

**§ 1942.10 Strategic economic and community development.**

Applicants with projects that support the implementation of Strategic Community Investment Plans are encouraged to review and consider 7 CFR part 1980, subpart K, which contains provisions for providing priority to projects that support the implementation of Strategic Community Investment Plans on a multi-jurisdictional and multi-sectoral basis.

[85 FR 59393, Sept. 22, 2020]

**§ 1942.11 [Reserved]****§ 1942.12 Loan cancellation.**

Loans which have been approved and obligations which have been established may be canceled before closing as follows:

(a) *Form Rural Development 1940-10, "Cancellation of U.S. Treasury Check and/or Obligation."* The Rural Development Manager or State Director may prepare and execute Form Rural Development 1940-10, Cancellation of U.S. Treasury Check and/or Obligation, in accordance with the Forms Manual Insert (FMI). If the disbursement has been received or is subsequently received in the Area Office, the Rural Development Manager will return it as prescribed in Rural Development Instruction 2018-D.

(b) *Notice of cancellation.* If the docket has been forwarded to Office of General Counsel that office will be notified of the cancellation by copy of Form Rural Development 1940-10. Any application for title insurance, if ordered, will be cancelled. The borrower's attorney and engineer/architect, if any, should be notified of the cancellation. The Rural Development Manager may provide the borrower's attorney and engineer/architect with a copy of the notification to the applicant. The State Director will notify the Director of Legislative Affairs and Public Information by telephone or electronic mail and give the reasons for such cancellation.

[50 FR 7296, Feb. 22, 1985, as amended at 53 FR 26589, July 14, 1988; 54 FR 39727, Sept. 28, 1989; 59 FR 54788, Nov. 2, 1994; 70 FR 19254, Apr. 13, 2005]

**§ 1942.13 Loan servicing.**

Loans will be serviced under subpart E of part 1951 of this chapter.

**§ 1942.14 Subsequent loans.**

Subsequent loans will be processed under this subpart.

**§ 1942.15 Delegation and redelegation of authority.**

The State Director is responsible for implementing the authorities in this subpart and for issuing State supplements redelegating authorities. Loan and grant approval authority is in Subpart A of Part 1901 of this chapter. Except for loan and grant approval authority, Rural Development Manager may redelegate their duties to qualified staff members.

[70 FR 19254, Apr. 13, 2005]

**§ 1942.16 State supplements and guides.**

State Directors will obtain National Office clearance for all State supplements and guides under RD Instruction 2006-B (available in any Rural Development office).

(a) *State supplements.* State Directors may supplement this subpart to meet State and local laws and regulations and to provide for orderly application processing and efficient service to applicants. State supplements shall not contain any requirements pertaining to bids, contract awards, and materials more restrictive than those in § 1942.18 of this subpart.

(b) *State guides.* State Directors may develop guides for use by applicants if the guides to this subpart are not adequate. State Directors may prepare guides for items needed for the application; items necessary for the docket; and items required prior to loan closing or start of construction.

**§ 1942.17 Community facilities.**

(a) *General.* This section includes information and procedures specifically designed for use by applicants, including their professional consultants and/or agents who provide such assistance and services as architectural, engineering, financial, legal, or other services related to application processing and facility planning and development.

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This section is made available as needed for such use. It includes Rural Development policies and requirements pertaining to loans for community facilities. It provides applicants with guidance for use in proceeding with their application. Rural Development shall cooperate fully with appropriate State agencies to give maximum support of the State's strategies for development of rural areas.

(b) *Eligibility.* Financial assistance to areas or communities adjacent to, or closely associated with, nonrural areas is limited by §1942.17(c) of this subpart.

(1) *Applicant.* (i) A public body, such as a municipality, county, district, authority, or other political subdivision of a state.

(A) Loans for water or waste disposal facilities will not be made to a city or town with a population in excess of 10,000 inhabitants. The population figure is obtained from the most recent decennial Census of the United States (decennial Census). If the applicable population figure cannot be obtained from the most recent decennial Census, RD will determine the applicable population figure based on available population data.

(B) Loans for essential community facilities will not be made to a city or town with a population in excess of 20,000 inhabitants according to the most recent decennial Census.

(ii) An organization operated on a not-for-profit basis, such as an association, cooperative, and private corporation. Applicants organized under the general profit corporation laws may be eligible if they actually will be operated on a not-for-profit basis under their charter, bylaws, mortgage, or supplemental agreement provisions as may be required as a condition of loan approval. Essential community facility applicants other than utility-type must have significant ties with the local rural community. Such ties are necessary to ensure to the greatest extent possible that a facility under private control will carry out a public purpose and continue to primarily serve rural areas. Ties may be evidenced by items such as:

(A) Association with or controlled by a local public body or bodies, or broad-

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ly based ownership and controlled by members of the community.

(B) Substantial public funding through taxes, revenue bonds, or other local Government sources, and/or substantial voluntary community funding, such as would be obtained through a community-wide funding campaign.

(iii) Indian tribes on Federal and State reservations and other Federally recognized Indian tribes.

(2) *Facility.* (i) Facilities must be located in rural areas, except for utility-type services such as water, sewer, natural gas, or hydroelectric, serving both rural and non-rural areas. In such cases, Rural Development funds may be used to finance only that portion serving rural areas, regardless of facility location.

(ii) Essential community facilities must primarily serve rural areas.

(iii) For essential community facilities, the terms *rural* and *rural area* will not include any area in any city or town with a population in excess of 20,000 inhabitants, but excludes certain populations pursuant to 7 U.S.C. 1991(a)(13)(H) and (I). The population figure is obtained from the most recent decennial Census. If the applicable population figure cannot be obtained from the most recent decennial Census, RD will determine the applicable population figure based on available population data.

(3) *Credit elsewhere.* Applicants must certify in writing and Rural Development shall determine and document that the applicant is unable to finance the proposed project from their own resources or through commercial credit at reasonable rates and terms.

(4) *Legal authority and responsibility.* Each applicant must have or will obtain the legal authority necessary for constructing, operating, and maintaining the proposed facility or service and for obtaining, giving security for, and repaying the proposed loan. The applicant shall be responsible for operating, maintaining, and managing the facility, and providing for its continued availability and use at reasonable rates and terms. This responsibility shall be exercised by the applicant even though the facility may be operated, maintained, or managed by a third party

under contract, management agreement, or written lease. Leases may be used when this is the only feasible way to provide the service and is the customary practice. Management agreements should provide for at least those items listed in guide 24 of this subpart (available in any Rural Development office). Such contracts, management agreements, or leases must not contain options or other provisions for transfer of ownership.

(5) *Refinancing debt.* The Government shall require an agreement that if at any time it shall appear to the Government that the borrower is able to refinance the amount of the indebtedness then outstanding, in whole or in part, by obtaining a loan for such purposes from responsible cooperative or private credit sources, at reasonable rates and terms for loans for similar purposes and periods of time, the borrower will, upon request of the Government, apply for and accept such loan in sufficient amount to repay the Government and will take all such actions as may be required in connection with such loan.

(6) Expanded eligibility for timber-dependent communities in Pacific Northwest. In the Pacific Northwest, defined as an area containing national forest covered by the Federal document entitled, "Forest Plan for a Sustainable Economy and a Sustainable Environment," dated July 1, 1993; the population limits contained §1942.17(b) are expanded to include communities with not more than 25,000 inhabitants until September 30, 1998, if:

(i) Part or all of the community lies within 100 miles of the boundary of a national forest covered by the Federal document entitled, "Forest Plan for a Sustainable Economy and a Sustainable Environment," dated July 1, 1993; and

(ii) The community is located in a county in which at least 15 percent of the total primary and secondary labor and proprietor income is derived from forestry, wood products, or forest-related industries such as recreation and tourism.

(c) *Priorities*—(1) *Truly rural areas.* Rural Development program assistance will be directed toward truly rural areas and rural communities. Normally, priority will not be given to

preapplications for projects that will serve other than truly rural areas. Truly rural areas are areas other than densely settled areas or communities adjacent to, or closely associated with, a city or town with a population exceeding 10,000 residents for water or waste disposal assistance, or 20,000 residents for essential community facility assistance. When determining whether a rural area or rural community is adjacent to, or closely associated with, a city or town with a population exceeding 10,000 residents for water and waste disposal, or 20,000 residents for essential community facility assistance, minor open spaces such as those created by physical or legal barriers, commercial or industrial development, parks, areas reserved for convenience or appearance, or narrow strips of cultivated land, will be disregarded. An area or community shall be considered adjacent to or closely related with a nonrural area when it constitutes for general, social, and economic purposes a single community having a contiguous boundary.

(2) *Project selection process.* The following paragraphs indicate items and conditions which must be considered in selecting preapplications for further development. When ranking eligible preapplications for consideration for limited funds, Rural Development officials must consider the priority items met by each preapplication and the degree to which those priorities are met, and apply good judgement.

(i) *Preapplications.* The preapplication and supporting information submitted with it will be used to determine the proposed project's priority for available funds.

(ii) *State Office review.* All preapplications will be reviewed and scored and Form AD-622, "Notice of Preapplication Review Action," issued within the time limits in §1942.2(a)(2)(iv) of this subpart. When considering authorizing the development of an application for funding, the State Director should consider the remaining funds in the State allocation, and the anticipated allocation of funds for the next fiscal year as well as the amount of time necessary to complete that application. Applicants whose

preapplications are found to be ineligible will be so advised. These applicants will be given adverse notice through Form AD-622 and advised of their appeal rights under subpart B of part 1900 of this chapter. Those applicants with eligible lower scoring preapplications which obviously cannot be funded within an eighteen month period of time, and are not within 150 percent of the State's allocation, should be notified that funds are not available; and requested to advise whether they wish to have their preapplication maintained in an active file for future consideration. The State Director may request an additional allocation of funds from the National Office for such preapplications. Such requests will be considered along with all others on hand.

(iii) *Selection priorities.* The priorities described below will be used by the State Director to rate preapplications. The priorities should be applied to water and waste disposal or community facilities preapplications as directed. The format found in part I of guide 26 of this subpart should be followed in scoring each preapplication. A copy of the score sheet should be placed in the case file for future reference.

(A) *Population priorities.* The following priorities apply to both Water and Waste Disposal and Community Facilities preapplications. Points will be distributed as indicated.

(1) The proposed project is located in a rural community having a population not in excess of 2,500—25 points.

(2) The proposed project is located in a rural community having a population not in excess of 5,500—20 points. (Points under this priority should not be assigned to a preapplication if points were assigned under paragraph (c)(2)(iii) (A)(1) of this section.)

(B) *Health priorities.* Points will be distributed as indicated.

(1) *Water and Waste Disposal preapplications only.* The proposed project is:

(i) Needed to alleviate the sudden unexpected diminution or deterioration of a water supply, or to meet health or sanitary standards which pertain to a community's water supply—25 points.

(ii) Required to correct an inadequate waste disposal system due to unexpected occurrences, or to meet health or sanitary standards which pertain to a community's waste disposal system—25 points.

(2) *Community Facility preapplication only.* The proposed project is required either to correct a health or sanitary problem, or to meet a health or sanitary standard—25 points.

(C) *Income priorities.* The following priorities apply to both Water and Waste Disposal and Community Facilities preapplications. Points will be distributed as indicated. The median income of the population to be served by the proposed facility is:

(1) Less than the poverty line for a family of four, as defined in Section 673(2) of the Community Services Block Grant Act (42 U.S.C. 9902(2)), or less than 80 percent of the statewide non-metropolitan median household income—25 points.

(2) Equal to or more than the poverty line and between 80% and 100%, inclusive, of the State's nonmetropolitan median household income—20 points.

(D) *Other factors.* Points will be distributed as indicated.

(1) *Water and Waste Disposal preapplications only.* The proposed project will: merge ownership, management, and operation of smaller facilities providing for more efficient management and economical service; and/or enlarge, extend, or otherwise modify existing facilities to provide service to additional rural residents—10 points.

(2) *Community Facilities preapplications only.* The purpose of the proposed project is to construct, enlarge, extend or otherwise improve the following types of facilities. (Select only the factor most applicable to the proposed project.)

(i) *Public safety*—10 points. (Examples include police services and fire, rescue and ambulance services as authorized by subpart C of this part 1942.)

(ii) *Health care*—5 points. (Examples include clinics, nursing homes, convalescent facilities, and hospital projects designed to make the facility conform with life/safety codes, medicare and medicaid requirements, and minor expansions needed to meet the

immediate requirements of the community. Points under this authority should not be awarded to a preapplication if points were awarded under § 1942.17(c)(2)(iii)(B)(2) of this subpart.)

(3) Water and Waste Disposal and Community Facilities preapplications.

(i) Applicant is a public body or Indian tribe—5 points.

(ii) Project is located in a “truly rural area” as described in § 1942.17(c)(1) of this subpart—10 points.

(iii) Amount of joint financing committed to the project is:

(a) 20% or more private, local or state funds except federal funds channeled through a state agency—10 points.

(b) 5%–19% private, local or state funds except federal funds channeled through a state agency—5 points.

(E) In certain cases the State Director may assign up to 15 points to a preapplication, in addition to those that may be scored under paragraphs (c)(2)(iii) (A) through (D), of this section. These points are primarily intended to address an unforeseen exigency or emergency, such as the loss of a community facility due to accident or natural disaster or the loss of joint financing if Rural Development funds are not committed in a timely fashion. However, the points may also be awarded to projects in order to improve compatibility/coordination between Rural Development’s and other agencies’ selection systems and to assist those projects that are the most cost effective. A written justification must be prepared and placed in the project file each time the State Director assigns these points.

(iv) *Results of State Office review.* After completing the review, the State Director will normally select the eligible preapplications with the highest scores for further processing. In cases where preliminary cost estimates indicate that an eligible, high scoring preapplication is unfeasible or would require an amount of funding from Rural Development that exceeds either 25 percent of a State’s current annual allocation or an amount greater than that remaining in the State’s allocation, the State Director may instead select the next lower scoring

preapplication(s) for further processing provided the high scoring applicant is notified of this action and given an opportunity to revise the proposal and resubmit it. If it is found that there is no effective way to reduce costs, the State Director, after consultation with applicant, may submit a request for an additional allocation of funds for the proposed project to the National Office. The request should be submitted during the fiscal year in which obligation is anticipated. Such request will be considered along with all others on hand. A written justification must be prepared and placed in the project file when an eligible preapplication with a higher rating is not selected for further processing. The State Director will notify the District Director of the results of the review action. The State Director will return the preapplication information with an authorization for the District Director to prepare and issue Form AD-622 in accordance with § 1942.2(a)(2)(iv) of this subpart. Priority will be given to those preapplications and applications for funding which meet criteria in § 1942.17(c)(2)(iii)(A) (1) or (2); and the criteria in § 1942.17(c) (2)(iii)(B)(1) (i) or (ii) or (B)(2) of this subpart.

(v) *Application development.* Applications should be developed expeditiously following good management practices. Applications that are not developed in a reasonable period of time taking into account the size and complexity of the proposed project may be removed from the State’s active file. Applicants will be consulted prior to taking such action.

(vi) *Project obligations.* To ensure efficient use of resources, obligations should occur in a timely fashion throughout the fiscal year. Projects may be obligated as their applications are completed and approved.

(vii) *Requests for additional funding.* All requests for additional allocations of funds submitted to the National Office must follow the formats found in parts I and II of guide 26. In selecting projects for funding at the National Office level, additional points may be scored based on the priority assigned to the project by the State Office.

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These points will be scored in the manner shown below. Only the three highest priority projects can score points. In addition, the Administrator may assign up to 15 additional points to account for items such as geographic distribution of funds and emergency conditions caused by economic problems or natural disasters.

Priority	Points
1 .....	5
2 .....	3
3 .....	1

(viii) *Cost overruns.* A preapplication may receive consideration for funding before others at the State Office level or at the National Office level, if funds are not available in the State Office, when it is a subsequent request for a previously approved project which has encountered cost overruns due to high bids or unexpected construction problems that cannot be reduced by negotiations, redesign, use of bid alternatives, rebidding or other means.

(d) *Eligible loan purposes.* (1) Funds may be used:

(i) 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.

(A) *Water or waste disposal facilities* include water, sanitary sewerage, solid waste disposal, and storm waste-water facilities.

(B) *Essential community facilities* are those public improvements requisite to the beneficial and orderly development of a community operated on a non-profit basis including but not limited to:

- (1) Health services;
- (2) Community, social, or cultural services;
- (3) Transportation facilities, such as streets, roads, and bridges;
- (4) Hydroelectric generating facilities and related connecting systems and appurtenances, when not eligible for Rural Electrification Administration (REA) financing;
- (5) Supplemental and supporting structures for other rural electrification or telephone systems (including

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facilities such as headquarters and office buildings, storage facilities, and maintenance shops) when not eligible for Rural Electrification Administration financing. Additionally, a borrower is permitted to use up to 10 percent of the amount provided under this subpart to construct, improve, or acquire broadband infrastructure related to the project financed, subject to the requirements of 7 CFR part 1980, subpart M.

(6) Natural gas distribution systems; and

(7) Industrial park sites, but only to the extent of land acquisition and necessary site preparation, including access ways and utility extensions to and throughout the site. Funds may not be used in connection with industrial parks to finance on-site utility systems, or business and industrial buildings.

(C) *Otherwise improve* includes but is not 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;

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

(3) Payment of tap fees and other utility connection charges as provided in utility purchase contracts prepared under § 1942.18(f) of this subpart.

(ii) To construct or relocate public buildings, roads, bridges, fences, or utilities, and to make other public improvements necessary to the successful operation or protection of facilities authorized in paragraph (d)(1)(i) of this section.

(iii) To relocate private buildings, roads, bridges, fences, or utilities, and other private improvements necessary to the successful operation or protection of facilities authorized in paragraph (d)(1)(i) of this section.

(iv) To pay the following expenses, but only when such expenses are a necessary part of a loan to finance facilities authorized in paragraphs (d)(1)(i), (d)(1)(ii) and (d)(1)(iii) of this section.

(A) Reasonable fees and costs such as legal, engineering, architectural, fiscal advisory, recording, environmental impact analyses, archeological surveys

and possible salvage or other mitigation measures, planning, establishing or acquiring rights.

(B) Interest on loans until the facility is self-supporting, but not for more than three years unless a longer period is approved by the National Office; interest on loans secured by general obligation bonds until tax revenues are available for payment, but not for more than two years unless a longer period is approved by the National Office; and interest on interim financing, including interest charges on interim financing from sources other than Rural Development.

(C) Costs of acquiring interest in land; rights, such as water rights, leases, permits, rights-of-way; and other evidence of land or water control necessary for development of the facility.

(D) Purchasing or renting equipment necessary to install, maintain, extend, protect, operate, or utilize facilities.

(E) Initial operating expenses for a period ordinarily not exceeding one year when the borrower is unable to pay such expenses.

(F) Refinancing debts incurred by, or on behalf of, a community when all of the following conditions exist:

(1) The debts being refinanced are a secondary part of the total loan;

(2) The debts are incurred for the facility or service being financed or any part thereof;

(3) 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.

(G) Prepay costs for which Rural Development grant funds were obligated provided there is:

(1) No conflict with the loan resolution, State statutes, or any other loan requirements; and

(2) Full documentation showing that:  
(i) Loan funds will only be utilized on a temporary basis; and

(ii) All Rural Development loan funds are restored at a later date for purpose(s) for which they were obligated.

(v) To pay obligations for construction incurred before loan approval. Construction work should not be started and obligations for such work or materials should not be incurred before the loan is approved. However, if there

are compelling reasons for proceeding with construction before loan approval, applicants may request Rural Development approval to pay such obligations. Such requests may be approved if Rural Development determines that:

(A) Compelling reasons exist for incurring obligations before loan approval; and

(B) The obligations will be incurred for authorized loan purposes; and

(C) Contract documents have been approved by Rural Development; and

(D) All environmental requirements applicable to Rural Development and the applicant have been met; and

(E) The applicant has the legal authority to incur the obligations at the time proposed, and payment of the debts will remove any basis for any mechanic, material, or other liens that may attach to the security property. Rural Development may authorize payment of such obligations at the time of loan closing. Rural Development's authorization to pay such obligations, however, is on the condition that it is not committed to make the loan; it assumes no responsibility for any obligations incurred by the applicant; and the applicant must subsequently meet all loan approval requirements. The applicant's request and Rural Development authorization for paying such obligations shall be in writing. If construction is started without Rural Development approval, post approval in accordance with this section may be considered.

(2) Funds may not be used to finance:

(i) On-site utility systems or business and industrial buildings in connection with industrial parks.

(ii) Facilities to be used primarily for recreation purposes.

(iii) Community antenna television services or facilities.

(iv) Electric generation or transmission facilities or telephone systems, except as provided in paragraph (d)(1)(i)(B)(4), or (d)(1)(i)(B)(5) of this section; or extensions to serve a particular essential community facility as provided in paragraph (d)(1)(ii) or (d)(1)(iii) of this section.

(v) Facilities which are not modest in size, design, and cost.

(vi) Loan or grant finder's fees.

(vii) Projects located within the Coastal Barriers Resource System that do not qualify for an exception as defined in section 6 of the Coastal Barriers Resource Act, Pub. L. 97-348.

(viii) New combined sanitary and storm water sewer facilities.

(ix) That portion of a water and/or waste disposal facility normally provided by a business or industrial user.

(e) *Facilities for public use.* All facilities financed under the provisions of this subpart shall be for public use.

(1) Utility-type service facilities will be installed so as to serve any user within the service area who desires service and can be feasibly and legally served. Applicants and borrowers must obtain written concurrence of the Rural Development prior to refusing service to such user. Upon failure to provide service which is reasonable and legal, such user shall have direct right of action against the applicant/borrower. A notice of the availability of this service should be given by the applicant/borrower to all persons living within the area who can feasibly and legally be served by the phase of the project being financed.

(i) If a mandatory hookup ordinance will be adopted, the required bond ordinance or resolution advertisement will be considered adequate notification.

(ii) When any portion of the income will be derived from user fees and a mandatory hookup ordinance will not be adopted, each potent user will be afforded an opportunity to request service by signing a Users Agreement.

Those declining service will be afforded an opportunity to sign a statement to such effect. Rural Development has guides available for these purposes in all Rural Development offices.

(2) In no case will boundaries for the proposed service area be chosen in such a way that any user or area will be excluded because of race, color, religion, sex, marital status, age, handicap, or national origin.

(3) This does not preclude:

(i) Financing or constructing projects in phases when it is not practical to finance or construct the entire project at one time; and

(ii) Financing or constructing facilities where it is not economically feasible to serve the entire area, provided

economic feasibility is determined on the basis of the entire system and not by considering the cost of separate extensions to or parts thereof; the applicant publicly announces a plan for extending service to areas not initially receiving service from the system; and potential users located in the areas not to be initially served receive written notice from the applicant that service will not be provided until such time as it is economically feasible to do so, and

(iii) Extending services to industrial areas when service is made available to users located along the extensions.

(4) The State Director will determine that, when feasibly and legally possible, inequities within the proposed project's service area for the same type service proposed (*i.e.*, water or waste disposal) will be remedied by the owner on or before completion of the project that includes Rural Development funding. Inequities are defined as flagrant variations in availability, adequacy or quality of service. User rate schedules for portions of existing systems that were developed under different financing, rates, terms or conditions, as determined by the State Director, do not necessarily constitute inequities.

(5) Before a loan is made to an applicant other than a public body, for other than utility type projects, the articles of incorporation or loan agreement will include a condition similar to the following:

In the event of dissolution of this corporation, or in the event it shall cease to carry out the objectives and purposes herein set forth, all business, property, and assets of the corporation shall go and be distributed to one or more nonprofit corporations or public bodies as may be selected by the board of directors of this corporation and approved by at least 75 percent of the users or members to be used for, and devoted to, the purpose of a community facility project or other purpose to serve the public welfare of the community. In no event shall any of the assets or property, in the event of dissolution thereof, go or be distributed to members, directors, stockholders, or others having financial or managerial interest in the corporation either for the reimbursement of any sum subscribed, donated or contributed by such members or for any other purposes, provided that nothing herein shall prohibit the corporation from paying its just debts.



(f) *Rates and terms*—(1) *General*. Each loan will bear interest at the rate prescribed in RD Instruction 440.1, exhibit B (available in any Rural Development office). The interest rates will be set by Rural Development at least for each quarter of the fiscal year. All rates will be adjusted to the nearest one-eighth of 1 percent. The applicant may submit a written request prior to loan closing that the interest rate charged on the loan be the lower of the rate in effect at the time of loan approval or the rate in effect at the time of loan closing. If the interest rate is to be that in effect at loan closing, the interest rate charged on a loan involving multiple advances of Rural Development funds, using temporary debt instruments, shall be that in effect on the date when the first temporary debt instrument is issued. If no written request is received from the applicant prior to loan closing, the interest rate charged on the loan will be the rate in effect at the time of loan approval.

(2) *Poverty line rate*. The poverty line interest rate will not exceed 5 per centum per annum. The provisions of paragraph (f)(2)(i) of this section do not apply to health care and related facilities that provide direct health care to the public. Otherwise, all loans must comply with the following conditions:

(i) The primary purpose of the loan is to upgrade existing facilities or construct new facilities required to meet applicable health or sanitary standards. Documentation will be obtained from the appropriate regulatory agency with jurisdiction to establish the standard, to verify that a bonafide standard exists, what that standard is, and that the proposed improvements are needed and required to meet the standard; and

(ii) The median household income of the service area is below the poverty line for a family of four, as defined in section 673(2) of the Community Services Block Grant Act (42 U.S.C. 9902(2)), or below 80 percent of the Statewide nonmetropolitan median household income.

(3) *Intermediate rate*. The intermediate interest rate will be set at the poverty line rate plus one-half of the difference between the poverty line rate and the market rate, not to exceed

7 percent per annum. It will apply to loans that do not meet the requirements for the poverty line rate and for which the median household income of the service area is below the poverty line or not more than 100 percent of the nonmetropolitan median household income of the State.

(4) *Market rate*. The market interest rate will be set using as guidance the average of the Bond Buyer Index for the four weeks prior to the first Friday of the last month before the beginning of the quarter. The market rate will apply to all loans that do not qualify for a different rate under paragraph (f)(2) or (f)(3) of this section. It may be adjusted as provided in paragraph (f)(5) of this section.

(5) *Prime farmland*. For essential community facilities loans, the rate indicated by paragraphs (f)(2), (f)(3) or (f)(4) of this section will be increased by two per centum per annum if the project being financed will involve the use of, or construction on, prime or unique farmland in accordance with RD Instruction 440.1, exhibits B and J (available in any Rural Development office).

(6) *Income determination*. The income data used to determine median household income should be that which most accurately reflects the income of the service area. The service area is that area reasonably expected to be served by the facility being financed by Rural Development. The median household income of the service area and the nonmetropolitan median household income of the State will be determined from 5-year income data from the American Community Survey (ACS) or, if needed, other Census Bureau data. If there is reason to believe that the ACS or other Census Bureau data does not accurately represent the median household income within the area to be served, the reasons will be documented and the applicant may furnish, or Rural Development may obtain, additional information regarding such median household income data. Information must consist of reliable data from local, regional, State or Federal sources or from a survey conducted by a reliable impartial source. The nonmetropolitan median household income of the State may only be updated on a national

basis by the Rural Development National Office. This will be done only when median household income data for the same year for all Bureau of the Census areas is available from the Bureau of the Census or other reliable sources. Bureau of the Census areas would include areas such as: Counties, County Subdivisions, Cities, Towns, Townships, Boroughs, and other places.

(7) *Repayment terms.* The loan repayment period shall not exceed the useful life of the facility, State statute or 40 years from the date of the note(s) or bond(s), whichever is less. Where FmHA or its successor agency under Public Law 103-354 grant funds are used in connection with a Rural Development loan, the loan will be for the maximum term permitted by this subpart, State statute, or the useful life of the facility, whichever is less, unless there is an exceptional case where circumstances justify making a Rural Development loan for less than the maximum term permitted. In such cases, the reasons must be fully documented. In all cases, including those in which the Rural Development is jointly financing with another lender, the Rural Development payments of principal and interest should approximate amortized installments.

(i) Principal payments may be deferred in whole or in part for a period not to exceed 36 months following the date the first interest installment is due. If for any reason it appears necessary to permit a longer period of deferment, the State Director may authorize such deferment with the prior approval of the National Office. Deferments of principal will not be used to:

(A) Postpone the levying of taxes or assessments.

(B) Delay collection of the full rates which the borrower has agreed to charge users for its services as soon as major benefits or the improvements are available to those users.

(C) Create reserves for normal operation and maintenance.

(D) Make any capital improvements except those approved by Rural Development determined to be essential to the repayment of the loan or to the obtaining of adequate security thereof.

(E) Accelerate the payment of other debts.

(ii) *Payment date.* Loan payments will be scheduled to coincide with income availability and be in accordance with State law. If consistent with the foregoing, monthly payments will be required and will be enumerated in the bond, other evidence of indebtedness, or other supplemental agreement. However, if State law only permits principal plus interest (P&I) type bonds, annual or semiannual payments will be used. Insofar as practical monthly payments will be scheduled one full month following the date of loan closing; or semiannual or annual payments will be scheduled six or twelve full months, respectively, following the date of loan closing or any deferment period. Due dates falling on the 29th, 30th or 31st day of the month will be avoided.

(g) *Security.* Loans will be secured by the best security position practicable in a manner which will adequately protect the interest of Rural Development during the repayment period of the loan. Specific requirements for security for each loan will be included in a letter of conditions.

(1) *Joint financing security.* For projects utilizing joint financing, when adequate security of more than one type is available, the other lender may take one type of security with the United States taking another type. For projects utilizing joint financing with the same security to be shared by the United States and another lender, the United States will obtain at least a parity position with the other lender. A parity position is to ensure that with joint security, in the event of default, each lender will be affected on a proportionate basis. A parity position will conform with the following unless an exception is granted by the National Office:

(i) *Terms.* It is not necessary for loans to have the same repayment terms to meet the parity requirements. Loans made by other lenders involved in joint financing with the United States for facilities should be scheduled for repayment on terms similar to those customarily used in the State for financing such facilities.

(ii) *Use of trustee or other similar paying agent.* The use of a trustee or other

similar paying agent by the other lender in a joint financing arrangement is acceptable to the United States. A trustee or other similar paying agent will not normally be used for the United States portion of the funding unless required to comply with State law. The responsibilities and authorities of any trustee or other similar paying agent on projects that include United States funds must be clearly specified by written agreement and approved by the State Director and Regional Attorney. The United States must be able to deal directly with the borrower to enforce the provisions of loan and grant agreements and perform necessary servicing actions.

(iii) *Regular payments.* In the event adequate funds are not available to meet regular installments on parity loans, the funds available will be apportioned to the lenders based on the respective current installments of principal and interest due.

(iv) *Disposition of property.* Funds obtained from the sale or liquidation of secured property or fixed assets will be apportioned to the lenders on the basis of the pro rata amount loaned, but not to exceed their respective outstanding balances; provided, however, funds obtained from such sale or liquidation for a project that included grant funds will be apportioned as may be required by the grant agreement.

(v) *Protective advances.* Protective advances are payments made by a lender for items such as insurance or taxes, to protect the financial interest of the lender, and charged to the borrower's loan account. To the extent consistent with State law and customary lending practices in the area, repayment of protective advances made by either lender, for the mutual protection of both lenders, should receive first priority in apportionment of funds between the lenders. To ensure agreement between lenders, efforts should be made to obtain the concurrence of both lenders before one lender makes a protective advance.

(2) *Public bodies.* Loans to such borrowers will be evidenced by notes, bonds, warrants, or other contractual obligations as may be authorized by relevant State statutes and by bor-

rower's documents, resolutions, and ordinances.

(i) Utility-type facilities such as water and sewer systems, natural gas distribution systems, electric systems, etc., will be secured by:

(A) The full faith and credit of the borrower when the debt is evidenced by general obligation bonds; and/or

(B) Pledges of taxes or assessments; and/or

(C) Pledges of facility revenue and, when it is the customary financial practice in the State, liens will be taken on the interest of the applicant in all land, easements, rights-of-way, water rights, water purchase contracts, water sales contracts, sewage treatment contracts, and similar property rights, including leasehold interest, used or to be used in connection with the facility whether owned at the time the loan is approved or acquired with loan funds; and/or

(D) In those cases involving water and waste disposal projects where there is a substantial number of other than full-time users and facility costs result in a higher than reasonable rate for such full-time users, the loan will be secured by the full faith and credit of the borrower or by an assignment or pledge of taxes or assessments from public bodies or other organizations having the authority to issue bonds or pledge such taxes or assessments.

(ii) *Solid waste systems.* The type of security required will be based on State law and what is determined adequate to protect the interest of the United States during the repayment period of the loan.

(iii) *Other essential community facilities* other than utility type, such as those for public health and safety, social, and cultural needs and the like will meet the following security requirements:

(A) Such loans will be secured by one or a combination of the following and in the following order of preference:

(1) General obligation bonds.

(2) Assessments.

(3) Bonds which pledge other taxes.

(4) Bonds pledging revenues of the facility being financed when such bonds provide for the mandatory levy and

collection of taxes in the event revenues later become insufficient to properly operate and maintain the facility and to retire the loan.

(5) Assignment of assured income which will be available for the life of the loan, from such sources as insurance premium rebates, income from endowments, irrevocable trusts, or commitments from industries, public bodies, or other reliable sources.

(6) Liens on real and chattel property when legally permissible and an assignment of the borrowers income from applicants who have been in existence and are able to present evidence of a financially successful operation of a similar facility for a period of time sufficient to indicate project success. National Office concurrence is required when the applicant has been in existence for less than five years or has not operated on a financially successful basis for five years immediately prior to loan application.

(7) Liens on real and chattel property when legally permissible and an assignment of income from an organization receiving Health and Human Services (HHS) operating grants under the "Memorandum of Understanding Between Health Resources and Services Administration, U.S. Department of Health and Human Services and Rural Development, U.S. Department of Agriculture" (see RD Instruction 2000-T, available in any Rural Development office.)

(8) Liens on real and chattel property when legally permissible and an assignment of income from an organization proposing a facility whose users receive reliable income from programs such as social security, supplemental security income (SSI), retirement plans, long-term insurance annuities, medicare or medicaid. Examples are homes for the handicapped or institutions whose clientele receive State or local government assistance.

(9) When the applicant cannot meet the criteria in paragraph (g)(2)(iii)(A) (1) through (8) of this section, such proposals may be considered when all the following are met:

(i) The applicant is a new organization or one that has not operated the type of facility being proposed.

(ii) There is a demonstration of exceptional community support such as substantial financial contributions, and aggressive leadership in the formation of the organization and proposed project which indicates a commitment of the entire community.

(iii) The State Director has determined that adequate and dependable revenues will be available to meet all operation expenses, debt repayment, and the required reserve.

(iv) Prior National Office review and concurrence is obtained.

(B) Real estate and chattel property taken as security in accordance with paragraphs (g)(2)(iii)(A) (6) through (9) of this section:

(1) Ordinarily will include the property that is used in connection with the facility being financed; and

(2) Will have an as-developed present market value determined by a qualified appraiser equal to or exceeding the amount of the loan to be obtained plus any other indebtedness against the proposed security; and

(3) May have one of the lien requirements deleted when the loan approval official determines that the loan will be adequately secured with a lien on either the real estate or chattel property.

(C) When security is not available in accordance with paragraphs (g)(2)(iii)(A) (1) through (5) of this section and State law precludes securing the loan with liens on real or chattel property, the loan will be secured in the best manner consistent with State law and customary security taken by private lenders in the State, such as revenue bonds, and any other security the loan approval official determines necessary for a sound loan. Such loans will otherwise meet the requirements of (g)(2)(iii)(A) (6) through (9) of this section as appropriate.

(3) *Other-than-public bodies.* Loans to other-than-public body applicants will be secured as follows:

(i) Utility-type facilities eligible for Rural Development assistance under paragraph (d) of this section such as water and sewer systems, natural gas distribution systems, electric systems, etc., will be secured as follows:

(A) Assignments of borrower income will be taken and perfected by filing, if legally permissible; and

(B) A lien will be taken on the interest of the applicant in all land, easements, rights-of-way, water rights, water purchase contracts, water sales contracts, sewage treatment contracts and similar property rights, including leasehold interest, used, or to be used in connection with the facility whether owned at the time the loan is approved or acquired with loan funds. In unusual circumstances where it is not feasible to obtain a lien on such land (such as land rights obtained from Federal or local government agencies, and from railroads) and the loan approval official determines that the interest of the United States otherwise is secured adequately, the lien requirement may be omitted as to such land rights.

(C) When the loan is approved or the acquisition of real property is subject to an outstanding lien indebtedness, the next highest priority lien obtainable will be taken if the loan approval official determines that the loan is adequately secured.

(D) *Other security.* Promissory notes from individuals, stock or membership subscription agreements, individuals member's liability agreements, or other evidences of debt, as well as mortgages or other security instruments encumbering the private property of members of the association may be pledged or assigned to the United States as additional security in any case in which the interest of the United States will not be otherwise adequately protected.

(E) In those cases where there is a substantial number of other than full-time users and facility costs result in a higher than reasonable rate for such full-time users, the loan will be secured by an assignment or pledge of general obligation bonds, taxes, or assessments from public bodies or other organizations having the authority to issue bonds or pledge such taxes, or assessments.

(ii) *Solid waste systems.* The type of security required will be based on State law and what is determined adequate to protect the interest of the United States during the repayment period of the loan.

(iii) *Essential community facilities* other than utility type such as those for public health and safety, social, and cultural needs and the like will meet the following security requirements:

(A) Such loans will be secured by one or a combination of the following and in the following order of preference:

(1) An assignment of assured income that will be available for the life of the loan, from sources such as insurance premium rebates, income from endowments, irrevocable trusts, or commitments from industries, public bodies, or other reliable sources.

(2) Liens on real and chattel property with an assignment of income from applicants who have been in existence and are able to present evidence of a financially successful operation of a similar facility for a period of time sufficient to indicate project success. National Office concurrence is required when the applicant has been in existence for less than five years or has not operated on a financially successful basis for at least the five years immediately prior to loan application.

(3) Liens on real and chattel property and an assignment of income from an organization receiving HHS operating grants under the "Memorandum of Understanding Between Health Resources and Services Administration, U.S. Department of Health and Human Services and Rural Development, U.S. Department of Agriculture" (see RD Instruction 2000-T, available in any Rural Development office).

(4) Liens on real and chattel property when legally permissible and an assignment of income from an organization proposing a facility whose users receive reliable income from programs such as social security, supplemental security income (SSI), retirement plans, long-term insurance annuities, medicare or medicaid. Examples are homes for the handicapped or institutions whose clientele receive State or local government assistance.

(5) When the applicant cannot meet the criteria in paragraphs (g)(3)(iii)(A) (1) through (4) of this section, such proposals may be considered when all the following are met:

(i) The applicant is a new organization or one that has not operated the type of facility being proposed.

(ii) There is a demonstration of exceptional community support such as substantial financial contributions, and aggressive leadership in the formation of the organization and proposed project which indicates a commitment of the entire community.

(iii) The State Director has determined that adequate and dependable revenues will be available to meet all operation expenses, debt repayment, and the required reserve.

(iv) Prior National Office review and concurrence is obtained.

(6) Additional security may be taken as determined necessary by the loan approval official.

(B) Real estate and chattel property taken as security:

(1) Ordinarily will include the property that is used in connection with the facility being financed; and

(2) Will have an as-developed present market value determined by a qualified appraiser equal to or exceeding the amount of the loan to be obtained plus any other indebtedness against the proposed security; and

(3) May have one of the lien requirements deleted when the loan approval official determines that the loan will be adequately secured with a lien on either the real estate or the chattel property.

(h) *Economic feasibility requirements.* All projects financed under the provisions of this section must be based on taxes, assessments, revenues, fees, or other satisfactory sources of revenues in an amount sufficient to provide for facility operation and maintenance, a reasonable reserve, and debt payment. An overall review of the applicant's financial status, including a review of all assets and liabilities, will be a part of the docket review process by the Rural Development staff and approval official. If the primary use of the facility is by business and the success or failure of the facility is dependent on the business, then the economic viability of that business must be assessed. The number of users for a rural business will be based on equivalent dwelling units, which is the level of service provided to a typical rural residential dwelling.

(1) *Financial feasibility reports.* All applicants will be expected to provide a

financial feasibility report prepared by a qualified firm or individual. These financial feasibility reports will normally be:

(i) Included as part of the preliminary engineer/architectural report using guides 6 through 10 as applicable; or

(ii) Prepared by a qualified firm or individual not having a direct interest in the management or construction of the facility using guide 5 when:

(A) The project will significantly affect the applicant's financial operations and is not a utility-type facility but is dependent on revenues from the facility to repay the loan; or

(B) It is specifically requested by Rural Development.

(2) *Applicants for loans for utility-type facilities* dependent on users fees for debt payment shall base their income and expense forecast on realistic user estimates in accordance with the following:

(i) In estimating the number of users and establishing rates or fees on which the loan will be based for new systems and for extensions or improvements to existing systems, consideration should be given to the following:

(A) An estimated number of maximum initial users should not be used when setting user fees and rates since it may be several years before all residents in the community will need the services provided by the system. In establishing rates a realistic number of initial users should be employed.

(B) User agreements from individual vacant property owners will not be considered when determining project feasibility unless:

(1) The owner has plans to develop the property in a reasonable period of time and become a user of the facility; and

(2) The owner agrees in writing to make a monthly payment at least equal to the proportionate share of debt service attributable to the vacant property until the property is developed and the facility is utilized on a regular basis. A bond or escrowed security deposit must be provided to guarantee this monthly payment and to guarantee an amount at least equal to the owner's proportionate share of construction costs. If a bond is provided, it

must be executed by a surety company that appears on the Treasury Department's most current list (Circular 570, as amended) and be authorized to transact business in the State where the project is located. The guarantee shall be payable jointly to the borrower and the Rural Development; and

(3) Such guarantee will mature not later than 4 years from the date of execution and will be finally due and payable upon default of a monthly payment or at maturity, unless the property covered by the guarantee has been developed and the facility is being utilized on a regular basis.

(C) Income from other vacant property owners will be considered only as extra income.

(ii) Realistic user estimates will be established as follows:

(A) Meaningful potential user cash contributions. Potential user cash contributions are required except:

(1) For users presently receiving service, or

(2) Where Rural Development determines that the potential users as a whole in the applicant's service area cannot make cash contributions, or

(3) Where State statutes or local ordinances require mandatory use of the system and the applicant or legal entity having such authority agrees in writing to enforce such statutes, or ordinances.

(B) The amount of cash contributions required in paragraph (h)(2)(ii)(A) of this section will be set by the applicant and concurred in by Rural Development. Contributions should be an amount high enough to indicate sincere interest on the part of the potential user, but not so high as to preclude service to low income families. Contributions ordinarily should be an amount approximating one year's minimum user fee, and shall be paid in full before loan closing or commencement of construction, whichever occurs first. Once economic feasibility is ascertained based on a demonstration of meaningful potential user cash contributions, the contribution, membership fee or other fees that may be imposed are not a requirement of Rural Development under this section. However, borrowers do have an additional responsibility relating to generating

sufficient revenues as set forth in paragraph (n)(2)(iii) of this section.

(C) Enforceable user agreement. Except for users presently receiving service, an enforceable user agreement with a penalty clause is required unless State statutes or local ordinances require mandatory use of the system and the applicant or legal entity having such authority agrees in writing to enforce such statutes or ordinances.

(iii) In those cases where all or part of the borrower's debt payment revenues will come from user fees, applicants must provide a positive program to encourage connection by all users as soon as service is available. The program will be available for review and approval by Rural Development before loan closing or commencement of construction, whichever occurs first. Such a program shall include:

(A) An aggressive information program to be carried out during the construction period. The borrower should send written notification to all signed users at least three weeks in advance of the date service will be available, stating the date users will be expected to have their connections completed, and the date user charges will begin.

(B) Positive steps to assure that installation services will be available. These may be provided by the contractor installing the system, local plumbing companies, or local contractors.

(C) Aggressive action to see that all signed users can finance their connections. This might require collection of sufficient user contributions to finance connections. Extreme cases might necessitate additional loan funds for this purpose; however, loan funds should be used only when absolutely necessary and when approved by Rural Development prior to loan closing.

(3) *Utility-type facilities for new developing communities or areas.* Developers are normally expected to provide utility-type facilities in new or developing areas and such facilities shall be installed in compliance with appropriate State statutes and regulations. Rural Development will be considered to an eligible applicant in such cases when failure to complete development would

result in an adverse economic condition for the rural area (not the community being developed); the proposal is necessary to the success of an area development plan; and loan repayment can be assured by:

- (i) The applicant already having sufficient assured revenues to repay the loan; or
- (ii) Developers providing a bond or escrowed security deposit as a guarantee sufficient to meet expenses attributable to the area in question until a sufficient number of the building sites are occupied and connected to the facility to provide enough revenues to meet operating, maintenance, debt service, and reserve requirements. Such guarantees from developers will meet the requirements in paragraph (h)(2)(i)(B) of this section; or
- (iii) Developers paying cash for the increased capital cost and any increased operating expenses until the developing area will support the increased costs; or
- (iv) The full faith and credit of a public body where the debt is evidenced by general obligation bonds; or
- (v) The loan is to a public body evidenced by a pledge of tax assessments; or
- (vi) The user charges can become a tax lien upon the property being served and income from such lien can be collected in sufficient time to be used for its intended purposes.

(i) *Reserve requirements.* Provision for the accumulation of necessary reserves over a reasonable period of time will be included in the loan documents and in assessments, tax levies, or rates charged for services. In those cases where statutes providing for extinguishing assessment liens of public bodies when properties subject to such liens are sold for delinquent State or local taxes, special reserves will be established and maintained for the protection of the borrower's assessment lien.

(1) *General obligation or special assessment bonds.* Ordinarily, the requirements for reserves will be considered to have been met if general obligation or other bonds which pledge the full faith and credit of the political subdivision are used, or special assessment bonds are used, and if such bonds provide for

the annual collection of sufficient taxes or assessments to cover debt service, operation and maintenance, and a reasonable amount for emergencies and to offset the possible nonpayment of taxes or assessments by a percentage of the property owners, or a statutory method is provided to prevent the incurrence of a deficiency.

(2) *Other than general obligation or special assessment bonds.* Each borrower will be required to establish and maintain reserves sufficient to assure that loan installments will be paid on time, for emergency maintenance, for extensions to facilities, and for replacement of short-lived assets which have a useful life significantly less than the repayment period of the loan. It is expected that borrowers issuing bonds or other evidences of debt pledging facility revenues as security will ordinarily plan their reserve to provide for a total reserve in an amount at least equal to one average loan installment. It is also expected the ordinarily such reserve will be accumulated at the rate of at least one-tenth of the total each year until the desired level is reached.

(j) *General requirements—(1) Membership authorization.* For organizations other than public bodies, the membership will authorize the project and its financing except that the State Director may, with the concurrence of OGC, accept the loan resolution without such membership authorization when State statutes and the organization's charter and bylaws do not require such authorization; and

(i) The organization is well established and is operating with a sound financial base; or

(ii) For utility-type projects the members of the organization have all signed an enforceable user agreement with a penalty clause and have made the required meaningful user cash contribution, except for members presently receiving service or when State statutes or local ordinances require mandatory use of the facility.

(2) *Planning, bidding, contracting, constructing.* (See § 1942.18).

(3) *Insurance and fidelity bonds.* The purpose of RD's insurance and fidelity bond requirements is to protect the government's financial interest based



on the facility financed. The requirements below apply to all types of coverage determined necessary. The National Office may grant exceptions to normal requirements when appropriate justification is provided establishing that it is in the best interest of the applicant/borrower and will not adversely affect the government's interest.

(i) *General.* (A) Applicants must provide evidence of adequate insurance and fidelity bond coverage by loan closing or start of construction, whichever occurs first. Adequate coverage in accordance with this section must then be maintained for the life of the loan. It is the responsibility of the applicant/borrower and not that of Rural Development to assure that adequate insurance and fidelity bond coverage is maintained.

(B) Insurance and fidelity bond requirements by Rural Development shall normally not exceed those proposed by the applicant/borrower if the Rural Development loan approval or servicing official determines that proposed coverage is adequate to protect the government's financial interest. Applicants/borrowers are encouraged to have their attorney, consulting engineer/architect, and/or insurance provider(s) review proposed types and amounts of coverage, including any deductible provisions. If the FmHA or its successor agency under Public Law 103-354 official and the applicant/borrower cannot agree on the acceptability of coverage proposed, a decision will be made by the State Director.

(C) The use of deductibles, *i.e.*, an initial amount of each claim to be paid by the applicant/borrower, may be allowed by Rural Development providing the applicant/borrower has financial resources which would likely be adequate to cover potential claims requiring payment of the deductible.

(D) Borrowers must provide evidence to Rural Development that adequate insurance and fidelity bond coverage is being maintained. This may consist of a listing of policies and coverage amounts in yearend reports submitted with management reports required under §1942.17(q)(2) or other documentation. The borrower is responsible for updating and/or renewing policies or coverage which expire between sub-

missions to Rural Development. Any monitoring of insurance and fidelity bond coverage by FmHA or its successor agency under Public Law 103-354 is solely for the benefit of FmHA or its successor agency under Public Law 103-354, and does not relieve the applicant/borrower of its obligation under the loan resolution to maintain such coverage.

(ii) *Fidelity bond.* Applicants/borrowers will provide fidelity bond coverage for all persons who have access to funds. Coverage may be provided either for all individual positions or persons, or through "blanket" coverage providing protection for all appropriate employees and/or officials. An exception may be granted by the State Director when funds relating to the facility financed are handled by another entity and it is determined that the entity has adequate coverage or the government's interest would otherwise be adequately protected.

(A) The amount of coverage required by Rural Development will normally approximate the total annual debt service requirements for the Rural Development loans.

(B) Form RD 440-24, "Position Fidelity Schedule Bond" may be used. Similar forms may be used if determined acceptable to Rural Development. Other types of coverage may be considered acceptable if it is determined by Rural Development that they fulfill essentially the same purpose as a fidelity bond.

(C) Fidelity bonds must be obtained from companies holding certificates of authority as acceptable sureties, as prescribed in 31 CFR part 223, "Surety Companies doing Business with the United States."

(iii) *Insurance.* The following types of coverage must be maintained if appropriate for the type of project and entity involved. Insurance must be in amounts acceptable to the Agency and at least equivalent to coverage for real property and equipment acquired without Federal funds.

(A) *Property insurance.* Fire and extended coverage will normally be maintained on all structures except as noted in paragraphs (j)(3)(iii)(A)(I) and (2) of this section. Ordinarily, Rural Development should be listed as mortgagee on

the policy when Rural Development has a lien on the property. Normally, major items of equipment or machinery located in the insured structures must also be covered. Exceptions:

(1) Reservoirs, standpipes, elevated tanks, and other structures built entirely of noncombustible materials if such structures are not normally insured.

(2) Subsurface lift stations except for the value of electrical and pumping equipment therein.

(B) *Liability and property damage insurance, including vehicular coverage.*

(C) *Malpractice insurance.* The need and requirements for malpractice insurance will be carefully and thoroughly considered in connection with each health care facility financed.

(D) *Flood insurance.* Facilities located in special flood- and mudslide-prone areas must comply with the eligibility and insurance requirements of subpart B of part 1806 of this chapter (RD Instruction 426.2).

(E) *Worker's compensation.* The borrower will carry worker's compensation insurance for employees in accordance with State laws.

(4) *Acquisition of land, easements, water rights, and existing facilities.* 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.

(i) *Title for land, rights-of-way, easements, or existing facilities.* The applicant must certify and provide a legal opinion relative to the title to rights-of-way and easements. Form RD 442-21, "Rights-of-Way Certificate," and Form RD 442-22, "Opinion of Counsel Relative to Rights-of-Way," may be used.

(A) *Rights-of-way and easements.* Applicants are responsible for and will obtain valid, continuous and adequate rights-of-way and easements needed for the construction, operation, and maintenance of the facility. Form RD 442-20, "Right-of-Way Easement," may be used. When a site is for major structures for utility-type facilities such as a reservoir or pumping station and the applicant is able to obtain only a right-of-way or easement on such a site rather

than a fee simple title, the applicant will furnish a title report thereon by the applicant's attorney showing ownership of the land and all mortgages or other lien defects, restrictions, or encumbrances, if any. It is the responsibility of the applicant to obtain and record such releases, consents or subordinations to such property rights from holders of outstanding liens or other instruments as may be necessary for the construction, operation, and maintenance of the facility and give Rural Development the required security.

(B) *Title for land or existing facilities.* Title to land essential to the successful operation of facilities or title to facilities being purchased, must not contain any restrictions that will adversely affect the suitability, successful operation, security value, or transferability of the facility. Title opinions must be provided by the applicant's attorney. The opinions must be in sufficient detail to assess marketability of the property. Form RD 1927-9, "Preliminary Title Opinion," and Form RD 1927-10, "Final Title Opinion," may be used to provide the required title opinions. If other forms are used they must be reviewed and approved by Rural Development and OGC.

(1) In lieu of receiving title opinions from the applicant's attorney, the applicant may use a title insurance company. If a title insurance company is used, the company must provide RD a title insurance binder, disclosing all title defects or restrictions, and include a commitment to issue a title insurance policy. The policy should be in an amount at least equal to the market value of the property as improved. The title insurance binder and commitment should be provided to RD prior to requesting closing instructions. RD will be provided a title insurance policy which will insure RD's interest in the property without any title defects or restrictions which have not been waived by RD.

(2) The loan approval official may waive title defects or restrictions, such as utility easements, that do not adversely affect the suitability, successful operation, security value, or transferability of the facility. If the District Director is the loan approval official

and is unable to waive the defect or restriction, the title opinion or title insurance binder will be forwarded to the State Director. If the State Director, with the advice of the OGC, determines that the defect or restriction cannot be waived, the defect or restriction must be removed.

(ii) *Water rights.* When legally permissible, an assignment will be taken on water rights owned or to be acquired by the applicant. The following will be furnished as applicable:

(A) A statement by the applicant's attorney regarding the nature of the water rights owned or to be acquired by the applicant (such as conveyance of title, appropriation and decree, application and permit, public notice and appropriation and use).

(B) A copy of a contract with another company or municipality to supply water; or stock certificates in another company which represents the right to receive water.

(iii) *Land purchase contract:* (A) A land purchase contract (known in some areas as a contract for deed) is an agreement between two or more parties which obligates the purchaser to pay the purchase price, gives the purchaser the rights of immediate possession, control, and beneficial use of the property, and entitles the purchaser to a deed upon paying all or a specified part of the purchase price.

(B) Applicants may obtain land through land purchase contracts when all of the following conditions are met:

(1) The applicant has exhausted all reasonable means of obtaining outright fee simple title to the necessary land.

(2) The applicant cannot obtain the land through condemnation.

(3) There are not other suitable sites available.

(4) National Office concurrence is obtained in accordance with paragraph (j)(4)(iii)(D)(2) of this section.

(C) The land purchase contract must provide for the transfer of ownership by the seller without any restrictions, liens or other title defects. The contract must not contain provisions for future advances (except for taxes, insurance, or other costs needed to protect the security), summary cancellations, summary forfeiture, or other clauses that may jeopardize the Gov-

ernment's interest or the purchaser's ability to pay the Rural Development loan. The contract must provide that if the purchaser fails to make payment that Rural Development will be given at least 90 days written notice with an option to cure the default before the contract can be cancelled, terminated or foreclosed. Then Rural Development must have the option of making the payment and charging it to the purchaser's account, making the payment and taking over the ownership of the purchase contract, or taking any other action necessary to protect the Government's interest.

(D) Prior to loan closing or the beginning of construction, whichever occurs first, the following actions must be taken in the order listed below:

(1) The land purchase contract and any appropriate title opinions must be reviewed by the Regional Attorney to determine if they are legally sufficient to protect the interest of the Government.

(2) The land purchase contract, the Regional Attorney's comments, and the State Director's recommendations must be submitted to the National Office for concurrence.

(3) The land purchase contract must be recorded.

(5) *Lease agreements.* Where the right of use or control of real property not owned by the applicant/borrower is essential to the successful operation of the facility during the life of the loan, such right will be evidenced by written agreements or contracts between the owner(s) of the property and the applicant/borrower. Lease agreements shall not contain provisions for restricted use of the site of facility, forfeiture or summary cancellation clauses and shall provide for the right to transfer and lease without restriction. Lease agreements will ordinarily be written for a term at least equal to the term of the loan. Such lease contracts or agreements will be approved by the Rural Development loan approval official with the advice and counsel of the Regional Attorney, OGC, as to the legal sufficiency of such documents. A copy of the lease contract or agreement will be included in the loan docket.

(6) *Notes and bonds.* Notes and bonds will be completed on the date of loan

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closing except for the entry of subsequent multiple advances where applicable. The amount of each note will be in multiples of not less than \$100. The amount of each bond will ordinarily be in multiples of not less than \$1,000.

(i) Form RD 440-22, "Promissory Note (Association or Organization)," will ordinarily be used for loans to nonpublic bodies.

(ii) Section 1942.19 contains instructions for preparation of notes and bonds evidencing indebtedness of public bodies.

(7) *Environmental review requirements.* Loans made under this subpart must comply with the environmental review requirements in accordance with 7 CFR part 1970.

(8) *Health care facilities.* The applicant will be responsible for obtaining the following documents:

(i) A statement from the responsible State agency certifying that the proposed health care facility is not inconsistent with the State Medical Facilities Plan.

(ii) A statement from the responsible State agency or regional office of the Department of Health and Services certifying that the proposed facility meets the standards in § 1942.18(d)(4).

(9) *Public information.* Applicants should inform the general public regarding the development of any proposed project. Any applicant not required to obtain authorization by vote of its membership or by public referendum, to incur the obligations of the proposed loan or grant, will hold at least one public information meeting. The public meeting must be held after the preapplication is filed and not later than loan approval. The meeting must give the citizenry an opportunity to become acquainted with the proposed project and to comment on such items as economic and environmental impacts, service area, alternatives to the project, or any other issue identified by Rural Development. The applicant will be required, at least 10 days prior to the meeting, to publish a notice of the meeting in a newspaper of general circulation in the service area, to post a public notice at the applicant's principal office, and to notify Rural Development. The applicant will provide Rural Development a copy of the pub-

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lished notice and minutes of the public meeting. A public meeting is not normally required for subsequent loans which are needed to complete the financing of the project.

(10) *Service through individual installation.* Community owned water or waste disposal systems may provide service through individual installations or small clusters of users within the applicant's service area. When individual installations or small clusters are proposed, the loan approval official should consider items such as: quantity and quality of the individual installations that may be developed; cost effectiveness of the individual facility compared with the initial and long term user cost on a central system; health and pollution problems attributable to individual facilities; operational or management problems peculiar to individual installations; and permit and regulatory agency requirements.

(i) Applicants providing service through individual facilities must meet the eligibility requirements in § 1942.17(b).

(ii) Rural Development must approve the form of agreement between the owner and individual users for the installation, operation and payment for individual facilities.

(iii) If taxes or assessments are not pledged as security, owners providing service through individual facilities must obtain security as necessary to assure collection of any sum the individual user is obligated to pay the owner.

(iv) Notes representing indebtedness owed the owner by a user for an individual facility will be scheduled for payment over a period not to exceed the useful life of the individual facility or the loan, whichever is shorter. The interest rate will not exceed the interest rate charged the owner on the Rural Development indebtedness.

(v) Owners providing service through individual or cluster facilities must obtain:

(A) Easements for the installation and ingress to and egress from the facility; and

(B) An adequate method for denying service in the event of nonpayment of user fees.

(11) *Funds from other sources.* Rural Development loan funds may be used along with or in connection with funds provided by the applicant or from other sources. Since “matching funds” is not a requirement for Rural Development loans, shared revenues may be used with Rural Development funds for project construction.

(k) *Other Federal, State, and local requirements.* Each application shall contain the comments, necessary certifications and recommendations of appropriate regulatory or other agency or institution having expertise in the planning, operation, and management of similar facilities. Proposals for facilities financed in whole or in part with Rural Development funds will be coordinated with appropriate Federal, State, and local agencies in accordance with the following:

(1) *Compliance with special laws and regulations.* Except as provided in paragraph (k)(2) of this section applicants will be required to comply with Federal, State, and local laws and any regulatory commission rules and regulations pertaining to:

(i) Organization of the applicant and its authority to construct, operate, and maintain the proposed facilities;

(ii) Borrowing money, giving security therefore, and raising revenues for the repayment thereof;

(iii) Land use zoning; and

(iv) Health and sanitation standards and design and installation standards unless an exception is granted by Rural Development.

(2) *Compliance exceptions.* If there are conflicts between this subpart and state or local laws or regulatory commission regulations, the provisions of this subpart will control.

(3) *State Pollution Control or Environmental Protection Agency Standards.* Water and waste disposal facilities will be designed, installed, and operated in such a manner that they will not result in the pollution of water in the State in excess of established standards and that any effluent will conform with appropriate State and Federal Water Pollution Control Standards. A certification from the appropriate State and Federal agencies for water pollution control standards will be obtained

showing that established standards are met.

(4) *Consistency with other development plans.* Rural Development financed facilities will not be inconsistent with any development plans of State, multi-jurisdictional areas, counties, or municipalities in which the proposed project is located.

(5) *State agency regulating water rights.* Each Rural Development financed facility will be in compliance with appropriate State agency regulations which have control of the appropriation, diversion, storage and use of water and disposal of excess water. All of the rights of any landowners, appropriators, or users of water from any source will be fully honored in all respects as they may be affected by facilities to be installed.

(6) *Civil Rights Act of 1964.* All borrowers are subject to, and facilities must be operated in accordance with, title VI of the Civil Rights Act of 1964 and subpart E of part 1901 of this chapter, particularly as it relates to conducting and reporting of compliance reviews. Instruments of conveyance for loans and/or grants subject to the Act must contain the covenant required by § 1901.202(e) of subpart E of part 1901 of this chapter.

(7) *Title IX of the Education Amendments of 1972.* No person in the United States shall, on the basis of sex, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any education program or education activity receiving Agency financial assistance except as otherwise provided for in the Education Amendments of title IX. The State Director will provide guidance and technical assistance to carry out the intent of this paragraph.

(8) *Section 504 of the Rehabilitation Act of 1973.* Under section 504 of the Rehabilitation Act of 1973, as amended (29 U.S.C. 794), no handicapped individual in the United States shall, solely by reason of their handicap, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Agency financial assistance.

(9) *Age Discrimination Act of 1975.* This Act provides that no person in the United States shall on the basis of age,

be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance. This Act also applies to programs or activities funded under the State and Local Fiscal Assistance Act of 1972 (31 U.S.C. 1221 et. seq.). This Act does not apply to: (i) age distinctions contained in Federal, State or local statutes or ordinances adopted by an elected, general purpose legislative body which provide benefits or assistance based on age; (ii) establish criteria for participation in age-related terms; (iii) describe intended beneficiaries or target groups in age-related terms; and, (iv) any employment practice of any employer, employment agency, labor organization, or any labor-management joint apprenticeship training program except for any program or activity receiving Federal financial assistance for public service employment under the Comprehensive Employment and Training Act of 1974 (CETA) (29 U.S.C. 801 et. seq.).

(1) *Professional services and contracts related to the facility*—(1) *Professional services.* Applicants will be responsible for providing the services necessary to plan projects including design of facilities, preparation of cost and income estimates, development of proposals for organization and financing, and overall operation and maintenance of the facility. Professional services of the following may be necessary: Engineer, architect, attorney, bond counsel, accountant, auditor, appraiser, and financial advisory or fiscal agent (if desired by applicant). Contracts or other forms of agreement between the applicant and its professional and technical representatives are required and are subject to Agency concurrence. Form RD 1942-19, "Agreement for Engineering Services," may be used when appropriate. Guide 20, "Agreement for Engineering Services (Agency/EPA—Jointly Funded Projects)" may be used on projects jointly funded by RD and EPA. Guide 14 may be used in the preparation of the legal services agreement.

(2) *Bond counsel.* Unless otherwise provided by §1942.19(b), public bodies are required to obtain the service of recognized bond counsel in the preparation of evidence of indebtedness.

(3) *Contracts for other services.* Contracts or other forms of agreements for other services including management, operation, and maintenance will be developed by the applicant and presented to the Agency for review and approval. Management agreements should provide at least those items in guide 24.

(4) *Fees.* Fees provided for in contracts or agreements shall be reasonable. They shall be considered to be reasonable if not in excess of those ordinarily charged by the profession for similar work when the Agency financing is not involved.

(m) *Applying for the Agency loans*—(1) *Preapplication.* Applicants desiring loans will file SF 424.2 and comments from the appropriate A-95 clearinghouse agency normally with the appropriate Agency County Office. The County Supervisor will immediately forward all documents to the District Office. The District Director has prime responsibility for all community program loan making and servicing activities within the District.

(2) *Preapplication review.* Upon receipt of the preapplication, RD will tentatively determine eligibility including the likelihood of credit elsewhere at reasonable rates and terms and availability of agency loan funds. The determination as to availability of other credit will be made after considering present rates and terms available for similar proposals (not necessarily based upon rates and terms available from Rural Development); the repayment potential of the applicant; long-term cost to the applicant; and average user or other charges. In those cases where Rural Development determines that loans at reasonable rates and terms should be available from commercial sources, Rural Development will notify the applicant so that it may apply for such financial assistance. Such applicants may be reconsidered for Rural Development loans upon their presenting satisfactory evidence of inability to obtain commercial financing at reasonable rates and terms.

(3) *Incurring obligations.* Applicants should not proceed with planning nor obligate themselves for expenditures until authorized by Rural Development.

(4) *Results of preapplication review.* After Rural Development has reviewed the preapplication material and any additional material that may be requested, Form AD-622 will be sent to the applicant. Ordinarily the review will not exceed 45 days.

(5) *Application conference.* Before starting to assemble the application and after the applicant selects its professional and technical representatives, it should arrange with Rural Development for an application conference to provide a basis for orderly application assembly. Rural Development will provide applicants with a list of documents necessary to complete the application. Guide 15 may be used for this purpose. Applications will be filed with the District Office.

(6) *Application completion and assembling.* This is the responsibility of the applicant with guidance from Rural Development. The applicant may utilize their professional and technical representatives or other competent sources.

(7) *Review of decision.* If an application is rejected, the applicant may request a review of this decision under subpart B of part 1900 of this chapter.

(n) *Actions prior to loan closing and start of construction—(1) Excess Rural Development loan and grant funds.* If there is a significant reduction in project cost, the applicant's funding needs will be reassessed before loan closing or the start of construction, whichever occurs first. In such cases applicable Rural Development forms, the letter of conditions, and other items will be revised. Decreases in Rural Development funds will be based on revised project costs and current number of users, however, other factors including Rural Development regulations used at the time of loan/grant approval will remain the same. Obligated loan or grant funds not needed to complete the proposed project will be deobligated.

(2) *Loan resolutions.* Loan resolutions will be adopted by both public and other-than-public bodies using Form RD 1942-47, "Loan Resolution (Public Bodies)," or Form RD 1942-9, "Loan Resolution (Security Agreement)." These resolutions supplement other

provisions in this subpart. The applicant will agree:

(i) To indemnify the Government for any payments made or losses suffered by the Government on behalf of the association. Such indemnification shall be payable from the same source of funds pledged to pay the bonds or any other legally permissible source.

(ii) To comply with applicable local, State and Federal laws, regulations, and ordinances.

(iii) To provide for the receipt of adequate revenues to meet the requirements of debt service, operation and maintenance, establishment of adequate reserves, and to continually operate and maintain the facility in good condition. Except for utility-type facilities, free service use may be permitted. If free services are extended no distinctions will be made in the extension of those services because of race, color, religion, sex, national origin, marital status, or physical or mental handicap.

(iv) To acquire and maintain such insurance coverage including fidelity bonds, as may be required by the Government.

(v) To establish and maintain such books and records relating to the operation of the facility and its financial affairs and to provide for required audit thereof in such a manner as may be required by the Government and to provide the Government without its request, a copy of each such audit and to make and forward to the Government such additional information and reports as it may, from time to time, require.

(vi) To provide the Government at all reasonable times, access to all books and records relating to the facility and access to the property of the system so that the Government may ascertain that the association is complying with the provisions hereof and of the instruments incident to the making or insuring of the loan.

(vii) To provide adequate service to all persons within the service area who can feasibly and legally be served and to obtain Rural Development's concurrence prior to refusing new or adequate services to such persons. Upon failure of the applicant to provide services

which are feasible and legal, such person shall have a direct right of action against the applicant organization.

(viii) To have prepared on its behalf and to adopt an ordinance or resolution for the issuance of its bonds or notes or other debt instruments or other such items and in such forms as are required by State statutes and as are agreeable and acceptable to the Government.

(ix) To refinance the unpaid balance, in whole or in part, of its debt upon the request of the Government if at any time it should appear to the Government that the association is able to refinance its bonds by obtaining a loan for such purposes from responsible cooperative or private sources at reasonable rates and terms.

(x) To provide for, execute, and comply with Form RD 400-4, "Assurance Agreement," and Form RD 400-1, "Equal Opportunity Agreement," including an "Equal Opportunity Clause," which is to be incorporated in or attached as a rider to each construction contract and subcontract in excess of \$10,000.

(xi)(A) To place the proceeds of the loan on deposit in a manner approved by the Government. Funds must be deposited and maintained in insured accounts whenever possible. Funds must be maintained in interest bearing accounts, unless the following apply:

(1) The borrower receives less than \$120,000 in Federal awards per year;

(2) The best reasonably available interest-bearing account would not be expected to earn interest in excess of \$500 per year on Federal cash balances;

(3) The depository would require an average or minimum balance so high that it would not be feasible within the expected Federal and non-Federal cash resources; and,

(4) A foreign government or banking system prohibits or precludes interest bearing accounts.

(B) Interest earned on Federal payments deposited in interest-bearing accounts must be remitted annually to the Department of Health and Human Services, Payment Management System, Rockville, MD 20852. Interest amounts up to \$500 per year may be retained by the non-Federal entity for administrative expense.

(xii) Not to sell, transfer, lease, or otherwise encumber the facility or any portion thereof or interest therein, and not to permit others to do so, without the prior written consent of the Government.

(xiii) Not to borrow any money from any source, enter into any contract or agreement, or incur any other liabilities in connection with making enlargements, improvements or extensions to, or for any other purpose in connection with the facility (exclusive of normal maintenance) without the prior written consent of the Government if such undertaking would involve the source of funds pledged to repay the debt to Rural Development.

(xiv) That upon default in the payments of any principal and accrued interest on the bonds or in the performance of any covenant or agreement contained herein or in the instruments incident to making or insuring the loan, the Government, at its option, may:

(A) Declare the entire principal amount then outstanding and accrued interest, due and payable;

(B) For the account of the association (payable from the source of funds pledged to pay the bonds or notes or any other legally permissible source), incur and pay reasonable expenses for repair, maintenance and operation of the facility and such other reasonable expenses as may be necessary to cure the cause of default; and/or

(C) Take possession of the facility, repair, maintain and operate, or otherwise dispose of the facility. Default under the provisions of the resolution or any instrument incident to the making or insuring of the loan may be construed by the Government to constitute default under any other instrument held by the Government and executed or assumed by the association and default under any such instrument may be construed by the Government to constitute default hereunder.

(3) *Interim financing.* In all loans exceeding \$50,000, where funds can be borrowed at reasonable interest rates on an interim basis from commercial sources for the construction period, such interim financing will be obtained so as to preclude the necessity for multiple advances of Rural Development



funds. Guide 1 or guide 1a, as appropriate, may be used to inform the private lender of Rural Development's commitment. When interim commercial financing is used, the application will be processed, including obtaining construction bids, to the stage where the Rural Development loan would normally be closed, that is immediately prior to the start of construction. The Rural Development loan should be closed as soon as possible after the disbursement of all interim funds. Interim financing may be for a fixed term provided the fixed term does not extend beyond the time projected for completion of construction. For this purpose, a fixed term is when the interim lender cannot be repaid prior to the end of the stipulated term of the interim instruments. When a Rural Development Water and Waste Disposal grant is included, any interim financing involving a fixed term must be for the total Rural Development loan amount. Multiple advances may be used in conjunction with interim commercial financing when the applicant is unable to obtain sufficient funds through interim commercial financing in an amount equal to the loan. The Rural Development loan proceeds (including advances) will be used to retire the interim commercial indebtedness. Before the Rural Development loan is closed, the applicant will be required to provide Rural Development with statements from the contractor, engineer, architect, and attorney that they have been paid to date in accordance with their contracts or other agreements and, in the case of the contractor, that any suppliers and subcontractors have been paid. If such statements cannot be obtained, the loan may be closed provided:

- (i) Statements to the extent possible are obtained;
- (ii) The interest of Rural Development can be adequately protected and its security position is not impaired; and
- (iii) Adequate provisions are made for handling the unpaid accounts by withholding or escrowing sufficient funds to pay such claims.

(4) *Obtaining closing instructions.* After loan approval, the completed docket will be reviewed by the State Director.

The information required by OGC will be transmitted to OGC with request for closing instructions. Upon receipt of the closing instructions from OGC, the State Director will forward them along with any appropriate instructions to the District Director. Upon receipt of closing instructions, the District Director will discuss with the applicant and its architect or engineer, attorney, and other appropriate representatives, the requirements contained therein and any actions necessary to proceed with closing.

(5) *Applicant contribution.* An applicant contributing funds toward the project cost shall deposit these funds in its construction account on or before loan closing or start of construction, whichever occurs first. Project costs paid prior to the required deposit time with applicant funds shall be appropriately accounted for.

(6) *Evidence of and disbursement of other funds.* Applicants expecting funds from other sources for use in completing projects being partially financed with Rural Development funds will present evidence of the commitment of these funds from such other sources. This evidence will be available before loan closing, or the start of construction, whichever occurs first. Ordinarily, the funds provided by the applicant or from other sources will be disbursed prior to the use of Rural Development loan funds. If this is not possible, funds will be disbursed on a pro rata basis. Rural Development funds will not be used to pre-finance funds committed to the project from other sources.

(o) *Loan closing—(1) Closing instructions.* Loans will be closed in accordance with the closing instructions issued by OGC.

(2) *Obtaining insurance and fidelity bonds.* Required property insurance policies, liability insurance policies, and fidelity bonds will be obtained by the time of loan closing or start of construction, whichever occurs first.

(3) *Distribution of recorded documents.* The originals of the recorded deeds, easements, permits, certificates of water rights, leases, or other contracts and similar documents which are not to be held by Rural Development will

be returned to the borrower. The original mortgage(s) and water stock certificates, if any, if not required by the recorder's office will be retained by Rural Development.

(4) *Review of loan closing.* In order to determine that the loan has been properly closed the loan docket will be reviewed by the State Director and OGC.

(p) *Project monitoring and fund delivery during construction*—(1) *Coordination of funding sources.* When a project is jointly financed, the State Director will reach any needed agreement or understanding with the representatives of the other source of funds on distribution of responsibilities for handling various aspects of the project. These responsibilities will include supervision of construction, inspections and determinations of compliance with appropriate regulations concerning equal employment opportunities, wage rates, nondiscrimination in making services or benefits available, and environmental compliance. If any problems develop which cannot be resolved locally, complete information should be sent to the National Office for advice.

(2) *Multiple advances.* In the event interim commercial financing is not legally permissible or not available, multiple advances of Rural Development loan funds are required. An exception to this requirement may be granted by the National Office when a single advance is necessitated by State law or public exigency. Multiple advances will be used only for loans in excess of \$50,000. Advances will be made only as needed to cover disbursements required by the borrower over a 30-day period. Advances should not exceed 24 in number nor extend longer than two years beyond loan closing. Normally, the retained percentage withheld from the contractor to assure construction completion will be included in the last advance.

(i) Section 1942.19 contains instructions for making multiple advances to public bodies.

(ii) Advances will be requested by the borrower in writing. The request should be in sufficient amounts to pay cost of construction, rights-of-way and land, legal, engineering, interest, and other expenses as needed. The applicant may use Form RD 440-11, "Esti-

mate of Funds Needed for 30 Day Period Commencing \_\_\_\_\_," to show the amount of funds needed during the 30-day period.

(iii) Rural Development loan funds obligated for a specific purpose, such as the paying of interest, but not needed at the time of loan closing will remain in the Finance Office until needed unless State statutes require all funds to be delivered to the borrower at the time of closing. Loan funds may be advanced to prepay costs under paragraph (d)(1)(iv)(G) of this section. If all funds must be delivered to the borrower at the time of closing to comply with State statutes, funds not needed at loan closing will be handled as follows:

(A) Deposited in an appropriate borrower account, such as the debt service account, or

(B) Deposited in a supervised bank account under paragraph (p)(3)(i) of this section.

(3) *Use and accountability of funds*—(i) *Supervised bank account.* Rural Development loan funds and any funds furnished by the applicant/borrower to supplement the loan including contributions to purchase major items of equipment, machinery, and furnishings may be deposited in a supervised bank account if determined necessary as provided in subpart A of part 1902 of this chapter. When Rural Development has a Memorandum of Understanding with another agency that provides for the use of supervised bank accounts, or when Rural Development is the primary source of funds for a project and has determined that the use of a supervised bank account is necessary, project funds from other sources may also be deposited in the supervised bank account. Rural Development shall not be accountable to the source of the other funds nor shall Rural Development undertake responsibility to administer the funding program of the other entity. Supervised bank accounts should not be used for funds advanced by an interim lender.

(ii) *Other than supervised bank account.* If a supervised bank account is not used, arrangements will be agreed upon for the prior concurrence by Rural Development of the bills or vouchers upon which warrants will be

drawn, so that the payments from loan funds can be controlled and Rural Development records kept current. If a supervised bank account is not used, use Rural Development 402-2, "Statement of Deposits and Withdrawals," or similar form to monitor funds. Periodic reviews of nonsupervised accounts shall be made by Rural Development at the times and in the manner as Rural Development prescribes in the conditions of loan approval. State laws regulating the depositories to be used shall be complied with.

(iii) *Use of minority owned banks.* Applicants are encouraged to use minority banks (a bank which is owned at least 50 percent by minority group members) for the deposit and disbursement of funds. A list of minority owned banks can be obtained from the Office of Minority Business Enterprise, Department of Commerce, Washington, DC 20230 and is also available in all Rural Development offices.

(4) *Development inspections.* The District Director will be responsible for monitoring the construction of all projects being financed, wholly or in part, with Rural Development FmHA or its successor agency under Public Law 103-354 funds. Technical assistance will be provided by the State Director's staff. Project monitoring will include construction inspections and a review of each project inspection report, each change order and each partial payment estimate and other invoices such as payment for engineering/architectural and legal fees and other materials determined necessary to effectively monitor each project. These activities will not be performed on behalf of the applicant/borrower, but are solely for the benefit of Rural Development and in no way are intended to relieve the applicant/borrower of corresponding obligations to conduct similar monitoring and inspection activities. Project monitoring will include periodic inspections to review partial payment estimates prior to their approval and to review project development in accordance with plans and specifications. Each inspection will be recorded using Form RD 1924-12, "Inspection Report." The original Form RD 1924-12 will be filed in the project case folder and a copy furnished to the State Director.

The State Director will review inspection reports and will determine that the project is being effectively monitored. The District Director is authorized to review and accept partial payment estimates prepared by the contractor and approved by the borrower, provided the consulting engineer or architect, if one is being utilized for the project, has approved the estimate and certified that all material purchased or work performed is in accordance with the plans and specifications, or if a consulting engineer or architect is not being utilized, the District Director has determined that the funds requested are for authorized purposes. If there is any indication that construction is not being completed in accordance with the plans and specifications or that any other problems exist, the District Director should notify the State Director immediately and withhold all payments on the contract.

(5) *Payment for construction.* Each payment for project costs must be approved by the borrower's governing body. Payment for construction must be for amounts shown on payment estimate forms. Form RD 1924-18, "Partial Payment Estimate," may be used for this purpose or other similar forms may be used with the prior approval of the State Director or designee. However, the State Director or designee cannot require a greater reporting burden than is required by Form RD 1924-18. Advances for contract retainage will not be made until such retainage is due and payable under the terms of the contract. The review and acceptance of project costs, including construction partial payment estimates by the Agency, does not attest to the correctness of the amounts, the quantities shown, or that the work has been performed under the terms of agreements or contracts.

(6) *Use of remaining funds.* Funds remaining after all costs incident to the basic project have been paid or provided for will not include applicant contributions. Applicant contributions will be considered as funds initially expended for the project. Funds remaining, with exception of applicant contributions, may be considered in direct proportion to the amount obtained

from each source. Remaining funds will be handled as follows:

(i) *Agency loan and/or grant funds.* Remaining funds may be used for purposes authorized by paragraph (d) of this section, provided the use will not result in major changes to the facility design or project and that the purposes of the loan and/or grant remains the same.

(A) On projects that only involve an agency loan and no agency grant, funds that are not needed will be applied as an extra payment on the RD indebtedness unless other disposition is required by the bond ordinance, resolution, or State statute.

(B) On projects that involve an agency grant, all remaining agency funds will be considered to be grant funds up to the full amount of the grant. Grant funds not expended under paragraph (p)(6)(i) of this section will be deobligated.

(ii) *Funds from other sources.* Funds remaining from other sources will be handled according to rules, regulations and/or the agreement governing their participation in the project.

(q) *Borrower accounting methods, management reporting and audits.* (1) *Annual financial statements.* Borrowers are required to provide the Agency with annual financial statements for the life of the loan as outlined in the Letter of Conditions issued by the Agency. The financial statements are the responsibility of the borrower's governing body. The type of statement required is dependent on the amount of Federal financial assistance received during the borrower's fiscal year. Federal financial assistance includes Federal assistance that a non-Federal entity received or administered during the entity's fiscal year in the form of grants, loans, and loan guarantees. A Federal award is Federal financial assistance a non-Federal entity received directly from Federal awarding agencies or indirectly from pass-through entities. Federal awards expended generally pertain to events that require the non-Federal entity to comply with Federal Statutes, regulations, and terms and conditions of federal awards, such as: expenditure/expense transactions associated with grants, cost-reimbursement contracts, cooperative agreements, and direct ap-

propriations; the disbursement of funds passed through to sub-recipients; the use of loan proceeds under loan and loan guarantee programs; the receipt of property; the receipt of surplus property; the receipt or use of program income; the distribution or consumption of food commodities; the disbursement of amounts entitling the non-Federal entity to an interest subsidy; and, the period when insurance is in force.

(2) *Method of accounting and preparation of financial statements.* Annual organization-wide financial statements must be prepared on the accrual basis of accounting, in accordance with Generally Accepted Accounting Principles (GAAP), unless State statute, tribal law or regulatory agencies provide otherwise, or an exception is granted by the Agency. An organization may maintain its accounting records on a basis other than accrual accounting, and make the necessary adjustments so that annual financial statements are presented on the accrual basis.

(3) *Record retention.* Each Applicant will retain all records, books, and supporting material for 3 years after the issuance of the audit or management reports, or for a time period required by other agencies or common business practice, whichever is longer. Upon request, this material will be made available to Rural Development, OIG, USDA, the Comptroller General, or to their assignees.

(4) *Audits.* Any applicant that expends \$750,000 or more in Federal financial assistance during their fiscal year must submit an audit report conducted in accordance with 2 CFR part 200, subpart F, "Audit Requirements." Applicants expending less than \$750,000 in Federal financial assistance per fiscal year are exempt from 2 CFR part 200 audit requirements. All audits are to be performed in accordance with the latest revision of the Generally Accepted Government Accounting Standards (GAGAS), developed by the Comptroller General of the United States. Further guidance on preparing an acceptable audit can be obtained from any Agency office. It is not intended that audits required by this part be separate and apart from audits performed in accordance with State and local laws. To the extent feasible, the

audit work should be done in conjunction with those audits. Audits should be supplied to the Processing Official within the timeframes stated in paragraph (f) of this section. OMB Circulars and Agency Compliance Supplements are available in any USDA/Agency office or OMB's Web site. Any state, local government, or Indian tribe that is required by constitution or state statute, in effect on January 1, 1987, to undergo its audits less frequently than annually, is permitted to undergo its audits biennially, pursuant to 2 CFR 200.504(a). This requirement must still be in effect for the biennial period. Any nonprofit organization that had biennial audits for all biennial periods ending between July 1, 1992, and January 1, 1995, is permitted to undergo its audits biennially, pursuant to 2 CFR 200.504(b). All biennial audits must cover both years within the biennial period.

(5) *Exemption from audits.* Except as noted in 2 CFR 200.503, Relation to other audit requirement, public bodies or nonprofits expending less than \$750,000 in Federal awards during its fiscal year, whose payments are current, and are having no signs of operational or financial difficulty may submit a management report. A management report, at a minimum, will include a balance sheet and income and expense statement. Financial information may be reported on Form RD 442-2, "Statement of Budget, Income and Equity" and RD Form 442-3, "Balance Sheet", or similar. The following management data will be submitted by the borrower to the servicing office. Records must be available for review or audit by appropriate officials of the Federal agency, pass-through entity, and Government Accountability Office (GAO).

(i) *Annual management reports.* Thirty days prior to the beginning of each fiscal year the following will be submitted to the Servicing Official:

(A) One copy of the proposed annual budget. The borrower will submit two copies of Form RD 442-2, or equivalent, Statement of Budget, Income and Equity, Schedule 1, page 1; and Schedule 2, Projected Cash Flow. The only data required at this time is Schedule 1,

page 1, Column 3, annual budget, and all of Schedule 2, Projected Cash Flow.

(B) An annual audit report may be submitted in lieu of Forms RD 442-2 and 442-3.

(ii) [Reserved]

(6) *Deadlines for submitting audits and management reports.* In accordance with 2 CFR part 200, audits must be submitted no later than 9 months after the end of the fiscal year or 30 days after the borrower's receipt of the auditor's reports, whichever is earlier. Management reports must be submitted no later than 2 months after the end of the borrower's fiscal year.

(7) *Additional information to be submitted with audits and management reports.* (i) *Insurance.* Agency borrowers will maintain adequate insurance coverage as required by the loan resolution and § 1942.17(j)(3). The servicing official is required to monitor insurance annually after the initial insurance verification.

(ii) *Reserve account(s).* Borrowers will provide documentation that the Agency required reserve account(s) is properly funded;

(iii) *Property tax information.* If applicable, documentation that property taxes have been paid and are current.

(iv) *A list of directors and officers.*

(8) *Quarterly reports.* A quarterly management report will be required for the first full year of operations for new borrowers, and existing borrowers operating a new facility, starting a new type of operation or proposing a significant expansion of an existing facility. Borrowers should submit the following to the Servicing Official:

(i) One copy of Form RD 442-2, or equivalent, Schedule 1, page 1, columns 4-6, as appropriate, and page 2. This information should be received in the Servicing Office 30 days after the end of each of the first three quarters of the fiscal year.

(ii) The Servicing Office may request a borrower experiencing financial or management problems to submit quarterly copies of Form RD 442-2, or equivalent, Schedule 1, pages 1 and 2.

[50 FR 7296, Feb. 22, 1985]

EDITORIAL NOTE: For FEDERAL REGISTER citations affecting § 1942.17, see the List of CFR Sections Affected, which appears in the

## § 1942.18

Finding Aids section of the printed volume and at [www.govinfo.gov](http://www.govinfo.gov).

### § 1942.18 Community facilities—Planning, bidding, contracting, constructing.

(a) *General.* This section is specifically designed for use by owners including the professional or technical consultants and/or agents who provide assistance and services such as architectural, engineering, inspection, financial, legal or other services related to planning, bidding, contracting, and constructing community facilities. These procedures do not relieve the owner of the contractual obligations that arise from the procurement of these services. For this section, an owner is defined as an applicant, borrower, or grantee.

(b) *Technical services.* Owners are responsible for providing the engineering or architectural services necessary for planning, designing, bidding, contracting, inspecting, and constructing their facilities. Services may be provided by the owner's "in house" engineer or architect or through contract, subject to Rural Development concurrence. Architects and engineers must be licensed in the State where the facility is to be constructed.

(c) *Preliminary reports.* Preliminary architectural and engineering reports must conform with customary professional standards. Preliminary report guidelines for water, sanitary sewer, solid waste, storm sewer, and other essential community facilities are available from Rural Development.

(d) *Design policies.* Facilities financed by Rural Development will be designed and constructed in accordance with sound engineering and architectural practices, and must meet the requirements of Federal, State and local agencies.

(1) *Natural resources.* Facility planning should be responsive to the owner's needs and should consider the long-term economic, social and environmental needs as set forth in this section. The Agency's environmental review requirements are found at 7 CFR part 1970.

(2) *Historic preservation.* Facilities should be designed and constructed in a manner which will contribute to the preservation and enhancement of sites,

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structures, and objects of historical, architectural, and archaeological significance. All facilities must comply with Section 106 of the National Historic Preservation Act of 1966 (16 U.S.C. 470), as implemented by 36 CFR part 800, and Executive Order 11593, "Protection and Enhancement of the Cultural Environment." 7 CFR part 1970 sets forth procedures for the protection of historic and archaeological properties.

(3) *Architectural barriers.* All facilities intended for or accessible to the public or in which physically handicapped persons may be employed or reside must be developed in compliance with the Architectural Barriers Act of 1968 (Pub. L. 90-480) as implemented by the General Services Administration regulations 41 CFR 101-19.6 and section 504 of the Rehabilitation Act of 1973 (Pub. L. 93-112) as implemented by 7 CFR parts 15 and 15b.

(4) *Health care facilities.* The proposed facility must meet the minimum standards for design and construction contained in the American Institute of Architects Press Publication No. ISBN 0-913962-96-1, "Guidelines for Construction and Equipment of Hospital and Medical Facilities," 1987 Edition. The facility must also meet the life/safety aspects of the 1985 edition of the National Fire Protection Association (NFPA) 101 Life Safety Code, or any subsequent code that may be designated by the Secretary of HHS. All publications referenced in this section are available in all Rural Development State Offices. Under § 1942.17(j)(8)(ii) of this subpart, a statement by the responsible regulatory agency that the facility meets the above standards will be required. Any exceptions must have prior National Office concurrence.

(5) *Energy conservation.* Facility design should consider cost effective energy saving measures or devices.

(6) *Lead base paints.* Lead base paints shall not be used in facilities designed for human habitation. Owners must comply with the Lead Base Paints Poisoning and Prevention Act of 1971 (42 U.S.C. 4801) and the National Consumer Health Information and Health Promotion Act of 1976 (Pub. L. 94-317) with reference to paint specifications used