general obligation bonds, but for not more than 2 years. Funding of these conditions is subject to National Office approval. In a situation where the borrower is unable to pay the initial operating expenses of the facility, section 1942.17 (d) (1)(iv) (E) and 3575.24(b)(3)(ii) permit financing of the expenses for a period ordinarily not exceeding one year. A Community Facilities Direct or Guaranteed loan may only fund for these conditions when they are a necessary part of a loan to finance an essential community facility as described in sections 1942.17 (d) (1) and 3575.24(d(1).

Short-term debt financing is not to be confused with refinancing of existing long term debt. Short-term debt refinancing is an ineligible purpose under the Community Facilities Direct and Guaranteed Loan Programs. Section 1942.17 (d) (1) (iv)(F) and Section 3575.24(b)(3)(vi) allow refinancing of existing debt on a community facility when all of the following conditions exist:

- a. The debts refinanced are less than 50% of the total loan.
- b. The debts were incurred for the facility or service being financed or any part thereof (such as interim financing, construction expenses, etc.), and
- c. Arrangements cannot be made with the creditors to extend or modify the terms of the debts so that a sound basis will exist for making a loan.
- d. The refinancing is a necessary part of a loan to finance an essential community facility as described in 1942.17 (d) (1) (iv) and 3575.24 (b) (3) (vi).

The loan case file must be documented with a copy(ies) of the original debt instrument(s) and supporting cost and expense documentation underlying the existing debt being refinanced with a Community Facilities Direct or Guaranteed loan. The lender must certify that the existing debt was not on reasonable terms (e.g. because interest rates have since fallen) and efforts to modify the repayment terms with the creditor(s) of the existing debt have been unsuccessful. The refinance must show a benefit to the applicant's cash flow.

A careful review is necessary of the creditor's efforts to work with the applicant on managing debt repayment. If the creditor for the existing debt is also the proposed lender, then the lender must provide the transaction history on the debt refinanced, demonstrating that debt repayment was maintained in a current fashion, to alleviate the risk of Rural Development sustaining the loss that the lender would have sustained if the debt had not been refinanced.

If you have any questions concerning this AN, please contact Karen Safer, Community Programs Specialist at (202) 720-0974.