USDA
United States Department of Agriculture

Rural Development

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December 22, 2014

TO: Area Offices, Rural Development, Virginia

FROM: Basil I. Gooden
State Director

SUBJECT: Requests from Borrowers For Parity and/or Consents to Incur Additional Indebtedness - Water and Waste and Community Facilities

PURPOSE/INTENDED OUTCOME:

To provide guidance to Area Office personnel in processing parity and/or consent to additional debt requests from existing Rural Development borrowers who seek financial assistance from other lenders.

COMPARISON WITH PREVIOUS AN:

This Administrative Notice (AN) replaces Virginia AN No. 513 (1782 and 1951-E), which expired July 31, 2013.

IMPLEMENTATION RESPONSIBILITIES:

RUS Instruction 1782, section 1782.17, and RD Instruction 1951-E, section 1951.222, set forth the requirements for processing of requests for parity/subordination of a security instrument. (For purposes of RD Instruction 1951-E and this AN, subordination is defined to include cases where a parity security position is being considered.) When one of our existing borrowers, who has the authority to issue a revenue-backed bond, proposes to fund a project with funds other than Rural Development funds and the lender requires a parity position with outstanding revenue bonds, the requirements of this AN, RUS Instruction 1782, section 1782.17, and RD Instruction 1951-E, section 1951.222, will apply. These requirements will also apply if the borrower requests our consent to incur additional indebtedness where a parity position is not being requested.

EXPIRATION DATE: December 31, 2015

FILING INSTRUCTIONS: File preceding RUS Instruction 1782 and RD Instruction 1951-E

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In cases where Rural Development may not be in a position to grant parity but would be in a position to consent to the additional indebtedness, this will, in effect, establish a junior lien position for the other lender.

The following guidelines will be used to determine whether or not Rural Development will grant parity, consent to the additional indebtedness, and/or deny the request:

1. If **both** the project and borrower's total operations cash flow, we will grant parity.

2. If **either** the project or the borrower's total operations cash flow, we will consent to the additional indebtedness versus parity. However, Rural Development would consider granting parity for the situations outlined below:

   a. If the proposed project does not cash flow but the total operations are capable of supporting the deficit, parity will be considered if the proposed project will generate revenue to support itself within 12 to 18 months.

   b. If the total operations do not cash flow but the proposed project does, thereby enhancing the financial position of the borrower, parity will be considered.

   c. If the proposed project is for the purpose of correcting a severe problem related the system and, without correction, the borrower would face enforcement action that may prevent them from continuing operations, i.e. sewer rehabilitation, water line replacement to reduce leakage, and/or treatment facility upgrades necessary to meet water quality standards not associated with growth, parity will be considered.

3. If **neither** the project nor the borrower's total operations cash flow, we will not be in a position to grant parity or consent to additional indebtedness.

We point out that the above guidelines are indeed guidelines, and each request will need to be reviewed individually. There may also be situations where Rural Development may entertain "springing parity." Springing parity is defined as parity being granted automatically once a certain condition is met. Language can be inserted in the bond documents to provide for springing parity. For example, if the required number of users has not been obtained, language could be inserted that states once a certain number of users have been obtained, the other lender would automatically "spring" into a parity position.

If the borrower (1) proposes to issue a revenue bond and the lender requests a parity position or (2) the borrower requests Rural Development's consent to incur additional indebtedness, the following items must be submitted:

1. A written request from the borrower, along with written documentation that our indebtedness cannot be refinanced;

* 2. A certification from the borrower concerning the number of user agreements obtained (for water/sewer);

3. Project Description (This description is a minimum requirement. In some cases, you may be of the opinion that obtaining a Preliminary Engineering Report or Architectural Feasibility Report is prudent);

* 4. Financial analysis or credit review performed by the lender to include financial projections through the first full year of operation for the project being financed **AND** the borrower's total operations;

5. Draft bond documents to include the bond resolution, form of bond, bond counsel's opinion, and consent and waiver of bondholder;

6. Draft of the proposed financing agreement;

7. Appropriate environmental assessment:

   a. Water and Waste - Approvals provided by Rural Development pursuant to loan contracts and security instruments, including approvals of lien accommodations, i.e., parity requests, do not require environmental reviews. ***Requests for lien subordinations, however, still require environmental reviews under RD Instruction 1794, section 1794.21(c)(4).*** For definitions of lien subordinations versus lien accommodations, please refer to RD Instruction 1794, sections 1794.3 and 1794.21.

   b. Community Facilities - The scope of the environmental assessment will be determined by criteria set forth in paragraphs 1940.310, 1940.311, and 1940.312 of RD Instruction 1940-G. Complete assessments will be prepared in the same manner as if Rural Development was the lender;

8. Form RD 465-1, Application for Partial Release, Subordination, or Consent (required only for parity requests);

9. Exhibit F of RUS Staff Instruction 1782-1 or Exhibit A of RD Instruction 1951-E, as appropriate (required only for parity requests); and

10. Recommendation from the Area Director.

* For water and waste, the financial projections prepared by the lender should be based on the number of users that have been obtained. If a different user base is used, we will require more documentation with regards to users.

If the borrower proposes to issue a general obligation (G.O.) bond versus a revenue bond and the borrower asks for our consent to incur additional indebtedness, we will require the following:

1. Request from the borrower
2. Financial projections for the proposed project
3. Borrower's most recent audit

If another lender is jointly financing a project along with Rural Development and the borrower proposes to issue a revenue bond, Rural Development will grant parity to the other lender, and the consent and waiver of bondholder form will serve as our consent to parity.

The servicing office (Area Office) is responsible for assisting borrowers in processing their requests for parity and/or incurring additional indebtedness. In all of the above-mentioned cases, the Area Office will review the information to determine if the borrower is financially able to incur the additional indebtedness. The Area Office will then forward the appropriate items, along with a recommendation from the Area Director, to the Community Programs Division in the State Office for final approval.

If you have any questions, please contact the Community Programs Division.