



Rural Development

May 29, 2020

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TO: State Directors
Rural Development

ATTN: Community Programs Directors

FROM: Bruce Lammers /s/ **Bruce Lammers**
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SUBJECT: Requirements of Financial Feasibility Evaluations
for Community Facility Applications

INTRODUCTION

The purpose of this unnumbered letter is to clarify the requirements for applicant financial feasibility evaluations under the Community Facilities (CF) Guaranteed and Direct Loan Programs. This unnumbered letter replaces and updates the July 19, 2018, unnumbered letter of same subject to provide improved implementation by removing the requirement for a feasibility study with compilation report and raising the dollar threshold when requiring a feasibility study with examination opinion.

The requirements outlined in this unnumbered letter support OMB Circular No. A-123, Management's Responsibility for Enterprise Risk Management and Internal Control, dated July 15, 2016, issued under the authority of the Federal Managers' Financial Integrity Act (FMFIA) of 1982, and the Government Performance Results Act (GPRA) Modernization Act, Public Law 111-352. Implementing these requirements will enhance the integrity, efficiency, and transparency of our CF operations.

7 CFR 3575, Subpart A, section 3575.47, and 7 CFR 1942, Subpart A, section 1942.17(h) establish the requirements for financial feasibility for all applicants. In many instances, a financial feasibility study completed by a Certified Public Accountant or Accounting (CPA) firm backed by an examination opinion attesting to the validity of the assumptions will be required. However, for certain loans, based on the size off the loan request, the security for the loan, or the applicant's operation and financial history, a financial feasibility analysis without an examination opinion will likely be appropriate.

EXPIRATION DATE:
May 31, 2021

FILING INSTRUCTIONS:
Community Programs

BACKGROUND

Based upon loan applications reviewed by the National Office for concurrence, we continue to find inconsistencies in administering the requirements of the financial feasibility evaluation and the Agency's evaluation of the information. We also found in some cases the previous guidance on this subject resulted in cost and burden to the applicant that could be eliminated without any elevated credit risk to the Agency. This unnumbered letter addresses these topics as we strive for consistency in processing applications and reducing the time for funding commitments resulting in an improved customer experience.

FINANCIAL FEASIBILITY REPORTS

CF accepts two levels of financial feasibility reports based on the loan amount requested, applicant experience and security. The two reports are a Financial Feasibility Analysis and a Financial Feasibility Study with Examination Opinion.

Financial Feasibility Analysis describes the applicant's present situation, analyzes alternatives and outlines the proposed project. The level of effort required to prepare the report and the depth of analysis within the report are proportional to the size and complexity of the proposed project. The preparer is expected to fully disclose and analyze all significant factors that may have a favorable or adverse effect on the financial success of the proposed facility. The report must be prepared by a qualified firm or individual. The financial feasibility analysis will be prepared in accordance with RD Instruction 1942-A, Guide 5 or 6, or RD Instruction 3575, Exhibit A. For fire and rescue facilities, and other small CF projects processed under 7 CFR 1942 Subpart C, Form RD 1942-54 "Applicant's Feasibility Report" may be used. The report must be prepared by a qualified firm or individual.

Financial Feasibility Study with Examination Opinion is the examination of the prospective financial information provided by the applicant ("management") culminating in an examination opinion on the reliability of the applicant's financial statements and management's underlying assumptions. The examination opinion provides a high level of assurance per the American Institute of Certified Public Accountants' (AICPA) standards.

A feasibility study with an examination opinion will be prepared by a CPA with the necessary industry expertise to perform the study and backed by their professional liability insurance. The processing office will verify the CPA has the required insurance coverage in place. The feasibility study with examination opinion will typically include the following:

1. Signed and dated opinion letter in accordance with the AICPA. A draft may be initially submitted with the application but a final study is required prior to loan approval.
2. 5 years historic and 5 years forecasted financial statements.
3. Sources and uses in line item detail.
4. Schedule of ratios pertinent to the industry for both the historic and forecasted financials.
5. Summary of significant financial forecast assumptions and accounting policies.
6. Summary of significant demand forecast assumptions (market assessment).

7. Sensitivity analyses of three to five meaningful values relative to the applicant's industry and areas of potential vulnerability.
8. Other information deemed appropriate by the preparer and/or the Agency.
9. Information regarding the Governing Body and Management Team (not required to be included but can be provided by the applicant).

FINANCIAL FEASIBILITY EVALUATION REQUIREMENTS

Use Attachment A as a decision tree to determine the level of financial feasibility evaluation required by the Agency. The level of evaluation will be dependent on several factors including the security for the loan, the size of the loan request, the longevity of the applicant's operation and its financial history. For direct loan requests where the security for the loan will be real estate, chattel and/or assignment of income, the processing office must first determine if the applicant meets the criteria established in either 7 CFR 1942.17(g)(2)(iii)(A)(6) for public bodies, or 7 CFR 1942.17 (g)(3)(iii)(A)(2) for nonprofit organizations. These criteria are sometimes referred to as the "5/5 criteria". Applicants that do not meet the 5/5 criteria must be referred to the National Office for concurrence to proceed with an application and obtain guidance on the level of financial feasibility evaluation required.

IMPLEMENTATION

It is intended that Community Programs (CP) Directors and other CF staff processing applications have a solid grasp of the required financial feasibility evaluation requirements. Sound financial feasibility evaluations are essential risk management tools for determining if the applicant can properly meet its financial obligations.

Before advising an applicant or lender on the type of financial feasibility evaluation required, CP Directors should consult with their Asset Risk Management Specialist. Establishing the appropriate type of evaluation early in the application process will help set clear expectations.

When a financial feasibility evaluation will be completed by a third party, CP Directors should encourage applicants requesting a direct loan to procure those services through a request for proposal (RFP). This process will help ensure the applicant receives an evaluation by a third party with the qualifications to meet its particular needs at a cost that is proportionate to the service provided. In accordance with 7 CFR 1942.17(l)(1) and (4), contracts and agreements between the applicant and those providing professional services are required and are subject to Agency concurrence. Fees provided for in contracts or agreements must be reasonable. The Agency shall consider fees to be reasonable if they are not in excess of those ordinarily charged by the profession as a whole for similar work when Agency financing is not involved.

To ensure applicants are aware of the requirement for a financial feasibility evaluation early in the application stage, State Directors will require staff administering the CF program to discuss these requirements with potential applicants, lenders and financial or project consultants. The date and results of the discussion will be documented and included in the applicant's project file.

Lastly, CP Directors and other CF staff processing applications are responsible for reviewing the financial feasibility report submitted with the application. Reports are not to be accepted at face value, but as a starting point for an independent analysis. If the report does not meet the expected requirements, the applicant or lender will be notified and given an opportunity to submit a revised report with the deficiencies corrected. At the completion of the review, the CP Director will approve the loan request or reject it on the basis of the Agency's independent analysis of all application documents. Loan requests above the CP Director's approval authority will only be approved or denied upon National Office review and concurrence in the recommended action.

SUMMARY

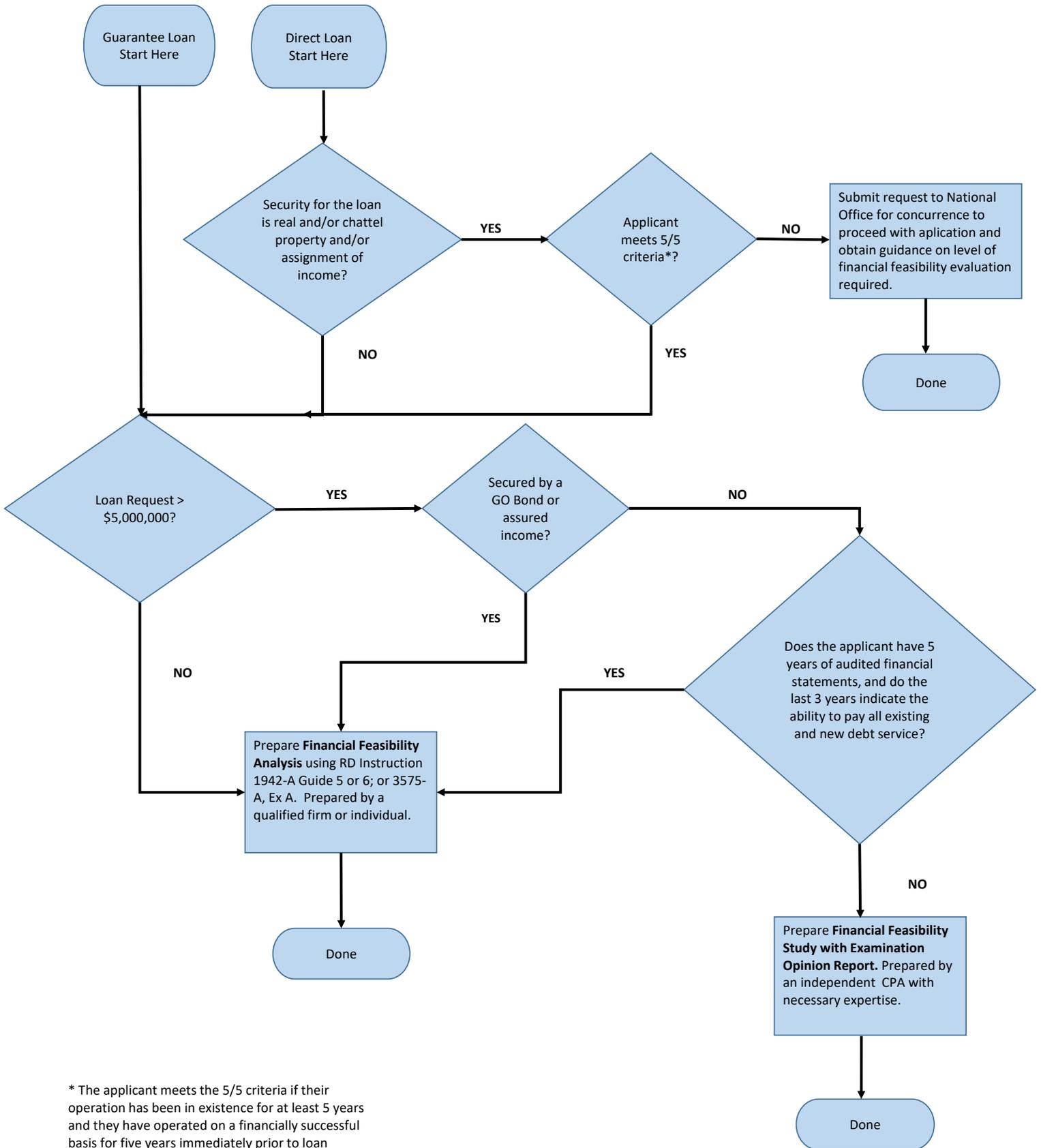
Determining the financial feasibility requirement early in the application process is essential to a successful underwriting and approval process. It is the Agency's responsibility to review and analyze the financial feasibility report received and determine if the applicant has demonstrated its ability to repay the loan and meets its financial obligations.

If you have any questions regarding the information in this unnumbered letter, please contact your Asset Risk Management Specialist.

Attachment A – Decision Tree

ATTACHMENT A

Decision tree to determine the level of financial feasibility evaluation for a Community Facilities Direct Loan or Guarantee



* The applicant meets the 5/5 criteria if their operation has been in existence for at least 5 years and they have operated on a financially successful basis for five years immediately prior to loan