
Title VI

Credit

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Title VI amends the Consolidated Farm and Rural Development Act, affecting the credit programs and lending policies of the Farm Service Agency (FSA). These farm credit programs were previously administered by the Farmers Home Administration, and then transferred to the newly created FSA in 1994. Many of the provisions modify policies set forth by the 1990 Farm Bill and the Agricultural Credit Improvement Act of 1992 (P.L. 102-554). Proposed provisions affecting the Farm Credit System and the Federal Agricultural Mortgage Corporation were not included in the 1996 Act, but were covered in the Farm Credit Reform Act of 1996 (P.L. 104-105), which was signed into law on February 10, 1996 (see legislative history in Appendix III).

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Title VI of the 1996 Act places stricter limits than before on the eligibility of producers to borrow through FSA farm credit programs, and it also limits the purposes for which the loans can be used. To encourage “graduation” from FSA credit programs (that is, shifting from FSA credit programs to commercial credit sources) stricter time limits on the eligibility to borrow through FSA’s programs are mandated. Some provisions target annual loan funds specifically to beginning farmers and ranchers. New debt restructuring rules are included to increase the likelihood that debt restructuring will be successful in helping farmers stay in business, and to reduce the Government’s costs associated with these actions. There are new limits on debt forgiveness and on the eligibility of borrowers for further loans if FSA discharges (forgives) indebtedness. Rules about the sale and management of real inventory property have been streamlined to expedite the disposal of acquired property and reduce program costs. Loan servicing rules are changed.

Subtitle A

Farm Ownership Loans

Farm ownership loans are made directly by FSA or through USDA guarantees of loans made by commercial or cooperative lenders. These loans can be made at subsidized interest rates for the purchase, improvement, or refinancing of farm and ranch land. The 1996 Act restricts direct farm ownership loan program eligibility to discourage long-term use of FSA credit programs. New loans can now only be made to applicants who have operated a farm for at least 3 years and who are qualified beginning farmers (less than 10 years of farming experience), or have not received a previous direct farm ownership loan, or have not received a direct farm ownership loan more than 10 years before the date the new loan would be made.

A transitional rule is provided for borrowers with outstanding direct farm ownership loans at the time of enactment of the 1996 Act. For borrowers that have had such loans for less than 5 years, another 10 years of program eligibility remains. For those borrowers that have had such a loan for 5 or more years, another 5 years of program eligibility remains. Previous FSA

youth loans are not to be considered when determining eligibility. No such eligibility restrictions were placed on guaranteed farm ownership loans.

Authority for making nonfarm loans was eliminated. Purposes no longer authorized include the financing or refinancing of nonfarm business enterprises, such as roadside sales stands, waste pollution abatement facilities, recreational uses and facilities, rural business enterprises, and nonfossil fuel energy systems. Little or no lending has been done for these purposes in recent years. Authorized purposes include: acquiring, enlarging, or making capital improvements to a farm or ranch; paying costs to promote soil and water conservation and protection; and paying loan closing costs. However, FSA can no longer make direct farm ownership loans to refinance existing indebtedness. The Secretary can now provide a 95-percent guarantee on private sector loans used to refinance direct loan debts. This latter provision is designed to facilitate graduation of existing direct loan program borrowers to commercial credit sources.

Subtitle B

Operating Loans

Direct and guaranteed operating loans provide subsidized and nonsubsidized credit for a range of purposes, such as the financing of annual operating expenses or capital purchases and certain debt refinancing. The 1996 Act adds restrictions on the eligibility of persons for direct farm operating loans. Under the Agricultural Credit Improvement Act of 1992 (P.L. 102-554) an applicant became ineligible for a new direct operating loan after receiving annual direct operating loans for 10 years. Borrowers also became ineligible for additional guaranteed loans after receiving either direct or guaranteed operating loans for a total of 15 years. The 1996 Act modifies eligibility for direct operating loans by restricting it to qualified beginning farmer applicants who have operated a farm or ranch for not more than 5 years or who have received direct operating loans in no more than 6 previous years. A transitional rule provides applicants with another 3 years of eligibility if they had a direct operating loans in 4 or more years prior to enactment. Previous youth loans are not to be considered when determining eligibility caps.

The 1996 Act eliminates the authority to use operating loans for the financing of nonfarm business enterprises, such as roadside sales stands, pollution abatement and control projects, recreational uses and facilities, rural business enterprises, and nonfossil fuel energy systems. The refinancing of indebtedness under the direct operating loan program is now limited to persons who refinanced a direct or guaranteed operating

loan fewer than five times before and who are existing direct loan program borrowers that have suffered a qualifying loss because of a natural disaster or is an applicant refinancing loans obtained outside the FSA.

New authority was granted to FSA to make direct operating line-of-credit loans. Such loans allow borrowers to increase their total loan balance up to a predetermined amount over a set period of years by drawing out money as needed. This eliminates costly and time-consuming annual applications and approvals. Line-of-credit loan terms can not exceed 5 years, and if an advance or withdrawal is made during a year, then the loan is counted against program eligibility time caps. If a borrower fails to meet scheduled payments, then no further withdrawals are permitted unless failure to pay was due to conditions beyond the control of the borrower, and the scheduled payments are made up by the end of a marketing period.

Rules governing nonsupervised operating loan accounts are modified. These are discretionary loan accounts in which the borrower can withdraw funds for family subsistence. Provisions that had allowed transfers from these accounts for other purposes and had allowed other adjustments are eliminated. Now the new maximum amount that can be in these accounts is either 10 percent of the operating loan, \$5,000, or an amount equivalent to 3 calendar months of family subsistence needs, whichever is smaller.

Subtitle C

Emergency Loans

Changes were made to the Emergency Disaster Loan Program to reduce program costs. Stricter eligibility requirements are applied, asset valuation procedures are revised, and total indebtedness is capped. Emergency disaster loans help farmers recover from actual production or physical losses inflicted by natural disasters in counties designated as disaster areas by the Secretary.

The 1996 Act tightens eligibility for the program by lowering the waiver on the “credit-elsewhere test” from \$300,000 to \$100,000. This means that for emergency loan requests over \$100,000, the applicant must provide FSA with written confirmations from two commercial creditors that the requested credit could not be obtained. One written denial of credit for emergency loan requests under \$100,000 may be required by FSA.

Maximum borrower indebtedness under the program is now capped at \$500,000. Under prior law, the cap only applied to a particular disaster, allowing total program indebtedness for a borrower to exceed \$500,000. The value of assets used as collateral for an emergency loan will also now be set equal to the value on the day before the disaster. Prior law had directed the Secretary to use the higher of the value on the day prior to the governor’s request to the Secretary for a disaster designation or the value of 1 year and 1 day prior to the governor’s request for disaster designation. Limiting asset valuations to the prior day will make valuations more consistent and reflective of current values, and be less administratively cumbersome to obtain. Also, applicants with financing requests associated with a change in operations must demonstrate that the change is necessitated by the natural disaster, and not simply based on the desire of the applicant, as previously allowed.

Subtitle D

Administrative Procedures

This subtitle covers various procedures for determining who will get loans in the future, how much money is available for loans, when and how debt restructuring will occur, as well as rules for managing and reselling real property assets of the Government, and other topics.

Beginning Farmer Assistance

Numerous provisions in the credit title provide assistance to beginning farmers—those producers with less than 10 years experience operating a farm or ranch. To qualify as a beginning farmer, the 1996 Act increased the maximum acreage an applicant can own from the previous 15 percent to 25 percent of the median acreage in the county where farm operations of the applicant are located, using data from the most recent Census of Agriculture. The mean is used though because the median is unavailable from the Census. This eligibility test no longer applies to farm operating loan programs.

Under the down payment loan program (section 310E) for beginning farmers, FSA may now guarantee up to 95 percent of a farm ownership loan used to acquire a farm or ranch. FSA can also guarantee up to 95 percent of an operating loan made to farm operators participating in the down payment program, but only if they have a direct farm ownership loan outstanding. Previously, FSA could only guarantee up to 90 percent for these situations.

The FSA may now also provide reduced interest rates on direct farm ownership loans made under joint financing arrangements. This will further benefit beginning farmers. Under such arrangements, when a lender other than FSA provides 50 percent or more of the amount financed in a farm ownership transaction, FSA may charge preferential annual interest rates of as little as 4 percent on the portion of financing it provides through its direct farm ownership program. Authority for the special operating loan assistance program for beginning farmers (section 318) was repealed by the 1996 Act. This program had been authorized by the Agricultural

Credit Improvement Act of 1992, but it was seldom used because of numerous eligibility restrictions.

Authorized Loan Amounts

The credit title spells out annual loan program authorization levels for each fiscal year, 1996 through 2002. Specific amounts are set by annual and supplemental appropriation bills. Funding levels throughout the period are set at a maximum of \$85 million for direct farm ownership loans and \$500 million for direct operating loans. For guaranteed farm ownership loans, authorized loan levels gradually rise from \$600 million in fiscal 1996 to \$750 million in fiscal 2000 and subsequent years. Annual guaranteed operating loan authority gradually rises from \$1.9 billion to \$2.1 billion during same period. These authorities are comparable with current funding levels.

Targeting of Authorized Loan Amount

Authorized loan amounts are targeted to specific programs and specific types of borrowers using new targeting formulas. For direct farm ownership loans, 70 percent of the total loan making authority must be reserved for qualified beginning farmers until the beginning of the last month of the fiscal year. Only after September 1 can FSA allocate any unused portion of the targeted annual authority to other applicants. Of the 70 percent targeted to beginning farmers, 60 percent must be reserved for the down payment loan program (section 310E) until April 1 of each fiscal year.

Other programs require similar targeting. Until September 1 of fiscal years 1996 through 1998, 25 percent of total direct operating loan authority must be held in reserve for beginning farmers. This level rises to 30 percent for fiscal year 1999 and 35 percent for fiscal year 2000 and beyond. Until April 1 of each year, 25 percent of guaranteed farm ownership authori-

ty and 40 percent of guaranteed operating loan authority must be reserved for qualified beginning farmer applicants.

Some reserved funds may be transferred among different uses. If sufficient funding is not available to meet program needs of the down payment loan program for beginning farmers, then beginning August 1 of each fiscal year, the Secretary must use available unsubsidized guaranteed farm operating loan funds to fund these direct farm ownership loans. Also, by September 1, the Secretary must make available this same unused funding authority to all qualified beginning farmers applying for direct farm ownership loans if sufficient loan funds are not available to meet demand. However, all guaranteed operating loan applications approved for a given year must be satisfied first.

FSA may also redirect unused emergency loan funds to finance credit sales of farm real estate acquired by FSA. FSA has the authority to sell inventory property by providing nonprogram financing for the transaction. Unused emergency loan-making authority cannot be released until September 1, and any unused supplemental appropriations made for emergency loans cannot be transferred. In transferring unused authority, the Secretary must ensure that all qualified applications for emergency loans are funded.

Socially Disadvantaged Targeting

FSA farm loan programs are currently targeted to members of socially disadvantaged groups—groups whose members have been subject to racial, ethnic, or gender prejudice. Within 180 days of enactment, the Secretary is to ensure that current target participation rules are consistent with the holding of the Supreme Court in *Adarand Constructors, Inc. v. Federico Pena, Secretary of Transportation*, 115 S. Ct. 2097 (1995).

Other Eligibility Rules

Loan program eligibility tests were tightened by the credit title to better ensure that applicants who obtain the loans are in need and to help facilitate graduation of borrowers from FSA direct loan programs to commercial credit sources. Applicants must now submit appropriate written financial statements instead of a simple statement showing net worth. Also, county or area committees must review a borrower's eligibility

for certain loan programs annually to determine if the applicant is eligible to graduate to commercial credit sources. To facilitate graduation, FSA no longer needs to get the borrower's approval when sending a prospectus of borrowers to area lenders. However, the borrower must be notified that a prospectus is being sent.

Debt Restructuring

Debt restructuring rules put in place by the Agricultural Credit Act of 1987 were modified. Under debt restructuring, borrowers unable to make current loan payments may have their loans restructured, allowing them to repay their indebtedness. Restructuring can include reamortizing loan payments, reducing loan interest rates, and even forgiving repayment on some debt. The 1996 Act changes these rules to increase the likelihood that debt restructuring will help farm businesses survive, while reducing program costs. To clarify the debt restructuring process for the purpose of loan servicing, the term "debt forgiveness" was defined to include any writedown or discharge action that results in a loss to the Secretary on a direct or guaranteed loan by FSA. Loan servicing actions that consolidate, reschedule, reamortize, or defer debt are not considered to be debt forgiveness actions. To resolve delinquent loan accounts more quickly, the time in which FSA must notify a borrower with a delinquent loan account of his or her other loan servicing options is shortened from 180 to 90 days.

When restructuring delinquent loan accounts and assessing the ability of the borrower to meet future debt obligations and continue farming operations, the FSA may write down the borrower's loans to create up to a 10-percent cash flow margin instead of the previous 5-percent margin. Prior to the 1990 farm bill, there was no margin requirement and many restructured loan accounts became delinquent again.

In situations where maximum authorized debt forgiveness still cannot remedy a delinquency, the borrower used to have the right to pay off the loan at its net recovery value (collateral value less liquidation costs) within 90 days. The 1996 Act modifies this rule by requiring the borrower to pay off the loan at the security's current market value, a higher amount. Also, when determining the future creditworthiness of an applicant, FSA can now take into account past debt-restructuring actions.

The credit title puts new limits on the eligibility of borrowers for debt forgiveness and for future loans. A direct loan borrower is now limited to just one instance of debt forgiveness, regardless of the debt-servicing mechanism used for the forgiveness. Borrowers whose default on a direct or guaranteed loan results in debt forgiveness by FSA will no longer be eligible for new or additional direct or guaranteed loans. An exception allows FSA to provide direct or guaranteed farm operating loans for annual farm or ranch operating expenses to borrowers that received a section 353 debt writedown.

Borrowers with a delinquent FSA loan are now prohibited from new obtaining direct operating loans. Previous law allowed direct loans for essential operating expenses and family living even if existing debt could not be repaid. Also, loans may no longer be rescheduled or reamortized outside the normal servicing process without a portion of the interest due being paid by the borrower. In the past, borrowers with delinquent accounts did not have to make any payments to be eligible for these loan servicing options.

Inventory Property Management

New rules for the management and sale of real estate acquired by the FSA as collateral on defaulted loans greatly expedite sale procedures and will reduce program costs. Previous rules were complex, providing certain groups of people preference in renting or purchasing FSA's acquired property. These cumbersome rules resulted in acquired property of the Government being held in inventory for years before being sold.

Under the 1996 Act, real property must be advertised for sale within 15 days of acquisition. Unleased real property in inventory prior to enactment must be offered for sale within 60 days of enactment. Property under a lease must be offered for sale within 60 days of the expiration of the lease. New leases on FSA inventory property are now prohibited, except that FSA may provide leases for up to 18 months to qualifying beginning farmers if authority or funding is not available for a credit sale or a direct farm ownership loan. Rental rates are to be determined by the income producing capability of the property, and the rental agreement must end when funding becomes available. Also, homestead protection rules were modified by shortening the time period from 90 to 30 days after FSA acquisition that the borrower may apply.

Property must be advertised for sale to beginning farmers within 15 days of acquisition and then advertised for sale to the highest bidder within 75 days from the date of acquisition if a beginning farmer does not first buy the property. If more than one beginning farmer applicant submits an offer to purchase property, the selection between qualified applicants is to be made randomly by FSA. A person can request a review by the FSA State Director within 30 days concerning their beginning farmer status for purposes of acquiring farm inventory property. The State Director is to provide an expedited decision on the requested review and the Secretary is to report to Congress on whether the reviews are having an adverse impact on the selling of accumulated farm properties.

If an acceptable offer by a qualified beginning farmer is not received by the 75th day after acquisition, the property must be sold to the highest bidder at a public sale within 30 days. If an acceptable bid is not obtained, then the property must be sold by negotiated sale at the best price obtainable. All interests in the property will convey to the purchaser, but the Secretary, for conservation purposes, may grant or sell an easement, restriction, development right, or similar rights to a State or local government body or a private nonprofit organization.

FSA can no longer establish wetland conservation easements on inventory real property that was used as cropland at the time of acquisition or that was used for farming during any of the previous 5 years. The 1990 Act had allowed the establishment of wetland easements on existing cropland. Also, FSA is no longer permitted to place conservation easements on a borrower's security property (FSA collateral). Instead, the FSA may enter into contracts with the borrower for conservation, recreation, and wildlife purposes. FSA is no longer prohibited from receiving compensation when transferring real property for conservation purposes to other Federal or State agencies. When transferring inventory property, FSA must now provide two public notices of the transfer and hold a public hearing if requested, plus FSA must also inform the Governor and at least one elected County official prior to the transfer. Finally, special rules for real property located on an Indian reservation were slightly modified and the outdated inventory property demonstration project with the Farm Credit System, which was authorized by the Agricultural Credit Act of 1987, was repealed.

Loan Servicing

To help reduce high delinquency rates and lower loan default costs, FSA may enter into loan servicing contracts with regulated financial institutions, on a pilot program basis, and may use collection agencies to collect on overdue loans. FSA already had authority to contract for these services. Starting in 1997, by the end of fiscal year the Secretary must report on its experience in using these contracts and make any recommendations for further legislation related to such contracting. Authority for the loan servicing projects ends September 30, 2002.

Hazard Insurance Requirement

FSA borrowers are now required to have and maintain hazard insurance as a condition for obtaining a direct farm ownership loan, an operating loan, or an emergency loan. Hazard insurance must be obtained and maintained on any property acquired or improved using a farm ownership or operating loan. In the case of an emergency loan, the property (farmland, buildings, livestock, equipment, crops, and other farm items) suffering a loss must have had an appropriate amount of hazard insurance coverage prior to the occurrence of the natural disaster. The Secretary shall determine the appropriate level of insurance for farm properties within 180 days of enactment. The requirement cannot become effective until such determinations are made.

Compliance Certification

To reduce regulatory burden, FSA is required to develop and utilize a consolidated short application form for program applicants to use in certifying compliance with laws and regulations (for example, conservation compliance requirements) that serve as prerequisites for a loan.

Credit Study

The Secretary is required to perform a study on the demand and availability of credit in rural areas for agriculture, rural housing, and rural development. The study is to be submitted to Congress.

Electronic Filing of Financing Statements

The Food Security Act of 1985 had established guidelines for States to operate central systems of filing financial statements used by lenders in order to help enforce liens against farm products. This centralized purchaser notification system required that the signatures of both the lender and the borrower be present on financing statements for it to be valid and hence enforceable. For States permitting electronic filing under applicable State law provisions of the Uniform Commercial Code, the debtor's signature is no longer required.