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RESTRUCTURING FARMERS HOME ADMINISTRATION LOANS

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The Farmers Home Administration has become a major supplier of agricultural credit. The Agency now provides nearly 25% of the nations operating credit and in some States we are providing over 50% of the operating credit. All of that credit is very high risk which requires very intensive supervision and frequent restructuring to minimize losses.

The Farmers Home Administration (FmHA), not unlike other agriculture lenders, has been restructuring loans for a good many years. This is a topic of interest at this time because of the requirements of the Agricultural Credit Act of 1987 and the fact that FmHA has accumulated 83,000 seriously delinquent accounts.

The Agricultural Credit Act of 1987 sets forth a precise process for the Agency to follow and requires restructuring of a borrowers debt when restructuring will provide a greater return to the Government than would be received in an involuntary liquidation. In addition, the Congress has very clearly set forth a public policy that requires FmHA to keep every FmHA farmer borrower on the farm that it possibly can.

To ensure that public policy will be carried out, a specific set of borrower's rights has been set forth by the Congress. These borrower rights provide a number of opportunities for borrowers in serious financial difficulty to have the debt written down in order to retain the farming business. These opportunities include the traditional rescheduling, reamortization and deferrals. The legislation adds debt write down, buyout at net recovery value and revises the provisions for leaseback/buyback and homestead protection which were included in the 1985 Farm Bill.

Let's examine each of these opportunities.

Rescheduling and/or Reamortization

Operating type loans can be rescheduled for up to 15 years with no limit on the number of times a loan can be rescheduled. Reamortization is for long term loans with reamortization of payments for up to 40 years from the date of the original loan. In addition, these loans can have interest rates reduced to limited resource rates which are 3 percent below regular rates.

Deferral

Deferrals can be up to 5 years with renewals possible. Interest accrues on deferred debt so it is not a very viable choice for a borrower unless a substantial amount of other lender debt can be paid off or income increased during the deferral period. Farm plans must show that payments on the deferred debt can be resumed at the end of the deferment period. Softwood timber is a new program that came out of the 1985 Farm Bill. It is a 45 year deferment of loan payments on land where softwood timber can be planted and harvested. The theory is that the harvested timber will pay off the deferred debt and accrued interest. There have been 5 softwood timber loans approved.

Debt Write Down

Debt write down is the major loan restructuring provision of the Agricultural Credit Act of 1987. The Act requires a determination be made as to whether the return to the Government would be equal or greater with the debt written down to net recovery value and keeping a farmer in business as compared to what would be received from foreclosure and liquidation. The key words in this process are "net recovery." "Net recovery" from an involuntary liquidation must be determined. Net recovery value is the market value less all costs of an involuntary liquidation. These costs include but are not limited to legal costs, prior liens, taxes, caretakers fees, sales costs and interest costs. The Act authorizes and requires debt to be written down to an amount that will provide cash flow. If the farm operation will cash flow at or above net recovery value, the debt will be restructured, thereby keeping the farmer on the farm.

Buy Out at Net Recovery Value

If all combinations of rescheduling, reamortization, deferral or write down do not provide a restructuring program that will keep the borrower paying the restructured debt, the borrower then has an opportunity to pay off the debt at net recovery value. As you can see, this can be a heavily discounted payoff.

The payoff must be payment in full to FmHA with no credit being provided by the Agency. There is a high probability that many borrowers whose loans cannot be restructured, will be able to pay off their loans at a few cents on the dollar. This will, as intended by Congress, keep the borrower on the farm, debt free as far as FmHA is concerned, with a good opportunity to continue the farm business.

Leaseback/Buyback

Leaseback/Buyback is a transaction whereby the borrower conveys the property to the Agency in satisfaction of the debt, and then leases the property back with an option to buy. The option must be exercised in 5 years or the property goes on the market. The Act requires that FmHA try to enter into a contract with the farmer wherein FmHA would assure the borrower that, upon conveyance, the Agency will lease or sell the property back to the borrower. Such sales may be made with FmHA providing the credit.

Homestead Protection

Homestead protection is considered last in the hierarchy of opportunities but it is probably the least costly method available to a farmer. FmHA is required to survey and establish a homestead. The homestead can consist of the home, outbuildings, and not more than 10 acres of land. This homestead is leased to the borrower at a rental rate comparable to rental rates for the area. The lease is up to 5 years and also carries an option to purchase. As stated in the previous paragraph, FmHA can provide the credit to eligible applicants in both buyback and homestead protection purchases.

Mediation

FmHA is required to participate in mediation in States that have USDA certified mediation programs. To date, 14 States have certified mediation. In those States without certified mediation, the Agency is required to attempt to get a meeting with undersecured creditors, for the purpose of attempting to get other lenders to make adjustments that would enable the farmer to continue to farm.

As you can see, borrowers in financial difficulty have many opportunities to stay on the farm. The Agency has advised 83,000 borrowers, whose accounts are from 180 days to more than 4 years behind schedule, of these new opportunities. The farmers have 45 days after receiving the information, to request consideration. Upon receipt of a request, FmHA has 60 days to process the application. The borrower then has 45 days to accept the restructuring proposal or appeal the Agencies decision.

Restructuring is a very complicated and complex process. Appraisals of all security property will be required. The mathematics of the restructuring will be done by computer so that all possible combinations off rates and terms can be considered. The dollar amount of debt to be written off will be substantial. The Agency projects somewhere in the vicinity of $9 billion.

FmHA LOAN SERVICING POLICY

The following policy statement has been published in the regulations. Any Farmer Program borrower may request Primary or Preservation Loan Service Programs. However, borrowers must be unable to pay their debt as scheduled before FmHA will use Primary or Preservation Loan Service Programs and must be behind on payments in order to be considered for write down, buyout at net recovery value or the Preservation Loan Service Programs. The County Supervisor will use an FmHA computer program (DALR$) to assist in identifying, combining, and documenting the loan service programs that will keep the farmer on the farm and provide the best net recovery to the Government. Servicing is a continuing process, not a single event. It begins the day a farmer comes into the FmHA supervised credit program. Servicing has two objectives: (1) to help the farmers manage credit so they can return to private sector credit sources, and (2) to minimize costs to the

Government of providing another opportunity to farmers in financial difficulty. Borrowers' accounts must be managed with an overall objective of keeping the farmer in business and at the same time, minimizing loan costs and losses. The tools are rescheduling and/or reamortization, lower interest rates, deferments, and write down of debt and, when all else fails, buyout at net recovery value, leaseback/buyback and homestead protection are available. FmHA can also use Conservation Easement and Softwood Timber Programs where and when applicable. To establish an effective servicing policy, it is necessary to include the borrower whose loan payments with FmHA are current. This can be called Phase I.

PHASE I

FmHA's servicing objective is to keep the borrower in business, paying at regular rates and on regular terms with graduation being the primary objective. The servicing tools available to keep a borrower in Phase I are rescheduling and/or reamortization. These tools must be used before an account gets behind schedule, if possible. In order for servicing to be effective, all farmer program loans must be reviewed annually, prior to the date the annual payments are due. This is necessary in order to determine what, if any, servicing action needs to be taken to keep an account from becoming delinquent.

When it becomes evident that FmHA cannot keep a borrower in business, paying regular rates and after having extended terms to the maximum extent allowable, the borrower is considered to be in Phase II where FmHA has more debt management tools available.

PHASE II

These additional tools are lower interest rates and deferrals. The objective is still the same, keep the borrower farming and minimize loan costs and losses to the Government. Depending upon the reasons the borrower entered Phase II, it is reasonable to expect, with proper servicing, along with normal production and marketing conditions, recovery and return to Phase I. However, some borrowers may stay in Phase II as long as they are indebted to FmHA. Here again, servicing should be used to prudently avoid delinquency rather than try to remove it.

When it becomes impossible to keep an account from being delinquent and such delinquency exists for 180 days, the borrower is considered in Phase III.

PHASE III

The borrower must be provided the Notice of Availability of Primary and Preservation Loan Service Programs for Delinquent Farmer Program borrowers. This phase begins the complicated process of determining if keeping the farmer on the farm will provide the best net recovery to the Government or whether liquidation offers the best net recovery.

FmHA's primary servicing tools in this phase include consolidation, rescheduling, reamortization, deferral, softwood timber loans, conservation easements, and write-down of a borrower's debt.

The procedure, at this point, requires an appraisal of all collateral and a sound and accurate determination as to whether or not the best net recovery to the Government exists in write down of debt and continuation of the farming operation, or in liquidation of the collateral securing the FmHA debt. The debt must be written down to a level at which a feasible plan can be developed. The write-down can go down to an amount that will provide a return to the Government equal to net recovery from an involuntary liquidation. FmHA will continue with the borrower if net recovery from loan payments on the restructured debt equals or exceeds net recovery from liquidation. Once it has been determined that a borrower cannot be helped with Primary Loan Service Programs, every effort must be made to keep the farmer in business, using mediation if necessary and available, in an attempt to get other creditors to restructure their debt if that is what is needed to develop a feasible plan.

If it is determined that FmHA cannot restructure the borrower's debt, the borrower is considered in Phase IV.

PHASE IV

A Notice of Intent to Accelerate will be sent to the borrower. This Notice will advise the borrower of the right to: 1) a meeting with FmHA, 2) an appeal, 3) request an independent appraisal and 4) buy out the FmHA debt at net recovery value. If none of the rights offered in the Notice of Intent to Accelerate provide a favorable solution, and the borrower does not buy out at net recovery value, FmHA will automatically consider the borrower/owner for the Preservation Loan Service Programs.

If the borrower/owner is eligible for the Preservation Loan Service Programs, FmHA expects to enter into a contract with the borrower wherein FmHA determines the borrower will receive a leaseback/buyback and/or homestead protection upon conveyance of the real estate and chattels securing the debt. It is expected that the transaction of conveyance from the borrower(s) and reconveyance by FmHA to the borrower(s) take place at one sitting, similar to a loan closing. This means that all documents necessary to complete this transaction must be prepared in advance and be ready for appropriate signature.

When a borrower's debts cannot be restructured or Preservation Loan Service Programs cannot be used by the borrower/owner, foreclosure and liquidation is required. Both before and after acceleration, the borrower can sell the property for market value or voluntarily convey to FmHA. If FmHA takes the property into inventory, the farmer is now considered in Phase V.

PHASE V

The borrower has the opportunity, along with spouse and children to once again be considered for the Preservation Loan Service Programs. The farmer also may elect to use the homestead protection program rather than leaseback/buyback which also can provide a base for farming operations.

Leaseback/buyback rights are available in Phase V to spouse and children. Homestead rights are available to only the former owner.

In summary, the loan restructuring policy is this:

(1) Use rescheduling and/or reamortization at regular interest rates to keep a borrower in Phase I if at all possible. If that is not possible, go to Phase II.

(2) In Phase II, use rescheduling and/or reamortization at limited resource interest rates and consider deferral, including softwood timber loans, if necessary, to keep a borrower from becoming delinquent. When a borrower's loans cannot be restructured using any or all combinations of consolidation, rescheduling, reamortization, deferral, and softwood timber programs where applicable, and with limited resource rates, begin Phase III.

(3) In Phase III, FmHA must determine whether or not the best net recovery to the Government is by keeping the farmer on the farm by using the Primary and Preservation Loan Service Programs, or through liquidation. At this point, the borrower is considered for a debt write-down. The value of the restructured debt will be based on the present value of payments the borrower would make to the FmHA using any combination of Primary Loan Service Programs that will provide a feasible plan. Present value is a calculation concept which assigns a lower current value to dollars received in later years than to dollars received at the present time using a specific discount rate. FmHA will use a discount rate based on the 90-day Treasury bill rate. FmHA will analyze the costs of involuntary liquidation to determine the net recovery value of the collateral securing the debt as if it was involuntarily acquired and disposed of under the normal FmHA inventory property disposal process. The County Supervisor will determine the current market value of the collateral. If the calculations show that the value of the restructured debt is greater than or equal to the net recovery value of the collateral, FmHA will restructure the debt. The Phase III process may include mediation if an approved State Mediation Program is available. When an approved State Mediation Program is not available, an effort must be made by FmHA to get undersecured creditors and the borrower together when the other creditors' debt is the reason a feasible plan cannot be developed. If underscored creditors agree to restructure debts owed to them, so that the borrower can develop a feasible plan of operation, FmHA will restructure the borrowers debt to FmHA. If underscored creditors will not participate in negotiations or will not restructure debts, FmHA will proceed with appropriate action to liquidate the borrowers' accounts. The borrower has the opportunity to retain the security property by paying FmHA the net recovery value, appeal, meet with the decisionmaker and/or request an independent appraisal. Credit will not be provided by FmHA for buyout at net recovery.

(4) When all or any combination of Phase III servicing tools have been fully and carefully considered and it is determined that the best net recovery to the Government is in liquidation, the borrower will be considered in Phase IV which is the beginning of the liquidation process.

FmHA will automatically consider the Preservation Servicing Program application in this phase. Both before and after acceleration, the borrower can apply for debt settlement when conveying the property, either by sale at market value or voluntary conveyance to FmHA.

(5) After acceleration of the accounts and upon acquisition of the security property by FmHA, the borrower is considered in Phase V. This last phase is when the property securing the loans passes into FmHA inventory. In this phase, once again, Preservation Loan Service Programs will be offered to the borrower. The objective is to try to keep the farmer on the farm. The borrower/owner's spouse and/or children are now considered in the priority for leaseback/buyback. This will be done with the Leaseback/Buyback Program for the farm or through the Homestead Protection Program for the home and 10 acres. The borrower/owner's spouse and/or children are not eligible for homestead protection.

The FmHA Primary Loan Service Program has the potential to keep many farmers on the farm, contributing to the economic viability of rural communities. The Farmers Home Administration will carry out this program in the full intent and spirit of the Act. Only time will tell how many FmHA borrowers will be able to continue with their farming business, but many rural communities will see a strengthening of their economy as the restructuring process takes place.

Attachments

Aging of Farmer Program DELINQUENT AMOUNTS *

RC 616, September 30, 1988
Insured Loans

PROGRAM	AMOUNT DELINQUENT ($1000)	Percent of Total AMOUNT DELINQUENT By Length of Delinquency			
		1 Year or Less	1-2 Years	2-3 Years	3 or More Years
Farm Ownership	$609,184	5.6%	9.0%	11.7%	73.7%
Farm Operating	$1,439,725	5.4%	12.0%	15.2%	67.4%
Emergency	$4,801,549	1.3%	2.7%	4.0%	92.0%
Economic Emergency	$1,408,611	1.9%	3.4%	8.5%	86.2%
Soil and Water	$52,615	3.8%	7.5%	10.3%	78.4%
All Others	$10,010	3.2%	4.4%	6.2%	86.2%
TOTALS	$8,321,694	2.4%	4.9%	7.3%	85.3%

* Excludes Association Loans

Prepared by the Information Resources Management Division
based on Report RC 616, 9/30/88

Changes in Insured Farmer Programs

September 1987 - September 1988

A M O U N T S

Insured Principal			Amount Delinquent		
1988	$25.36	Billion	1988	$8.33	Billion
1987	$26.07	Billion	1987	$6.60	Billion

B O R R O W E R S

Program Delinquency Rates

	September 1987	September 1988
FO	23	25
OL	33	38
EM	39	44
EE	45	50

Number of Delinquent Borrowers

	September 1987	September 1988
FO	26,680	27,869
OL	36,210	41,476
EM	40,297	43,080
EE	19,483	20,481

Prepared by the Information Resources Management Division
based on Report RC 616, 9/30/88

Attachment 3, Page 1 of 1

Potential Farmer Program Servicing Workload
Program Development Staff, FP
10-21-88

DELINQUENT BORROWERS

State	Total Caseload as of 10-03-88	SAGAR 12-31-87 Number Filed for Bankruptcy	No. Borrowers notified of "Right to Request Inc. Release"	Calculated RC541 Residual Number of * OTHER Borrowers	Number of Delinquent Borrowers NOT Accelerated	Potential Workload under New Regulations	Workloa as % o Tota Caseloa
ALABAMA	4584	226	198	-12	739	1151	25.1
ARIZONA	989	34	103	91	227	455	46.0
ARKANSAS	9115	255	516	185	2102	3058	33.5
CALIFORNIA	3352	253	273	44	1119	1689	50.4
COLORADO	2266	98	62	219	625	1004	44.3
CONNECTICUT	240	4	7	4	38	53	22.1
DELAWARE	290	4	12	11	24	51	17.6%
FLORIDA	2706	111	255	556	678	1600	59.1%
GEORGIA	6950	671	841	718	1938	4168	60.0%
IDAHO	3984	250	247	105	1191	1793	45.0%
ILLINOIS	8369	304	292	31	1413	2040	24.4%
INDIANA	5493	441	400	508	1088	2437	44.4%
IOWA	12818	508	372	647	1528	3055	23.8%
KANSAS	7103	410	205	268	1024	1907	26.8%
KENTUCKY	8046	315	273	36	1300	1924	23.9%
LOUISIANA	7659	403	1211	804	2002	4420	57.7%
MAINE	1735	11	26	93	444	574	33.1%
MARYLAND	993	23	24	118	191	356	35.9%
MASSACHUSETTS	389	3	10	20	26	59	15.2%
MICHIGAN	4541	207	81	158	1331	1777	39.1%
MINNESOTA	9542	398	411	141	2974	3924	41.1%
MISSISSIPPI	10506	343	1056	817	2667	4883	46.5%
MISSOURI	10187	538	253	481	1994	3266	32.1%
MONTANA	3592	89	67	75	997	1228	34.2%
NEBRASKA	8375	518	563	65	1130	2276	27.2%
NEW HAMPSHIRE	118	0	0	1	8	9	7.6%
NEW JERSEY	628	17	53	78	112	260	41.4%
NEW MEXICO	1346	16	77	72	249	414	30.8%
NEW YORK	5081	349	133	121	1176	1779	35.0%
NORTH CAROLINA	7270	170	483	611	1232	2496	34.3%
NORTH DAKOTA	8387	175	470	150	2095	2890	34.5%
OHIO	3801	272	243	311	610	1436	37.8%
OKLAHOMA	9040	401	172	414	2514	3501	38.7%
OREGON	2137	60	90	156	434	740	34.6%
PENNSYLVANIA	2690	81	102	93	284	560	20.8%
RHODE ISLAND	49	0	2	1	7	10	20.4%
SOUTH CAROLINA	3392	79	391	150	621	1241	36.6%
SOUTH DAKOTA	10276	593	475	178	1887	3133	30.5%
TENNESSEE	7616	327	375	76	1975	2753	36.1%
TEXAS	14372	499	444	1977	3601	6521	45.4%
UTAH / NV	1514	37	17	45	271	370	24.4%
VERMONT	709	5	4	9	35	53	7.5%
VIRGINIA	3631	199	216	151	740	1306	36.0%
WASHINGTON	2303	95	105	-55	667	812	35.3%
WEST VIRGINIA	1593	37	19	3	254	313	19.6%
WISCONSIN	8132	222	181	544	1485	2432	29.9%
WYOMING	878	51	45	36	146	278	31.7%
ALASKA	11	0	0	1	3	4	36.4%
HAWAII	348	2	0	7	104	113	32.5%
W.P.TERR.	20	0	0	0	9	9	45.0%
PUERTO RICO	2642	41	114	37	691	883	33.4%
VIRGIN ISLANDS	27	0	1	0	15	16	59.3%
NATIONAL TOTALS	231835	10145	11970	11350	50015	83480	36.0%

* The "OTHER" column is calculated by subtracting the number of borrowers notified of "Right to Request Income Release" and the "Number Filed for Bankruptcy" from the number of OTHER borrowers listed on RC 541. A negative number prevents a borrower from being counted twice by this estimate.