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An Agricultural Law Research Article

**Financing the Agricultural Operation:
Recent Developments and Current Trends**

by

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FINANCING THE AGRICULTURAL OPERATION: RECENT DEVELOPMENTS AND CURRENT TRENDS

*Susan A. Schneider**

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I. INTRODUCTION

This Article addresses current agricultural finance and credit issues. It is divided into five sections. The first section discusses the increased importance of capital to farming operations.¹ The second section presents an overview of the current farm finance situation.² The third section introduces the traditional sources of agricultural lending and provides an update on legal issues affecting these lenders.³ The fourth section presents information on several increasingly important new sources of agricultural financing,⁴ and the final section offers some concluding thoughts on the future of farm finance.⁵

II. FINANCING THE FARM: THE CAPITALIZATION OF AMERICAN FARMING

As American agriculture has evolved, the need for capital has risen dramatically. Farmers are no longer simple "tillers of the soil," but must seek significant amounts of capital to fund their operations. Agricultural economist Thomas L. Frey and certified commercial lender Robert H. Behrens analyzed the historical transition of agriculture in terms of three revolutions.⁶ Each "revolution" has resulted in an agriculture that was more dependent upon capital resources.

First, there was the mechanical revolution, when the "four-legged, oat-eating sources of power" were replaced by the "four-wheeled gas-and diesel-hogging tractors and self-propelled combines."⁷ Equipment costs increased dramatically, but so did yields.⁸

Next, there was the technological revolution, bringing tremendous yield advancements as a result of new hybrid seed varieties, chemical pest controls, fertilizers, irrigation, and other technological changes.⁹ Whether a farmer successfully coped with this revolution depended upon whether he or she was able to "adopt the proper technologies in the right amounts and at the right time."¹⁰ Again, although production increased, input costs also increased.¹¹

1. See discussion *infra* Part II.

2. See discussion *infra* Part III.

3. See discussion *infra* Part IV.

4. See discussion *infra* Part V.

5. See discussion *infra* Part VI.

6. See THOMAS L. FREY & ROBERT H. BEHRENS, LENDING TO AGRICULTURAL ENTERPRISES 3-4 (1981).

7. *Id.* at 3.

8. See *id.*

9. See *id.*

10. *Id.*

11. See *id.*

According to Frey and Behrens, the third revolution reflects the present time.¹² Under this revolution, financial and business management considerations take center stage in determining the success of the farming operation.¹³ They described this “financial and management era” as one where “[c]ash budgeting, sophisticated accounting systems, regular monitoring of financial performance, much greater use of debt, leasing resources, utilization of sophisticated business organization structures, and [utilizing] never-ending developments in tax law” are essential elements of farm financial success.¹⁴ They noted that agricultural lenders in this era would “face a tremendous challenge in financing an industry that is in transition from just a way of life to a highly capitalized industry of sophisticated businesses.”¹⁵

While Frey and Behrens’ analysis is a useful way to emphasize the importance of business decision-making in agricultural operations, it is even more intriguing when it is noted that this passage was written in 1981—just prior to the beginning of a severe economic crisis in agriculture that resulted in a surge of farm foreclosures and that rocked the agricultural lending community.¹⁶ Many farmers who had sought to embrace the third revolution and incorporated a much greater use of debt in their operations found themselves going out of business.¹⁷

Thus, the analysis raises two important issues. First, it testifies to the significance of astute business and management decision making for success in today’s farm operation. Few people, if any, would argue that wise business decisions are not an essential factor for farm business success in modern agriculture. Second, however, the Frey & Behrens’ analysis also raises the question that it failed to consider in 1981: when is the greater use of farm debt and the greater capitalization of the agricultural operation a sign of looming financial crisis? These two issues form an underlying theme for the more practical consideration of recent changes in farm finance options.

12. *See id.*

13. *See id.* at 4.

14. *Id.* at 3-4.

15. *Id.* at 4. Frey and Behrens appear to view the “way of life” model of farming as inconsistent with the model of a sophisticated business. They state that agriculture is “in transition” from one system to the other. *See id.* Although this raises issues that are beyond the scope of this Article, one can certainly argue that successful business management is not incompatible with the concept of family farming. While farming is indisputably a highly capitalized industry that requires careful management, for many farmers and for the rural communities in which they live, it also remains a way of life.

16. *See id.* at 3-4.

17. *See* Jeffrey R. Kayl, Student Paper, *Farm Credit Amendments Act of 1985: Congressional Intent, FCA Implementation and Courts’ Interpretation and the Effect of Subsequent Legislation on the 1985 Act*, 37 *DRAKE L. REV.* 271, 279-83 (1988).

III. AN OVERVIEW OF THE CURRENT FARM FINANCE SITUATION

According to the Economic Research Service (ERS) of the United States Department of Agriculture (USDA), farm business debt has increased in eight of the last nine years, including each of the last six years.¹⁸ The amount of debt incurred by farmers went up from \$155.5 billion in 1996 to \$165.9 billion in 1997; by the end of 1998, farm business debt is expected to total approximately \$172 billion.¹⁹ Farm borrowers have recently benefited from increased credit availability and relative interest rate stability.²⁰ Competition between lenders for "high-quality" farm loans has increased loan availability and has made for generally favorable terms for these borrowers.²¹

In general, this debt expansion has reflected a renewed confidence in the farm economy on the part of both farm debtors and lenders. When farm business debt increased in 1997, the ERS attributed it to "[c]ontinued economic growth, relatively strong crop field prices and increased farm incomes in 1996."²² Evidencing this positive analysis, "[a]verage net worth of farm businesses increased for the fourth consecutive year in 1997."²³ Further debt expansion in 1998 was attributed to "generally favorable income conditions in the farm sector."²⁴

Unfortunately, "generally favorable income conditions" did not continue in the farm sector in 1998. Disastrous weather conditions and/or crop disease in a number of areas, a sharp decline in commodity prices, and reduced government support have dramatically reduced 1998 farm income.²⁵ ERS projections forecast 1998 net farm income to be \$45.7 billion.²⁶ This amount is \$4.1 billion less than net farm income for 1997 and \$7.6 billion below 1996.²⁷

The impact of this decline in farm income is not yet known. Loan default and related indicators of farm financial distress do not become immediately evident

18. See Jerome Stam & James Ryan, *Farm Credit Use Up for 6th Straight Year*, AGRIC. OUTLOOK, June-July 1998, at 16, 17.

19. See *id.* at 16.

20. See Paul Sundell & Ted Covey, *Stable Interest Rates, Ample Credit in 1998 & 1999*, AGRIC. OUTLOOK, May 1998, at 27, 28.

21. See *id.*

22. Jerome Stam & James Ryan, *Farm Credit Use Up for 5th Straight Year: Market Stronger for Farm Lenders*, AGRIC. OUTLOOK, April 1997, at 27, 27.

23. Mitch Morehart et al., *Record 1997 Net Cash Income Braces Farms for Market Downturn*, AGRIC. OUTLOOK, Sept. 1998, at 2, 4.

24. Stam & Ryan, *supra* note 18, at 16.

25. See *id.* at 19.

26. See Economic Research Service, United States Department of Agriculture, *Agricultural Relief Package Will Bolster 1998 Farm Income* (visited Nov. 26, 1998) <<http://www.econ.ag.gov/Briefing/fbe/fore/ffore.htm>>.

27. See *id.*

and are considered "lagging indicators of financial stress."²⁸ Two concerns are most apparent: whether the decrease in farm income will cause farmers to be unable to service the debt that they have incurred and whether the availability of credit will be adversely affected by lender concerns about the farm economy.

The ERS has made a cautious, but fairly positive projection regarding farmers' debt repayment capability. In July 1998, it reported that "[n]ationwide, farm operators' expanding use of credit is not expected to place excessive demands on their ability to meet their debt obligations."²⁹ In September, when farm income forecasts were lowered, the ERS acknowledged that "[l]ower income in 1998 could weaken the ability of farm businesses to meet debt repayment obligations."³⁰ However, the same publication also emphasized that at least going into 1998, farm businesses were considered to be in a "favorable financial situation" and that overall, farm balance sheets remained strong.³¹

With regard to the continued availability of credit, in September, the ERS made the following guarded assessment:

[F]arm credit availability remained strong in the first half of 1998. Most U.S. farmers continue to enjoy competitive credit markets and lower interest rates. However, if the prices of major commodities remain weak, lenders will be more cautious when lending to farmers in the coming months, particularly in regions most dependent on commodities experiencing lower prices and poor production.³²

With regard to both the overall financial condition of farmers and of farm lenders, however, ERS generally emphasizes that the 1990s have been a good time for agriculture and that profits in previous years should allow most losses in 1998 to be successfully managed.³³ Although acknowledging that farmers have invested heavily in capital assets in recent years and that some will undoubtedly have difficulty servicing this debt, the ERS concludes that "most farmers strong balance sheets will allow them to weather a temporary economic downturn."³⁴ Similarly, because the financial condition of farm lenders is good, having reported strong profits in recent years, "lenders should be able to weather a shortrun deterioration in farm credit quality."³⁵

28. Morehart et al., *supra* note 23, at 5.

29. Stam & Ryan, *supra* note 22, at 16.

30. Morehart et al., *supra* note 23, at 4.

31. *See id.* at 2.

32. *Id.* at 5.

33. *See id.* at 2.

34. *Id.*

35. *Id.*

Other sources have expressed greater concern, particularly with regard to farm debt repayment ability.³⁶ In May, 1998 the *Wall Street Journal* published a front page article on the "stampede" of farmers getting out of farming in the Northern Plains as a result of low prices, wheat scab, and declining government payments.³⁷ The *Wall Street Journal* published another analysis during mid-summer 1998 stating that "[p]roblems are piling up for the U.S. farm economy."³⁸ One Nebraska banker commented that "[t]his could be the worst time around here in ten years."³⁹ In October 1998, noted agricultural law professor Neil D. Hamilton stated that "[f]ew could have predicted the depths of the current financial crisis unfolding in agriculture, or the rapidity with which it has set upon us during the fall of 1998. But as anyone who works in rural America knows, the current farm crisis is real and may be severe."⁴⁰

In response to these concerns, when Congress and President Clinton reached agreement on the omnibus appropriations bill in October 1998, a generous farm relief package was included.⁴¹ This package contained a number of different mechanisms for directing financial assistance to farmers.⁴² An additional \$6 billion was appropriated for disaster and price relief.⁴³ Although a substantial portion of these funds may be available to farmers during 1998, individual farmer's tax considerations, as well as the efficiency of the USDA in distributing payments, will affect what income is received by farmers in 1998. ERS estimates of 1998 farm income of \$45.7 billion assumes that forty percent (\$2.4 billion) of this assistance will be received in 1998.⁴⁴

While this appropriation from Congress was clearly a generous contribution to the agricultural economy, much of the money is directed to crop farmers participating in the "market transition" program. This provides little assistance to livestock farmers who may also be nearing financial ruin. On November 27, 1998, the *Wall Street Journal* reported:

36. See Neil D. Hamilton, *A Changing Agricultural Law for a Changing Agriculture*, 4 DRAKE J. AGRIC. L. 41, 43-47 (1999).

37. Scott Kilman, *Off the Land: On the Northern Plains, Free Market Farming Yields Pain, Upheaval*, WALL ST. J., May 5, 1998, at A1.

38. Scott Kilman, *Farm Economy Enters an Anxious Time: Decline in Exports to Asia and a Drought Worry Farmers and Bankers*, WALL ST. J., July 16, 1998, at A2.

39. *Id.* (quoting Phil Burns, Chief Executive Officer of Farmers & Merchants National Bank in West Point Nebraska).

40. Hamilton, *supra* note 36, at 41, 42.

41. See, e.g., Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, Pub. L. No. 105-277, 1998 U.S.C.A.N. (112 Stat.) 2681.

42. For an excellent discussion of the various farm programs, as well as information on the omnibus appropriations funds devoted thereto, see Christopher R. Kelley, *Federal Farm Program Developments*, 4 DRAKE J. AGRIC. L. 93 (1999).

43. Economic Research Service, *supra* note 26.

44. See *id.*

The hog market has collapsed, delivering another blow to a U.S. farm economy already reeling from low grain prices.

. . . [S]wine prices at the farm are at their lowest level in 27 years.

. . . . Many hog farmers are losing thousands of dollars a week. Some economists are predicting as many as one-fifth of the nation's 122,000 hog farmers will quit the business by next summer.⁴⁵

Problems experienced in the hog industry reflect a central concern regarding the current financial situation in agriculture. Whereas in previous times of financial stress, either crop or livestock production income was affected, recent problems cross into both areas, leaving even diversified operations in distress.

The full effect of the current farm income problems on debt repayment is not immediately evident. The impact of these problems on future farm credit availability will also not be known for some time. Nevertheless, it is apparent that 1998 marks a clear shift away from the positive farm financial scenario that produced the optimistic farm debt expansion of the previous years.

IV. THE TRADITIONAL SOURCES OF CAPITAL FOR FARMING OPERATIONS

For a number of years, four groups of institutional lenders have made up the largest portion of business loans made to agricultural operations. These lender groups are composed of the following: (1) the commercial banks, (2) Farm Credit System lenders, (3) the Farm Service Agency, and (4) insurance companies. In 1997, these lenders held seventy-seven percent of outstanding agricultural loans; the remaining twenty-three percent of loans were primarily from machinery and input suppliers, cooperatives, processors, and individuals.⁴⁶ Table 1 reflects the percentage of farm loans outstanding with each group in 1996 and 1997.

45. Scott Kilman, *Hog Market Collapses on Glut of Animals*, WALL ST. J., Nov. 27, 1998, at A2.

46. See Stam & Ryan, *supra* note 18, at 16.

TABLE 1
 PERCENTAGE OF OUTSTANDING FARM LOANS HELD BY THE FOUR MAIN
 CATEGORIES OF INSTITUTIONAL LENDERS IN 1996-97⁴⁷

| Institutional Lender Category | Farm Loans Outstanding in 1996 | Farm Loans Outstanding in 1997 |
|----------------------------------|-----------------------------------|-----------------------------------|
| Commercial Banks | 39% | 40.5% |
| Farm Credit System (FCS) | 26% | 26% |
| Farm Service Agency (FSA) | 6% | 5% |
| Life Insurance Companies | 6% | 5.5% |

Although there has not been any major shift in the position of these agricultural lenders during the last few years, some significant trends have been apparent. Moreover, with regard to the FSA, there have been some significant legal changes affecting their loan making authorities. These trends and changes are reflected in the following discussion of each major institutional lender.

A. Commercial Lenders

According to a recent ERS report, commercial banks dominate most rural financial markets and are "well positioned to provide financial support to rural sectors of the economy."⁴⁸ Bank profitability has been characterized as "high," and the financial condition of rural banks considered to be "particularly healthy going into 1996."⁴⁹

Looking specifically at loans to agricultural operations, commercial banks provide the largest source of financing.⁵⁰ The total volume of outstanding farm loans by commercial banks reached \$67.2 billion in 1997, up 8.9% from 1996.⁵¹ Surveys of rural banks in the first quarter of 1998 indicate continued efforts by banks to expand farm lending.⁵²

Nevertheless, from the borrower's perspective, the availability of banking alternatives in rural communities remains limited. Although the number of competing banks within rural counties has remained "remarkably stable" over the

47. See Sundell & Covey, *supra* note 20, at 27; Stam & Ryan, *supra* note 18, at 16-17.

48. ECONOMIC RESEARCH SERV., USDA, CREDIT IN RURAL AMERICA 6 (1998). Congress requested a study of the availability of credit in rural areas in the Federal Agriculture Improvement and Reform Act of 1996. See Federal Agriculture Improvement and Reform Act of 1996, Pub. L. No. 104-127, § 650, 110 Stat. 888, 1105. *Credit in Rural America* is the ERS report that was produced as a result of this study.

49. ECONOMIC RESEARCH SERV., *supra* note 48, at 6.

50. See Stam & Ryan, *supra* note 18, at 17.

51. See *id.*

52. See Sundell & Covey, *supra* note 20, at 27.

past fifteen years,⁵³ in 1994, twenty-seven percent of rural counties were served by two or fewer banks.⁵⁴ Forty percent of urban counties were served by ten or more banks.⁵⁵ Therefore, while rural banks may be profitable, this may not translate into available and affordable credit for all rural borrowers. From this perspective, "rural bank performance is often a function of the degree of competition within the local financial markets in which loan decisions are made."⁵⁶ A borrower whose loan is denied at one rural bank may have few other alternative sources of credit.⁵⁷

One potential source of alternative financing is with a Farm Credit System (FCS) lender. Rural banks have generally viewed FCS lenders as their main rival and competitor with regard to agricultural loans. ERS projections indicate that banks will continue to compete aggressively with FCS for high quality farm loans.⁵⁸ Some have recently observed that this competition may have made rural banks more vulnerable to a downturn in the farm economy. The *Wall Street Journal* reported that farm banks had "relatively little liquidity for emergencies because they have been lending much more of their deposits in order to take market share" from FCS.⁵⁹ Rural banks have allowed their average loan-to-deposit ratio to climb to a record seventy percent from fifty-four percent a decade ago.⁶⁰ Because of this competition with regard to both farm and other business loans, bank lending spreads for these high quality loans are expected to remain narrow by industry standards.⁶¹

Nationwide consolidation of the banking industry has dramatically affected the ownership of rural commercial banks. In 1996, only about nine percent of rural counties were served solely by local banking organizations.⁶² Banking

53. See ECONOMIC RESEARCH SERV., *supra* note 48, at 10. Possible reasons for this stability include "potential antitrust enforcement by the Department of Justice and bank regulator concerns over the local impacts of mergers." *Id.*

54. ECONOMIC RESEARCH SERV., *supra* note 48, at 10.

55. *See id.*

56. *Id.*

57. This situation may be particularly problematic in the context of agricultural loans. Uniform Commercial Code provisions protecting the rights of secured creditors are particularly strong with regard to "floating liens" applied to crops. In some instances, it is virtually impossible for a farmer to give the equivalent of a "purchase money security interest" priority to a new lender that has financed the farmer's crop. This difficulty results in the crop lender having a "practical monopoly in the extension of production credit to the farmer." Steve H. Nickles, *Setting Farmers Free: Righting the Unintended Anomaly of UCC Section 9-312(2)*, 71 MINN. L. REV. 1135, 1180-88 (1987).

58. See Sundell & Covey, *supra* note 20, at 28.

59. Kilman, *supra* note 38, at A2.

60. *See id.*

61. See Sundell & Covey, *supra* note 20, at 27.

62. See ECONOMIC RESEARCH SERV., *supra* note 48, at 10. "Local banking organizations" are defined as banks with no offices outside that county. *See id.*

mergers have continued since that time, so it is likely that this percentage is now significantly lower.⁶³ However, according to the ERS, available evidence indicates that the availability of credit does not suffer as a result of this change of ownership, or at least that “negative effects are limited.”⁶⁴ Although this may be true with regard to the availability of credit, it may not be true with regard to the willingness of a lender to restructure or otherwise “work with” a farm borrower experiencing financial distress.

It is difficult at this time to predict the full impact and extent of 1998 farm financial problems. There is, however, much concern being expressed in the commercial banking industry. The Federal Reserve Bank of Minneapolis recently expressed this concern in a summary of the results of a survey of its district banks.⁶⁵ Bankers who responded to the survey “revealed the most pessimistic outlook seen this decade.”⁶⁶ They reported that repayment rates were below normal and that loan renewals and extensions were up as farmers held grain in the hopes of higher future prices.⁶⁷ The estimated proportion of borrowers at their debt limits increased from twenty-seven percent to forty-one percent overall; Montana and North Dakota farmers were in the worst condition with sixty-three and forty-five percent respectively of farmers at their debt limit.⁶⁸ Wisconsin farmers, buoyed by relatively strong milk prices and declining feed costs, were the only state group to show improvement.⁶⁹ In an analysis “echoed by colleagues,” a South Dakota banker reported that “[t]he current pricing and near-term prices for crops and livestock are extremely serious. If our agricultural borrowers are not able to get better prices, they will not be able to survive their debtor make purchases to stimulate the economy.”⁷⁰

63. *See id.* (predicting the percentage has consistently decreased). For example, the recently approved merger of Norwest Bank with Wells Fargo will affect many rural banks in Minnesota and the Dakotas.

64. *Id.*

65. *See* Edward Lotterman, *Low Commodity Prices Taking Toll Across the Ninth District*, FEDGAZETTE, Nov. 1998 <<http://woodrow.mpls.frb.fed.us/pubs/fedgaz/98-10/adfin.html>>. Each quarter the Federal Reserve Bank of Minneapolis surveys agricultural bankers in the Ninth Federal Reserve District (Montana, North & South Dakota, Minnesota, Northwestern Wisconsin, and the Upper Peninsula of Michigan). *See id.* In August 1998, 107 bankers responded to the survey, and their responses reflect conditions experienced during the second quarter of 1998. *See id.* A summary of the responses was published on the Federal Reserve Bank of Minneapolis Internet website. *See id.*

66. *Id.*

67. *See id.*

68. *See id.*

69. *See id.*

70. *Id.*

B. The Farm Credit System

The Farm Credit System (FCS) is a network of federally-chartered, borrower-owned cooperatives that was specifically created to provide a competitive source of agricultural credit.⁷¹ FCS now holds the second largest portfolio of outstanding agricultural loans. At the end of 1997, FCS held \$42.6 billion in farm business loans, up 6.9% from 1996.⁷² FCS farm business debt is forecast to increase about 3.5% in 1998.⁷³

The FCS has effectively rebuilt its farm loan portfolio after the near disastrous results of the farm financial crisis of the 1980s. The FCS farm loan portfolio dropped forty-five percent from a high point in 1982 to its low point in 1993.⁷⁴ In contrast, the FCS has gained loan market share in each of the past three years.⁷⁵ The ERS recently concluded that the FCS was "well positioned to supply farmers' future needs."⁷⁶ Its access to national money markets and the resulting ability to provide credit at competitive rates makes it an attractive alternative to commercial banks. Summarizing its analysis, the ERS concluded that "[t]he system has demonstrated financial strength in recent years while undergoing massive restructuring of its organization and procedures. In an effort to enhance loan quality and expand market share, the FCS is offering farm customers competitive interest rates and credit arrangements."⁷⁷

As with the analysis of commercial banks, however, this positive scenario is directed to the availability of agricultural credit. Two caveats are appropriate. First, projections to date do not reflect concerns with the downturn in the

71. The FCS was created in 1916 to provide agricultural loans "because rural banks were unable or unwilling to risk doing so." See ECONOMIC RESEARCH SERV., *supra* note 48, at 11. The authorizing statute states that it is the "policy of Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, that the farmer-owned cooperative Farm Credit System be designed to accomplish the objective of improving the income . . . by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations." 12 U.S.C. § 2001 (1994). For a discussion of the history and purpose of the FCS, see Christopher R. Kelley & Barbara J. Hoekstra, *A Guide to Borrower Litigation Against the Farm Credit System and the Rights of Farm Credit Borrowers*, 66 N.D. L. REV. 127, 130-49 (1990).

72. See Stam & Ryan, *supra* note 18, at 19.

73. See *id.*

74. See Sundell & Covey, *supra* note 20, at 28.

75. See Stam & Ryan, *supra* note 18, at 19.

76. *Id.*

77. *Id.*

agricultural economy. "Lagging indicators of financial distress" have not yet had an impact on farm credit availability.⁷⁸

Second, credit availability is a different measure of the farm financial situation than is loan servicing availability. While the FCS's access to the secondary loan market has enhanced credit availability and in some cases, loan terms, it has also sacrificed numerous borrower's rights provisions that previously protected borrowers who experienced financial distress. Recent legislation provides that if a loan is designated for the secondary market upon its making, and if it is sold unto that market, the majority of the usual FCS borrower protection provisions do not apply. Protections that are lost include the right to debt restructuring consideration upon default and the right of first refusal to repurchase property lost to foreclosure, as well as certain appeal rights.⁷⁹

The FCS has recently embarked on two simultaneous institutional efforts to solidify its strength as a rural lender. These efforts are first, to expand its clientele, that is, the types of persons and entities that are eligible to be FCS borrowers and second, to expand the types of loans that it offers. Each of these efforts will be discussed in turn.

1. *Expanding FCS Loan Eligibility*

In an effort to compete effectively with commercial banks, the Farm Credit Administration (FCA), the federal agency that oversees the FCS lenders, has sought to expand FCS lending authority.⁸⁰ This effort has been controversial, and it has met with substantial opposition from the rural banking industry.⁸¹

Recent FCA regulatory action exemplifies this effort and the controversy it has generated. In September 1995, the FCA published a proposed rule to amend its regulations governing the eligibility requirements for FCS loans.⁸² This rule proposed a substantial expansion of the loan-making authority of the FCS lenders.⁸³ After the required ninety-day comment period and the receipt of over three hundred comments, the FCA redrafted the proposed rule and republished it.⁸⁴ More than 1500 comments were received.⁸⁵ On January 30, 1997, the final rule was

78. See Morehart et al., *supra* note 23, at 5, and accompanying text. See Stam & Ryan, *supra* note 18, at 19.

79. See Farm Credit System Reform Act of 1996, Pub. L. No. 104-105, § 208, 110 Stat. 162, 173 (to be codified at 12 U.S.C. § 2202a).

80. See, e.g., 60 Fed. Reg. 47,103, 47,103-106 (proposed Sept. 11, 1995).

81. See *id.* at 47,106.

82. See generally *id.*

83. See generally *id.* (amendment to govern eligibility and purposes for financing FCS).

84. See generally 61 Fed. Reg. 42,092 (proposed Aug. 13, 1996) (involving a reproposal that eliminates current eligibility requirements not required by the Act).

85. See *id.*

published, with an effective date of March 11, 1997.⁸⁶ Although modified from the previous proposals, the final rule broadens the qualifications used to determine borrower eligibility for FCS loans, thus expanding FCS loan making authorities.⁸⁷

Soon thereafter, the Independent Bankers Association of America and the American Bankers Association brought suit against the FCA.⁸⁸ In this suit, the bankers argued that the new regulations violated both the plain language and the congressional intent of the statutes creating the FCS and further argued that the "regulations caused competitive injury to their member institutions."⁸⁹ The United States District Court for the District of Columbia dismissed the suit on its merits.⁹⁰

On appeal, the United States Court of Appeals for the District of Columbia affirmed in part and reversed in part the lower court's decision.⁹¹ The appeals court held that most of ways in which the FCA sought to expand the lending authorities of its member institutions were permissible under the Farm Credit Act, and accordingly, these aspects of the regulations were upheld.⁹² The court also held, however, that two proposed areas of expansion were contrary to the language of the Farm Credit Act, and the regulations implementing these areas of expansion were struck down.⁹³ The FCA's expansion of loan making authority to loans for any business activity conducted by a farm-related service business was struck down.⁹⁴ Similarly, the expansion of its authority to offer loans for non-owner occupied housing was rejected.⁹⁵ Thus, although the bankers' challenge was of somewhat limited success, it did confirm that there are specific limitations on the role that Congress envisioned for the FCS. It is likely that competitors of the FCS will continue to monitor their actions closely and challenge any future encroachments into non-farm lending.

2. *Expanding the Types of Loans Offered*

In an effort to compete effectively with lending by "captive supply" companies that are offering loans to farmers through input and equipment dealers,

86. *See id.*

87. *See id.*

88. *See Independent Bankers Ass'n of Am. v. Farm Credit Admin.*, 986 F. Supp. 633, 636 (D.D.C. 1997).

89. *Id.*

90. *See id.* at 644.

91. *See Independent Bankers Ass'n of Am. v. Farm Credit Admin.*, 164 F.3d 661, 671 (D.C. Cir. 1999).

92. *See id.*

93. *See id.*

94. *See id.* at 667.

95. *See id.* at 671.

the FCS has developed a new point of sale financing program called AgSmart.⁹⁶ It provides for indirect farmer financing of farmers who purchase goods at authorized input suppliers and equipment dealers.⁹⁷ It is offered by the FCS through an agreement with the technology services provider, EDS, and American Centurion Bank.⁹⁸

FCS loan officers market participation in the AgSmart program to agricultural input suppliers and equipment dealers.⁹⁹ If the supplier or dealer agrees to participate, it registers with the AgSmart program, and its farmer customers can then apply for AgSmart financing.¹⁰⁰ Seasonal and operating loans, term loans and leases, and a revolving credit card are all available at the point-of-sale or lease.¹⁰¹ The loan is made to the farmer or input customer by FCS indirectly, through the input supplier.¹⁰² The loan obligation flows directly from the farmer-customer to American Centurion Bank, supported by the FCS.¹⁰³ If a leasing option is selected, Farm Credit Leasing Corporation provides the financing.¹⁰⁴

The loan application form is shorter than the usual FCS form, as is the loan approval process. The customer completes a one page loan application that is immediately faxed from the supplier to an EDS processing center.¹⁰⁵ The application is evaluated via a computerized credit scoring system.¹⁰⁶ Approval or denial is often made within ten to fifteen minutes.¹⁰⁷

Operating loans are generally available from \$5000 to \$100,000, although certain areas may be able to process larger loan.¹⁰⁸ Operating loan terms are from three to fifteen months.¹⁰⁹ There is a one hundred dollar fee assessed as of the first draw against the loan—the merchant can choose to sponsor this fee, charge the customer, or to increase the fee and participate, up to five hundred dollars.¹¹⁰ A

96. See National Agribusiness Trade Credit Program Launched Today: AgSmart Offers Quick, Easy and Customized Financing Programs, AgSmart Press Release (Jan. 5, 1998).

97. See EDS to Provide Comprehensive National Point-of-Sale Financing Program for Farmers Through the Farm Credit System, AgSmart News Release (Mar. 13, 1998).

98. See *id.*

99. See *id.*

100. See Telephone Interview with Lisa Vaughan, Processor Services Analyst, AgSmart in Plano, Tex. (Sept. 1, 1998).

101. See EDS to Provide Comprehensive National Point-of-Sale Financing Program for Farmers Through the Farm Credit System, *supra* note 97.

102. See *id.*

103. See *id.*

104. See *id.*

105. See *id.*

106. See *id.*

107. See Telephone Interview with Lisa Vaughn, *supra* note 100. The EDS press release promises approval within 30 minutes. See EDS to Provide Comprehensive National Point-of-Sale Financing Program for Farmers Through the Farm Credit System, *supra* note 97.

108. See AGSMART, OPERATING LOAN (1998) (pamphlet on file with author).

109. See *id.*

110. See *id.*

security interest will be claimed on the growing crop.¹¹¹ The interest rate charged is variable, indexed to the prime rate.¹¹²

Term loans and leases are available for financing new or used machinery, equipment, or fixtures.¹¹³ Loan or lease amounts range from \$5000 to \$100,000, although some areas can process loans up to \$250,000.¹¹⁴ The terms available are one, three, five, or seven years.¹¹⁵ There is a one hundred dollar fee assessed at closing.¹¹⁶ The merchant can choose to sponsor this fee or to charge the customer and increase the fee and participate, up to five hundred dollars.¹¹⁷ A security interest will be claimed on the item purchased.¹¹⁸ Rates are fixed for the term of the loan or lease.¹¹⁹ There may be no-recourse options depending upon the credit risk.¹²⁰

Two types of credit cards are available through AgSmart: "The AgSmart Exclusive Card is designed for exclusive use at one business. The AgSmart QuickStep Card may be used at all approved AgSmart business locations."¹²¹ Credit is available up to \$100,000 depending upon the risk and the customer's need.¹²² Approval is for a three-year term.¹²³ Both farmer and non-farmer customers are eligible.¹²⁴ The minimum monthly payment amount is eight percent of the balance, plus accrued interest.¹²⁵ There are no fees associated with either of the cards.¹²⁶ The interest rate is the prime rate plus eight percent.¹²⁷

In the press release announcing the new AgSmart program, the national director of the program stated that "customer demand for a quicker, more convenient process was the driving force behind the push for indirect financing."¹²⁸

111. *See id.*

112. *See id.*

113. *See* AGSMART, TERM LOAN/LEASE (1998) (pamphlet on file with author).

114. *See id.*

115. *See id.*

116. *See id.*

117. *See id.*

118. *See id.*

119. *See id.*

120. *See id.*

121. AGSMART, REVOLVING CREDIT CARD (1998) (pamphlet on file with author).

122. *See id.*

123. *See id.*

124. *See id.*

125. *See id.*

126. *See id.*

127. *See id.*

128. EDS to Provide Comprehensive National Point-of-Sale Financing Program for Farmers Through the Farm Credit System, *supra* note 97.

He added, however, that "competition among agricultural suppliers and dealers was another catalyst for the change."¹²⁹

C. *The Farm Service Agency*

The FSA (formerly Farmers Home Administration (FmHA)) is an agency within the USDA that was created expressly for the purpose of providing credit to eligible farmers who cannot obtain credit elsewhere.¹³⁰ The farm financial crisis of the 1980s took a major toll on FmHA's loan portfolio. The economic fragility of FSA/FmHA borrowers combined with questionable lending and loan servicing practices led to widespread defaults and enormous losses.¹³¹ Large loan writeoffs and congressionally-limited lending authority has dramatically reduced FSA's current share of farm lending.¹³² Adjusted for inflation, FSA direct lending is the lowest since 1946, when FmHA was created.¹³³

FSA's farm loan portfolio again declined in 1997, when FSA held only five percent of farm business loans.¹³⁴ In 1997, FSA had \$8.3 billion in outstanding farm loans, a 16.3% decline since 1987 and an 8.7% decline from the previous year.¹³⁵ In addition to the debt writeoffs referenced above, much of this decline can be attributed to the agency's move away from direct lending and toward guaranteed lending.¹³⁶ However, there was also a 14.9% decline in the loan guarantees made by FSA in 1997.¹³⁷ Loan guarantees of \$1.57 billion were made in 1997.¹³⁸

FSA loan demand is difficult to predict because of the FSA's special status as a "lender of last resort." Therefore, in good economic times for farmers, and when credit is available from other lenders, presumably, FSA loans applications will be down.¹³⁹ Conversely, in times of farm financial distress, applications for

129. *Id.*

130. *See* 7 U.S.C. § 1922 (1994). For a history of the FSA loan programs and FSA's predecessor agency, Farmers Home Administration, *see* Curry v. Block, 541 F. Supp. 506 (S.D. Ga. 1982).

131. U.S. GEN. ACCOUNTING OFFICE, FARMERS HOME ADMINISTRATION: FARM PROGRAM DEBT, DELINQUENCIES, AND LOAN LOSSES AS OF JUNE 30, 1989, at 1-3 (1990).

132. *See id.* at 2-3.

133. *See* Stam & Ryan, *supra* note 22, at 29.

134. *See* Stam & Ryan, *supra* note 18, at 16.

135. *See id.* at 19.

136. *See id.* *See also* U.S. GEN. ACCOUNTING OFFICE, FARMERS HOME ADMINISTRATION: IMPLICATIONS OF THE SHIFT FROM DIRECT TO GUARANTEED FARM LOANS 2 (1989) (discussing the progress of FmHA in shifting its lending focus from direct to guaranteed lending).

137. *See* Stam & Ryan, *supra* note 18, at 19.

138. *See id.*

139. Even in good financial times, however, certain groups of farmers may have difficulty obtaining a farm loan from one of the other traditional lenders. Marginal operators and beginning farmers frequently lack access to credit, even when the farm economy as a whole is healthy. *See id.*

FSA loans, in particular, emergency loans, will be increased. Anecdotally, an increase in FSA loan applications is taken as a sign of pending financial crisis. Emphasizing the financial stress in the northern plains, the *Wall Street Journal* reported: "In the courthouse basement, the federal Farm Service Agency office is so swamped with requests for emergency loans that a copy-machine room and junk room were cleared out for space to take applications. 'A lot of these farmers were your blue-chippers,' says Kelly Turgeon, county director."¹⁴⁰ FSA loan "demand" has also been affected, however, by statutory changes in loan eligibility requirements. Statutory changes made to the FSA loan programs in recent years have generally placed greater restrictions on the lending authority of the FSA.¹⁴¹ A number of these restrictions were focused on the eligibility criteria for obtaining an FSA loan.

Reversing this trend, Title VIII of the Omnibus Appropriations Bill, entitled *Agricultural Credit*, makes a number of significant amendments to current credit laws applicable to the FSA farm loan programs.¹⁴² Some of these amendments temper the eligibility restrictions and expand certain FSA lending authority. The changes to FSA lending programs in the recent appropriations bill are explained as follows.

1. *Changes to Loan Eligibility Restrictions: 7 U.S.C. § 2008h*

Section 801 of the omnibus bill amends some of the basic loan making restrictions placed on FSA lending.¹⁴³ These restrictions are found in § 2008h of Title 7, and they are divided into three categories of loan eligibility limitations. Under subsection (a), delinquent borrowers are prohibited from obtaining direct operating loans.¹⁴⁴ This restriction is not changed by the new law.¹⁴⁵

Prior to the omnibus bill, subsection (b) of § 2008h provided a general rule that any borrower who received "debt forgiveness" (also referred to as "debt write-down") on a direct or guaranteed USDA loan was ineligible for any type of new direct or guaranteed loan.¹⁴⁶ There was one exception, but it was limited to one category of borrower and one category of loan; it provided that borrowers who

140. Kilman, *supra* note 37, at A1.

141. See Federal Agriculture Improvement and Reform Act of 1996, Pub. L. No. 104-127, 110 Stat. 888, 1084-1108.

142. See Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, Pub. L. No. 105-277, §§ 801-808, 1998 U.S.C.C.A.N. (112 Stat.) 2681, ____.

143. See *id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

144. See 7 U.S.C. § 2008(h) (Supp. III 1997).

145. See *id.* § 2008h(a).

146. See *id.* § 2008h(b).

received their debt forgiveness as a result of the administrative debt restructuring process could still be considered for direct or guaranteed *operating* loans for the purpose of paying their annual expenses.¹⁴⁷ All other situations fell under the general rule and loan making was prohibited. The result was particularly harsh when applied to the FSA emergency loan program.¹⁴⁸

Under the new law, there is a different general rule for direct and guaranteed loans; the general rule for guaranteed loans is much less restrictive. There is also a significant expansion to the exception provision.¹⁴⁹

Under the general rule, a direct loan cannot be made to a farmer that has received debt forgiveness in the past unless the farmer falls within one of the exceptions.¹⁵⁰ A guaranteed loan cannot be made to a farmer if he or she received debt forgiveness *after* April 4, 1996.¹⁵¹ A guaranteed loan also cannot be made to a farmer that received debt forgiveness on *more than three occasions on or before* April 4, 1996 unless the farmer falls within one of the exceptions.¹⁵² Thus, a farmer that received debt forgiveness on as many as three occasions before April 4, 1996 can still be considered for a loan guaranteed by the FSA.¹⁵³

The exception to the general rule is also expanded. There are now two exceptions. With regard to direct and guaranteed operating loans, where previously, the exception only applied to borrowers who received their debt forgiveness as a result of the administrative debt restructuring process, the exception now also applies to borrowers who are current on payments under a confirmed bankruptcy reorganization plan under Chapters 11, 12, or 13 of Title 11 (the Bankruptcy Code). Thus, farmers who have received debt forgiveness as a result of the administrative debt restructuring process or who are current on payments under a confirmed bankruptcy reorganization plan can be considered for either a direct or guaranteed operating loan for payment of their annual expenses.¹⁵⁴

The new law establishes a new second exception to the loan-making restriction that applies specifically to the emergency loan program. The new law provides that an emergency loan can be granted to a borrower who has received "not more than one debt forgiveness" on or before April 4, 1996 and who has not received debt forgiveness after April 4, 1996.¹⁵⁵ Thus, emergency loans still cannot be made to borrowers who received more than one debt forgiveness prior to or on April 4, 1996, and emergency loans still can not be made to borrowers who

147. *See id.*

148. *See id.*

149. *See* Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, Pub. L. No. 105-277, § 801, 1998 U.S.C.C.A.N. (112 Stat.) 2681, ____.

150. *See id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

151. *See id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

152. *See id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

153. *See id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

154. *See id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

155. *Id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

received debt forgiveness at any time after April 4, 1998.¹⁵⁶ However, borrowers who received one occasion of debt forgiveness granted prior to or on April 4, 1996 should still be considered for emergency loans.¹⁵⁷

Subsection (c) of § 2008h limits farm borrowers to one administrative "debt forgiveness . . . on a direct loan."¹⁵⁸ The new law does not change this limitation on the availability of debt forgiveness.¹⁵⁹

2. *Changes to Loan Term Provisions: 7 U.S.C. § 1964*

Section 802 of the new law amends 7 U.S.C. § 1964.¹⁶⁰ Section 1964 provides some of the basic rules for emergency loan eligibility.¹⁶¹ The new law amends the security rules for emergency loans contained in subsection (d) of § 1964.¹⁶² The new law allows the Secretary of Agriculture some flexibility in evaluating the collateral necessary to support the loan.¹⁶³ Although the general rule that there must be adequate security for the loan remains the same, the new law adds the following new language to subsection(d) as a new subsection(d)(2):

NO BASIS FOR DENIAL OF LOAN.—

(A) IN GENERAL.—Subject to subparagraph (B), the Secretary shall not deny a loan under this subtitle to a borrower by reason of the fact that the borrower lacks a particular amount of collateral for the loan if the Secretary is reasonably certain that the borrower will be able to repay the loan.¹⁶⁴

However, the new law also provides a restriction that allows the Secretary to refuse to grant the loan if the borrower refuses to pledge requested collateral. This provision is subparagraph (B) as referenced above. It provides that the Secretary "may deny or cancel a loan under this subtitle if a borrower refuses to pledge available collateral on request by the Secretary."¹⁶⁵

156. *See id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

157. *See id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

158. 7 U.S.C. § 2008h(c) (Supp. III 1997).

159. *See id.* § 2008h(c); Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 § 801, 1998 U.S.C.C.A.N. (112 Stat.).

160. *See id.* § 802, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

161. *See* 7 U.S.C. § 1964 (1994 & Supp. III 1997).

162. *See* Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 § 802, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

163. *See id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

164. *Id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

165. *Id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

3. *Changes to Crop Insurance/Disaster Program Multiple Benefits Rule: 7 U.S.C. § 1508(n), 7 U.S.C. § 7333(i)(3)*

Section 803 of the new law amends 7 U.S.C. §§ 1508(n) and 7333(i)(3). Section 1508 is part of the law governing crop insurance; subsection(n) limits the receipt of multiple benefits from crop insurance and other USDA loss assistance on the same crop loss.¹⁶⁶ Section 7333 is part of the law governing the Non-Insured Disaster Assistance Program (NAP), the hybrid insurance/disaster program for crops for which insurance is not available.¹⁶⁷ Subsection (i)(3) limits the receipt of NAP benefits in combination with other disaster-related benefits.¹⁶⁸

Prior to the new law, farmers entitled to receive crop insurance benefits under "catastrophic risk protection" (CAT) coverage (the lowest level of coverage available to satisfy the crop insurance requirements) who were also eligible for other USDA assistance related to the loss had to elect which benefit to receive.¹⁶⁹ Similarly, under NAP, farmers who were eligible for NAP benefits as well as other USDA assistance related to the loss also had to elect which benefit to receive.¹⁷⁰ Emergency loans were interpreted to be loss benefits, so in either case, the farmer had to choose between the CAT or NAP benefits and obtaining the loan.¹⁷¹

Under the new law, an exception is added to both §§ 1508(n) and 7333(i)(3). Emergency loans are exempted;¹⁷² thus, the multiple benefits provision no longer applies to emergency loans. Farmers who suffer losses covered by their federal crop insurance policies, even if they are only in the CAT program, and farmers who are eligible for NAP benefits are still eligible for emergency loans.¹⁷³

4. *New Notice Requirement: Loan Eligibility: 7 U.S.C. § 1922*

Section 804 of the new law adds a new notice requirement to the loan eligibility restrictions contained in 7 U.S.C. § 1922.¹⁷⁴ Section 1922(b) attempts to put time limits on obtaining a direct farm ownership loan, thereby requiring farmers to graduate from the subsidized federal loan program to either conventional or guaranteed farm financing arrangements.¹⁷⁵ It provides that direct farm ownership loans can only be made to borrowers who are either "qualified

166. See 7 U.S.C. § 1508(n) (Supp. III 1997).

167. See *id.* § 7333.

168. See *id.* § 7333(i)(3).

169. See *id.* §§ 1508(n), 7333(i)(3).

170. See *id.*

171. See *id.*

172. See Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999, Pub. L. No. 105-277, § 803, 1998 U.S.C.C.A.N. (112 Stat.) 2681, ____.

173. See *id.* § 803, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

174. See *id.* § 803, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

175. See 7 U.S.C. § 1922(b).

beginning farmers or ranchers," new borrowers (those who have not received a previous direct farm ownership loan), or borrowers who have "not received a direct farm ownership loan . . . more than 10 years before the date the new loan would be made."¹⁷⁶

The new law does not amend this restriction, but it requires the Secretary of Agriculture to provide borrowers with notice that they will become ineligible for additional loans within twelve months before they become ineligible.¹⁷⁷ This notice requirement does not begin, however, until fiscal year 2000.¹⁷⁸

5. *Changes in Guaranteed Loan Eligibility Requirements Regarding Training or Experience: 7 U.S.C. § 1922(a)(2); 7 U.S.C. § 1941(a)(2); 7 U.S.C. § 2006a*

Prior to the new law, general eligibility requirements for either direct or guaranteed farm program loans included a requirement that the borrower have either "training or farming experience that the Secretary determines is sufficient to assure reasonable prospects of success in the proposed farming operation."¹⁷⁹ Essentially the same requirement was provided with regard to farm ownership loans.¹⁸⁰ The Secretary of Agriculture was authorized to provide training programs for borrowers, both directly and by contracting with others.¹⁸¹

Section 805 of the new law exempts both farm ownership and operating guaranteed loans from the training or experience requirement.¹⁸² This requirement now applies only to the direct loan programs.¹⁸³ The new law also eliminates the specific statutory authority for conducting and contracting for borrower training programs for guaranteed loan borrowers.¹⁸⁴

6. *Changes in Guaranteed Loan Limits: 7 U.S.C. §§ 1925 and 1943*

Sections 1925 and 1943 set the maximum loan amounts for certain farm program loans, including guaranteed operating and guaranteed farm ownership

176. *Id.* § 1922(b)(1).

177. *See* Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 § 804, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

178. *Id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

179. 7 U.S.C. § 1922(a)(2) (1994) (applying to direct and guaranteed operating loans).

180. *See id.* § 1941(a)(2).

181. *See id.* § 2006a.

182. *See* Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 § 805, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

183. *See id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

184. *See id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

loans.¹⁸⁵ Prior to the new law, § 1925 provided that no farm ownership loan could be made that would cause the unpaid balance of the borrower's debt to exceed \$300,000.¹⁸⁶ Section 1943 provided that no guaranteed operating loan could be made that would cause the unpaid balance of the borrower's debt to exceed \$400,000.¹⁸⁷

Section 806 of the new law combines these amounts for purposes of the loan limitation, replacing the total unpaid indebtedness to \$700,000 in guaranteed loan obligations for both programs.¹⁸⁸ This new limit also takes into consideration direct loans that are of the same type.¹⁸⁹ Thus, a borrower is limited to \$700,000 in outstanding guaranteed and direct operating loans, and to \$700,000 in guaranteed and direct farm ownership loans.¹⁹⁰ It also provides for an indexing of this maximum amount, allowing it to increase according to the Prices Paid by Farmers Index compiled by the National Agricultural Statistics Service of the USDA.¹⁹¹

7. *New Notice Requirement: Shared Appreciation Mortgages: 7 U.S.C. § 2001(e)*

Section 807 of the new law adds a new notice requirement to the debt restructuring and loan servicing requirements.¹⁹² Under this amendment, the Secretary will be required to notify borrowers at least one year prior to the end of the term of the shared appreciation agreement associated with their mortgage.¹⁹³ As with the loan eligibility notice provision contained in the law, this notice requirement does not take effect until fiscal year 2000.¹⁹⁴

8. *Revised Percentage to Be Used in Restructuring Computations: 7 U.S.C. § 2001(c)(3)(C)*

The loan servicing and debt restructuring process for farm program loans is set forth in 7 U.S.C. § 2001. One of the computations made as part of the debt restructuring analysis is the value of the borrower's restructured loan.¹⁹⁵ Prior to the new law, § 2001(c)(3)(C) allowed the Secretary to assume that the borrower

185. See 7 U.S.C. §§ 1925, 1943.

186. See *id.* § 1925.

187. See *id.* § 1943.

188. See Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 § 806, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

189. See *id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

190. See *id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

191. See *id.* § 806, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

192. See *id.* § 907, 1998 U.S.C.A.A.N. (112 Stat.) at ____ (amending 7 U.S.C. § 2001).

193. See *id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

194. See *id.*, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

195. See 7 U.S.C. § 2001(c) (1994).

would need up to 110% of the amount estimated for payment of farm operating expenses, debt service obligations, and family living expenses.¹⁹⁶ This provided a ten percent cushion for unanticipated or larger than expected expenses.¹⁹⁷ Section 808 of the new law amends § 2001(c)(3)(C) to replace the 110% value with 100%.¹⁹⁸

D. *The Life Insurance Industry*

Historically, life insurance companies have been major investors in real estate financing. The long-term nature of real estate mortgages has been seen to match well with the long-term nature of life insurance liabilities. However, the significance of insurance company lending to the agricultural sector has greatly decreased.¹⁹⁹

At one time, life insurance companies exceeded commercial banks in the amount of outstanding farm loans.²⁰⁰ They maintained this dominance until 1986, when banks took the market share lead.²⁰¹ Over recent years, their loan share has diminished, and in 1996-97, life insurance companies only held between five and six percent of outstanding agricultural loans.²⁰²

In addition to the overall decline in the percentage of agricultural lending done by life insurance companies, a recent ERS analysis revealed significant trends concerning the agricultural loans that insurance companies do continue to make.²⁰³ First, there has been a geographic concentration that has become apparent. This has produced a shift away from lending to farmers in the Corn Belt states to lending instead to farmers in the Southeast and the Pacific Coast.²⁰⁴

Second, in a related shift, insurance companies have tended to prefer to make loans to larger commercial farms.²⁰⁵ Preference is also given to enterprises with

196. See 7 U.S.C.A. § 2001(c)(3)(C) (West Supp. 1998).

197. See *id.*

198. See Omnibus Consolidated and Emergency Supplemental Appropriations Act of 1999 § 808, 1998 U.S.C.C.A.N. (112 Stat.) at ____.

199. See generally JEROME M. STAM ET AL., LIFE INSURANCE COMPANY MORTGAGE LENDING TO U.S. AGRICULTURE, ECONOMIC RESEARCH SERV., USDA, AGRIC. ECON. REP. NO. 725 (Dec. 1995). This report provides an excellent analysis of the history of insurance company lending to the agricultural sector and discusses the reasons why this lending has declined. See generally *id.*

200. See *id.* at 11.

201. See *id.* at 11. In 1986, commercial banks held 13.3% of outstanding agricultural loans while insurance companies held 11.4%. See *id.*

202. See Stam & Ryan, *supra* note 22, at 27. See also Stam & Ryan, *supra* note 18, at 16-17.

203. See generally STAM ET AL., *supra* note 199.

204. See *id.* at 13-15.

205. See *id.* at 13.

primarily real estate assets as opposed to depreciable buildings, and with soil and water conditions that minimize farming risks.²⁰⁶

Third, the average loan amount has increased dramatically.²⁰⁷ The average outstanding loan size for an agricultural loan increased 298.2% during 1980-94.²⁰⁸ The ERS analysis concludes that “[l]ife insurance companies are insignificant players in the market for farm mortgages under \$150,000 and are relatively minor players for mortgages under \$500,000.”²⁰⁹ At least two insurance companies restrict new farm loans to those over \$500,000; one company requires a minimum of \$1,000,000.²¹⁰

Thus, while insurance companies continue to play a role as one of the four major institutional lenders, this role has decreased, and, although there are exceptions, this role has only been significant with regard to large farming operations.

V. NEW ISSUES: THE CHANGING LANDSCAPE OF AGRICULTURAL LENDING

Over the few years, there has been a quiet revolution in farm finance as important and powerful new players have strengthened their position as competitive agricultural lenders. “Captive finance companies” now provide a substantial amount of loans to farmers.²¹¹ A captive finance company is best defined as a non-bank lender that is tied to a company that seeks to use agricultural financing as a tool to market its products or services.²¹²

The combination of product-seller and lender present several distinct advantages. First, because the lender’s profit is not determined solely on the basis of the loan, but on the purchase of the underlying product, loans can be made at a rate that may well be lower than either a bank or FCS.²¹³

206. *See id.* These trends all indicate a concern for risk avoidance on the part of the insurance companies. Apparently, it is assumed that the large volume agribusiness operations present less risk. However, by so limiting their agricultural portfolio, both by size and by region, the industry may be concentrating its interests in a way that would be vulnerable to a shift in profitability or to weather-related losses in a particular area.

207. *See id.* at 17.

208. *See id.*

209. *Id.*

210. *See id.* at 18. The analysis states that most insurance companies would like more farm business, but have difficulty finding borrowers that meet their lending requirements. Again, it appears that insurance companies view these larger loans as a less risky investment than the diversified, smaller loans characteristic of their portfolios in the past. Time will tell whether this, in fact, will be the case.

211. *See Dan Looker, Captive Finance Companies, SUCCESSFUL FARMING, Feb. 1998, at 18, 18.*

212. *See id.*

213. *See id.* at 18-19.

Second, because the product-seller has an independent relationship with the farmer, e.g., through the sale of agricultural inputs or farm machinery, the seller may use this relationship to encourage lending.

Third, captive finance companies are not regulated as banks,²¹⁴ nor are they regulated as government instrumentalities (as is FCS), or as a government agency (as is FSA).²¹⁵ Thus, their lending has all of the efficacy (and all of the potential dangers) of an unregulated industry. They are able to move fast, change lending practices frequently, and are able to react quickly to changes in the market, and to changes in the customer's demands.

Initially, captive finance lending was limited to the products sold by the lender. For example, Case Credit Corporation would finance the purchase or lease of equipment manufactured by Case Corporation. A number of captive finance lenders have expanded, however, into other areas of agricultural financing, making loans to pay for services, purchases, and even cash farmland rent that is not related to the captive finance product.

Examples of the captive finance companies that are currently active in the agricultural lending include:

Agricredit Corporation (fifty-one percent owned by Rabobank Nederland): reported to have approximately \$1.2 billion in outstanding loans, offers machinery and operating loans as well as a farm credit card program;²¹⁶

Ag Services of America, Inc.: based in Cedar Falls, Iowa, with links to DeKalb Seed and Novartis, offers flexible operating credit while also serving as an outlet for all crop input supplies through its *AgriFlex* program.²¹⁷

Cooperative Farm Finance Association, Inc. (CFA): a member-owned cooperative finance association based in Kansas, Missouri, owned in large part by Farmland Industries, offers to finance all types of farm inputs sold by its member cooperatives as well as a credit card with a sliding interest rate depending upon an assessment of the borrower's risk level.²¹⁸

214. *See id.*

215. *See id.*

216. *See id.* at 18.

217. *See Ag Services of America, Inc.* (last modified Feb. 20, 1999) <<http://www.agservice.com>>.

218. *See* Letter and Informational Material from Theresa M. Wren, Input Finance Loan Officer, The Cooperative Finance Association, Inc., to Susan A. Schneider (Sept. 3, 1998) (on file with the *Drake Journal of Agricultural Law*). Other financial services advertised by CFA include: commercial lending for seasonal and term financing for agri-business operations; production agriculture lending for producers; equipment leasing; and a full service collection agency and credit management service. *See id.* In addition, there is a Specialty Lending Program that offers "single

Case Credit: a financial services subsidiary of Case Corporation, is reported to have a credit portfolio of \$5.3 billion in equipment financing. It also offers a credit card program in conjunction with Nations Bank.²¹⁹

John Deere Credit: the largest of the captive finance lenders and a subsidiary of the equipment giant, Deere & Company, reports approximately \$8.4 billion in net receivables and leases.²²⁰ It offers financing and leasing options for farm equipment, operating loans for agricultural inputs and a farm business credit card, Farm Plan.²²¹ Farm Plan accounts are now available in all fifty states. Its sister program, AgLine, is available in Canada.²²² Charge volumes for 1996 are estimated at \$1 billion.²²³ John Deere Credit has alliances with numerous cooperatives, including Growmark and Countrymark, as well as Pioneer Hi-Bred International.²²⁴

New Holland Credit Co., a subsidiary of Ford Motor Co., presently offers an operating line of credit program and a credit card.²²⁵

VI. CONCLUSION: THOUGHTS ON AGRICULTURAL FINANCE

After surveying the farm financial picture as the end of 1998 nears, two observations are appropriate. The first concerns the potential changes in farm lending caused by financial stress in 1998. The second concerns a trend in loan availability that may well transcend this year's financial problems.

After several years of general farm financial stability and profitability, most borrowers and lenders entered 1998 with a sense of optimism. In mid-1998, however, that optimism crashed head on with the reality of the income volatility of an unregulated agriculture. Low farm prices reduced anticipated farm income dramatically and concern mounted. Low farm incomes will no doubt cause many farmers to default on their loan obligations; the unanswered question is how

purpose loans to retail agribusiness that have a borrowing relationship with another lender." *Id.* CFA also offers wire transfer services, commercial paper investment options and letter of credit services. *See id.*

219. *See Case Corporation* (visited Feb. 20, 1999) <<http://www.casecredit.com>>; *Case Credit Mission Statement* (visited Jan. 29, 1999) <http://www.casecorp.com/credit/who_we_are/page1.html>; *Case Credit Private Label Credit Card* (visited Feb. 20, 1999) <<http://www.casecorp.com/credit/financial/insurance/page12.html>>.

220. *See DEERE & CO., 1997 ANNUAL FINANCIAL REPORT 22* (1998).

221. *See John Deere Credit* (last modified Jan. 30, 1999) <<http://www.deere.com/jdcredit>>; DEERE & CO., *supra* note 220, at 22.

222. *See John Deere Credit, supra* note 221; DEERE & CO., *supra* note 220, at 22.

223. *See John Deere Credit, supra* note 221; DEERE & CO., *supra* note 220, at 22.

224. *See John Deere Credit, supra* note 221; DEERE & CO., *supra* note 220, at 22.

225. *See NEW HOLLAND CREDIT CO., CREDIT APPLICATION* (1996) (pamphlet on file with author).

widespread this default will be. Another unknown is how this will affect lenders' interest in and commitment to agricultural lending.

The second observation raises a concern about an overall trend in farm lending. There are numerous lenders that are anxious to expand their farm loan portfolios. Commercial banks compete with FCS, and both compete with the new captive finance companies. On the surface it appears that farm loans are readily available at favorable terms for all farm borrowers. In fact, however, lenders are really only competing for the "high quality" farm loans. Farm operators that are considered to be "marginal" are likely to lack credit access.²²⁶ Beginning farmers, without the track record necessary to prove their credit worthiness are also likely to be denied loans.²²⁷ Rural development officials surveyed by the General Accounting Office confirm this split in access to credit and define the types of borrowers that have difficulty as "start-up, expanding, and minority businesses."²²⁸ Captive finance companies further encourage the division by utilizing credit scoring systems that approve or deny credit on the basis of objective criteria and credit history. There is little opportunity in such a system for explanations and subjective persuasion.

In a dual borrower system, "high quality" borrowers get loans, and they get them with promptness, and on terms that are favorable. Other borrowers have to search for credit, perhaps obtaining loans later in the crop cycle than is desirable and/or for less amount than that which would be preferred to maximize profits. If credit is obtained, the loan terms may not be as favorable. Interest rates may be higher and repayment term shorter. These factors combine to make the "less than high quality" borrower at a continual competitive disadvantage. His or her profitability is jeopardized, and the chance to move into that "high quality" realm is lost. In effect, a kind of agricultural credit underclass is formed.

The analysis of these two observations about farm finance will have to be continued at some point in the future. Both are developing issues, and because of the dependence of agriculture upon borrowed capital, both raise serious public policy concerns about the future of American agriculture. Hopefully, these topics will be considered in a future article.

226. See Stam & Ryan, *supra* note 18, at 19.

227. See *id.*

228. U.S. GEN. ACCOUNTING OFFICE, RURAL DEVELOPMENT: AVAILABILITY OF CAPITAL FOR AGRICULTURE, BUSINESS, AND INFRASTRUCTURE 2 (1997).