



**Farmers' Guide**  
to the  
**Farm Service Agency**  
**Microloan Program**

**June 2014**

**A Publication of Farmers' Legal Action Group**



# **Farmers' Guide to the Farm Service Agency Microloan Program**

**June 2014**

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**A Publication of Farmers' Legal Action Group**



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# Introduction

This guide will introduce you to the new Microloan program offered by the Farm Service Agency (FSA) of the United States Department of Agriculture (USDA).<sup>1</sup> Under this new program, FSA will make loans of up to \$35,000 to farmers for farm operating expenses. This guide will help you know what to expect should you choose to apply for a Microloan for your farming operation.

The new Microloan program is intended for farmers who run small-scale farm operations, including beginning farmers and immigrant and minority farmers. It is expected that many farmers who will be interested in the Microloan program will never before have taken out a loan for their farming operations. Some may not have known that credit was available for their farm operations; others will have gradually grown past the size where they can sustain their operations using only savings, off-farm income, and credit cards; still others will not have wanted to go through the full application process for a standard farm operating loan when looking to borrow only a small amount of money. The new Microloan program will likely be a good fit for many such farmers who are new to farm loans.

Because these farmers will not be familiar with the language and relationships in farm operating credit, Part One of this guide will provide some background information about credit, farm operating loans in general, and FSA loans in particular. Farmers who are familiar with general farm operating loans can jump ahead to Part Two, which explains the new Microloan program in detail.

## **Part One of this guide covers important background information:**

- Farm operating loan basics
- How the FSA loan programs work
- Other farm operating lenders
- Understanding your “credit history”

## **Part Two of this guide covers getting a new Microloan operating loan:**

- What a Microloan can and cannot be used for
- Who is eligible for Microloans
- Microloan approval requirements

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<sup>1</sup> See 78 Fed. Reg. 3828 (January 17, 2013) (codified at scattered sections of 7 C.F.R. Parts 761 and 764).

- Microloan interest rate and repayment periods
- The Microloan application process
- How to appeal the denial or change of a Microloan application

**Part Three of this guide covers farm business matters:**

- How to create a Farm Business Plan with FSA
- How to outline farm business objectives
- How to follow the plan
- Release of farm income

**Part Four of this guide covers trouble repaying a Microloan:**

- Primary loan servicing to help distressed borrowers and FSA agree to new payment plans
- Disaster set-aside to help borrowers struggling to make payments after a disaster
- Debt settlement
- How to appeal the denial or reduction of a loan servicing request

# **PART ONE:**

## **Important Information for New Borrowers**

This section of the guide will introduce new borrowers to many of the general terms, processes, and organizations they will encounter during the loan application and approval process. It is extremely helpful for borrowers to have a working understanding of these ideas before beginning the loan application process.

### **I. Farm Operating Loan Basics**

The term “lender” applies to anyone who provides funds to another person with the expectation that the funds will be repaid, usually with interest or other fees. A lender can be an individual, such as a family member or friend. A lender can also be a public or private organization, such as FSA or a private bank. The term “borrower” refers to the individual who requests funds from the lender and enters into an agreement to repay the money. When a lender provides money to a borrower under a repayment plan, the borrower is said to be taking out “credit” from the lender, who can also be called a “creditor.”

#### **A. Secured and Unsecured Credit**

One type of credit, known as “secured” credit, involves the use of security interests, through which the borrower allows the creditor to have a claim against some or all of the borrower’s property as an incentive for the creditor to make the loan. A security interest in property provides creditors with financial protection in case a borrower defaults on a loan. The most common way for a borrower to default is by missing payments, but the loan agreement can specify other actions that will be considered a default (such as not maintaining insurance on security property or misuse of security proceeds). Borrowers must be sure they understand all of the obligations of their loan agreements so they can avoid default.

A creditor who has a security interest in the borrower’s property has the legal right to take possession of that property or claim proceeds from the sale of that property if the borrower defaults on the debt. For example, if a borrower gives a creditor a security interest in his tractor as part of the loan agreement but fails to make his payments, the creditor may be able to repossess the tractor or collect the proceeds if the tractor is sold. Borrowers provide security interests to their creditors through the use of security agreements. Security property is sometimes also called “collateral.”

Any credit that is given to a borrower without a security interest is considered “unsecured” credit. The most common type of unsecured credit is credit cards. Unsecured credit presents a much higher risk for the creditor because if the borrower does not pay, the creditor must go to court and get a judgment against the borrower before the creditor can make a claim against the borrower’s

property. This higher risk for creditors is one reason why unsecured credit tends to have much higher interest rates.

## **B. Loan Documents**

Unless a farmer is borrowing money from family members or friends, the first step in getting a loan will usually be to fill out a loan application. The application will ask many detailed questions about the farmer's financial situation and past experience with credit, if any. Lenders will often also ask for documents to support the answers in the application, such as proof of past farm and off-farm income, and proof that the farmer owns any property that will be used as security for the loan. Most lenders, including FSA, will also require the borrower to prepare a farm business plan that maps out both the income and expenses the farmer expects for the upcoming year of production. This plan shows the lender that the borrower will actually be able to repay any money borrowed.

If the loan application is approved, the borrower will generally be required to sign a promissory note—a legally enforceable promise to repay money—which will set out the amount of money borrowed, the interest rate that the borrower will pay, and the date when the money plus interest must be repaid.

If the loan is a secured loan, at the same time the borrower signs the promissory note he or she will also sign a security agreement giving the lender a security interest in the property listed in the agreement.

## **C. Types of Farm Loans**

Farm lenders, including FSA, generally offer many types of loans to farmers. The FSA loans available to farmers include annual Operating Loans, term Operating Loans, Microloans, and Farm Ownership Loans.

Annual Operating Loans can be used to pay for the up-front costs of planting, tending, and harvesting crops for the year, such as paying rent and labor costs and purchasing seed, fertilizer, fuel, and other expenses. These loans typically must be repaid by the end of the year once the crops have been sold.

Term Operating Loans can be used for larger purchases that have a longer life than annual crops, such as farm equipment, livestock, bushes and trees that produce crops over many years, and improvements that do not qualify as real estate—that is, improvements that will not become a permanent part of the land—such as moveable fencing. These loans are typically repaid over multiple years, and in most cases must be paid off completely within seven years.

Microloans are a type of operating loan—either an annual operating loan or a term operating loan—that provide a simplified application process and more flexible requirements for managerial experience and loan security, in order to be more accessible for small-scale farm operations, beginning farmers, and those with limited farm management experience. The maximum amount of a Microloan is much less than a typical operating loan, which allows the lender to be more flexible with security and eligibility requirements.

Farm Ownership Loans are real estate loans that can be used to buy land and to buy or build permanent structures on land. They are typically repaid over a long period, typically up to 30 years.

## **II. How the FSA Loan Programs Work**

The Farm Service Agency (FSA) offers loans to eligible farmers who are unable to obtain credit from other lenders with reasonable terms. The goal of FSA's Farm Loan Programs is to help farmers stabilize their farm finances, develop strong financial and production recordkeeping practices, and build a good credit history in order to "graduate" to being able to get loans from commercial lenders.

There are two main types of FSA loans: direct and guaranteed. Under FSA's direct loan program, loan funds are given directly to the borrower from FSA. Under the guaranteed loan program, loan funds are given to the borrower by a private lender but are backed up by FSA to protect the lender in case of default. Microloans are one category of loans available under FSA's direct loan program.

### **A. FSA Loan Program Requirements Are Established by Law**

The FSA loan programs are created and controlled by complicated laws and rules. One benefit of these rules is that, unlike other types of lenders, FSA must make loans to all eligible applicants if funding is available. FSA is not allowed to deny an applicant who satisfies all of its eligibility and approval requirements (discussed further in Part Two of this guide). A borrower who meets all of the specific eligibility and approval requirements for an FSA loan will be entitled to receive a loan in the order that his or her application was received.

Other results of the specific FSA loan program rules can be less beneficial to borrowers. While FSA is not allowed to deny a borrower who meets all of the eligibility and approval requirements, it is also not allowed to approve a borrower who fails to meet any of those requirements, even if the borrower has a good explanation for the failure. Also, the rules specifically limit the number of years that a farmer is allowed to receive an FSA operating loan. These "term limits" are discussed further in Part Two of this guide.

### **B. FSA Is Required to Accept Applications, Help Applicants**

FSA is required to work with farmers who wish to apply for loans, provide all needed forms, explain program requirements, and assist the farmer to develop a farm business plan if requested by the farmer.<sup>2</sup> If the farmer requests language assistance in order to understand the program forms and requirements, FSA must provide translation services.<sup>3</sup>

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<sup>2</sup> FSA Handbook 3-FLP (Revision 2), "Direct Loanmaking," Page 3-1, Para. 41.A (January 15, 2013).

<sup>3</sup> Exec. Order No. 13,166, 65 Fed. Reg. 50121 (August 16, 2000).

### **C. Targeted Funding for Minority and Beginning Farmer Borrowers**

Every year, FSA targets a certain portion of its loan funds to minority and women farmers. The agency refers to these borrowers as “socially disadvantaged applicants,” meaning a farmer who is a member of a group that has been subject to racial, ethnic, or gender prejudice simply because of membership in the group without regard to their individual qualities. These groups include American Indians or Alaskan Natives, Asians, African Americans, Native Hawaiians or other Pacific Islanders, Hispanics, and women.<sup>4</sup> While the loan process and eligibility and approval requirements are the same for socially disadvantaged applicants as for all other applicants, this targeted funding means that a farmer who qualifies as a socially disadvantaged applicant may be able to receive a loan even if general loan funding has run out. To be eligible for the targeted funding, farmers must be willing to identify their ethnicity, race, and gender on the loan application.

Similarly, FSA targets a certain portion of its annual loan funds to beginning farmers and farmers who are veterans of the Armed Forces of the United States. A beginning farmer is an individual or entity who has operated a farm for less than ten years and substantially participates in running the farm.<sup>5</sup> A military-veteran farmer is an individual who served in and was not dishonorably discharged from the United States Army, Navy, Marine Corps, Air Force, or Coast Guard and has operated a farm or ranch for less than ten years.<sup>6</sup>

### **III. Other Farm Lenders**

While the rest of this guide discusses the details of the new FSA Microloan program, it is important to understand that FSA is not the only lender making loans to farmers. Farmers can obtain operating, equipment, and real estate loans from many private banks and Farm Credit Services entities such as AgCountry, AgDirect, and AgStar. Some farm equipment dealers offer loans for equipment purchases and even operating expenses. In fact, many private lenders have their own Microloan programs as well.

Each lender decides for itself which eligibility criteria it considers important and whether a potential borrower’s application should be approved. As mentioned above, one of the advantages of borrowing from FSA is the predictability provided by the agency’s regulations—unlike FSA, private lenders are free to accept or deny an application for almost any reason. The downside to the

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<sup>4</sup> 7 C.F.R. § 761.2(b), “Socially disadvantaged applicant or farmer,” “Socially disadvantaged group” (2014).

<sup>5</sup> 7 C.F.R. § 761.2(b), “Beginning farmer” (2014). For real estate loans, the total amount of farm property owned by the beginning farmer must be relatively small compared to other farms in the same county.

<sup>6</sup> 7 U.S.C. § 2279(e)(7); 38 U.S.C. § 101(2), (10).

predictability of FSA's loan program regulations is that the agency often has little flexibility to work with potential borrowers, while private lenders may be more open to negotiation.

#### **IV. Understanding Your “Credit History”**

No matter which lender a farmer approaches for a farm operating loan, the farmer's credit history will play an important role in the approval or denial of the loan. For this reason, it is helpful for farmers to understand the terms “credit history” and “credit report” before they begin discussions with lenders. Your credit history is a record of your history of repaying certain debts, including loans and credit cards. Creditors report new accounts and payment activity to organizations called “credit reporting agencies,” which collect all of the information for each person into an individual credit history. When you apply for a new loan or credit card, the new lender will request your credit report from a credit reporting agency to help decide whether to approve your application.

Credit reports contain such information as: the number and types of credit accounts (including credit cards and loans) opened by an individual; how long each account has been open; the amount currently owed on each account; whether there is more credit available on an account; whether an individual has paid bills on time or has a pattern of late payment; and the number of recent credit inquiries (usually made by creditors when payment is late or the individual is applying for a new credit account). Credit reports also show whether an individual has ever declared bankruptcy, experienced a mortgage foreclosure, or has any outstanding liens, legal judgments, or collection actions.

All of the information contained in an individual's credit report is used by lenders to determine the individual's credit worthiness—meaning whether it makes sense for the lender to provide credit to the individual because he or she has shown a good record of an ability and willingness to repay debts. When negative information shows up on a credit report, there is not much an individual can do to remove it if the information is truthful and accurate. This information, including information about a foreclosure, will usually stay on an individual's credit report for seven years. Bankruptcy declarations usually show up for ten years.

While FSA will order a credit report on a farmer and consider his or her credit history when deciding whether to approve a loan, the agency will be more willing to overlook a negative incident if it occurred several years ago or was caused by circumstances beyond the farmer's control. Farmers with less-than-perfect credit histories should not feel discouraged from applying for FSA Microloans, as the agency will consider this among many other factors when deciding whether to grant a loan.

FSA regulations specifically state that certain circumstances will not automatically be considered as showing an unacceptable credit history, including:<sup>7</sup>

1. Foreclosure, judgment, or delinquent payments that occurred more than 36 months before the application, provided there are no recent similar situations.
2. Delinquencies on FSA loans that were resolved through loan servicing.
3. Isolated incidents of delinquent payments that do not represent a general pattern of late or missing payments.
4. No history of credit transactions.
5. Recent bankruptcy, foreclosure, court judgment, or delinquent payments if:
  - a. Circumstances causing the situation were of a temporary nature and beyond the borrower's control (for example, loss of income or increased expenses due to a natural disaster, medical crisis, or temporary unemployment); or
  - b. The debtor refused to pay because of a justifiable dispute about goods or services.

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<sup>7</sup> 7 C.F.R. § 764.101(d)(3) (2014).

## PART TWO:

# Getting an FSA Microloan

### I. What Can a Microloan Be Used For?

FSA regulations name specific purposes for which direct Operating Loan funds may be used.<sup>8</sup> These authorized loan purposes are the same for the new Microloan program as for all other direct Operating Loans from FSA.

Loan purposes available to all borrowers under the Microloan program are:<sup>9</sup>

1. **Paying annual farm operating expenses.** These expenses may include: seed and transplants, fertilizer, pesticides, farm supplies, livestock feed, livestock medical expenses, cash rent for farmland and equipment, some repairs and improvements to farm equipment,<sup>10</sup> interest on loans, hired labor, fuel, taxes, and insurance.<sup>11</sup> Other expenses necessary for the farming operation can also be included if approved by FSA; and
2. **Paying family living expenses.** FSA regulations state that this means providing for the needs of family members and those for whom the borrower has a financial obligation, such as alimony, child support, and care of elderly parents.<sup>12</sup> Expenses that may be covered include: household operating expenses and utilities, food, clothing, personal care, health and medical expenses, medical insurance, house repair and sanitation, school and religious expenses, transportation, taxes, and insurance.<sup>13</sup>

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<sup>8</sup> 7 C.F.R. § 764.251 (2014).

<sup>9</sup> 7 C.F.R. § 764.251(a)(3) (2014); FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Page 9-7, Para. 202.B (September 3, 2010).

<sup>10</sup> To qualify, repairs and improvements must be expensed in the farmer’s financial records and tax return. 7 C.F.R. § 764.251(a)(3) (2014).

<sup>11</sup> 7 C.F.R. § 764.251(a)(3) (2014); FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Exhibit 2, Page 8 (September 3, 2010).

<sup>12</sup> 7 C.F.R. § 761.2(b), “Family living expenses” (2014).

<sup>13</sup> FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Exhibit 2, Page 8 (September 3, 2010).

In addition to these two primary loan purposes, most Microloan borrowers will be eligible to use loan funds for several other purposes.<sup>14</sup> These are:<sup>15</sup>

1. Purchasing farm machinery and equipment;
2. Purchasing livestock (including poultry);
3. Purchasing stock or other entry requirements to participate in a cooperative or association for credit, production, processing, or marketing purposes;
4. Paying the costs of reorganizing the farm to improve profitability;
5. Paying scheduled, non-delinquent principal and interest payments on long-term debt that was taken out for purposes authorized under FSA's Farm Ownership or Operating Loan programs;<sup>16</sup>
6. Paying the costs of any training required or recommended by FSA;
7. Paying the costs of complying with occupational health and safety requirements if necessary to avoid substantial economic injury;<sup>17</sup>
8. Paying the costs of minor real estate repairs or improvements that can be repaid within seven years;
9. Paying the costs of land and water development, use, or conservation;
10. Paying loan closing costs such as taxes, recording fees, appraisal fees, and fees for title reports and insurance; and
11. Refinancing existing debt in order to improve the farm's profitability, if all of the following conditions are met:
  - a. The borrower has refinanced an FSA Operating Loan no more than four times in the past,
  - b. The debt to be refinanced was not for real estate, and

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<sup>14</sup> These additional uses of loan funds are not available to any direct Operating Loan borrower who has caused a loss to FSA under its direct or guaranteed loan programs. FSA Handbook 3-FLP (Revision 2), "Direct Loanmaking," Page 9-7, Para. 202.B (September 3, 2010). The exception for losses to FSA caused by debt writedown, a bankruptcy discharge, or a disaster—as explained in the eligibility section of this guide—only allows for loan funds to be used for annual farm operating and family living expenses. 7 C.F.R. § 764.252(c) (2014).

<sup>15</sup> 7 C.F.R. § 764.251(a) (2014).

<sup>16</sup> FSA Handbook 3-FLP (Revision 2), "Direct Loanmaking," Page 9-3, Para. 201.E (September 3, 2010).

<sup>17</sup> The health and safety measures must be required by a federal or state agency, and FSA must agree that both the penalties for not complying and the costs of complying would be economically substantial.

- c. One of the following is true:
  - i. The need for refinancing is due to a qualifying natural disaster;  
or
  - ii. The applicant is refinancing debt owed to a non-USDA creditor.

## **II. What Can a Microloan Not Be Used For?**

### **A. No Real Estate**

Microloans cannot be used to purchase real estate.<sup>18</sup> Farmers who wish to purchase farmland using FSA financing should instead apply for a loan under FSA's Farm Ownership loan program.

### **B. No Damage to Erodible Lands or Wetlands**

Microloans will also not be approved for any farming purpose that will contribute to excessive erosion of highly erodible lands, damage to wetlands, or reduction of water flow.<sup>19</sup> "Highly erodible lands" and "wetlands" are specific types of land identified by USDA. There can be expensive penalties for violating these restrictions, so farmers should consult FSA before taking any action if they are unsure whether planned farming activities will affect land that FSA considers highly erodible or wetlands.

### **C. No Non-Eligible Enterprises**

FSA borrowers are not allowed to use loan funds for any non-eligible enterprises.<sup>20</sup> This means that activities that are not authorized by the Microloan purposes cannot be supported by Microloan funds, even if the income from those activities is used to support the farm.

## **III. Who Is Eligible for a Microloan?**

There are two stages to getting an FSA loan. First, the farmer must be eligible for the loan. If the farmer is not eligible, the application will be denied. If the farmer is eligible, the application will move on to the approval process, discussed in the next section of this guide.

FSA regulations set out specific loan eligibility requirements.<sup>21</sup> If a farmer meets the requirements to be eligible for a loan, his or her application will move forward

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<sup>18</sup> FSA Handbook 3-FLP (Revision 2), "Direct Loanmaking," Page 9-5, Paras. 201.L-M (January 15, 2013).

<sup>19</sup> 7 C.F.R. § 764.102(d) (2014).

<sup>20</sup> 7 C.F.R. § 764.102(f) (2014).

<sup>21</sup> 7 C.F.R. § 764.101 (2014).

to be considered in the approval process. FSA cannot refuse to process the application or delay its processing.

The eligibility requirements for the Microloan program are the same as those for all direct Operating Loans, with one exception: there is a somewhat different standard for demonstrating managerial ability for Microloans.<sup>22</sup>

1. The borrower must be a **citizen, a non-citizen national, or a lawful alien resident** of the United States. Non-immigrants who simply hold visas to the United States are ineligible.
2. The borrower must have the **legal capacity** to incur the debt. This means the borrower must be at least 18 years of age and have the mental capacity and authority to enter into a legally binding contract.<sup>23</sup>
3. The borrower must have an **acceptable credit history** demonstrated by debt repayment. Credit history is discussed in more detail in Part One of this guide.
4. The borrower must agree to meet certain **training requirements**, unless FSA chooses to grant a waiver. If required, the training will cover farming practices, managing farm finances, or both.<sup>24</sup>
5. The borrower must have sufficient **managerial ability** to assure reasonable prospects of loan repayment. This is the eligibility requirement that has been changed for Microloans. For Operating Loans generally, managerial ability must be demonstrated by education, on-the-job training, or farming experience within the last five years.<sup>25</sup> Microloan applicants have two additional options for demonstrating managerial ability:<sup>26</sup>
  - a. Certification of past participation with an agriculture-related organization that demonstrates experience in farming similar to what the borrower will use the Microloan funds for. This could be a beginning farmer training program, a youth program such as 4-H Club or Future Farmers of America, or another program that provides training and guidance for new farmers; or
  - b. Prior experience working on a farm or managing a small business combined with a written plan for a self-directed farm apprenticeship

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<sup>22</sup> 7 C.F.R. § 764.101(i)(4) (2014).

<sup>23</sup> FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Page 4-3, Para. 63.A (January 15, 2013).

<sup>24</sup> 7 C.F.R. §§ 764.451-454 (2014); FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Part 18 “Borrower Training” (latest amendment June 5, 2013).

<sup>25</sup> 7 C.F.R. § 764.101(i) (2014).

<sup>26</sup> 7 C.F.R. § 761.101(i)(4) (2014); FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Pages 4-13 to 4-14, Para. 69 (January 15, 2013).

after receiving loan funds. This “self-directed apprenticeship” means that the Microloan applicant arranges for a qualified person (called a “mentor”) to provide guidance and share knowledge, skills, and information during the Microloan applicant’s first production and marketing cycle to help the applicant develop his or her farming skills and management ability. The mentor must be knowledgeable in production, management, and marketing practices relevant to the Microloan applicant’s farming operation. The Microloan applicant and mentor do not need to have operations that are exactly the same, but they should be related—for example, a vegetable farmer should not pair with a mentor who has only dairy farming experience.<sup>27</sup>

6. The borrower must agree to obtain **hazard insurance** on any property that will be purchased or improved with the loan, as well as on any property that will serve as primary security for the loan.<sup>28</sup> This means that the property must be insured against damage or destruction from fire, storms, flood, and other hazards as applicable for the area and type of property. Insurance is only required if insurance is readily available at the level considered standard for the local area, and only if the cost of the insurance is less than the benefit if the property were destroyed.
7. If crop insurance is available for the borrower’s crops, the borrower must agree to obtain at least the minimum level of **crop insurance** on every crop that is a basic part of the borrower’s total farming operation, or sign a waiver of eligibility for emergency crop loss assistance (not including FSA Emergency Loans) for any uninsured crop.<sup>29</sup>

Many Microloan borrowers will grow specialty crops that are not covered by crop insurance but instead are covered by FSA’s Noninsured Crop Disaster Assistance Program (NAP). FSA will generally encourage borrowers to obtain NAP coverage for their non-insurable crops, but it is not required by the loan regulations.<sup>30</sup>

8. The borrower must be **unable to get sufficient credit elsewhere** to finance the actual needs of the farming operation at reasonable rates and terms.<sup>31</sup> FSA will evaluate the borrower’s ability to obtain credit by considering such factors as the loan amounts, rates, and terms that are

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<sup>27</sup> FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Page 4-14, Para. 69 (January 15, 2013).

<sup>28</sup> 7 U.S.C. §§ 1923(c), 1942(c); 7 C.F.R. § 764.108.

<sup>29</sup> 7 C.F.R. § 764.108(d) (2014).

<sup>30</sup> FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Page 6-3, Para. 112.D (June 5, 2013).

<sup>31</sup> 7 C.F.R. §§ 764.101(e), 764.252(a) (2014).

available in the marketplace, as well as the borrower's property interests, income, and significant non-essential assets.<sup>32</sup>

9. The borrower must be the **operator of a family farm** after the loan is closed. The term "family farm" is defined by FSA regulations.<sup>33</sup> Some of the factors considered include whether the farm is operated in a business-like manner, keeping good records and attempting to make a profit; whether a member of the farm family is the final decision-maker for day-to-day farm management and operational choices; and whether family members or co-borrowers provide a substantial amount of the full-time labor used on the farm.<sup>34</sup> For the Microloan program, an operation will be considered a farm if it has gross sales each year of \$1,000 or more of agricultural products.<sup>35</sup>
10. The borrower cannot have exceeded the **term limit** for receiving direct FSA loans. The number of years that loans are available will depend on the type of loan and whether the farmer qualifies as a beginning farmer or military-veteran farmer. (The requirements to qualify as a beginning farmer or military-veteran farmer are discussed in Part One of this guide.)

The general rule for Operating Loans, including Microloans, is that a borrower cannot get a new direct Operating Loan if he or she has already closed on such loans in seven or more different calendar years, unless

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<sup>32</sup> FSA Handbook 3-FLP (Revision 2), "Direct Loanmaking," Page 4-9, Para. 66 (January 15, 2013).

<sup>33</sup> "Family farm" is defined by the FSA loan regulations as a farm that:

- (1) Produces agricultural commodities for sale in sufficient quantities so that it is recognized as a farm rather than a rural residence;
- (2) Has both physical labor and management provided as follows:
  - (i) The majority of day-to-day, operational decisions, and all strategic management decisions are made by:
    - (A) The borrower and persons who are either related to the borrower by blood or marriage, or are a relative, for an individual borrower; or
    - (B) The members responsible for operating the farm, in the case of an entity.
  - (ii) A substantial amount of labor to operate the farm is provided by:
    - (A) The borrower and persons who are either related to the borrower by blood or marriage, or are a relative, for an individual borrower; or
    - (B) The members responsible for operating the farm, in the case of an entity.
- (3) May use full-time hired labor in amounts only to supplement family labor.
- (4) May use reasonable amounts of temporary labor for seasonal peak workload periods or intermittently for labor-intensive activities.

7 C.F.R. § 761.2(b) "Family farm" (2014).

<sup>34</sup> FSA Handbook 3-FLP (Revision 2), "Direct Loanmaking," Page 4-15, Para. 71 (January 15, 2013).

<sup>35</sup> FSA Handbook 3-FLP (Revision 2), "Direct Loanmaking," Page 9-45, Para. 216.B (June 5, 2013).

the borrower qualifies as a beginning farmer.<sup>36</sup> However, there are two important exceptions to this limit that are likely to be available for many farmers interested in Microloans.

First, if a borrower receiving a Microloan qualifies as a beginning farmer or military-veteran farmer, that loan will not be counted toward the term limits on FSA Operating Loans.<sup>37</sup> In such cases, the farmer's seven-year limit on FSA Operating Loans will only begin after the farmer has been in operation for more than 10 years and no longer qualifies as a beginning farmer or military-veteran farmer.

Second, on a case-by-case basis, FSA can waive the Operating Loan term limit one time per borrower, for two calendar years.<sup>38</sup> FSA can only grant the waiver for farmers who have financially viable operations, who have unsuccessfully applied for commercial credit, and who have completed or will complete FSA's required borrower training.

11. In general, the borrower cannot have received **"debt forgiveness"** on a prior loan from USDA.<sup>39</sup> Debt forgiveness is defined as the reduction or termination of a loan resulting in a loss to USDA through write-down, write-off, debt settlement, payment of a loss claim on a guaranteed loan, or a discharge in bankruptcy.<sup>40</sup> "Debt forgiveness" does not include the reduction or termination of a loan as a result of the resolution of a discrimination claim against USDA.<sup>41</sup>

However, some borrowers who have received debt forgiveness on a prior FSA loan may be eligible for a new FSA loan depending on the circumstances.<sup>42</sup> Farmers interested in Microloans who know or believe

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<sup>36</sup> 7 U.S.C. § 1941(c)(1)(C); 7 C.F.R. § 764.252(e). The term limit on Operating Loan eligibility also does not apply to borrowers whose land is subject to the jurisdiction of an Indian tribe, whose loan is secured by one or more security instruments subject to the jurisdiction of an Indian tribe, and who do not have commercial credit generally available for such operations. 7 C.F.R. § 764.252(e)(2) (2014).

<sup>37</sup> Agricultural Act of 2014 (2014 Farm Bill), Pub. L. No. 113-79, Title V, § 5106(b)(1) (Feb. 7, 2014) (to be codified at 7 U.S.C. § 1941(c)(2)); FSA Notice FLP-670, "Implementing the Agricultural Act of 2014 (2014 Farm Bill): Microloans to Beginning Farmers and Ranchers," Page 2, Para. 2-A (March 25, 2014).

<sup>38</sup> 7 C.F.R. § 764.252(e)(4) (2014).

<sup>39</sup> 7 U.S.C. § 2008h(b); 7 C.F.R. § 764.252(b).

<sup>40</sup> 7 U.S.C. § 1991(a)(12). Note that a bankruptcy in which FSA debt was not discharged does not result "in a loss to the Secretary." Similarly, if payment on a shared appreciation agreement enabled the Secretary to recover all prior losses, arguably the writedown did not result in a net "loss to the Secretary."

<sup>41</sup> 7 U.S.C. § 1991(a)(12)(B)(ii).

<sup>42</sup> A borrower who received debt forgiveness in the past may still be eligible for a new direct Operating Loan, including a Microloan, to cover annual farm operating and family living expenses, if: (1) the prior debt forgiveness was through a write-down;

that they have received debt forgiveness from FSA should contact FLAG or FSA to learn more about these exceptions.

12. If the borrower owes a non-tax debt to the United States government, the borrower must not be delinquent on that debt at the time of loan closing.
13. If the borrower has ever been sued by the United States government in any court other than the U.S. Tax Courts, the borrower must have paid any judgment that was ordered.
14. The borrower must not be ineligible for federal programs due to a federal crop insurance violation.
15. The borrower must not have been recently convicted of violating any state or federal drug laws.<sup>43</sup>

## IV. The Microloan Approval Process

Even when a borrower can demonstrate eligibility for a Microloan and is intending to use the loan for an authorized purpose, FSA must still approve the amount of the loan before it will be made. There are two parts to the loan approval process: the borrower's ability to repay the money and the borrower's ability to satisfy security requirements.<sup>44</sup>

### A. Repayment Ability

When determining repayment ability, FSA considers whether the borrower is likely to be able to make the scheduled payments on the loan—usually a single payment for an annual operating loan or several once-per-year payments for a longer term loan—while still satisfying the borrower's other financial commitments. FSA will examine the borrower's "Farm Business Plan"<sup>45</sup> (discussed in Part Three of this guide) and other cash flow projections to see whether the borrower is presenting a "feasible plan."

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(2) the prior debt forgiveness was through a discharge in a reorganization bankruptcy (under Chapter 11, 12, or 13), and the borrower is current on all payments under the reorganization plan; or (3) the borrower received debt forgiveness on no more than one occasion after April 4, 1996, resulting "directly and primarily" from a disaster or emergency. 7 U.S.C. § 2008h(b)(2)(A); 7 C.F.R. § 764.252(c).

<sup>43</sup> 7 C.F.R. § 718.6 (2014). If the conviction was for planting, cultivating, growing, producing, harvesting, or storing a controlled substance (drug), the person convicted cannot participate in USDA programs, including FSA loan programs, for five years. If the conviction was for possession or trafficking, the person convicted cannot participate in USDA programs for whatever period is set by the court.

<sup>44</sup> 7 C.F.R. § 764.401(a) (2014).

<sup>45</sup> See FSA Handbook 1-FLP (Revision 1), "General Program Administration," Exhibit 15 "Farm Business Plan – FSA User Guide" (latest amendment April 23, 2014).

A feasible plan is a cash flow budget or farm operating plan that shows there is sufficient cash coming in to pay all projected cash going out.<sup>46</sup> Cash coming in will include, at a minimum, projected farm operating income and any reliable non-farm income for the household. Cash going out will include, at a minimum, farm operating expenses, taxes, the Microloan payment, other scheduled farm debt payments, family living expenses, and personal debt payments.<sup>47</sup>

Borrowers may request assistance from FSA in developing a farm operating plan.<sup>48</sup> A cash flow analyst from the Extension Service or other organization can also provide helpful assistance if a borrower has questions about repayment ability.

## **B. Security Requirements**

The general security requirement for all direct FSA loans is that the loan be secured by interests in property worth at least the full amount (100 percent) of the loan.<sup>49</sup> For most loan types, if additional property value is available, FSA will require security worth up to 150 percent of the loan amount.<sup>50</sup> This means that, for example, for a loan of \$20,000, FSA will require security worth \$20,000 for the loan to be approved and will take security worth up to \$30,000 if it is available. If there is more security available than is needed (more than 150 percent of the loan amount), FSA will decide which security it considers best.<sup>51</sup>

Security interests and secured credit are explained in more detail in Part One of this guide.

Beyond the general requirements for how much security FSA will take, each loan type has specific requirements for what type of property is preferred or required as security. The specific security requirements for Microloans are somewhat different depending on the intended purpose of the loan. Whatever the intended purpose, property that may be used as security for a Microloan includes crops, livestock, livestock products, farm equipment, and farm real estate (if non-real

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<sup>46</sup> 7 C.F.R. § 761.2(b), “Feasible plan” (2014).

<sup>47</sup> FSA Handbook 1-FLP (Revision 1), “General Program Administration,” Exhibit 15 “Farm Business Plan – FSA User Guide,” Pages 71-76, Paras. G - H-2 (latest amendment November 11, 2012).

<sup>48</sup> 7 C.F.R. § 761.104(b) (2014).

<sup>49</sup> 7 C.F.R. § 764.103(b) (2014). If the farmer does not have security worth the full loan amount, it is possible to satisfy the security requirement with a pledge of security from another person or other interests that can be valued (such as water rights or royalties).

<sup>50</sup> 7 C.F.R. § 764.103(c) (2014).

<sup>51</sup> 7 C.F.R. § 764.103(d) (2014).

estate security is not sufficient).<sup>52</sup> FSA will not take a mortgage on a personal residence as security for a Microloan.<sup>53</sup>

### ***1. Loans for Annual Operating Purposes***

For Microloans made for annual operating purposes—that is, loans to cover the normal ongoing expenses of the farming operation for a single year—FSA will require a minimum security value of at least 100 percent of the loan amount, taking security worth up to 150 percent of the loan amount if available.<sup>54</sup>

### ***2. Loans Not for Annual Operating Purposes***

For Microloans made for purposes other than annual operating purposes—for example, to purchase a piece of farm equipment, refinance prior farm debt, or purchase livestock that will be kept for longer than a year—FSA will only require security worth 100 percent the loan amount; additional security up to 150 percent of the loan amount is not required.<sup>55</sup> However, these Microloans must be secured by a first lien (meaning no other creditor has a higher claim) on all farm property or products purchased with the loan funds.<sup>56</sup> If that security is not worth at least 100 percent of the loan amount, FSA will take additional security owned by the farmer to reach the 100 percent level.

## **C. Other Factors**

In addition to the primary considerations of repayment ability and security, FSA will also consider other, more subjective factors as part of loan approval. These include:

1. Whether the applicant's circumstances will permit continuous operation and management of the farm.<sup>57</sup>

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<sup>52</sup> FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Page 9-16, Para. 205.A (June 5, 2013).

<sup>53</sup> 7 C.F.R. § 764.255(c)(4) (2014).

<sup>54</sup> 7 C.F.R. § 764.255(c)(1) (2014). Unlike standard direct Operating Loans, Microloans made for annual operating purposes are not required to be secured by a first lien on the property or products purchased or produced with loan funds. 7 C.F.R. § 764.255(b)(1) (2014); FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Page 9-16, Para. 205.A (June 5, 2013).

<sup>55</sup> 7 C.F.R. § 764.255(c)(2) (2014).

<sup>56</sup> If the Microloan purpose is refinancing other debt, the loan may be secured by any farm property worth 100 percent of the loan amount. FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Page 9-16, Para. 205.A (June 5, 2013).

<sup>57</sup> 7 C.F.R. § 764.401(b)(6) (2014).

2. Whether the applicant, the farming operation, or other circumstances surrounding the loan present inconsistencies with federal law or federal credit policies.<sup>58</sup>

#### **D. Lack of Funding**

FSA cannot reject a loan application solely because funding for the loan is unavailable when the farmer applies. If funding is not available, FSA should place the application in pending status so that it may be considered when funds become available.<sup>59</sup> Farmers who wish to apply for a Microloan should go ahead and submit an application even if they hear that funds are unavailable, because once funding is available again, completed applications will be considered in the order they were received.<sup>60</sup>

#### **V. Microloan Terms**

FSA regulations set out specific terms for all types of direct FSA loans. “Terms” are the requirements in the loan agreement that spell out, for example, the loan amount, interest rate, amount and schedule of payments, and any actions that the borrower or lender is either required to do or required not to do to uphold the agreement. Most of the terms that apply to all loans made under FSA’s direct Operating Loan program also apply to the Microloan program.

##### **A. Repayment Period**

The maximum repayment period for any FSA direct Operating Loan, including Microloans, is seven years.<sup>61</sup> Within this timeframe, FSA will decide the repayment period for each loan depending on several factors.

If the loan is for annual farm operating and family living expenses, FSA will generally require that it be repaid within 12 to 18 months of the loan closing.<sup>62</sup>

If the loan is for purposes other than family living and farm operating expenses, it will be scheduled over the minimum period FSA considers necessary taking into account the borrower’s ability to pay, the age and type of security for the loan

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<sup>58</sup> 7 C.F.R. § 764.401(b)(7) (2014).

<sup>59</sup> 7 U.S.C. § 1983a(a)(4); 7 C.F.R. § 764.53(e), (f). If more than one application is received on the same day and funds are limited, FSA will give preference to a veteran of any war. If there are no veteran applicants, preference will next be given to: (1) an applicant who has a dependent family; (2) an applicant who is able to make a down payment; or (3) an applicant who owns livestock and/or equipment necessary to farm or ranch successfully. 7 C.F.R. § 764.54 (2014).

<sup>60</sup> 7 C.F.R. § 764.53(a) (2014).

<sup>61</sup> 7 C.F.R. § 764.254(b) (2014).

<sup>62</sup> 7 C.F.R. § 764.253(b)(1) (2014).

(for example, a four-year-old rototiller), and the maximum repayment period of seven years.<sup>63</sup>

## **B. Interest Rate**

The interest rate for a Microloan will either be the FSA Operating Loan rate that is in effect at the time of loan approval or the rate in effect at the time of loan closing—whichever is lower.<sup>64</sup> As of June 1, 2014, the standard interest rate for FSA Operating Loans is 2.250 percent.<sup>65</sup> This interest rate can and often does change from month to month.

Microloan applicants who qualify as beginning farmers or military-veteran farmers will have their choice between this standard Operating Loan rate and the Microloan interest rate of 5 percent.<sup>66</sup> (The requirements to qualify as a beginning or military-veteran farmer are discussed in Part One of this guide.) This 5 percent interest rate is also available to borrowers who are not beginning farmers or military-veteran farmers but are unable to develop a feasible plan using the standard interest rate.<sup>67</sup> Although this alternative rate is not helpful now when the standard Operating Loan interest rate is so low, it will be important to borrowers during times of high standard Operating Loan interest rates.

## **C. Maximum Loan Amounts**

The maximum Microloan amount is \$35,000.<sup>68</sup> If the farmer has previously received an FSA direct Operating Loan—whether a Microloan or a standard Operating Loan—the farmer’s outstanding direct Operating Loan principal balance (not including interest) together with the new Microloan amount must be no more than \$35,000 at loan closing.<sup>69</sup> If a farmer needs to borrow more than \$35,000, or has too much outstanding loan principal to meet the \$35,000 Microloan limit, a standard direct Operating Loan would be more appropriate. These have a limit of \$300,000.<sup>70</sup>

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<sup>63</sup> 7 C.F.R. § 764.253(b)(2) (2014).

<sup>64</sup> 7 U.S.C. § 1927a; 7 C.F.R. § 764.254(a)(3).

<sup>65</sup> FSA Handbook 1-FLP (Revision 1), “General Program Administration,” Exhibit 17 (April 23, 2014).

<sup>66</sup> 2014 Farm Bill § 5106(b)(3) (to be codified at 7 U.S.C. § 1946(a)(2)); FSA Notice FLP-670, “Implementing the Agricultural Act of 2014 (2014 Farm Bill): Microloans to Beginning Farmers and Ranchers,” Page 3, Para. 2-C (March 25, 2014).

<sup>67</sup> 7 C.F.R. §§ 761.2(b), “Limited resource interest rate,” 764.254(a)(2) (2014).

<sup>68</sup> 7 C.F.R. § 764.51(c)(1)(ii) (2014).

<sup>69</sup> 7 C.F.R. § 764.51(c)(1)(ii) (2014).

<sup>70</sup> 7 C.F.R. § 761.8(a)(2)(i) (2014).

In February 2014, Congress authorized USDA to increase the maximum Microloan amount to \$50,000.<sup>71</sup> It is not certain if or when USDA will implement this authority.

## VI. The Microloan Loan Application Process

The standard Microloan application form that applicants must complete is only part of the application package.<sup>72</sup> The application is not complete until the applicant has provided all of the required documents, signatures, and fees. FSA is required to inform an applicant in writing within 10 days of receiving an incomplete application what information is still needed to complete the application.<sup>73</sup> FSA will then provide written confirmation when the application is considered complete.

Once a complete loan application has been received, FSA must process the application and notify the applicant of a decision within **60 calendar days**.<sup>74</sup>

### A. Who Is the Applicant?

FSA loan applications must be submitted in the name of the actual operator of the farm.<sup>75</sup> FSA will consider tax filing status and other business dealings to determine who is the operator of the farm.

When two or more applicants apply jointly (including a married couple), they will be considered an entity applicant.<sup>76</sup> A married couple applying as a joint operation may be required to provide documents to verify loan eligibility and security, such as their marriage license.<sup>77</sup> Current personal financial statements will also be required to show the individual and joint finances of the couple. A married person who wishes to apply for a Microloan as an individual can do so, so long as the applicant is the operator of the farm and the spouse is minimally or not at all involved in the day-to-day management and operations of the farm.<sup>78</sup> Also, if any of the property used as security for the loan belongs to both spouses, the non-farming spouse may be required to sign the security agreement.

If joint applicants are not a married couple—such as two brothers or a mother and son—they will be required to: (1) identify everyone with an interest in the farming operation and the ownership share of each person; (2) provide a current

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<sup>71</sup> 2014 Farm Bill § 5106(a) (to be codified at 7 U.S.C. § 1943(c)(2)).

<sup>72</sup> 7 C.F.R. § 764.51(b)(1) (2014).

<sup>73</sup> 7 C.F.R. § 764.52(a) (2014).

<sup>74</sup> 7 C.F.R. § 764.53(c) (2014).

<sup>75</sup> 7 C.F.R. § 764.51(a) (2014).

<sup>76</sup> 7 C.F.R. § 764.51(a) (2014).

<sup>77</sup> 7 C.F.R. § 764.51(b)(2)(v) (2014).

<sup>78</sup> FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Page 3-2, Para. 41 (September 3, 2010).

personal financial statement for each person; and (3) if the operation is a formal entity, such as a cooperative or limited liability company, provide copies of the entity's financial statements, the entity's organizing documents (such as a charter), and proof of authority to enter into the loan agreement.<sup>79</sup>

## **B. Required Information for Microloan Applications**

The application process for Microloans is simpler than the process for standard FSA direct Operating Loans, reflecting the relatively low dollar amount of the loans. Nonetheless, FSA may still require a Microloan applicant to submit additional information normally required of an Operating Loan applicant if it is needed to make a determination on the loan application.<sup>80</sup>

### **1. *Written Description of Farm Training and Experience***

Individual applicants and each member of an entity applicant who will be involved in managing or operating the farm must provide a written description of his or her farm training and experience.<sup>81</sup> Farm experience from any place and any point in the applicant's lifetime can be included, but as discussed above in the eligibility section, Microloan applicants whose experience occurred more than five years before the application must also show either (1) sufficient on-the-job training or education within the last five years to demonstrate managerial ability, (2) certification of past participation with an agricultural organization providing training and guidance in farming, or (3) a written plan for an apprenticeship with a qualified mentor.<sup>82</sup>

### **2. *Documentation of Inability to Obtain Credit Elsewhere***

The applicant must provide documentation of the inability to obtain sufficient credit on reasonable rates and terms from other lenders.<sup>83</sup> FSA will usually consider this requirement satisfied by the applicant's signing the Microloan

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<sup>79</sup> 7 C.F.R. § 764.51(b)(2) (2014).

<sup>80</sup> 7 C.F.R. § 764.51(c) (2014). This information can include: farm financial and production records from the last three years (unless the applicant has been farming less than three years); verification of all non-farm income; a legal description of any farm property owned (and any leases, contracts, options, or other agreements pertaining to the property); verification of all debts; and any other information FSA deems necessary to effectively evaluate the applicant's eligibility and farm operating plan.

<sup>81</sup> 7 C.F.R. § 764.51(b)(3) (2014).

<sup>82</sup> 7 C.F.R. § 764.101(i)(4) (2014); FSA Handbook 3-FLP (Revision 2), "Direct Loanmaking," Pages 4-13 to 4-14, Para. 69 (January 15, 2013).

<sup>83</sup> 7 C.F.R. § 764.51(b)(6) (2014). This includes loans under FSA's Guaranteed Operating Loan program.

application form, which includes a certification that the applicant cannot get credit elsewhere.<sup>84</sup>

### ***3. Documentation of Compliance with Conservation Regulations***

The applicant must complete Form AD-1026 for all land in the farming operation, certifying that the applicant will comply with certain USDA regulations related to protecting highly erodible lands and wetlands.<sup>85</sup> By signing the form, the applicant also authorizes FSA to inspect the farm to confirm the certification.

### ***4. Current Financial Statement and Farm Operating Plan***

The applicant must provide a current financial statement and farm operating plan. This must include a projected cash flow budget showing expected crop production, income, expenses, and the loan repayment plan.<sup>86</sup>

### ***5. Production and Financial Records from Most Recent Production Cycle***

The applicant must submit financial and production records for the most recent production cycle if such records are available and they would be useful in projecting the cash flow of the production cycle to be funded by the Microloan.<sup>87</sup>

### ***6. Verification of Non-Farm Income Needed for Loan Repayment***

The applicant must provide verification of all non-farm income that will be relied upon for repayment of the loan, if any.<sup>88</sup> If verification is required, a self-employed applicant must provide three years of tax returns; otherwise the applicant must either provide the two most recent earnings statements or complete a form authorizing FSA to contact the applicant's employer.<sup>89</sup>

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<sup>84</sup> FSA Handbook 3-FLP (Revision 2), "Direct Loanmaking," Page 3-7, Para. 42.A (June 5, 2013). However, after reviewing the applicant's financial information, FSA may require the applicant to provide further evidence, such as letters from banks denying the applicant's loan request.

<sup>85</sup> 7 C.F.R. § 764.51(b)(7) (2014); FSA Handbook 3-FLP (Revision 2), "Direct Loanmaking," Page 3-8, Para. 42.A (June 5, 2013).

<sup>86</sup> 7 C.F.R. § 764.51(b)(9) (2014).

<sup>87</sup> 7 C.F.R. § 764.51(c)(2)(ii) (2014).

<sup>88</sup> 7 C.F.R. § 764.51(c)(2)(iv) (2014).

<sup>89</sup> FSA Handbook 3-FLP (Revision 2), "Direct Loanmaking," Page 3-8, Para. 42.A (June 5, 2013).

### C. Credit Report Fee

The applicant must pay a fee to FSA to cover the cost of ordering a credit report on the applicant.<sup>90</sup> The fees are: \$13.50 for an individual applicant, \$20.50 for a joint application, and \$75.00 for an entity applicant.<sup>91</sup> Credit reports are discussed in more detail in Part One of this guide.

## VII. What If a Microloan Application Is Denied or Changed?

If FSA denies a loan application for any reason or approves a loan in a smaller amount or for a different purpose than was requested, the applicant has the **right to seek review** of that decision.<sup>92</sup> Any request for review must be made in writing **within 30 days** after the applicant received the FSA decision.<sup>93</sup> This deadline is strictly enforced.

If a loan application is denied, FSA will send a letter informing the applicant of the decision, how the applicant can ask for review, and the deadline for seeking review.<sup>94</sup>

If the loan application is approved but the terms are different from what the applicant requested, the notice informing the applicant of the approval should give the applicant the opportunity to request a meeting to discuss the changes.<sup>95</sup> If the applicant and FSA cannot reach agreement on the final terms, FSA should tell the applicant that the applicant has 30 days to request a review.

An applicant whose loan application is denied or changed does not need to simply give up—in many cases, problems with an application can be fixed or explained in order to reach an understanding with FSA.

The options available to an applicant whose loan application has been denied or changed include the right to request: (1) reconsideration by the local loan officer, (2) mediation, and (3) appeal to the USDA National Appeals Division.<sup>96</sup>

More detailed information on how to seek review of a loan application denial or change is available from Farmers' Legal Action Group (FLAG) and FSA itself.

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<sup>90</sup> 7 C.F.R. § 764.51(b)(11) (2014).

<sup>91</sup> FSA Handbook 1-FLP (Revision 1), “General Program Administration,” Page 3-26, Para.48-H (March 26, 2013).

<sup>92</sup> 7 C.F.R. Parts 11, 780 (2014).

<sup>93</sup> 7 C.F.R. §§ 11.6(b)(1), 780.15 (2014).

<sup>94</sup> FSA Handbook 3-FLP (Revision 2), “Direct Loanmaking,” Page 15-15, Para. 356 (October 20, 2011).

<sup>95</sup> Form FSA-2313, “Notification of Loan Approval and Borrower Responsibilities” (January 31, 2011).

<sup>96</sup> 7 C.F.R. § 780.6(b) (2014).

## PART THREE:

### Following the Farm Business Plan

As part of any loan agreement with FSA (and most other lenders as well), the borrower must make a plan for how the coming year of the farm operation is expected to go. The plan reflects the cash flow and business activities for that year's operating cycle. On the income side, this includes: which crops and/or livestock will be produced and their expected yields, when they will be sold and the expected prices, and when the farmer expects to be paid. On the expense side, the borrower's plan includes: what types of expenses the farmer will have, when expenses will occur, and the expected amount of the expenses. FSA's form for this plan is called a Farm Business Plan.<sup>97</sup>

It is extremely important for borrowers to understand that FSA's claim on the property given as security for the loan—whether crops, livestock, equipment, land, or anything else—means that the borrower must get FSA's approval before selling, consuming, giving away, or in any way transferring possession of that property.<sup>98</sup> Through the loan-making process, FSA will give general approval for the borrower to sell crops and livestock and use the income from those sales to pay the expenses in a plan agreed to by FSA and the borrower. Small differences from the plan will not be a concern, but the borrower must get approval from FSA for any significant expense that is not on the plan.<sup>99</sup> Getting this approval requires the borrower to visit his or her local FSA office to discuss the possible use of funds before spending them. If FSA approves a revision to the borrower's Farm Business Plan, the revision will be dated and initialed by the borrower and an FSA employee authorized to approve the change.<sup>100</sup>

Borrowers can face default on their loans or potentially even criminal charges in some cases if they dispose of security property or use the income from selling

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<sup>97</sup> See FSA Handbook 1-FLP (Revision 1), "General Program Administration," Part 8, Section 3, "Farm Operating Plan" (latest amendment June 16, 2013).

<sup>98</sup> 7 C.F.R. Part 765, Subparts E-H (2014).

<sup>99</sup> FSA Handbook 1-FLP (Revision 1), "General Program Administration," Page 8-85, Para.241-B (April 13, 2012). Whether a borrower uses FSA's form or something similar, FSA requires all borrowers to sign the following statement:

"I agree to follow this plan and to discuss with the authorized agency official, any important changes that may become necessary. This is a projected plan and does not release the security interest of the Government in any security referred to in this plan. I recognize that making any false statement on this plan or any other loan document may constitute a violation of Federal criminal law."

<sup>100</sup> FSA Handbook 1-FLP (Revision 1), "General Program Administration," Page 8-92, Para. 243 (April 13, 2012).

security property in a way that was not previously agreed upon with FSA.<sup>101</sup> However, if a borrower needs the money from the sale of security property to pay for essential family living or farm operating expenses, FSA may be required by law to release the borrower's security property.<sup>102</sup>

## **I. FSA Required to Release Certain Types of Security**

FSA regulations require the agency to release its security interest in property that is considered “normal income security”<sup>103</sup> to allow the borrower to pay living and operating expenses. Generally, normal income security includes all crops, livestock, poultry, milk, and other products sold to produce the farm's annual operating income.<sup>104</sup> It also includes FSA farm program payments, such as Noninsured Crop Disaster Assistance Program (NAP) and Conservation Reserve Program (CRP) payments.<sup>105</sup>

However, FSA is not permitted to release any property that is “basic” to the ongoing farming operation from year to year and would not normally be sold to earn operating income.<sup>106</sup> This includes equipment, vehicles, foundation and breeding livestock herds and stock, and any real estate given as security for the loan.<sup>107</sup> FSA will not release its interest in these types of property even if needed to pay family living or farm operating expenses.

## **II. Release Only Required for Essential Expenses**

Only certain kinds of expenses will trigger FSA's obligation to release income from the sale of normal income security. The borrower must need the money to pay essential family living and farm operating expenses, which are those that are basic, crucial, or indispensable to the farming operation and the farm family considering the borrower's operation.<sup>108</sup> Examples of many expenses that can be considered crucial are included in the FSA regulations (such as expenses for food, clothing, and medical care, or for seed, fertilizer, or machinery repair).<sup>109</sup>

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<sup>101</sup> 7 C.F.R. § 765.304(b) (2014). See 18 U.S.C. § 658.

<sup>102</sup> 7 U.S.C. § 1985; 7 C.F.R. § 765.303(b) (2014).

<sup>103</sup> 7 C.F.R. § 765.303(b), (c)(1) (2014).

<sup>104</sup> 7 C.F.R. § 761.2(b), “Normal income security” (2014).

<sup>105</sup> 7 C.F.R. § 761.2(b), “Farm Program payments” (2014).

<sup>106</sup> 7 C.F.R. § 765.303(c)(1) (2014). Basic security may be released for the purpose of paying FSA debt or exchanging property. 7 C.F.R. § 765.303(a), (c)(2)-(3) (2014).

<sup>107</sup> 7 C.F.R. § 761.2(b), “Basic security” (2014).

<sup>108</sup> 7 C.F.R. § 765.303(b) (2014); C.F.R. § 761.2(b), “Essential family living and farm operating expenses” (2014).

<sup>109</sup> 7 C.F.R. § 761.2(b), “Essential family living and farm operating expenses” (2014).

### III. How Normal Income Security Release Works

At the same time the borrower is preparing the annual Farm Business Plan, both the borrower and the local FSA representative will also sign a form listing all of the borrower's FSA loans and the security property that will be sold to repay those loans.<sup>110</sup> This form is known as Form 2040, "Agreement for the Use of Proceeds and Security," and it lists the amount of income the borrower expects to receive from the sale of the listed security property and how that money will be used to repay the FSA loans.

Form 2040 serves as FSA's permission to the borrower to sell or transfer the normal income security and use the proceeds to pay essential family living and farm operating expenses and make FSA loan payments, as agreed to in the Farm Business Plan. If the normal income security property is listed on the Form 2040 or is included in the Farm Business Plan, borrowers are not required to obtain additional permission from FSA before selling, exchanging, or disposing of that security property. However, they must use the proceeds from the sale of that property only for the purposes outlined in the Farm Business Plan and the Form 2040.

Borrowers whose actual expenses are higher than expected should not simply go ahead and use proceeds from the sale or transfer of security property to pay for these additional expenses—they must communicate with FSA again to discuss the changed circumstances and get permission by adjusting Form 2040. Similarly, if the proceeds from the sale of the security property listed on Form 2040 are less than expected, so the borrower will not be able to make the FSA payment as scheduled, the borrower must communicate with FSA to obtain approval of necessary changes on the Form 2040. If the changes are needed to allow the borrower to pay essential family living or farm operating expenses, FSA will be required to give its permission. These changes can initially be reported to FSA by telephone, e-mail, letter, or visiting the local FSA office. Depending on how big the changes are, FSA might require the borrower to come in and sign a formal revision of the plan.

The borrower must also identify on Form 2040 potential purchasers who often buy the farmer's crops, livestock, and livestock products and must also describe the method of sale when the buyer is not known in advance, such as sales made at roadside stands or farmers' markets. Any security property sold to a purchaser who is not identified on Form 2040 or by a method not described on Form 2040 must be reported to FSA immediately with a description of what was sold and the name and business address of the purchaser or a description of the new method of sale. All checks must be made jointly to FSA and the borrower unless the farmer has no outstanding FSA loan payments. The borrower must obtain FSA's signature on these checks in order to cash or deposit them in a bank account.

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<sup>110</sup> 7 C.F.R. § 765.302 (2014); Form FSA-2040, "Agreement for Use of Proceeds and Security" (December 16, 2013).

Borrowers must also keep records of all proceeds from the sales of security property whether received by check, cash, or other form of payment and of all expenses paid with those proceeds. This includes maintaining records of all cash received from the sale of livestock and crops, including produce sold at farmers' markets or roadside stands.

#### **IV. What to Do If You Disagree With FSA on Release of Income**

As with other “adverse decisions”—meaning decisions that are not favorable to the borrower—certain actions by FSA related to the release of income process can be appealed. FSA must notify the borrower of the right to an appeal hearing if (1) FSA and the borrower cannot agree on how to complete a Form 2040; (2) FSA denies a written request by the borrower to change the form; or (3) FSA denies a borrower's written request to use the proceeds from the sale of normal income security.<sup>111</sup> FSA must provide the borrower with notice of appeal rights within 10 days after making the adverse decision, but the borrower can appeal as soon as the decision is made. Borrowers who disagree with FSA's decision on a release of income issue should remember that they have the right to appeal.

More detailed information on how to seek review of a release of income decision is available from FLAG and from FSA itself.

#### **V. What Happens If You Violate the Agreement**

A borrower who violates the Form 2040 agreement with FSA by disposing of security property or using the proceeds from the sale of security property in a manner that was not agreed to by FSA will have the opportunity to correct the violation and get FSA approval for the action after it has occurred.<sup>112</sup> However, this post-approval is only available to a borrower one time.

If a borrower is not able to correct the violation within 30 days by paying back the amount received for the security property involved or by providing enough information to allow FSA to approve the sale and use of proceeds—or the borrower commits a second offense—then the borrower will be considered in default on the loan and FSA will be authorized to pursue legal action.<sup>113</sup> FSA can begin procedures to sell a borrower's other security property and may even press criminal charges against the borrower. Therefore, borrowers should be very careful about closely following their Form 2040 agreements and promptly communicating any changed circumstances to FSA.

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<sup>111</sup> 7 C.F.R. Parts 11, 780 (2014); see FSA Handbook 4-FLP, “Regular Direct Loan Servicing,” Para. 163.B, page 7-8 (September 3, 2010).

<sup>112</sup> 7 C.F.R. § 765.304(a) (2014).

<sup>113</sup> 7 C.F.R. § 765.304(b) (2014).

## PART FOUR:

# Trouble Repaying a Microloan

This part of the guide provides a very brief overview of the programs available if a borrower is unable to repay an FSA loan. You can find more detailed information about these programs by contacting FLAG or FSA directly. For borrowers just getting a new loan, the important thing to keep in mind is that there are restructuring and other programs available that can help if weather disasters, disease, low prices, health problems, or any other cause leaves you unable to make your FSA loan payment. However, these programs have deadlines. Don't wait until it is too late.

Borrowers who are unable to pay their loans and are facing default or a delinquency may be able to find relief through FSA's loan servicing programs. In this case, "loan servicing" refers to working with distressed borrowers to find a financial arrangement that is agreeable to both FSA and the borrower.

### I. Restructuring of Distressed Direct FSA Loans – Primary Loan Servicing

"Primary loan servicing" refers to a group of loan restructuring options FSA offers to its direct Farm Loan Program borrowers—including Microloan borrowers—who are unable to make their payments as originally scheduled.<sup>114</sup> Primary loan servicing allows these borrowers to rework their debt obligations, arrange for manageable debt repayment, and continue operating their farms.<sup>115</sup>

#### A. Types of Primary Loan Servicing Available

There are several types of primary loan servicing, with differing levels of benefit to the borrower. The following options are presented in roughly increasing order of power, which is the order that FSA will consider them.

##### 1. Consolidation

Consolidation means combining the principal and interest balance of two or more Operating Loans of the same type.<sup>116</sup>

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<sup>114</sup> "Homestead protection" is also available to help borrowers who own a personal residence subject to an FSA mortgage that is being foreclosed upon. 7 C.F.R. Part 766, Subpart D (2014). However, FSA will not take a mortgage on a personal residence as security for a Microloan. 7 C.F.R. § 764.255(c)(4) (2014).

<sup>115</sup> 7 C.F.R. § 761.2(b), "Primary loan servicing programs" (2014).

<sup>116</sup> 7 C.F.R. § 761.2(b), "Consolidation" (2014).

## 2. *Rescheduling*

Rescheduling means changing the interest rate or repayment period on an Operating Loan and can be used to extend the payment term on a loan.<sup>117</sup> This extension can be helpful for borrowers who are struggling to come up with the full payment amount but would be able to make smaller payments.

## 3. *Deferral*

Deferral means postponing the payment of interest, principal, or both.<sup>118</sup> Borrowers who are approved for deferral can choose to postpone whole payments or make partial payments for up to five years.

## 4. *Interest Rate Reduction*

If interest rates go down after a borrower gets a Microloan, loan servicing can allow the borrower to make payments more manageable by reducing the interest rate on the restructured loan to the new, lower rate.<sup>119</sup>

## 5. *Writedown*

Through a writedown, FSA can reduce the present value of the debt the borrower owes to no less than the net recovery value of the property that is security for the loan. FSA will consider this option in cases where none of the previously mentioned loan servicing programs, either separately or combined, can be used to help the borrower create a feasible plan but the borrower can create a feasible plan with a writedown.<sup>120</sup> The lowest amount to which a debt can be written down is the amount that FSA would receive if it went through collection actions on the loan.

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<sup>117</sup> 7 C.F.R. § 761.2(b), “Reamortization,” “Rescheduling” (2014).

<sup>118</sup> 7 C.F.R. § 761.2(b), “Deferral” (2014).

<sup>119</sup> 7 C.F.R. § 766.107(d) (2014). The new interest rate applied will be the lowest of three possible rates: (1) the interest rate that was in place for Microloans when the borrower applied for servicing; 2) the interest rate that was in place for Microloans on the date of restructuring; or (3) the lowest original interest rate for all of the loans being restructured, if several loans are being restructured together.

<sup>120</sup> 7 C.F.R. § 766.111(b)(1) (2014). When determining how much debt to forgive in a writedown, FSA will generally restructure the loan so that the borrower will be paying the most that he or she can afford, taking into account the value of any assets that are not essential and therefore not exempt from consideration. However, FSA is not authorized to forgive a borrower’s debt beyond the “net recovery value” of the loan security, meaning the amount of money FSA realistically expects could be collected on the debt by liquidating the property. 7 C.F.R. § 766.111(b)(2) (2014). FSA uses a “net recovery value” formula to calculate the amount of money that could realistically be collected on the debt through legal foreclosure and liquidation procedures. 7 C.F.R. § 761.2(b), “Net recovery value of security” (2014).

## 6. *Conservation Contract*

Borrowers with loans secured by land—which will not be the case for most Microloans—may cancel a portion of their debt in exchange for setting aside land for conservation, recreation, or wildlife purposes.<sup>121</sup>

### **B. Notification of Primary Loan Servicing Rights – Borrower in Default Must Respond Within 60 Days**

FSA is required to send out a “Notice of Availability of Loan Servicing Programs” to borrowers who are 90 days past due on scheduled loan payments and in certain other situations.<sup>122</sup> A borrower may also request the notice from FSA.<sup>123</sup> Borrowers who are in default have **60 days to respond** to the notice.<sup>124</sup> If a borrower does not respond to the notice by the deadline, FSA can accelerate the borrower’s loan, making the full balance due immediately, as a first step toward liquidation.<sup>125</sup>

If the borrower submits a complete application for loan servicing by the deadline, FSA cannot proceed with initiating liquidation, requesting a conveyance of security property, accelerating the loan, repossessing property, foreclosing on property, or taking other actions to collect on the loan until after it has considered the borrower’s application, and any subsequent appeals by the borrower of a loan servicing determination have been fully completed.<sup>126</sup>

Once FSA has received a complete application for loan servicing that includes all of the necessary documents, it will have 60 days to consider the application and send a written response to the borrower.<sup>127</sup>

### **C. Eligibility for Primary Loan Servicing**

Generally, borrowers who meet FSA’s specific eligibility criteria for a primary loan servicing option are entitled to receive servicing under that option. Unlike private lenders who are not obligated to help struggling farm borrowers find a solution, FSA is not allowed to deny a borrower’s request for loan servicing if the borrower satisfies all the requirements for eligibility.

That said, the eligibility requirements for loan servicing are significant. Most importantly, the borrower’s application for loan servicing must show that with the

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<sup>121</sup> 7 C.F.R. § 761.2(b), “Conservation Contract” (2014).

<sup>122</sup> 7 C.F.R. § 766.101(a) (2014). The three forms of the notice (less than 90 days past due, 90 days past due, and nonmonetary default) can be found at 7 C.F.R. Part 766, Subpart C, Appendices A-C (2014).

<sup>123</sup> 7 C.F.R. § 766.101(a)(5) (2014).

<sup>124</sup> 7 C.F.R. § 766.101(d) (2014).

<sup>125</sup> 7 C.F.R. § 766.103(b) (2014).

<sup>126</sup> 7 U.S.C. § 2001(g).

<sup>127</sup> 7 C.F.R. § 766.106 (2014).

loan servicing option in place, the borrower will be able to pay for all family living expenses, farm operating expenses, and taxes, as well as being able to service all debts.<sup>128</sup> The full list of loan servicing eligibility requirements is described in detail in other FLAG publications and in FSA program materials.

#### **D. Current Market Value Buyout**

Delinquent borrowers who are not eligible for primary loan servicing will be informed of the right to buy their loan out and terminate their loan obligations to FSA.<sup>129</sup> The price for the buyout will be the current market value of the borrower's security property and all non-essential assets. If the debt owed is less than the current market value of the security, the buyout will be for the amount of the debt.<sup>130</sup>

## **II. Disaster Set-Aside**

If a natural disaster causes a borrower to struggle with making his or her annual payment on an FSA loan, the Disaster Set-Aside program can help by moving the current or next year's payment to the end of the loan term.<sup>131</sup> Most types of FSA farm program loans, including Microloans, are eligible for this set-aside.<sup>132</sup>

Borrowers have eight months from the date the disaster is officially declared to make a written request for a set-aside.<sup>133</sup> Because set-aside is based on the borrower's production, income, and expense records for the year of the disaster,<sup>134</sup> it is extremely important for FSA borrowers to keep detailed and thorough records in each and every production cycle so they can be prepared to prove that they qualify for assistance in the case of a natural disaster.

## **III. Debt Settlement**

FSA's debt settlement programs can be helpful for farmers who are not eligible or have inadequate cash flow for primary loan servicing. Any FSA farm program loan can be debt settled, including Microloans.<sup>135</sup> It is not necessary for a

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<sup>128</sup> 7 C.F.R. §§ 766.105(b), 761.2, "Feasible plan" (2014).

<sup>129</sup> 7 C.F.R. § 761.2(b), "Current market value buyout" (2014).

<sup>130</sup> FSA Handbook 5-FLP, "Direct Loan Servicing – Special and Inventory Property Management," Para. 321.A, page 8-1 (December 31, 2007).

<sup>131</sup> 7 C.F.R. Part 766, Subpart B (2014).

<sup>132</sup> 7 C.F.R. § 766.51(a) (2014).

<sup>133</sup> 7 C.F.R. § 766.54(a)(1) (2014).

<sup>134</sup> 7 C.F.R. § 766.54(b) (2014).

<sup>135</sup> 7 C.F.R. § 1956.51 (2014).

borrower to be delinquent or attempt to get primary loan servicing before applying for debt settlement.<sup>136</sup>

There are several types of debt settlement available for FSA loans. Two types—adjustment and compromise—allow the borrower to keep his or her security property and continue farming after paying an agreed-on amount of money to FSA to “settle” the debt.<sup>137</sup> The borrower must pay FSA at least the market value of any security property that is kept. Another type of debt settlement—cancellation—requires that all of the borrower’s security property be sold.<sup>138</sup>

#### **IV. What If Your Microloan Servicing Request Is Denied or Reduced?**

If FSA denies a request for loan servicing or debt settlement or offers less servicing or settlement than the borrower believes he or she is eligible for, that decision can be appealed.<sup>139</sup> More information on how to seek review of FSA’s decision on a loan servicing or debt settlement application is available from FLAG and FSA itself.

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<sup>136</sup> FSA Handbook 5-FLP, “Direct Loan Servicing – Special and Inventory Property Management,” Page 3-33, Para. 82.A (October 28, 2010).

<sup>137</sup> 7 C.F.R. §§ 1956.54, “Adjustment,” “Compromise,” 1956.66(a)(2) (2014).

<sup>138</sup> 7 C.F.R. § 1956.54, “Cancellation,” “Chargeoff” (2014).

<sup>139</sup> 7 C.F.R. Parts 11, 780 (2014).



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