RD AN No. 3975 (4279-B)
April 26, 2004

SUBJECT: Business and Industry Guaranteed Loan Program
Working Capital Advances

TO: State Directors, Rural Development

ATTN: Business Programs Directors

PURPOSE/INTENDED OUTCOME:

The Management Control Review, Business and Industry (B&I) Guaranteed Loan Program, completed in 2003, identified a concern related to working capital advances. Working capital advances should have adequate collateral coverage at the time of the advance.

The purpose of this Administrative Notice (AN) is to provide guidance regarding the advance of working capital in accordance with RD Instruction 4279-B, section 4279.181(h).

COMPARISON WITH PREVIOUS AN:

There is no previous AN on this subject.

IMPLEMENTATION RESPONSIBILITIES:

Since permanent working capital is a permanent investment made by the company to sustain operations, and is the first use of cash by a business, it is important to determine that the business will have sufficient permanent working capital. Additionally, some businesses need operating capital to support seasonality of sales, short-term contracts, or other temporary cash needs. These lines of credit should be calculated based on a borrowing base established by the bank using an advance rate typical to the type of financing. The advance rate should be disclosed by the lender in the application material.

EXPIRATION DATE:
April 30, 2005

FILING INSTRUCTIONS:
Preceding RD Instruction 4279-B

The following formula may be used to calculate permanent working capital (PWC) needs:

Step 1

Since each business will have a unique operating cycle, you must calculate the length of time it takes for cash used in operations to generate a profit. The operating cycle is determined by the following calculation:

	Days Receivable (A/R)
+	Days Inventory (Inv)
-	Days Payable (A/P)
-	Days Accrual (Acc.)
=	Operating Cycle

Step 2

To measure the amount of PWC in dollars necessary to sustain the operating cycle, you must perform the following calculation:

$$\frac{\text{Days A/R}}{360} \times \text{Sales}$$
$$+ \quad \frac{\text{Days Inv.}}{360} \times \text{Cost of Good Sold (COGS)}$$
$$- \quad \frac{\text{Days A/P}}{360} \times \text{COGS}$$
$$- \quad \frac{\text{Days Acc.}}{360} \times \text{COGS}$$
$$= \quad \text{Permanent Working Capital in Dollars}$$

To determine if there is sufficient PWC to support the projections, you must compare the existing permanent working capital based on the most recent year-end financial statement with the projected financial statement for the first year.

Step 3

To compare the PWC requirement to support the projections with the existing permanent working capital invested in the business, you must perform the following calculation:

	New PWC need
-	Existing PWC
=	PWC to be Financed

PWC is generated by profits, long-term borrowing, equity infusion, and the sale of fixed assets.

Only PWC loans are eligible for the B&I program. Loans for PWC must be adequately secured on a discounted basis at loan closing. In accordance with RD Instruction 4279-B, section 4279.131(b)(1), collateral must be discounted consistent with sound loan-to-value policy. This includes cases where the lender has requested disbursement of the PWC over a period of time.

If the Agency has approved the lender's request to disburse working capital over a period of time, the Agency must ensure that the advance rate is in accordance with prudent lending practices. The advance rate should be based on an established borrowing base requirement determined by the Agency and the lender.

If you have any questions, please contact the Business Programs Processing Division, (202) 690-4103.

(Signed by John Rosso)

JOHN ROSSO
Administrator
Rural Business-Cooperative Service