United States Department of Agriculture

**Rural Development**

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RD AN No. 4859 (1942-A, 1942-C, 3570-B, 3575-A)
April 17, 2018

TO: State Directors
Rural Development

ATTN: Community Program Directors

FROM: Curtis M. Anderson /s/ ***Curtis M. Anderson***
Acting Administrator
Rural Housing Service

SUBJECT: Eligible Loan Purposes under the Community Facilities Programs

**PURPOSE/INTENDED OUTCOME:**

This Administrative Notice (AN) is issued to provide policy and guidance on the eligibility of Community Facilities loan guarantees, direct loans and grants when monies are used to purchase existing facilities.

**BACKGROUND:**

Community Facilities loan guarantees, direct loans, and grants can be used to finance the purchase of existing facilities. This is an eligible loan purpose only when the applicant requesting funds to purchase the existing facility is doing so to either improve or to prevent the loss of service related to the facility.

The regulatory authorization for these types of projects is contained in 7 CFR 1942.17(d)(1)(i), 7 CFR 3570.62(a) and 7 CFR 3575.24(a).

Funds may be used to construct, enlarge, extend, *or otherwise improve* water or waste disposal and other essential community facilities providing essential service primarily to rural residents and rural businesses. Rural businesses would include facilities such as educational and other publicly owned facilities.

EXPIRATION DATE:
April 30, 2019

FILING INSTRUCTIONS:
Preceding RD Instructions 1942-A, 1942-C, 3570-B, and 3575-A

7 CFR 1942.17(d)(1)(i)(C), 7 CFR 3570.62(a)(2) and 7 CFR 3575.24(a)(1)(2) further clarifies "otherwise improve" to include but not be limited to the following:

(*1*) The purchase of major equipment, such as solid waste collection trucks and X-ray machines, which will in themselves provide an essential service to rural residents; and,

**(*2*) The purchase of existing facilities when it is necessary either to improve or to prevent loss of service.**

7 CFR 1942.17(j)(4), 7 CFR 3570.62(a)(2)(ii) and 7 CFR 3575.24(a)(2)(ii) further provide that applicants are responsible for acquisition of all property rights necessary for the project and will determine that **prices paid are reasonable and fair**. Rural Development may require an appraisal by an independent appraiser or Rural Development employee.

In accordance with this regulatory language, CF direct loan funds may be used to purchase existing facilities only when it is necessary either to improve an essential community facility or to prevent the loss of service. Also the price paid for the facility will be fair and reasonable and not directly related to the dollar amount of debt retired. The Agency will not use CF loan funds toward purchases where the primary purpose is to retire debt.

**COMPARISON WITH PREVIOUS AN:**

None

**IMPLEMENTATION RESPONSIBILITIES:**

CF will not fund applications for purchases in which the transaction's purpose is to primarily retire the debt of the seller. Refinancing as a primary purpose is a prohibited use of Community Facilities direct and guaranteed loan funds in accordance with 7 CFR 1942.17(d)(1)(F) and 7 CFR 3575.24(b)(3)(vi)(A). Refinancing as a primary or secondary purpose is a prohibited use of Community Facilities Grant funds in accordance with 7 CFR 3570.63(a)(3). The CF direct loan, grant and guaranteed loan regulations also do not permit the funding of applications where an applicant may request funds to purchase an existing facility, and the purchase is not necessary to either improve or to prevent loss of service. Characteristics of such ineligible transactions may include the following:

a. An entity, which may or may not be eligible for CF loan funds, forms a new eligible entity or uses an existing eligible related entity to purchase all or part of its assets;
b. The new entity uses CF loan funds to purchase the assets at the agreed upon price and leases the assets back to the seller, generally at a rate which equates to the new debt payments; and,
c. The seller uses the proceeds of the sale to retire its high cost debt and continues to use the facilities at a lower cost.

The formation, by the seller, of a related company or the amendment of bylaws of an existing related company that was strictly for the purpose of this transaction should be examined carefully to ensure that the primary purpose of the transaction is not to retire the debt of the seller. Also if the transaction includes a lease-back of the facility to the seller, this acquisition would require additional scrutiny as a means to retire high cost debt.

Purchases are only for the purpose of improving the facility or to improve or prevent the loss of service. Additionally, the price of the purchase must be fair and reasonable, not based on the amount of debt to be retired by the seller.

For applications which include a purchase of existing facilities, the following are required in order for the transaction to be eligible:

1. The application must include an appraisal for the facility which demonstrates that the purchase price of the assets is fair and reasonable and represents the fair market value of the facility.

   See 7 CFR 1942.3, 7 CFR 3570.71(b)(4) and 7 CFR 3575.49 Preparation of appraisal reports. The approving official must document that the appraised value reflects the present market value of the facility. When determining the fair market value of a piece of property, the price for the property must be obtained through a potential buyer and seller operating through an “arm's length transaction.” Otherwise, the agreed-upon price is likely to differ from the actual fair market value of the property.

   For purposes of this Notice, an arm's length transaction is a transaction in which the buyer and seller act independently and have no relationship to each other. The concept of an arm's length transaction allows the market to ensure that both parties in the deal are acting in their own self-interest and are not subject to any pressure or duress from the other party.

2. If the transaction is necessary to improve the facility, the applicant must provide documentation on the improvements required to the facility and the plan to complete those improvements within a reasonable timeframe, as well as the source of funding.

3. If the transaction is necessary to prevent a loss of service, the applicant must submit a financial analysis documenting the potential loss of service from the seller under existing conditions. This will include a financial pro-forma which clearly demonstrates that the seller will not have the financial means to continue to operate the facility.

This AN is effective as of the date of its publication for new applications that have not received a signed AD-622 “Notice of Preapplication Review Action” inviting a full application *prior* to the publication date. For those applications that do have a signed AD-622 prior to the publication date of this AN, this AN will apply to those applications on October 1, 2018, if funding for those applications has not been obligated by September 30, 2018.