



Rural Development

July 19, 2018

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TO: State Directors
Rural Development

ATTN: Community Programs Directors

FROM: Joel C. Baxley /s/ *Joel C. Baxley*
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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 March 14, 2018, unnumbered letter of same subject to correct a technical error, replacing Review Report with Compilation, and making minor changes to provide improved implementation of the requirements.

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 small loans, less than \$500,000, a financial feasibility analysis without an examination opinion will likely be appropriate.

BACKGROUND

Based upon loan applications reviewed by the National Office for concurrence, we

EXPIRATION DATE:
July 31, 2019

FILING INSTRUCTIONS:
Community Programs

continue to find inconsistencies in administering the requirements of the financial feasibility evaluation. A major concern is the financial feasibility study is not supported by an examination opinion, when necessary.

FINANCIAL FEASIBILITY REPORTS

CF accepts three levels of financial feasibility reports based on loan amount requested, applicant experience and security. They are Financial Feasibility Analysis, Financial Feasibility Study with a Compilation Report, and 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 may be used. The report must be prepared by a qualified firm or individual.

Financial Feasibility Study with a Compilation Report consists of applying accounting and financial reporting expertise to assist the applicant in the presentation of prospective financial information and reporting. No assurances are provided; however, the preparer will consider whether the presentation appears appropriate in form and free from obvious material misstatements.

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.

A feasibility study with a compilation report or examination opinion will be prepared by a CPA with the necessary 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 compilation report or examination opinion will typically include the following:

1. Signed and dated compilation or opinion letter
2. 5 years historic and 5 years forecasted financial statements
3. Schedule of ratios pertinent to the industry
4. Summary of significant financial forecast assumptions and accounting policies
5. Summary of significant demand forecast assumptions (market assessment; not provided with a compilation but can be provided by the applicant)
6. Sensitivity analyses
7. Other information deemed appropriate by the preparer

8. Information regarding the Governing Body and Management Team (not required to be included in the compilation or examination opinion 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 CF staff 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.

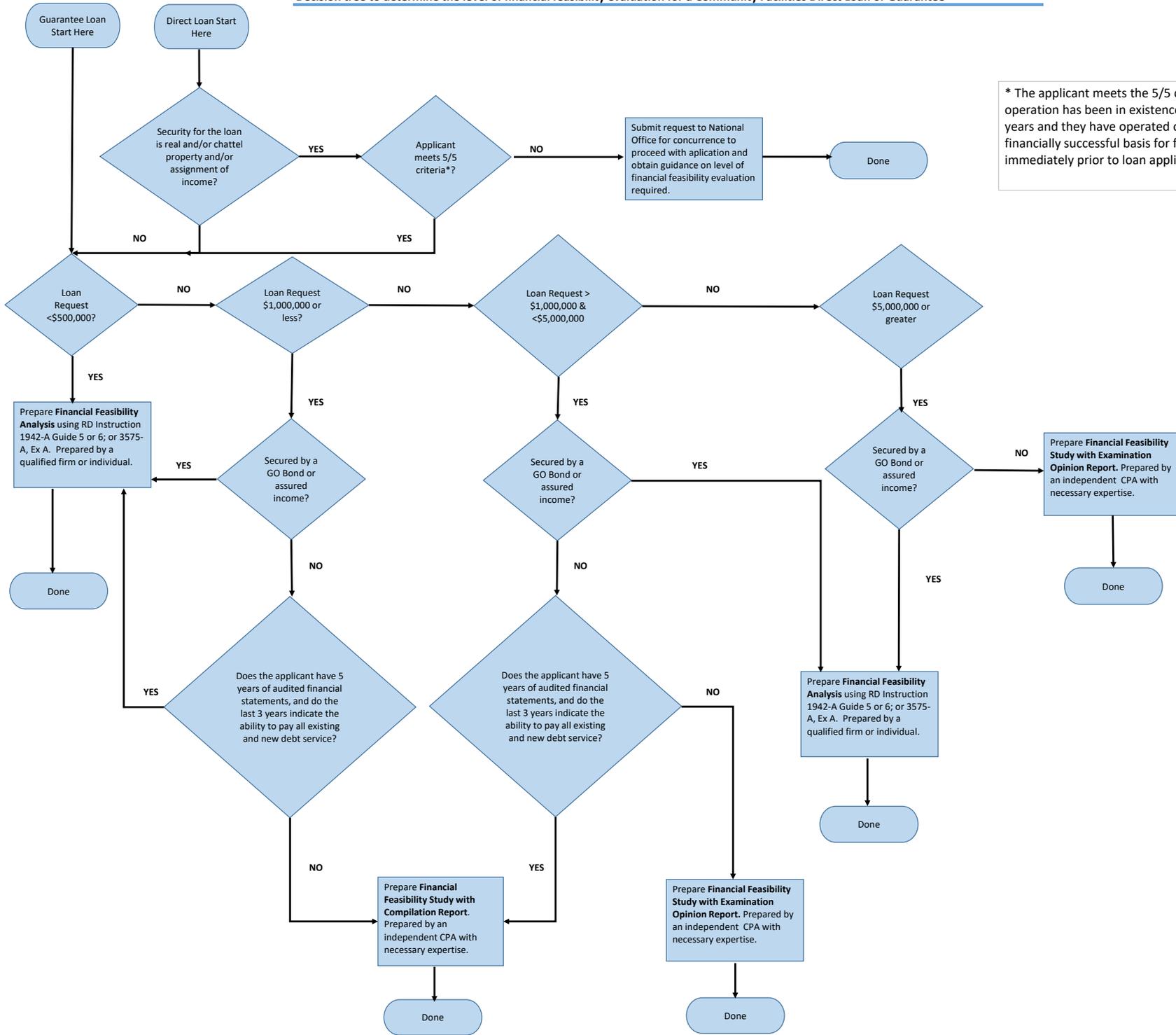
To insure applicants are aware of the requirement for a financial feasibility evaluation early in the application stage, State Directors will require staff administering the CF program to discuss these requirements with potential applicants, lenders and financial or project consultants. The date and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

SUMMARY

If you have any questions about the type of financial feasibility evaluation that should be required, please contact the National Office for assistance. Determining the financial feasibility requirement early in the application process is essential to a successful underwriting and approval process.

If you have any other questions regarding the information in this unnumbered letter, please contact Karla Peiffer, Asset Risk Management Specialist, at karla.peiffer@wdc.usda.gov.

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 application.