Programmatic Environmental Assessment

United States Department of Agriculture

Farm Service Agency

February 2003

Regulatory Streamlining of the Farm Service Agency's Direct Farm Loan Programs

If you wish to comment on the environmental assessment, you may submit comments by regular mail or email to the name and address below. Our practice is to make comments, including names and home addresses of respondents, available for public review during regular business hours. Individual respondents may request that we withhold their home address from the record, which we will honor to the extent allowable by law. There also may be circumstances in which we would withhold from the record a respondent's identity, as allowable by law. If you wish us to withhold your name and/or address, you must state this prominently at the beginning of your comment. We will make all submissions from organizations or businesses, and from individuals identifying themselves as representatives or officials of organizations or businesses, available for public inspection in their entirety.

Please Address Comments to:

William D. Cobb
USDA/FSA/DAFLP/STOP 0520
1400 Independence Avenue, S.W.
Washington, D.C., 20250-0520
Tel: (202) 720-1059
bill_cobb@wdc.fsa.usda.gov

Table of Contents

Summary ..... **i**

Chapter 1: Purpose and Need **1**
Document Structure 1
Background 1
Purpose and Need for Action 2
Proposed Action 2
Decision Framework 2
Public Involvement 2
Issues 3
Significant Issues 3
Non-significant Issues 4

Chapter 2: Alternatives, Including the Proposed Action **7**
Alternatives 7
Alternative 1: No Action 7
Alternative 2: Proposed Action 7
Mitigation Common to All Alternatives 9
Comparison of Alternatives 9

Chapter 3: Affected Environment and Environmental Consequences **11**
Land Use 12
Affected Environment 12
Environmental Consequences 17
Socioeconomic Conditions 20
Affected Environment- Loan Users 20
Affected Environment- Agency Operations 23
Environmental Consequences 24

Chapter 4: Consultation and Coordination **30**

Appendix A – Comments (FSA Staff) **32**

Appendix B – Glossary/Acronyms **33**

Appendix C – Reference **36**

Appendix D – Cost-Benefit Assessment **37**

SUMMARY

The Farm Service Agency FSA proposes to streamline regulations governing the direct Farm Loan Programs. FSA's regulations are found in Title 7 of the Code of Federal Regulations (CFR). Streamlining of the regulations would be accomplished by moving the majority of the FSA's direct loan making and loan servicing rules for Farm Loan Programs from 7 CFR Chapter XVIII to Chapter VII. Concurrently, FSA proposes to remove internal procedures, administrative procedures, and obsolete parts from the CFR text, and to streamline certain program requirements.

FSA has completed an evaluation in accordance with Subpart G of 7 CFR part 1940 and determined that a Programmatic Environmental Assessment (PEA) should be prepared to analyze the potential impacts of this program on the human environment in accordance with the National Environmental Policy Act (NEPA).

The proposed regulatory action is needed to enable FSA to simplify and clarify direct loan regulations, implement the recommendations of the United States Department of Agriculture (USDA) Civil Rights Action Team, meet the objectives of the Paperwork Reduction Act of 1995, meet the goals and objectives of the National Performance Review, and separate the Agency's direct Farm Loan Program regulations from Rural Development mission area loan program regulations.

The proposed action may have impacts on land use, socioeconomic conditions, and agency operations.

FSA is evaluating two alternatives, including the proposed action and the No Action alternative. These alternatives are described briefly below:

- Alternative A: No Action. No streamlining effort will be undertaken. The regulations will remain in separate chapters, keeping all parts, including applicable and obsolete parts.
- Alternative B: Proposed Action. The proposed rule will be implemented; existing regulations will be consolidated to Chapter VII, and the body of regulations governing direct loan programs will be streamlined to remove administrative/internal procedures and obsolete parts, and to simplify program requirements.

After considering the effects of the alternatives, the responsible official will decide whether or not to implement the actions contemplated under Alternative B. If implemented, the responsible official will also decide what specific mitigation measures to employ.

CHAPTER 1: PURPOSE AND NEED

Document Structure

FSA has prepared this PEA in compliance with NEPA and other relevant Federal laws and regulations. This PEA discloses the direct, indirect, and cumulative environmental impacts that would result from implementation of either the proposed action or the No Action Alternative. The document is organized into four parts:

- *Chapter 1: Purpose and Need.* The chapter includes information on the history of the project proposal, the purpose of and need for the project, and the agency's proposal for achieving that purpose and need. This section also details how FSA conducted its scoping efforts.
- *Chapter 2: Alternatives, including the Proposed Action.* This chapter provides a detailed description of FSA's proposed action as well as alternative methods for achieving the stated purpose. These alternatives were developed based on significant issues raised in the scoping process. This discussion also includes possible mitigation measures. Finally, this section provides a summary table of the environmental consequences associated with each alternative.
- *Chapter 3: Affected Environment and Environmental Consequences.* This chapter describes existing conditions and the environmental effects of implementing either the proposed action or the No Action Alternative. This analysis is organized by significant issue. Within each significant issue section, the affected environment is described first, followed by the effects of the No Action Alternative and the effects of the proposed action.
- *Chapter 4: Consultation and Coordination.* This section provides a list of preparers and agencies consulted during the development of the environmental assessment.
- *Appendices.* The appendices provide detailed information to support the analyses presented in the PEA

Additional documentation, including more detailed analyses of farm loan programs, may be found in the project record located at FSA's Washington, D.C. office.

Background

FSA plans to streamline the regulations that govern its direct Farm Loan Programs. Prior to the Department of Agriculture Reorganization Act of 1994 (1994 Act), Title 7, Chapter XVIII of the CFR (7 CFR XVIII) had been assigned to the Farmers Home Administration (FmHA), and Chapter VII of Title 7 (7 CFR VII) had been assigned to the Agricultural Stabilization and Conservation Service (ASCS).

Under the provisions of the 1994 Act, both FmHA and ASCS were abolished. FmHA's Farm Loan Programs and ASCS's programs were consolidated under the newly created FSA, while the remaining FmHA programs were transferred to the Rural Business

Cooperative Service (RBCS), Rural Housing Service (RHS), and Rural Utilities Service (RUS). Currently, the provisions of 7 CFR VII apply to FSA, while the provisions of 7 CFR XVIII are shared by FSA and the following Rural Development mission area agencies: RBCS, RHS, and RUS.

Purpose and Need for Action

The purpose of this initiative is to separate FSA's direct Farm Loan Program regulations from the Rural Development mission area loan program regulations, and to improve the utility and accessibility of Farm Loan Program regulations.

The proposed regulatory action is needed to simplify and clarify FSA's direct loan regulations, implement the recommendations of the USDA Civil Rights Action Team, meet the objectives of the Paperwork Reduction Act of 1995, and to meet the goals and objectives of the National Performance Review. Under the National Performance Review initiative, Federal agencies were charged with "creating a government that works better and costs less." Federal agencies were commissioned to focus on results rather than procedures, empower employees, put customers first, and cut red tape. The proposed action responds to this challenge by eliminating unnecessary procedural or internal requirements, clarifying regulations with multiple interpretations, and adding flexibility to allow employees to address each customer's unique needs.

Proposed Action

The action proposed by FSA to meet the purpose and need is to move the majority of its Farm Loan Programs direct loan making and servicing rules from 7 CFR Chapter XVIII to 7 CFR Chapter VII, remove administrative and internal procedures, streamline program requirements, and remove obsolete parts. These actions would be accomplished through the formal rulemaking process.

Decision Framework

Given the purpose and need, the deciding official reviews the proposed action and alternatives to make the following decisions:

- Whether or not to implement the actions contemplated under Alternative B (the proposed action);
- Whether or not to employ specific mitigation measures if Alternative B (the proposed action) is implemented.

Public Involvement

The proposal was disseminated among appropriate FSA personnel on November 6, 2003, who were asked to provide input and comment on the scope and potential impacts of implementation.

The FSA interdisciplinary team developed a list of issues to address.

Issues

FSA has separated the issues into two groups: significant and non-significant issues. Significant issues were defined as those directly or indirectly caused by implementing the proposed action. Non-significant issues were identified as those: (1) outside the scope of the proposed action; (2) already decided by law, regulation, or other higher level decision; (3) irrelevant to the decision to be made; or (4) conjectural and not supported by scientific or factual evidence. The Council on Environmental Quality (CEQ) NEPA regulations require this delineation in Sec. 1501.7, "…identify and eliminate from detailed study the issues which are not significant or which have been covered by prior environmental review (Sec. 1506.3)…" Significant and non-significant issues are detailed below.

Significant Issues

Significant Issue #1—Land Use: Over the past several decades, population growth and urban sprawl have decreased the farming land-base. A trend toward fewer farms and larger farm size has also been observed. Implementation of the proposed action may have effects, both beneficial and adverse, to land-use dynamics. All Federal agencies are required to analyze the effects of their actions on soils classified as prime or unique by the Natural Resource Conservation Service (NRCS), as required by the CEQ in a memorandum of August 1980. The Farmland Protection Policy Act of 1981, as amended, also requires Federal agencies to consider adverse effects to prime and unique farmlands that would result in conversion of prime and unique farmland to non-agricultural uses. Prime farmland is defined as soil that particularly produces general crops as common foods, forage, fiber, and oil seed; unique farmland produces specialty crops such as fruits, vegetables and nuts. The proposed rule will be analyzed to determine the anticipated effects of its implementation on land uses nationwide. The indicators for impacts will be:

- Acres of farmland converted to non-farm uses as a result of the proposed action
- Anticipated change to number of farms and average farm size as a result of implementing the proposed action

Significant Issue #2—Socioeconomic Conditions: The proposed rule would change some of the loan making and loan servicing policies and procedures. As a result of the streamlining effort, it is anticipated that some changes to socioeconomic conditions are possible. The proposed rule will be analyzed to determine the anticipated socio-economic effects on a nationwide basis. The indicators for impacts to loan users will be:

- Anticipated financial impact to loan users and applicants
- Anticipated time impact to loan users and applicants

In addition to imposing potential time and dollar impacts on loan applicants and users, the proposed action will change administration costs and time requirements within FSA. The proposed rule will be analyzed to determine the anticipated operational impact to FSA that would result from implementation. The indicators for impacts on agency operations will be:

- Change in time spent in loan making and loan servicing activities within FSA
- Change in cost of loan making and loan servicing activities within FSA

Non-significant Issues

Coastal Zone Management Areas: FSA's actions must be in conformance with the requirements of the Coastal Zone Management Act. Implementation of this rule would not require or approve any specific actions with direct, indirect, or cumulative impacts to coastal zone management areas. FSA addresses potential effects on such areas by completing a site-specific determination for each loan request relating to properties within approved State coastal zone management area.

Sole Source Aquifers: FSA's actions must comport with the Safe Drinking Water Act, and as a result, actions located within areas designated by the EPA as sole source aquifer recharge areas require review by EPA. No sole source aquifer recharge areas would be impacted by implementation of the proposed rule. Any potential effects to specific sole source aquifers will be addressed by completing a site-specific determination for each loan request relating to properties located within EPA-designated sole source aquifer recharge areas.

Endangered Species: FSA's policies and regulations do not permit authorization, funding, or implementation of any proposal that is likely to jeopardize the continued existence of any plant or wildlife species listed as endangered or threatened, or any proposal that is likely to destroy or adversely modify the habitats of listed species when such habitats have been determined critical to the species' existence, unless FSA has been granted an exemption under paragraph (h) of Section 7 of the Endangered Species Act. Implementation of this rule would not require or approve any specific actions that have direct, indirect, or cumulative impacts to protected species. FSA addresses potential effects on threatened and endangered species or critical habitat by completing a site-specific determination of effects for each loan request.

Wild and Scenic Rivers: FSA, as a matter of policy, does not provide financial assistance or plan approval for any water resource project that would have a direct and adverse effect on the values for which a river has been either included in the National Wild and Scenic Rivers System or is designated for potential addition. FSA does not approve or assist developments located below or above a wild, scenic, or recreational river area, or on any stream tributary, which will invade the area or unreasonably diminish the scenic, recreational, or fish/wildlife values present in the area. The proposed rule would not require or approve any action that would have direct, indirect, or cumulative impacts to wild and scenic rivers.

Cultural Resources: FSA is mandated to preserve, protect, and consider cultural resources through numerous laws and regulations, including the National Historic Preservation Act of 1966, and the Advisory Council on Historic Preservation's implementing regulations regarding "Protection of Historic Properties" (36 CFR Part 800). Implementation of the actions contemplated in this PEA would not require or approve actions that have direct or indirect impacts to historic or cultural properties. The FSA's regulations require identification of any properties in the area of potential impact that are listed in, or eligible for listing in, the National Register of Historic Places. No such properties can be identified in association with implementation of the proposed rule.

However, specific farm loans may be used for property improvements and certain types of development. In cases where such activities may impact cultural or historic resources, FSA will determine, on a site-specific basis, the most appropriate course of action for protecting any identified properties, or mitigating potential impacts to them.

Coastal Barriers: In conformance with the Coastal Barrier Resources Act, FSA does not provide financial assistance for any activity that is located within the Coastal Barrier Resources System unless the activity meets the criteria for an exception, or consultation regarding the activity has been completed with the Secretary of the Interior. Implementation of the proposed rule would have no direct impact to any components of the Coastal Barrier Resources System.

Water Quality: FSA seeks to restore, maintain, and enhance the quality of all surface and ground waters within its purview, consistent with the Federal Water Pollution Control Act, as amended, and other applicable Federal, State, and local laws and regulations. Implementing the proposed rule would not require actions that affect the quality of ground or surface water. Further, FSA does not provide financial assistance for any site-specific activity that would either impair a State water quality standard, including designated and/or existing beneficial uses that water quality criteria are designed to protect, or that would not meet antidegradation requirements.

FSA takes a serious look at the potential impacts of loans made to construct Animal Feeding Operations (AFOs) and Confined Animal Feeding Operations (CAFOs) on water quality. With direct loans, fewer loans would be made to finance CAFOs than with the guaranteed loan program. However, there would still be some operating loans and small farm ownership loans made that could be used to replace equipment in existing AFOs or CAFOs or used to add extra capacity to an existing operation. Site-specific consideration of the related impacts will be required for each requested loan.

Air Quality: Implementation of the proposed rule would have no direct or indirect impacts to air quality. The proposed rule would not change traffic, fugitive dust, or airborne pollutant levels. Because the proposed rule would not have a specific effect on air quality, no detailed analysis is required.

Some of FSA's farm loans may be used to finance CAFOs. The operation of CAFOs does not affect any specific air quality criterion, but odor emissions may in some cases create undesirable air conditions. The presence of CAFOs has been demonstrated to adversely affect property values, and can create adverse impacts to social conditions.

Because of this, FSA requires that site-specific evaluation of such impacts be conducted within the appropriate NEPA process for loan requests involving CAFOs.

Floodplains: Executive Order 11988, Floodplain Management, requires an examination of impacts to floodplains. It specifically requires all Federal agencies to avoid construction within the 100-year floodplain unless no other practical alternative exists. The proposed rule would not require any construction within the 100-year floodplain; therefore, no impacts to floodplains would occur. Any site-specific actions occurring within or near 100-year floodplains and financed by FSA's farm loans will be reviewed to determine potential effects.

Wetlands: Executive Order 11990, Protection of Wetlands, requires Federal agencies to avoid, where possible, impacts on wetlands. Section 363 of the Consolidated Farm and Rural Development Act places further requirements on FSA's Farm Loan Programs by prohibiting the use of any loan funds to drain, dredge, fill, level, or otherwise manipulate a wetland or to engage in any activity that results in imparing or reducing the flow, circulation, or reach of water, except in the case of activity related to the maintenance of previously converted wetlands. No jurisdictional wetlands would be affected as a result of implementing the proposed rule.

Environmental Justice: In general, the term "environmental justice" refers to fair treatment of all races, cultures, and income levels with respect to laws, policies, and government actions. In February 1994, Executive Order 12898, titled Federal Actions to Address Environmental Justice in Minority Populations and Low income Populations, was released to Federal agencies. This order requires each Federal agency to incorporate environmental justice as part of its mission. Federal agencies are specifically ordered to identify and address disproportionately high and adverse effects of its programs, policies, and activities on minority and low-income populations. In a related memorandum to heads of all Federal departments and agencies, released concurrently with Executive Order 12898, the President underscores provisions of existing laws that are intended to help ensure the environmental quality of communities throughout the nation. This memorandum further states that mitigation measures identified in environmental documents should address significant and adverse environmental effects on minority communities and low-income communities. None of the alternatives would have disproportionate health or environmental effects on minorities or low-income populations or communities as defined in the Environmental Protection Agency's Environmental Justice Guidance, drafted in July 1996, as well as Executive Order 12898. This topic will not be analyzed in this document but each farm loan approved under the proposed action will be reviewed to determine its effects on environmental justice.

CHAPTER 2: ALTERNATIVES, INCLUDING THE PROPOSED ACTION

This chapter describes and provides a summary comparison of the alternatives considered for FSA's regulatory streamlining project. It presents the alternatives in comparative form, sharply defining the differences between each alternative, to provide a clear basis for choice among options by the decision maker and the public.

Alternatives

Alternative 1: No Action

Under Alternative A: No Action, no streamlining effort would be undertaken. The regulations would remain in separate chapters, and all parts, including applicable and obsolete parts, would be kept.

No specific modification of rules would be implemented to address the purposes and needs articulated in Chapter 1.

Alternative 2: Proposed Action

The action proposed by FSA to meet the purpose and need is to move the majority of its Farm Loan Programs direct loan making and servicing rules from 7 CFR Chapter XVIII to 7 CFR Chapter VII, remove administrative and internal procedures, streamline program requirements, and remove obsolete parts. These modifications are detailed in the following sections.

Consolidating the Rules

The Farm Loan Programs direct loan making and loan servicing rules are currently in numerous parts of Chapter XVIII, making their use difficult to all but the most well-informed user. FSA proposes to consolidate and reorganize these rules in an orderly and logical manner. General Program Administration (7 CFR, Chapter VII, Part 761) contains the rules that, in general, apply either to guaranteed and direct loans, or to direct-loan making and direct-loan servicing. Part 762 of the same Title and Chapter, which contains regulations pertaining to the Guaranteed Loan Program, was published as a final rule on February 12, 1999 (64 FR 7358-7403). Part 763 is reserved for future use. Part 764 is titled Direct Loan Making and consists of the regulations governing the origination of direct loans. Part 765, Regular Servicing, contains the regulations related to servicing for direct loans. Regulation policies for distressed and delinquent borrowers with direct loans are contained in part 766, Special Servicing. Part 767 is titled Inventory Property Management and contains regulations pertaining to security property that is abandoned by the borrower or acquired by the Agency. Parts 768 and 769 are reserved for future

use. Table 2.1 illustrates how the existing CFR parts will be consolidated within the proposed parts.

Table 2.1_____Proposed and Existing Subparts

Proposed 7 CFR Subparts	Existing 7 CFR Subparts from which FSA Provisions will be Consolidated
761–General	1806-A,B; 1901-A,F; 1902-A; 1924-A,B; 1940-Q.
764–Direct Loan Making	1910-A; 1927-B; 1941-A,B; 1943-A,B; 1945-D.
765–Direct Loan Servicing-Regular	1925-A; 1950-C, 1951-A,D,F,J; 1962-A; 1965-A.
766–Direct Loan Servicing-Special	1951-L,S,T; 1962-A.
767–Inventory Property Management	1955-A,B,C.

By reorganizing the loan making and loan servicing rules in this manner, loan applicants, borrowers, other members of the public, and FSA can more easily find needed information. In addition, this structure helps to eliminate redundancies and thereby avoid inconsistencies. The proposed rule references—rather than repeats—other parts of the chapter, making it easier to incorporate future policy changes.

Removal of Internal and Administrative Procedures

The existing regulations often describe in detail FSA's internal and administrative procedures for implementing Farm Loan Programs. This approach not only contributes to a lengthy body of regulations, but also creates a barrier to quickly improving procedures which have no impact on loan applicants and borrowers. FSA currently has to use the rulemaking process to modify these procedures, which adds unnecessary time and expense to making such changes. In contrast to the current regulations, the proposed rule focuses on FSA policies impacting loan applicants and borrowers. FSA is moving the administrative procedures to a series of new handbooks which will parallel the topics in this proposed rule. The handbooks will be issued simultaneously with the final rule.

Streamlining of Program Requirements

While consolidating the loan making and loan servicing regulation parts, FSA also proposes to streamline its Farm Loan Program policies. With the aid of working groups of both Headquarters and Field staff, FSA has formulated and is proposing policy changes consistent with the existing statutory authority. FSA proposes to clarify certain regulations that have multiple interpretations, amend others that have led to unintended consequences, and revise policies to reduce burdens on loan applicants and borrowers. In addition, the proposed rule initiates action toward achieving recommendation number 56 of the USDA Civil Rights Action Team Report dated August 1997, which mandated that agencies "streamline program regulations and application forms to make USDA programs easily accessible to all customers."

Removal of Obsolete Parts

As a result of the 1994 Act, some of the CFR subparts published by FmHA continue to be used by FSA and one or more of the Rural Development mission area agencies, while others are used exclusively by FSA. When the final rule for this proposed rule is published, FSA will remove the subparts which are used only by FSA. The following subparts will be removed in the final rule: 1910-A, 1924-B, 1941-A, 1941-B, 1943-A, 1943-B, 1951-J, 1951-L, 1951-S, 1951-T, and 1965-A.

Mitigation Common to All Alternatives

No specific mitigation measures are proposed to ease the potential impacts that alternative actions may cause. This analysis assumes, however, that FSA's loan making and loan servicing activities will be conducted in conformance with all applicable environmental laws and regulations, as well as FSA's applicable rules and policies. In some cases, this may require site-specific environmental analysis and documentation, depending on the nature of the actions and the potential for impacts on associated resources.

Comparison of Alternatives

Table 2.2 provides a summary of the effects of implementing each alternative. Information in the table is focused on activities and effects where different levels of effects or outputs can be distinguished quantitatively or qualitatively among alternatives.

Table 2.2_____ Impact Comparison Matrix

	Alternative 1 – No Action	Alternative 2 – Proposed Action
Land Use	Under this alternative, FSA would retain its current loan making and loan servicing rules. The number of farms and average size of farms nationwide would be anticipated to continue to follow current, relatively stable trends, with farmland in prime locations converted to non-farm uses as prevailing market conditions and market dynamics dictate.	Negligible impacts to land use in the short term. Improving the process by which FSA makes and services farm loans would allow some additional farmers to obtain needed financing to continue their operations or obtain servicing in a more timely fashion for existing FSA indebtedness. Over the long term, improvements to the youth loan program may lead to minor beneficial impacts to land-use dynamics by involving young farmers in the industry in a meaningful and responsible way. This involvement may slow the trends toward corporate-owned and -controlled farms, larger farm size, and land conversion to non-farm uses. Implementation of the Proposed Action would not be anticipated to add incrementally to the long-term trends of increasing farm size or decreasing farm numbers. The actions contemplated under this alternative would not result in the conversion of any specific land to non-farm uses, although the trend toward continued development of farmland would likely continue independently.
Socio-Economic Conditions Including Agency Operations	Under the No Action Alternative, FSA would continue to use the existing regulations. No consolidation of rules would occur, internal and administrative rules would remain integrated in the regulatory texts, and obsolete parts would stay in place. Implementation of the No Action Alternative would have negligible socio-economic impacts to the average farm loan applicant and user. However, the result of implementing this alternative would be to retain rules that are unnecessarily complex and unnecessarily expensive to implement. FSA would incur an unnecessary annual cost of approximately $7 million annually from continuing to administer the current system.	Implementation of Proposed Action would have mixed financial impacts; some beneficial, and some adverse. Overall, the benefits to farm loan users would be major, as improved payment options would extend repayment capacities of 50,000 to 100,000 farmers nationwide. The benefit to taxpayers would also be beneficial, as a result of millions of dollars in savings in administrative costs and loan loss reductions. Implementation of the Proposed Action would consolidate and simplify FSA's rules. Collectively, the changes associated with implementing the proposed rule would save FSA an estimated 7 million dollars per year—the equivalent cost of 140 full-time employees. This equates to a moderate, long-term, beneficial effect on agency operations. Because current staffing levels are inadequate to complete the required actions, this streamlining will benefit the agency by decreasing workload, while benefiting loan users by speeding the application and loan approval processes.

CHAPTER 3: AFFECTED ENVIRONMENT AND ENVIRONMENTAL CONSEQUENCES

This chapter summarizes the affected physical, biological, social, and economic environments and the potential changes to those environments that would be anticipated as a result of implementing the alternatives. It also presents the scientific and analytical basis for comparison of alternatives presented in the chart above. The alternatives considered in detail include:

- Alternative 1: No Action. No streamlining effort would be undertaken. The regulations would remain in separate chapters, and all parts, including applicable and obsolete parts, would be kept.
- Alternative 2: Proposed Action. The action proposed by FSA to meet the purpose and need is to move the majority of its Farm Loan Programs direct loan making and servicing rules from 7 CFR Chapter XVIII to 7 CFR Chapter VII, remove administrative and internal procedures, streamline program requirements, and remove obsolete parts.

Three significant issues have been identified—land use, socioeconomic conditions, and agency operations—and each will be carried into detailed analysis. These significant issues are evaluated according to the following methodology.

To determine the relative change in resource conditions, the characterization of effects was based on the following factors:

- *Beneficial*: A positive change in the condition of the resource or a change that moves the resource toward a desired condition.
- *Adverse*: A change that moves the resource away from a desired condition or detracts from its condition.
- *Direct*: An effect that is caused by an action and occurs in the same time and place.
- *Indirect*: An effect that is caused by an action but is later in time or farther removed in distance, but is still reasonably foreseeable.
- *Short-term*: An effect that within a short period of time would no longer be detectable as the resource is returned to its pre-implementation condition, generally less than 5 years.
- *Long-term*: An effect on a resource or its condition that does not return the resource to its pre-implementation condition, and for all practical purposes is considered permanent.
- *Cumulative*: The effect on a resource or its condition that results from combined past, present, and reasonably foreseeable future actions (regardless of who undertakes these additional actions). Impacts from these actions could result in individually minor effects, but when considered cumulatively, could result in more intense effects taking place over a period of time.

The threshold or intensity of the effect – whether negligible, minor, moderate, or major – is specifically defined in the methodology section at the beginning of the discussion for each significant issue. Threshold values were developed based on applicable Federal and state standards and consultation with Interdisciplinary Team members.

Land Use

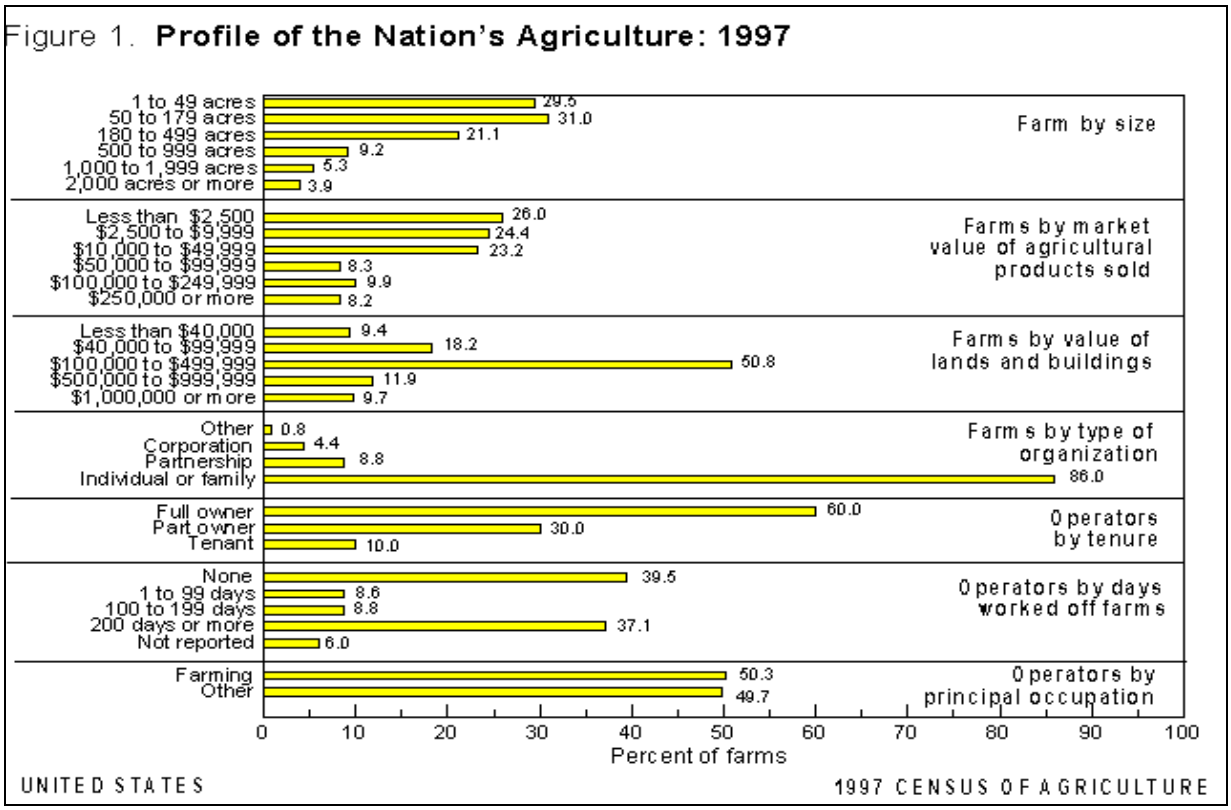
Affected Environment

Farms and Farm Size

During the first half of the 20th century, total farm and ranch acreage in the United States (U.S.) increased steadily as a result of land policies that encouraged continued conversion of large tracts of arid government lands to agricultural uses in the west and midwest.

As late as 1950, the labor-intensive agriculture industry provided jobs for at least 12 percent of the workforce. Since then, both agricultural employment rates and the number of farms in the U.S. have dramatically dropped. Mechanization, technological advancements, wide fluctuations in farm incomes, and patterns of urban sprawl have contributed to the decline. Although only about one-third the numbers of farms exist today as compared with 50 years ago, output has more than doubled, and exports of agricultural goods continue to contribute positively to the U.S. foreign trade balance. Today, agricultural production remains one of the nation's top industries in terms of total employment (U.S. Dept. of Labor 2003). Figure 1 presents a profile of U.S. agriculture in 1997.

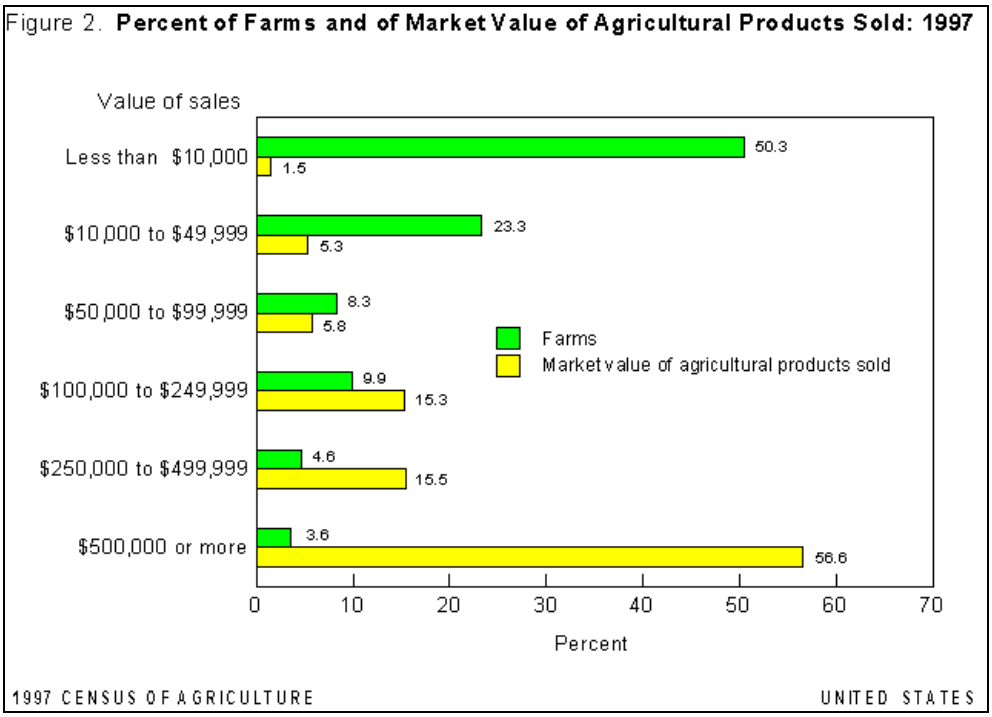
The most recent farm census, conducted in 1997, found that there were about 1,911,859 farms nationwide, approximately the same number as in 1992 (1,925,300). Average farm size in 1997 was 487 acres, compared with 491 acres in 1992. As of 1997, 86 percent of U.S. farms were owned by individuals or families—the same is in 1992. These figures point to stabilizing land-use dynamics among U.S. farms (USDA 1997). Most of the farms and ranches in the U.S. have remained in individual or family ownership. Commercial farms and ranches have become increasingly specialized, and now produce more food for domestic and export markets than ever before (USDA 2003).



The 1997 Census noted two significant trends occurring in the agricultural sector over the past 100 years. The first was increased mechanization and technological advancement, and the second was the involvement of government price supports. The effect of these trends was the notable increase the size of farms to gain efficiency (USDA 2003).

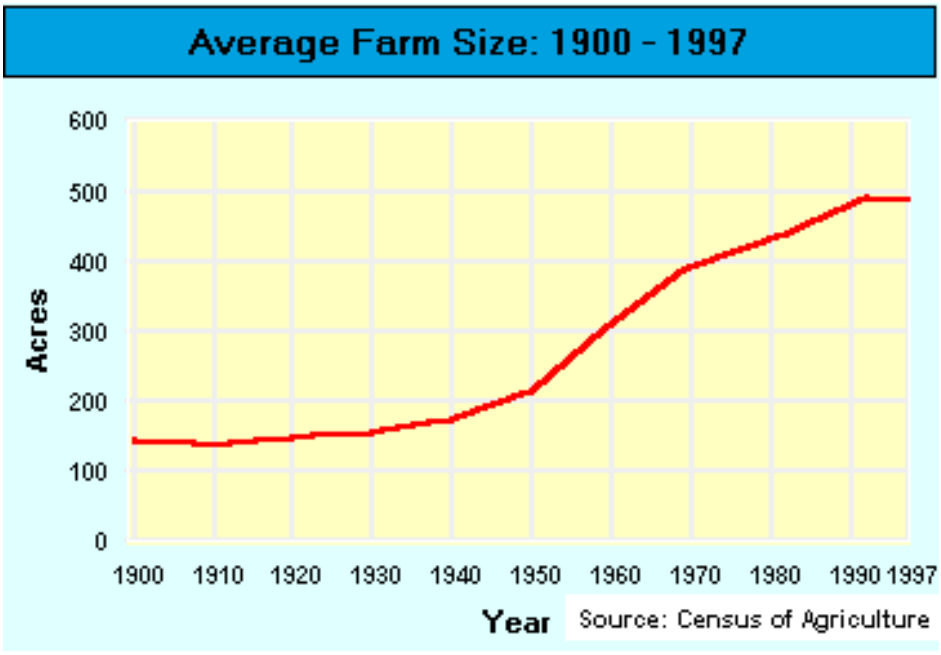
Over the course of the century, fewer individuals were willing to spend the capital needed to buy the new machinery and farm technology. Those willing to invest in technology became more specialized, and began producing larger quantities of a limited number of products. A clear change in the agricultural economy took place, as fewer farms were needed to meet the demand for agricultural products (USDA 1997). With this increase in specialization, a small number of operators now produce the majority of agricultural products consumed today. Figure 2 illustrates the relationship between the number of U.S. farms and the value of agricultural sales.

Large, corporate-controlled farms are more and more frequently replacing the generational family farmer. For example, ten poultry firms control 70 percent of the U.S. market, and the entire industry is composed of 48 companies. In the beef industry, four beef companies process 82 percent of the U.S. supply, while in the pork industry, ten pork firms process 80 percent of the U.S. volume (Erickson 2003). As shown in Figure 3, average farm size has increased steadily over the past century to accommodate larger, more efficient operations.



The national trend is also toward vertical integration where large farming companies combine fertilizer plants with feed lots, grain fields, packing houses, and marketing machines; with the in-house integration of virtually every phase of agricultural development and production (Erickson 2003). According to the farm census, large corporate-owned farms are on the increase at the same time mid-range farms—with annual sales between $25,000 and $100,000—are on the decrease, by about 60 percent (Erickson 2003).

Figure 3 Average Farm Size 1900-1997



The trend in growth of larger farms that rely on modern technology and streamlined production has improved our country's ability to meet the U.S. consumer's demand for cheap food. The U.S. produces food more efficiently and for lower prices than does any other country in the world (Tri-city Herald 2003). Further technological advances are likely to perpetuate the trend toward higher yields and increased productivity, boosting output through 2010 (U.S. Dept. of Labor 2003).

Federal government subsidy payments traditionally have shielded many agricultural producers from volatile agricultural markets. Currently, Federal policy trends are opening up the industry to competitive forces. In the U.S., the 1996 Federal Agriculture Improvement and Reform Act (also known as the 1996 Farm Act) was enacted to phase out price supports for agricultural produce such as wheat, corn, grain, sorghum, barley, oats, rice, and upland cotton by having producers enter into production flexibility contracts. The 2002 Farm Security and Rural Investment Act authorized direct and counter cyclical payments for commodities such as wheat, corn, grain sorghum, barley, oats, upland cotton, rice, soybeans, other oilseeds, and peanuts. The 2002 legislation was similar to that of the 1996 Farm Act with the addition of soybeans, other oilseeds, and peanuts as eligible crops.

In the future, declines in the number of smaller, family-operated farms might be counterbalanced somewhat by other changes taking place in the agricultural production industry. Employment in aquaculture (the farming of plants and animals that live in water, such as fish, shellfish, and algae), for example, has been growing steadily over the past ten years in response to consumer consumption demands for items such as fish products. Because of low prices for some agricultural commodities, more farmers are switching to aquaculture production. New developments in marketing milk and other agricultural produce through farmer-owned and -operated cooperatives hold promise for many farmers and dairymen.

Furthermore, demand for organic farm produce is growing. Consumers are becoming more conscious about pesticide and fertilizer use in conventional agriculture, allowing small acreage farms—which only 12 years ago appeared to have almost no future as working farms—to remain economically viable. Also, Federal, state, and local government programs may increasingly provide assistance targeted at small farms. For example, some programs allow farmers to sell the development rights to their property to nonprofit organizations pledged to preserving open or green space. This immediately lowers the market value of the land—and the property taxes levied on it—making farming more affordable (U.S. Dept. of Labor 2003).

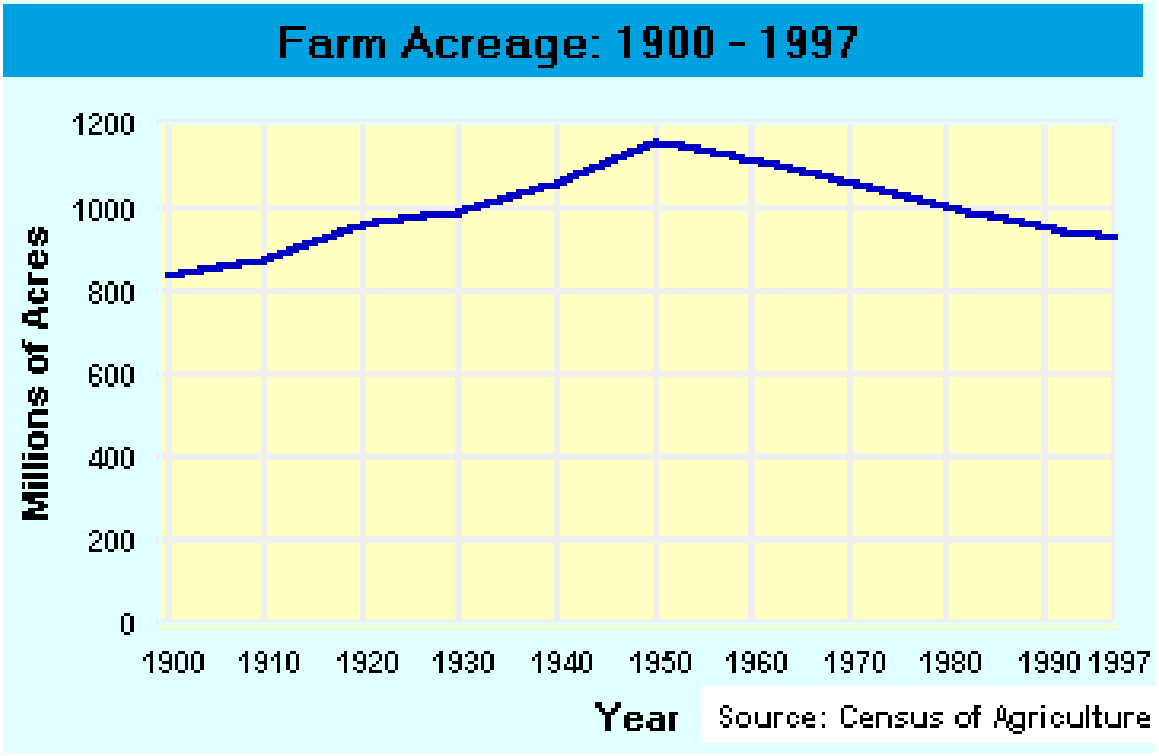
Conversion of Farms to Non-Farm Uses

In October 2002, The American Farmland Trust released a report that found that between 1992 and 1997, over six million acres of farmland were lost. Americans developed twice as much farmland in the 1990s as in the 1980s (see Figure 4). The most dramatic losses are impacting high-quality farmland—the land best suited for growing food. Prime farmland is often targeted by developers for building new homes and business parks

because it is frequently located in flat, low-lying, fertile valleys. In the West, rights to prime farming real estate also provide rights to scarce water resources—a prime commodity for large residential and commercial developers.

"Urban-influenced" counties currently account for more than half of total U.S. farm production; yet these same counties have annual population growth rates more than twice the national average. This rapid growth threatens the nation's most important crop-producing land. As farmland acreage is converted to non-farm uses, the community's ability to provide fresh, local food, native biodiversity, and a sustained quality of life diminishes.

Figure 4 Total Farm Acreage in U.S., 1900-1997



Farms provide habitat for many different species of plants and animals, and offer corridors that allow species to move between natural areas. The protection of wildlife corridors provides opportunities for species migration, which allows for the population of new patches of habitat. These links can enhance the genetic diversity of populations by providing opportunities for breeding among diverse wildlife populations, and by facilitating dispersal throughout a species' range. Because the majority of agricultural land is located near expanding metropolitan areas, farms provide key natural areas for harboring biodiversity.

As the number of communities and states trying to protect their farmland continues to increase, so does the need for Federal support. Nationally, voters have consistently supported farmland and open space protection initiatives. State and local farmland

protection programs have also found widespread support, and have continued to grow. (American Farmland Trust 2003).

Two of the key factors driving the conversion of farmland to non-farm uses are the steadily increasing value of farmland and the decrease in land base that correlates with continued development of existing farmland. USDA has noted (USDA 2003):

> "In 2000, the average value of agricultural land and buildings was $1,050 per acre, 52 times greater than the average of $20 per acre in 1900. Land values climbed through most of the century, and saw only a few periods of decline. The first decline began in 1920 when agricultural land values averaged $69 per acre. While many industries were thriving in the 1920's, farm prices dropped due to huge agricultural surpluses, causing agricultural commodity prices and land values to drop steadily throughout the 1920's. Agricultural land values saw the largest percentage declines of the century in the early 1930's, the beginning of the Great Depression. Agricultural land values dropped 37 percent over a period of 3 years and remained between $30 and $33 per acre throughout the 1930's. Following the Great Depression, land values were revitalized and began a climb that continued until the early 1980's.
>
> The 1970's showed the largest percentage increase in agricultural land values. In 1970 the average value was $197 and increased to an average value of $737 by 1980, a yearly average increase of more than 10 percent. The climb in land values was primarily due to strong farm prices, expanding trade, high inflation, and speculation that land values would continue to rise. However, in the mid-1980's, farm prices dropped due to surpluses, inflation slowed, and demand for agricultural land decreased. These factors caused the second large decline of agricultural land values during the century. Land values dropped from $801 in 1984 to $599 in 1987, a decline of 25 percent. This sharp drop caused a great deal of hardship in the agricultural community. Many farmers and ranchers who had taken on large amounts of debt, based on inflated land values, were not able to continue operating. Agricultural land values have steadily increased since 1987 to the current average U.S. value of $1,050 per acre."

Farm land values have consistently increased with two notable exceptions; the Great Depression, and the recession of the 1980s.

Environmental Consequences

Methodology

The proposed rule will be analyzed to determine the anticipated effects of its implementation on land uses nationwide. The indicators for impacts will be:

- Anticipated change to number of farms and average farm size as a result of implementing the proposed action
- Acres of farmland converted to non-farm uses as a result of the proposed action

For purposes of analyzing potential impacts to land use, the thresholds of change for the intensity of an impact are defined as follows:

- **Negligible/minor:**
  - Implementation of the alternative would result in little or no change to the number of farms or average farm size; little or no farmland would be converted to non-farm uses as a result of implementing the alternative.

- **Moderate:**
  - Adverse impact – Implementation of the alternative could directly cause decreases in the number of farms or increases in average farm size, and could encourage farmers to convert farmland to non-farm uses.
  - Beneficial impact – Implementation of the alternative could directly cause increases in the number of farms or decreases in average farm size, and would encourage farmers to avoid converting farmland to non-farm uses.
- **Major:**
  - Adverse impact – Implementation of the alternative would directly cause or require decreases in the number of farms or increases in average farm size, and would provide incentives for farmers to convert farmland to non-farm uses.
  - Beneficial impact – Implementation of the alternative would directly cause or require increases in the number of farms or decreases in average farm size, and would provide incentives for farmers to avoid converting farmland to non-farm uses.

Alternative 1 – No Action

Direct/Indirect Impacts: Under this alternative, no short- or long-term changes would be made to the existing regulations. Implementation of the No Action Alternative would have no direct or indirect impact to the number of farms or to average farm sizes nationwide. Additionally, this alternative would not result in the conversion of farmland to non-farm uses.

Cumulative Impacts: Under No Action, no action would be taken. Therefore, no project-related cumulative impacts would occur. However, FSA would still have loan making and loan servicing rules in place, and the number of farms and average size of farms nationwide would be anticipated to continue to follow current, relatively stable trends, with farmland in prime locations converted to non-farm uses as prevailing market conditions and market dynamics dictate.

Conclusion: Implementation of the No Action Alternative would be anticipated to have negligible impacts on the number of farms and average farm sizes nationwide. This alternative would not cause the conversion of any specific farmland to non-farm use.

Alternative 2 – Proposed Action

Direct/Indirect Impacts: Under the Proposed Action, consolidation of rules, removal of internal and administrative procedures, streamlining of program requirements, and removal of obsolete parts would occur. These actions may have minor beneficial impacts to the number of farms, average farm size, and the rate of conversion of farmland to non-farm uses. With streamlined regulations, it is anticipated that FSA would be able to make and service loans more efficiently. This would enable more farmers to obtain lower

interest loans and better servicing options, which would contribute to maintaining a greater presence of limited resource farmers.

The proposal to exclude non-family size farms from loan eligibility could adversely impact some large family farms, quantitatively providing the largest potential impact to land use. Based on current data, estimates indicate that the proposed rule's new definition of "family farm" may result in FSA denying credit to about 110 full-time, family-owned, and family-operated farms each year (Appendix D). However, the impact of this would likely be minimal, because in addition to meeting the family-size criteria, an applicant must be unable to meet other loan eligibility requirements, including the requirement that the applicant must be unable to obtain credit elsewhere at reasonable rates and terms. Most farms excluded on the basis of size would be considered large and financially successful, typically achieving average household incomes of more than $350,000 and typically having a net worth exceeding $2.5 million.

While implementation of the proposed rule modifying the definition of family farm would limit the pool of farmers eligible for FSA loans, exclusion from the FSA loan program would not necessarily mean that more farmers would be forced out of farming, rather, they would have to pursue alternative financial strategies. The availability of funds and credit from numerous public and private sources would continue to ensure that most farmers are able to obtain the resources needed to maintain operations.

The proposed streamlining effort would improve the youth loan program by streamlining the application process, improving program accessibility, and placing greater emphasis on the financing of agricultural projects. The youth loan program is intended to expand opportunities for the youth of farm families, and to teach them to accept responsibility and practice financial management within the context of a farming operation. Over the long-term, this would be anticipated to stabilize land-use dynamics by maintaining intergenerational interest in individual-owned and family-owned farming operations.

Cumulative Impacts: Implementation of the Proposed Action would not be anticipated to add incrementally to the trends of increasing farm size or decreasing farm numbers. The actions contemplated under this alternative would not result in the conversion of any specific land to non-farm uses, although the trend toward continued development of farmland would likely continue independently. Improvement of the youth loan program under this alternative would likely contribute beneficially in slowing the trends of land disposal, increasing farm size, and decreasing farm numbers.

Conclusion: Implementing the Proposed Action would have negligible impacts to land use in the short term by improving the process by which FSA makes and services farm loans. This would allow some additional farmers to obtain needed financing to continue their operations or obtain servicing in a more timely fashion for existing FSA indebtedness. Over the long term, improvements to the youth loan program may lead to minor beneficial impacts to land-use dynamics by involving young farmers in the industry in a meaningful and responsible way. This involvement may slow the trends

toward corporate-owned and -controlled farms, larger farm size, and land conversion to non-farm uses.

Socioeconomic Conditions

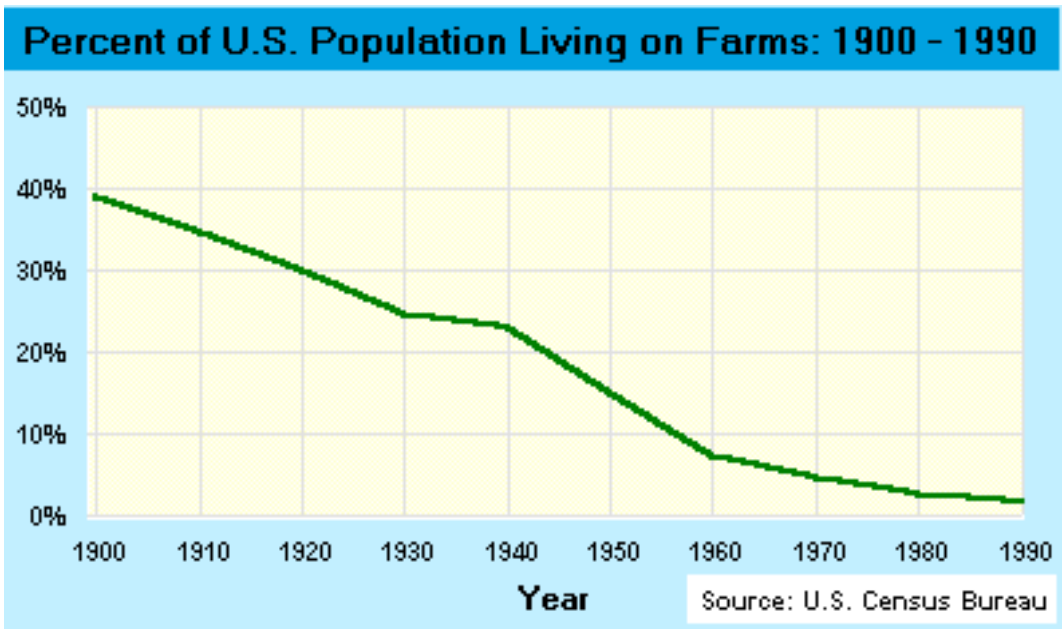
Affected Environment- Loan Users

Farm Population and Labor

Well-managed farms have always provided a number of socio-economic benefits. They protect water quality, significantly reducing the need for costly water treatment. They also provide open space, rural economic stability, and a link with traditional rural lifestyles (Biodiversity Project, 2003). The loss of farmland and open space often causes unexpected economic challenges for rural communities. In these communities, farmland, forests, ranch land, and/or open space tend to be the economic drivers that attract businesses, residents, and tourists.

The past century has also brought significant change in the relationship between farm labor and population. Nearly 40 percent of the U.S. population lived on farms in 1900, versus less than two percent in 1990 (see Figure 5). Because of mechanization, the need for farm labor has declined steadily throughout the century. While farm operations depended on human or animal labor before the turn of the century, machines have

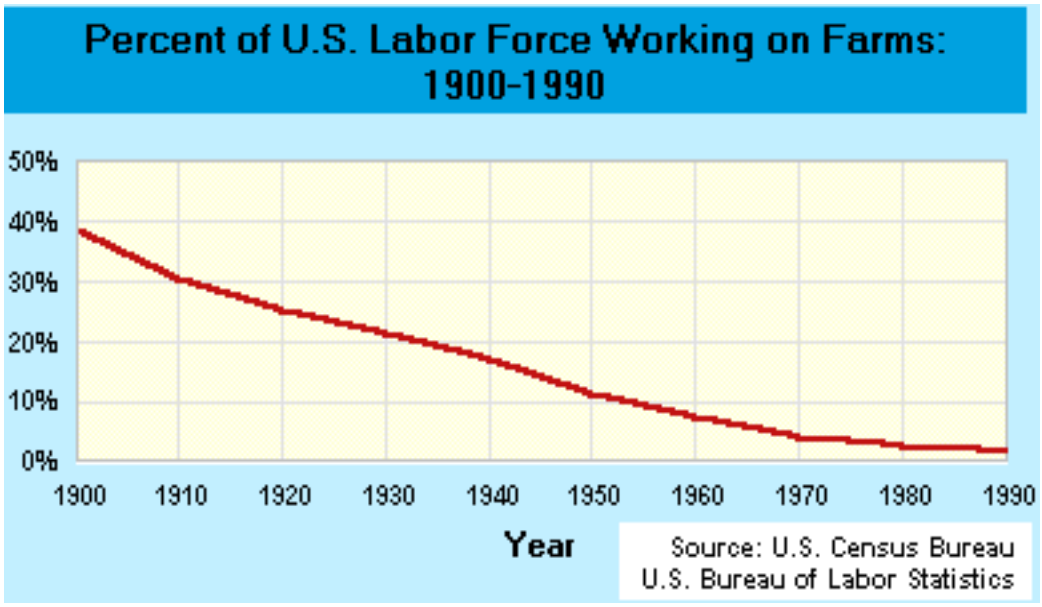
Figure 5 Percent of U.S. Population Living on Farms



supplanted the farm worker almost entirely. This has raised farm efficiency while reducing the need for farm labor (USDA 1997).

In addition to farm populations, the percentage of the total U.S. labor force working on farms has declined steadily throughout the century (see Figure 6). When the country came out of the Great Depression and into industrial growth following World War II, a large migration from rural to urban areas took place. The migration coincided with the trend shift from cultivation of new agricultural land to more intensive farming on existing land. This, along with new mechanization and technology, substantially lowered the demand for agricultural labor.

Figure 6 Percent of U.S. Labor Force Working on Farms 1900-1990



The cost of technology and mechanization, along with consistently increasing land prices, caused steady increases in the cost of production—with little change in the prices of the produced commodities. Farm operators were forced to farm more efficiently and manage resources more carefully to stay in business. The risks involved in farming became disproportionate compared with the rewards, and as a result many farmers took on non-farm occupations as primary income sources. Children from farm families, likewise, chose careers off the farm (USDA 2003).

On an average, workers in agriculture production are older than workers in other industries. In 2000, 50 percent of workers involved in livestock production were age 45 or older, compared with 35 percent for all workers in all industries (U.S. Dept. of Labor 2003). As of 1978, the percent of farm operators aged 65 and older rose steadily until it

reached 26 percent in 1997. Thus, over one-fourth of U.S. farm operators were at lest 65 years old, well beyond conventional retirement age. By comparison, only about three percent of the U.S. labor force falls within this age group (Gale 2002).

The rising share of older farmers results from an absolute increase in their numbers, as well as a steady decrease in the number of farmers under the age of 65. The number of 65-and-older farm operators reached its lowest point at 370,000 in 1978, and rose to 500,000 in 1997. Between 1978 and 1997, the number of operators under age 65 fell from 1.9 million to 1.4 million. The growing population of older farmers may, in part, reflect the weakening of "family farm" institutions, including life-cycle patterns of farmland acquisition and disposal in intergenerational transfer of farm assets. Farm families have a strong tradition of transferring farm businesses from parent to child. For example, a study in 1983 found that children of farmers were 30 times more likely than the average worker to follow their parents' occupational or business choice (Gale 2002).

More recently, the traditional pattern of intergenerational transfer of family-operated farm operations from parent to child has reportedly become less common as fewer farm children choose farm careers. A 2002 study indicates that the annual number of new farm entrants under age 35 declined from 39,300 during 1978-1982 to 15,500 during 1992-1997 (Gale 2002), a drop of more than 50 percent.

Economists suggest that this trend may partially be due to tighter farm credit, staggering start-up costs, and the practice of already established farmers buying up available farm land. Some new farmers may inherit a small piece of the family farm, but these smaller farm parcels, in most cases, are no longer profitable (Beloit Daily News 1999).

To purchase a bigger, economically viable farm is expensive, and lenders are less willing to invest large sums of money in new farmers in a business where, even when crops are strong and plentiful, a plunge in the commodity market could put that farmer out of business. A survey of agricultural lenders by the Federal Reserve Bank of Chicago shows that more than half the banks in some Midwest states have tightened credit standards because of the rising levels of loan payment defaults since 1985 (Beloit Daily News 1999).

U.S. agricultural land can cost upwards of $3,000 an acre. Statistics show that a producer needs between 800 and 1,000 acres to compete and make a living at farming. Used equipment—tractors, combines, and planters—can cost another $250,000. To plant and fertilize a crop costs, on average, $150 an acre. Thus, for many today, joining an existing family farm, held in corporation, is the only way most young people can afford to become viable farmers in today's market (Beloit Daily News 1999).

While white males were getting out of the farming business between 1992 and 1997, more women and minorities were entering the industry. Both of these groups saw increased percentages in farm ownership during that same time period (Erickson 2003). Still, of all private U.S. agricultural land, Whites account for 96 percent of the owners, 97 percent of the value, and 98 percent of the acreage. Nonetheless, four minority groups--Blacks, American Indians, Asians, and Hispanics--own over 25 million acres of agricultural land, valued at over $44 billion (Gilbert 2002).

Currently, local communities benefit from farming because of the tax structure. Owners of farm, forest, and open lands pay more in local tax revenues than it costs local government to provide services to their properties—a net gain for governmental budgets. In contrast, residential land uses are a net drain on municipal coffers (Open Space & Farmland 2003). On average, farmland, forest, and open land require a median 27 cents in services for every dollar of community revenues generated, while residential development demands $1.15 in services for each dollar generated. Community members and leaders across the country have found the benefits of protecting farmland and open spaces as a means of strengthening the health and viability of their existing communities.

Affected Environment- Agency Operations

The following sections describe the areas of agency operation that would be affected by the proposed rule.

Location of Rules

The Farm Loan Programs direct loan making and loan servicing rules are currently in numerous parts of Chapter XVIII, making their use difficult to all but the most well-informed user (see Table 3.1).

Table 3.1- Location of existing loan making and loan servicing rules

Subject Matter of Existing Regulations	Location of Information
General	1806-A,B; 1901-A,F; 1902-A; 1924-A,B; 1940-Q.
Direct Loan Making	1910-A; 1927-B; 1941-A,B; 1943-A,B; 1945-D.
Direct Loan Servicing-Regular	1925-A; 1950-C, 1951-A,D,F,J; 1962-A; 1965-A.
Direct Loan Servicing-Special	1951-L,S,T; 1962-A.
Inventory Property Management	1955-A,B,C.

Internal and Administrative Procedures

The existing regulations often describe in detail FSA's internal and administrative procedures for implementing Farm Loan Programs. This approach contributes to a lengthy body of regulations, and creates a barrier to quickly improving procedures which have no impact on loan applicants and borrowers. FSA currently has to use the rulemaking process to modify these procedures, which adds time and expense to making such changes.

Program Requirements

Currently, certain regulations have multiple interpretations, and others have led to unintended consequences. In addition, some existing program requirements and policies are burdensome on loan applicants and borrowers. In their current state, program

requirements do not achieve the intent of recommendation number 56 of the USDA Civil Rights Action Team Report dated August 1997, which mandated that agencies "streamline program regulations and application forms to make USDA programs easily accessible to all customers."

Removal of Obsolete Parts

As a result of the 1994 Act, some of the CFR subparts published by FmHA continue to be used by FSA and one or more of the Rural Development mission area agencies, while others are used exclusively by FSA. This leads to confusion and unnecessary expenditure of time working through the rules when looking for specific information. In addition, existing regulations address loan making processes for loan types that are no longer Congressionally funded, such as Soil and Water loans. Regulations that apply to making such loans will also be removed.

Environmental Consequences

Methodology

The proposed rule would change some of the loan making and loan servicing policies and procedures. As a result of the streamlining effort, it is anticipated that some changes to socioeconomic conditions are possible for loan users. The proposed action will also change costs and time requirements within FSA. The proposed rule will be analyzed to determine the anticipated time and money impacts to loan users and FSA that would result from implementation. The indicators for impacts will be:

- Anticipated financial impact to loan users and applicants
- Anticipated time impact to loan users and applicants
- Change in time spent in loan making and loan servicing activities within FSA
- Change in cost of loan making and loan servicing activities within FSA

For purposes of analyzing potential impacts to socioeconomic conditions, the thresholds of change for the intensity of an impact are defined as follows:

- **Negligible/minor:**
  - Compared with existing conditions, implementation of the alternative would have an inconsequential financial or time impact on loan users or agency operations.
- **Moderate:**
  - Adverse impact – Implementation of the alternative would impose considerable financial or time costs on loan users or agency operations.
  - Beneficial impact – Implementation of the alternative would remove considerable financial or time costs from loan users or agency operations.
- **Major:**
  - Adverse impact – Implementation of the alternative would impose prohibitive financial or time costs on loan users or agency operations.

- Beneficial impact – Implementation of the alternative would remove prohibitive financial or time costs from loan users or agency operations.

Alternative 1 – No Action

Direct/Indirect Impacts: Under the No Action Alternative, loan users and applicants would continue to use the existing loan system and structure. The Farm Loan Programs direct loan making and loan servicing rules are currently in numerous parts of Chapter XVIII, making their use difficult to all but the most well-informed user. Loan users and applicants would likely continue to expend unnecessary time and effort in the loan process. However, as no specific action is contemplated under the No Action Alternative, it is anticipated that implementation of this alternative would have negligible socio-economic impacts to farm populations, compared with current conditions. With no change in the program, the availability of funds and credit from numerous public and private sources would continue to ensure that farmers are able to obtain the resources needed to maintain operations.

Under this alternative, taxpayers would bear the majority of potential socio-economic impacts. Currently, FSA does not use nonessential assets as loan security on direct loans. During the 1990's, more FSA incurred more than 569 million dollars in loan losses. This trend would be anticipated to continue under the No Action Alternative.

Cumulative Impacts: No action is contemplated under the No Action Alternative; therefore no cumulative impacts would occur in relation to implementing this alternative. FSA would continue making and servicing loans under the existing rules.

Conclusion: Implementation of the No Action Alternative would have negligible socio-economic impacts to the average farm loan applicant and user. However, the result of implementing this alternative would be to retain rules that are unnecessarily complex and unnecessarily expensive to implement. FSA would incur an unnecessary annual cost of approximately $7 million annually from continuing to administer the current system.

Alternative 2 – Proposed Action

Direct/Indirect Impacts: By reorganizing the loan making and loan servicing rules in this manner, loan applicants, borrowers, and other members of the public can more easily find needed information. In addition, this structure helps to eliminate redundancies and avoid inconsistencies.

Under the proposed rule, it is anticipated that few individuals would be adversely impacted by the change. Farmers dealing with FSA may experience increased information requirements for such things as financing construction or additional documentation of repayment ability. Provisions of the proposed rule that may benefit both current and future applicants would include expansion and streamlining of the youth loan program, reducing the years of records required, and reducing requirements for appraisals in the case of partial releases--all contributing to time savings for applicants.

Proposed changes to the direct loan program include provisions that will reduce economic losses. While, individually, most changes would have a relatively minor

economic impact, collectively the changes would have a net benefit equivalent to about $7 million, and would reduce workload for FSA offices. Provisions would reduce losses, and, thereby, risks to taxpayers. Utilization of nonessential assets as loan security is likely to reduce loan losses. A provision to place on borrowers the burden to demonstrate the soundness of any construction projects would reduce FSA's civil liability, and assure the viability of loan security. Overall, proposed changes would result in improved performance of FSA's Farm Loan Programs, providing for fewer regulations, reduced workload, and decreased risk to taxpayers.

Listed below are proposed changes to the Direct Loan Program that may have a measurable time and/or cost impact to loan users and/or FSA.

Borrower Training: The proposed rule would change existing rules concerning borrower training, eliminating the requirement to assess the need for borrower training when a borrower makes a request for primary loan servicing. Currently a borrower needs to apply for a training waiver. The proposed change would also clarify situations where a borrower would be required to undergo additional training. Annual projected savings from time spent processing training waivers and staff costs is approximately $150,000.

Financing of Capital Improvement Projects: The proposal would no longer make FSA responsible for reviewing cost estimates or development plans for specialized or unique building construction prior to loan approval. While the applicant would now be responsible for shouldering the cost of obtaining professional certification and inspection, which may run as high as 1 percent of the loan amount, costs incurred by borrowers should be offset by greater control over construction timing.

FSA would achieve times savings since the proposed change would no longer require FSA employees to make project soundness determinations. Applicants would be required to provide written certification from applicable professionals regarding technical soundness of proposed projects, unless applicant uses pre-approved plans, such as those developed by the Cooperative Extension Service, or the applicant applies for small capital improvement loans, such as those for under $25,000 that would not require a professional opinion or certification.

According to USDA work measurement studies, the estimated average time required for reviewing specialized plans is 60 minutes per loan application. Based on FSA database calculations, an estimated 332 loans made annually would no longer require FSA employee certification and inspection. Estimated value of time savings is $10,000 annually.

Definition of Family Farm: The proposed rule would modify the definition of family farm for purposes of determining FSA loan eligibility. Farms that produce a gross income above a specific annual farm sales threshold would be considered ineligible for FSA loans. This proposed rule should save time for operators of large farms who could use this criterion to evaluate whether or not to pursue an FSA loan.

The proposed rule establishes objective criteria that would be used to evaluate loan eligibility as it relates to farm size. Authorized agency officials could utilize this

criterion to evaluate an applicant's eligibility before significant time and effort is spent on processing and evaluating a loan applications. Dollar savings, based on the estimated salary and benefits of a farm loan officer, nationwide, FSA savings of 4.7 full time employees are projected under the proposed rule, equating to an annual savings of $234,443.

FSA Lien on Non-Essential Assets: Non-essential assets are those assets that are deemed not to be essential to the farming operation, and that do not contribute income to pay family living expenses. FSA's ability to collect against non-essential assets may have a notable impact on loss rates. Implementation would equate to an FSA projected annual budget savings of $2.3 million, based on a FY 2002 program level.

Real Estate Improvements: Existing regulations allow Farm Operating (OL) funds to be used to make improvements or repairs to farm land or buildings. Under the proposed rule OL funds may still be used for minor repairs and improvements to farm land or buildings, provided that total costs do not exceed $15,000 per borrower annually. Under this provision, borrowers would benefit from a longer amortization period permitted for Farm Ownership (FO) loans when costs will exceed $15,000. Increasing the amortization period from seven years (time frame under previously funded FO loans) to 30 years would reduce the borrower's annual debt service obligation by $3,400--based on the average loan amount of $32,000, at a six percent rate, and an extension from a 7 to 30 year amortization.

Because FO funds are more limited than OL funds, borrowers may find it more difficult to obtain direct loans to finance capital improvements. For FY 2002, there was $600 million available to fund direct OL loans, and $128 million to fund direct FO loans. Also, a major portion of FO funds are targeted to beginning and socially disadvantaged farmers.

The proposed change would have a minimal impact on agency operations. Based on past FSA loan information, the proposed change would result in $3.2 million of loans being made as OL loans rather FO loans. Since FO loans have a lower subsidy rate, the proposed change would have a small budgetary impact, resulting in an annual budget outlay decrease of $204,600. FSA would experience a slight increase in workload as more time is required to process an FO loan than an OL loan. Assuming five additional hours are required to process each real estate loan, the proposed rule would increase nationwide workload by the inconsequential amount of about 500 hours.

Extending Youth Loan Program Eligibility to Cities and Towns with Populations between 10,000 and 50,000: By extending the Youth Loan Program to counties with cities with populations up to 50,000—the current cap is 10,000--FSA anticipates that there would be a 23 percent annual increase in Youth Loans for agriculturally related projects. This equates to an additional 308 loans per year, or an additional 308 youth participants in the program. Since the average size of a loan is $3,500, outlays to finance agricultural activities could increase to over $1,000,000.

Given the subsidy rate on OL loans from the President's 2002 budget of 8.93 percent, this proposed change could require an additional budget outlay of $96,000. The additional loans would result in marginally more workload for FSA staff. From USDA work measurement studies, it is estimated that 25.7 hours are required to process each youth loan application. Processing the additional loans would increase the workload by the equivalent of 4.5 full time employees nationwide.

Streamlining the Youth Loan Application Process: The proposed rule would eliminate the application requirement of youth (between the ages of 10 and 20) to provide: three years of farm production records, verification of off-farm income, credit report, verification of the applicant's debts, and legal documentation of real property or leases owned by the youth. Under the proposed rule, a complete application would now only include: a forecast of income and expenses for the project, a recommendation and plan of supervision by a project advisor, and consent of a parent or guardian. The streamlining of the application process for youth loans is expected to result in a significant time savings to the applicant. For a typical youth loan, FSA estimates that the proposed rule would save three hours for every application, resulting in a total annual savings of 6,000 hours to the public.

The streamlining of the application process for youth loans is also expected to result in a significant time savings to FSA. Based on USDA work measurement studies, it is estimated that the proposed rule would save about 7 hours from the time currently required to process an application, determine eligibility, and disburse funds for each youth loan. Based on an expected annual demand for youth loans of 2,000, the proposed rule is expected to save 14,000 FSA staff hours resulting in a savings of about eight full time employees.

Disposing of a Portion of Real Estate Security: Under the proposed rule, the maximum property value of secured property that could be released without an appraisal would be increased from $10,000 to $20,000. FSA estimates show that the increase would result in an estimated 20 percent reduction in the number of partial release appraisals required annually, equating to FSA savings of $85,000 per year. Even though FSA staff is not likely to perform the appraisals, appraisals still require some time on the part of staff to make necessary arrangements and appraisal reviews. Work measurement studies indicate that coordinating each appraisal requires one hour of work by FSA staff. Thus, the proposed rule should reduce workload by 112 hours per year.

Nonprogram Loan Terms: The proposed rule would base the nonprogram loan term on the applicant's repayment ability for up to a maximum term of 25 years instead of the current 15 year maximum term. Based on a 1999 Agricultural Resource Management Study (RMS) data, it was estimated that lowering the annual debt service obligation by $2,000 would result in an additional 50,000 to 100,000 farmers having the repayment capacity to purchase inventory property.

Lengthening the term for real estate secured nonprogram loans to 25 years should enable FSA to resolve delinquent accounts quickly. The proposed rule would also enable

inventory property to be sold more readily if budget authority is granted for credit sales in the future.

Cumulative Impacts: Implementation of the Proposed Action would not be anticipated to add incrementally to the cost or time requirements imposed on loan users in association with FSA's direct loan programs. Overall, a moderate beneficial cumulative impact would be achieved as a result of the simplification of the rules. Loans could be made in a more timely fashion, which should increase the inflow of dollars into local agribusiness. The proposed rule would base the nonprogram loan term on the applicant's repayment ability for up to a maximum term of 25 years instead of the current 15 year maximum term, which would result in an additional 50,000 to 100,000 farmers having the repayment capacity to purchase inventory property.

Additionally, the Proposed Action is anticipated to lead to a reduction in long-term costs to the public in excess of $7 million per year.

Conclusion: Implementation of the Proposed Action would have mixed financial impacts; some beneficial, and some adverse. Overall, the benefits to farm loan users would be major, as improved payment options would extend repayment capacities of 50,000 to 100,000 farmers nationwide. The benefit to taxpayers would also be beneficial, as a result of millions of dollars in savings in administrative costs and loan loss reductions. FSA would benefit from a $7 million annual savings resulting from simplifications to agency processes and operations.

CHAPTER 4: CONSULTATION AND COORDINATION

This chapter identifies the persons responsible for preparing this document, and lists the individuals that were consulted or coordinated with for information regarding document content.

PREPARERS

The Shipley Group, Inc.
Buck Swaney, Project Manager

The Shipley Group, Inc.
Shanna Francis, Environmental Writer/Analyst

ID TEAM MEMBERS:

William D. Cobb
Special Projects Coordinator - FSA
B.S. – Agricultural Science
19 years experience with FSA

James Fortner
Environmental Compliance Manager - FSA
B.S. – Agricultural and Extension Education
19 years experience with FSA

Nikki Chavez
Senior Loan Officer - FSA
9 years experience with FSA

Kathleen Schamel
Historic Preservation Officer
M.A. Anthropology
20 years experience in cultural resources and environmental protection

FEDERAL, STATE, AND LOCAL AGENCIES:

Name	Title	Organization
Dale Carlson	Farm Loan Chief	Alaska FSA State Office
William H. Sewell	Farm Loan Chief	Alabama FSA State Office
Marvin O. Sutterfield	Farm Loan Chief	Arkansas FSA State Office
Sharon Kinnison	Farm Loan Chief	Arizona FSA State Office
Darrel G. Zerger	Farm Loan Chief	California FSA State Office
Leon Sanders	Farm Loan Chief	Colorado FSA State Office

Carrie L. Novak	Farm Loan Chief	Connecticut, Massachusetts, and Rhode Island FSA State Offices
Harry Wass	Farm Loan Chief	Delaware and Maryland FSA State Offices
Mike Graham	Farm Loan Chief	Florida FSA State Office
David F. Laster	Farm Loan Chief	Georgia FSA State Office
Steven Bazzell	Farm Loan Chief	Hawaii FSA State Office
Chris Beyerhelm	Farm Loan Chief	Iowa FSA State Office
Aaron Johnson	Farm Loan Chief	Idaho FSA State Office
Fred Kocher	Farm Loan Chief	Illinois FSA State Office
Brent Kerns	Farm Loan Chief	Indiana FSA State Office
Arlyn Stiebe	Farm Loan Chief	Kansas FSA State Office
James Dunsmore	Farm Loan Chief	Kentucky FSA State Office
Brad Smith	Farm Loan Chief	Louisiana FSA State Office
David B. Marshall	Farm Loan Chief	Maine FSA State Office
David P. Russ	Farm Loan Chief	Michigan FSA State Office
Stuart Shelstad	Farm Loan Chief	Minnesota FSA State Office
Daniel Gieske	Farm Loan Chief	Missouri FSA State Office
John S. Porter	Farm Loan Chief	Mississippi FSA State Office
Roger J. Meredith	Farm Loan Chief	Montana FSA State Office
Ron Pearson	Farm Loan Chief	North Carolina FSA State Office
Rodney R. Hogan	Farm Loan Chief	North Dakota FSA State Office
Bob Jedlicka	Farm Loan Chief	Nebraska FSA State Office
Patrick Freeman	Farm Loan Chief	Vermont and New Hampshire FSA State Offices
Gerald G. Hlubik	Farm Loan Chief	New Jersey FSA State Office
Christian Anderson	Farm Loan Chief	New Mexico FSA State Office
Gus Wegren	Farm Loan Chief	Nevada FSA State Office
Nancy L. New	Farm Loan Chief	New York FSA State Office
David A. Drake	Farm Loan Chief	Ohio FSA State Office
Phil Estes	Farm Loan Chief	Oklahoma FSA State Office
Lynn Voigt	Farm Loan Chief	Oregon FSA State Office
Charles L. Marshall	Farm Loan Chief	Pennsylvania FSA State Office
Wanda Perez	Farm Loan Chief	Puerto Rico FSA State Office
Wesley L. Harris	Farm Loan Chief	South Carolina FSA State Office
Tom Bowar	Farm Loan Chief	South Dakota FSA State Office
Frank M. Rodgers	Farm Loan Chief	Tennessee FSA State Office
Larry Owens	Farm Loan Chief	Texas FSA State Office
Bill York	Farm Loan Chief	Utah FSA State Office
Russell Marsh	Farm Loan Chief	Virginia FSA State Office
Donald N. Downing	Farm Loan Chief	Washington FSA State Office
Ray Ellenberger	Farm Loan Chief	Wisconsin FSA State Office
Howard M. Lester	Farm Loan Chief	West Virginia FSA State Office
Bruce K. Mair	Farm Loan Chief	Wyoming FSA State Office

APPENDIX A – COMMENTS (FSA STAFF)

- Would like to see all lending aspects addressed within FSA's regulatory streamlining proposal.
- As an alternative management strategy, would like to see specific processes and forms taken out of regulations, and addressed only in internal handbook.
- The proposed FSA regulatory streamlining effort is a very productive undertaking.
- Would like to see regulations simplified and clarified.
- Would like to know Farm Loan managers' responsibilities associated with Direct and Guaranteed loan making and servicing; would like to see instructions developed that can be easily followed and understood.
- Would like to see management strategies kept simple.
- Under the proposal to streamline FSA's regulations, would like to know if there will be additional responsibilities associated with Farm Programs. Will FSA still be responsible for reviewing CRP environmental evaluations completed by NRCS?
- Would like to see 1940-G environmental regulations streamlined.
- Would like to see the requirements for completing assessments for guaranteed loans eliminated. Other government agencies such as SBA do not seem to have same constraints as FSA; all agencies should all be consistent.
- Would like all reporting requirements to be reviewed, and the requirement for obsolete reports eliminated.
- Would like to see all reports listed together rather than scattered throughout handbooks.
- Would like a draft of FSA's proposed changes distributed to Chiefs association for their review and comment before the plan is finalized.

APPENDIX B – GLOSSARY/ACRONYMS

AFO: Animal Feeding Operation.

Applicant: Applicant means the lender requesting a guarantee, or the individual or business entity applying for a direct loan.

ASCS: Agricultural Stabilization and Conservation Service.

Assistance: Assistance is financial assistance in the form of a loan or interest subsidy. It also includes servicing of existing loans by providing reamortization, deferrals, debt forgiveness, or lowering of interest rates.

Borrower: Borrower is an individual or business entity that has outstanding obligations to the lender under any Agency loan or loan guarantee program. A borrower includes all parties liable for Agency debt, including collection-only borrowers, except those whose total loan and accounts have been voluntarily or involuntarily foreclosed or liquidated, or who have been discharged of all Agency debt.

CAFO: Confined Animal Feeding Operation.

CEQ: Council on Environmental Quality.

CFR: Code of Federal Regulations.

Collateral: Collateral is property pledged as security for a loan to ensure repayment of an obligation.

Credit Sale: Credit sale is a sale of Farm Loan Program property for which FSA provides financing to the purchaser.

Delinquent Borrower: Delinquent borrower is a borrower whose payments to FSA are at least 30 days past due.

EA: Environmental Assessment.

Family Living Expenses: Family living expenses are any withdrawals from income to provide for needs of family members.

Farm: A farm is a tract or tracts of land, improvements, and other appurtenances that are used, or will be used, in the production of crops, livestock, or aquaculture products for sale in sufficient quantities so that the property is recognized as a farm rather than a rural

residence. Ranching operations are also included in the definition of a farm. The term "farm" also includes any such land and improvements and facilities used in a non-farm enterprise. It may also include the residence which, although physically separate from the farm acreage, is ordinarily treated as part of the farm in the local community.

Farm Income: Farm income is the proceeds from the sale of chattel that is normally sold annually during the regular course of business, such as crops, feeder livestock, and other farm products.

Floodplains: Floodplains are lowland and relatively flat areas adjoining inland and coastal waters, including flood-prone areas of offshore islands. At a minimum, floodplains consist of those areas subject to a one percent or greater chance of flooding in any given year. The term floodplain will be taken to mean the base floodplain, unless the action involves a critical action, in which case the critical action floodplain is the minimum floodplain of concern.

(1) Base floodplain (or 100-year floodplain) is the area subject to inundation from a flood of a magnitude that occurs once every 100 years on the average (the flood having a one percent chance of being equaled or exceeded in any given year).
(2) Critical action floodplain (or 500-year floodplain) is the area subject to inundation from a flood of a magnitude that occurs once every 500 years on the average (the flood having 0.2 percent chance of being equaled or exceeded in any given year).

FmHA: Farmer's Home Administration.

FO Loan: Farm Ownership Loan

FSA: Farm Services Agency.

FY: Fiscal Year.

Inventory Property: Inventory Property is real estate and chattel property and related rights to which the Federal Government has acquired title.

NEPA: National Environmental Policy Act.

Non-essential Assets: Non-essential assets are assets in which the borrower has an ownership interest, that:

i. Does not contribute to:
(A) income to pay essential family living expenses, or
(B) to the farming operation; and

ii. Is not exempt from judgment creditors or in a bankruptcy action.

NRCS: Natural Resource Conservation Service.

OL Loan: Farm Operating Loan

PEA: Programmatic Environmental Assessment.

Program Loans: Program loans include Farm Ownership, Operating, Soil and Water, Recreation, Economic Emergency, Emergency, Economic Opportunity, and Rural Housing loans made for farm service buildings.

RBCS: Rural Business Cooperative Service.

RHS: Rural Housing Service.

RUS: Rural Utilities Service.

Security: Security is property or a right of any kind that is subject to a real or personal property lien.

USDA: United States Department of Agriculture.

Wetlands: Wetlands are defined in the current edition of the National Food Security Act manual and generally may be those areas that are inundated by surface or ground water with a frequency sufficient to support, and under normal circumstances, do or would support a prevalence of vegetative or aquatic life that requires saturated or seasonally saturated soil conditions for growth and reproduction. Wetlands generally include swamps, marshes, bogs, and similar areas, such as sloughs, potholes, wet meadows, mudflats, and natural ponds. They are determined by agencies other than FSA.

APPENDIX C – REFERENCE

American Farmland Trust. 2003. "Nation's Need for Effective Farmland Protection Greater Than Ever." Website www.farmland.org/news/120699.htm

Beloit Daily News. 1999. "Aging farmers." April 12, 1999.

Biodiversity Project. 2003. Farmland loss at a glance. Website: www.biodiversityproject.org

Citizen's Planner Guide. 1999. Citizen's Planner Guide to Subdivision Development. Utah League of Cities and Towns and Utah Association of Conservation Districts.

Erickson, Herald, and Paul T. Erickson. 2003. "Losing Ground." Website: http://archive.tri-cityherald.com/losingground

Gale, Fred. 2002. "The Graying Farm Sector." Rural America, Volume 17, Issue 3/fall, p. 28-31.

Gilbert, Jess, and Spencer D. Wood. 2002. "Who Owns the Land? Agricultural Land Ownership by Race/Ethnicity." Rural America, Vol. 19, Issue 4/winter, p 55-63.

Open Space & Farmland. 2003. Website: www.smartgrowthamerica.com/openspace.html

United States Department of Agriculture (USDA). 1997. 1997 Census of Agriculture. Website: http://www.nass.usda.gov/census/census97/atlas97/summary1.htm

United States Department of Agriculture (USDA). 2003. "National Agricultural Statistics Service—Trends in US Agriculture." Website: http://www.usda.gov/nass/pubs/trends/index.html.

United States . Department of Labor, Bureau of Labor Statistics. 2003. Website: http://www.bls.gov

APPENDIX D – COST-BENEFIT ASSESSMENT

Cost Benefit Assessment

Title: Streamlining of Direct Farm Loan Programs

Cite: 7 CFR Parts 761 - 769

Contact Charles B. Dodson,
Agricultural Economist
Economic and Policy Analysis Staff
Room SB 3736 ph 720-4144
Email Cdodson@wdc.fsa.usda.gov

Background

The Farm Service Agency (FSA) is proposing to streamline its direct loan programs. FSA intends to clarify certain rules that have multiple interpretations, amend others that have led to unintended consequences, and revise policies to reduce requirements on applicants and borrowers. Under the proposed rule, unnecessary procedural requirements would be eliminated, and employees would be allowed greater flexibility to address each customer's unique needs.

FSA proposes to move the majority of its Farm Loan Programs (FLP) direct loan making and servicing rules from Chapter XVIII to Chapter VII of the Code of Federal Regulations (CFR). Prior to the Department of Agriculture Reorganization Act of 1994 (1994 Act), Chapter XVIII was assigned to the Farmers Home Administration (FmHA) and Chapter VII was assigned to the Agricultural Stabilization and Conservation Service (ASCS). Under the provisions of the 1994 Act, both FmHA and ASCS were abolished. FmHA's Farm Loan Programs and ASCS programs were consolidated under the newly created FSA while the remaining FmHA programs were transferred to one of the following Rural Development mission area agencies: Rural Business Cooperative Service, Rural Housing Service, and Rural Utilities Service. Chapter VII of the CFR is now assigned to FSA while Chapter XVIII is shared by FSA and the Rural Development mission area agencies. Consolidation and organization of rules concerning farm loan programs into Chapter VII will make their use easier for all users.

Proposed changes partly represent a response to recommendations of the Civil Rights Action Team (CRAT) and challenges expressed by the National Performance Review (NPR) initiatives. Recommendation 56 of the CRAT mandated that all agencies:

> "Streamline program regulations and application forms to make USDA programs easily accessible to all customers".

The NPR challenged all Federal agencies to focus on results rather than procedures, put customers first, and cut red tape. NPR mandates Federal agencies to review their policies, better organize their rules and procedures, and utilize a more user-friendly writing style. The intent was to make the rules easier to read and understand, thereby addressing much of the public's confusion about how the Government conducts business.

FLP regulations are streamlined under this proposal includes numerous changes to the direct farm loan programs which are addressed in this analysis. Proposed changes are intended to improve the youth loan program by streamlining the application process, improving program accessability, and placing greater emphasis on the financing of agricultural projects. Proposed changes would eliminate unnecessary programs such as the Softwood Timber Loan Program, accelerated repayment agreements in cases of nonmonetary default, and requirement that non-supervised bank accounts be used in conjunction with supervised bank accounts, reducing the burden on FSA employees. Reducing from 5 to 3 years the need for financial and production documentation and eliminating the requirement that borrowers receive financial training before being eligible for primary loan servicing would both benefit borrowers. A proposal to make the borrower more responsible for demonstrating project soundness should decrease FSA's civil liability. The proposed rule allows FSA to require additional information from applicants beyond what is included in the application if it is affects repayment ability which should further reduce the risk of loss. Several of the proposed changes have minimal impacts as they clarify existing rules. This would include clarification of the requirement that loan funds only be used to finance U.S. farm production and clarification of conditions where borrowers may require additional training.

Part 761 General Program Administration

Subpart A- General Provisions

Financing of Capital Improvement Projects (§761.10)

Existing regulations require applicants to select from design standards that have been adopted by FSA. Also, FSA must review any plans to determine the technical soundness of the project and offer suggestions on how specifications may be altered to improve the project design. Further, FSA must review competitive bids with the applicant. Currently, these reviews are conducted by Farm Loan Officers (FLO) or Farm Loan Managers (FLM), many of whom lack the engineering and architectural expertise necessary to review the wide variety of construction and development plans. The lack of expertise can result in delays in construction as the applicant waits for FSA approval and can expose FSA to civil liability if it fails to detect construction deficiencies.

Under the proposed rule, FSA would ensure project soundness by requiring the applicant to provide written certification from the applicable professionals. Depending on the project, the professional may be an architect, an engineer, or an extension specialist. Thus, the applicant and professionals hired by the applicant would be responsible for the technical soundness of the proposal. While the proposal may increase project costs, the loan amount may be increased by the applicant's cost of obtaining a professional opinion. However, not all plans would likely require a professional opinion since many applicants may use pre-approved plans such as those developed by the Cooperative Extension Service. Small capital improvement loans, such as those for under $25,000, would also not require any expert opinion since most are likely made for maintenance of existing structures rather than new construction. Still, even small structures would require site inspections to insure compliance with construction standards.

The proposed rule is expected to lead to FSA time savings because employees would not have to

make project soundness determinations. It also is expected to reduce the civil liability FSA may face for incorrectly assessing project soundness. Likewise, this proposal would increase project costs for applicants having to obtain professional certifications rather than FSA inspections. This change would most likely affect those farm ownership (FO) and farm operating (OL) loans in excess of $25,000 where the primary purpose of the loan was to fund capital improvements. Also affected would be FO loans for which the loan purpose would be to finance the construction of a specialized livestock facility such as a poultry house, dairy barn, or hog facility.

Estimating the impact of this proposed change was based on the following approach. Within FSA's database, loans made for the purchase of real estate and construction of facilities were grouped together. The share of these loans used to finance the construction of specialized livestock facilities was directly related to the number of poultry, dairy, and hog farms within each county as determined from the Census of Agriculture. The share of FO funds used for new construction was assumed to be the same as the share of total capital in buildings as estimated from the Census.

Share of real estate purchase loans within a county assumed to be used for new construction =

$$[S_p * (\#\text{ of poultry farms w/sales} > \$10{,}000) + S_d * (\#\text{ of dairy farms w/sales} > \$10{,}000) + S_h * (\#\text{ of swine farms w/sales} > \$10{,}000)] \div \text{Total \# of farms with sales} > \$10{,}000$$

Where: S_p = share of total capital invested in buildings for poultry farms; S_d =share of total capital invested in buildings for dairy farms; S_h =share of total capital invested in buildings for hog farms. The number of FO loans made for land purchase was estimated as follows:

Number of FO loans for capital construction =
[Total # of direct FO loans for land purchase within county *
Share of real estate purchase loans within a county assumed to be used for new construction].

Based on this calculation, it was estimated that about 225 of FO loans made annually for purchasing real estate were actually used for construction of specialized facilities. Additionally, there are approximately 107 OL and FO loans of over $25,000 made annually to finance capital improvements. Thus, an estimated 332 FO and OL loans made annually would require certifications and inspections (Table 1). The proposed rule would have greatest impacts in States with larger numbers of dairy, swine, or poultry operations, namely: Arkansas, Iowa, Minnesota, Pennsylvania, and Wisconsin.

Table 1. Estimated Number of Direct OL & FO Loans Made Annually for New Construction or Capital Improvements Requiring Inspections, by State, 1996-99.					
AL	9	LA	2	OR	5
AK	2	ME	2	PA	17
AZ	1	MD	4	PR	9
AR	25	MA	4	RI	1
CA	10	MI	13	SC	5
CO	2	MN	14	SD	8
CT	2	MS	11	TN	6
DE	11	MO	5	TX	5
FL	4	MT	2	UT	3
GA	9	NE	12	VT	3
Guam	1	NV	1	VI	1
HI	3	NH	4	VA	5
ID	3	NJ	2	WA	1
IL	10	NY	11	WV	3
IN	6	NC	10	WI	17
IA	19	ND	3		
KS	6	OH	4		
KY	9	OK	7	TOTAL	332
Sources: FSA OBFN database and 1997 Census of Agriculture					

Costs of inspections or professional certifications can vary depending on the nature of the project. No professional certification may be required for small, inexpensive buildings, pre-fabricated buildings, or buildings using approved plans. On the other hand, additional costs to obtain a professional certification and inspection may run as high as 1 percent of the loan amount for specialized or unique buildings. Payment of these costs is an authorized loan purpose and may result in a slight increase of the loan size. But the increased risk from slightly larger loans would be offset by the Government savings of no longer having to conduct inspections or provide certification of plans. Additional costs incurred by borrowers should be offset by greater control over construction timing.

FSA would achieve time savings from not having to review cost estimates or development plans. According to USDA work measurement studies, the estimated average time required for these activities is 60 minutes per loan application, resulting in a total time savings of over 300 hours. Smaller capital improvements would require little or no time, while some specialized livestock facilities may require several hours. Given that these savings would be spread over all county offices, actual impacts from this one change would be inconsequential for a given FSA office.

	332	capital improvement loans annually requiring professional opinions
*	1	[hour of time savings]
)	1776	[hours per FTE]
=	0.20	[FTE's saved]
*	$ 50,000	[$ per FTE]
=	$10,000	[Estimated value of time savings]

While these estimates represent only a rough approximation and are trivial in their magnitude, they indicate that the proposed process improves efficiency. With borrowers having greater control over project timing, it is likely that construction would progress quicker. Secondly, FSA would receive intangible benefits as professional certification and inspections would more likely assure the soundness of loan security and reduce FSA's liability for improper construction.

Subpart D - Borrower Training

The proposed rule would change existing rules concerning borrower training. First, it would eliminate the requirement to assess the need for borrower training when a borrower makes a request for primary loan servicing. FSA can restructure loan terms for borrowers whose accounts are distressed or delinquent due to circumstances beyond their control. Current rules require that before a borrower may receive primary loan servicing, their training needs must be assessed. This provision has the adverse affect of prolonging a borrower's financial stress. It is in the best interest of FSA and the borrower that primary loan servicing be implemented as soon as possible for those borrowers in need, thereby reducing their financial stress.

While assessing training needs of those borrowers experiencing financial stress may be important, it could more effective if undertaken at other times. Ideally, borrower training should be provided before the onset of financial difficulties. By the time financial problems arise, it may be too late for training to be beneficial. This would especially be true for those borrowers requiring write-downs or liquidation. Most financial difficulties are addressed through restructuring or consolidation of debts (Table 2). Borrowers experiencing less severe financial difficulties which can be addressed through a rescheduling may benefit from additional training; however, these needs could probably be more effectively assessed on an ongoing basis. Training needs could easily be evaluated as part of the loan assessment process, year-end review, or limited resource rate review without any substantive change.

Table 2. Borrowers Receiving Primary Loan Servicing and Type of Action Taken Since FY 1989

FY	Number of loans	Number of loans receiving					
		Rescheduling	Consolidation	Deferral	Easement	Buyout	Write-down
1989	84,608	44,022	2,490	6,519	1	17,722	13,842
1990	53,527	29,075	2,066	4,390	9	10,964	6,988
1991	30,619	20,111	1,650	2,372	10	4,658	1,801
1992	26,032	18,531	1,374	2,095	4	2,977	1,032
1993	38,280	23,326	1,055	4,806	7	3,972	5,012
1994	24,849	16,677	934	2,586	39	2,274	2,227
1995	17,680	12,287	812	2,265	20	966	1,239
1996	19,841	14,048	1,101	2,723	49	1,095	697
1997	17,867	12,654	944	3,365	68	271	448
1998	15,486	11,203	822	2,735	56	166	392
1999	14,570	10,292	1,505	2,220	98	107	226
2000	11,047	7,732	1,193	1,560	134	90	185
2001	11,485	8,244	1,138	1,605	165	55	162

Source :FSA's OM3RS Database, October 2001

Also, the proposed rule will clarify situations where a borrower would be required to undergo additional training despite having previously received a waiver or having completed training requirements. Current regulations allow FSA to require additional training when it is deemed necessary. Examples include situations where a new enterprise is established or there are notable changes in the borrower's financial position. However, once a borrower receives a waiver, they rarely take additional training. For example, in September 1998, 15,682 borrowers with OL or FO loans had received a waiver. Two years later, in September 2000, only 16 of these borrowers had been required to take additional training. The proposed rule clarifies that FSA may require additional training for borrowers with waivers where (1) The proposed loan is to finance a new enterprise for which the applicant has not had the appropriate training or (2) information contained in the loan assessment or obtained from year-end analysis, farm visits or the borrower's case file indicates a need for additional training. While this represents no substantive change over current regulations, the additional clarification may result in FSA requiring additional training.

One impact of the proposed rule would be that FSA no longer has to consider additional training for borrowers whose accounts are restructured resulting in a time saving to FSA. These savings would be:

(# of loans expected to annually undergo primary loan servicing) * (time spent processing training waiver) * staff cost

=(11,000 * 0.5 hours)) (1,776 hours/FTE) * ($50,000 per FTE)= 3.1 FTEs or □$150,000.

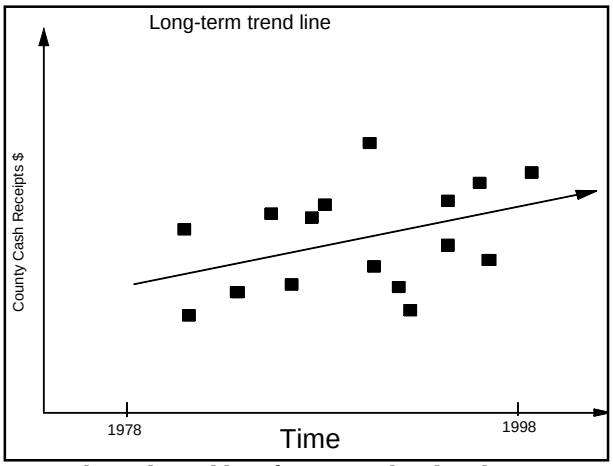
Part 764 - Direct Loan Making

Subpart B - Loan Application Process

Production and Financial Record Documentation

Under the proposed rule, FSA would require 3 years of financial and production documentation as opposed to the 5 years as required under current rules. The current industry standard used by most commercial lenders is 3 years, which is considered to be sufficient to establish trends and measure financial performance. The change is being made because it is believed that the additional 2 years of data do not significantly improve the quality of loan-making decisions. Thus, the current regulations place unnecessary paperwork burden on both applicants and FSA.

Production variables, such as farm income or gross farm sales, can be quite variable from year to year. Despite this variability, there is little indication that the additional 2 years of data are sufficient to make any difference in the quality of information. The impacts of dropping 2 years of production data were evaluated by examining historical county-level data of crop cash receipts which were obtained from USDA's National Agricultural Statistical Service (NASS). While farm-level data would be more indicative of the impacts of the proposed rule, county-level data represents the lowest possible level of aggregation from publically available data. The long-term average was determined by estimating county-level crop cash receipts for the 1978-1998 period. County-level crop cash receipts were estimated as the county production estimate for each commodity times the average state price. Using regression techniques, a trend line for the 1978-98 period was estimated for each county. The trend line should approximate the long-term historical average as hypothetically shown in figure 1. Ideally, analysis of loan repayment ability should be based on these long-term historical trends. Using 5 years of production history rather than 3 years would be expected to provide a more accurate estimate of the long-term average. However, it was found that, on average for all counties, the difference between the 3-year and a longer-term 20-year average for county-level cash crop receipts was only 8.7 percent. In comparison, the difference between the 5-year and 20-year average for county-level cash receipts was 8.6 percent. This 0.1 percent differential (8.7 - 8.6 percent) is deemed inconsequential, and amounting to only $0.25 per acre relative to expected total receipts of $200 per acre. Thus, on average, 5-years of production history provides little additional information over 3-years of production history.



1Hypothetical trend line for county-level cash receipts for 1978-98.

Also, lenders do not use production history as the sole indicator of repayment ability. Rather, lenders may examine trends in the farmer's production or to compare how the farmer's recent production compares with similar farms, such as those within the lender's portfolio or the county. Thus, this proposed change should have little impact on the riskiness of loans made by FSA.

There would be some benefits to both applicants and county offices. In analyzing loan feasibility, the reduction in data requirements is likely to result in some small FSA time savings. It is assumed that it takes 10 minutes for FLO or FLM to verify the fourth and fifth year of production history. The proposed change would only impact new borrowers, however, since the production records would already be available in existing borrowers' case files. Total time savings for FSA are expected to be trivial, less than 1 FTE nationwide. Borrowers also benefit by not having to produce 2 additional years of records.

Requiring Additional Information for Loan Applications

Current regulations do not include any provisions directing FSA to identify and require specific additional information which may be needed for each applicant. In order to accurately assess an applicant's repayment ability, FSA must be able to collect any relevant information which may have an impact on repayment ability. Some examples would include divorce decrees or documentation of child support payments. Based on Census of Population estimates, 9.5 percent of the US population is divorced. Assuming FSA borrowers are reflective of the general population, this suggests that about 10 percent of borrowers could be impacted by the proposed rule. Also, additional information could be required for circumstances where there is passive income such as judgements, class action settlements, or royalty income. It would be very impractical to identify every piece of information which may impact repayment ability and, consequently, require each applicant to provide that information. The proposed rule would allow specific information to be requested as deemed necessary by FSA.

While the proposed rule would require applicants to submit additional information, it is likely that few applicants would notice any change from existing procedures. In most cases, FLO and FLM's are already requesting additional information when it is needed to assess repayment ability or property to secure the loan. Thus, the proposed rule would have minimal impacts since it merely brings regulations in compliance with current procedures. Even if this were not the case, the proposed rule should not affect existing borrowers in good standing. Only those applying for new loans or those going through primary loan servicing would likely be required to submit additional information. Also, there would likely be minimal impacts on cash flow, since most applicants would already correctly include these items.

Loan Funds for Farming Operations in the United States

The proposed rule clarifies the existing statutory requirement that loan funds be used in farming operations located in the United States. The most common instances of cross-border farming

occur in North Dakota and Montana, where U.S. citizens also lease or own land in Canada. There are cases where US citizens own farmland in the United States and Mexico or other Latin American countries. The proposed rule would restrict FSA loan funds from being used to finance livestock or crop production in Canada or Mexico.

This rule would have very limited impact. Currently, it is estimated that there are fewer than 10 cases of both direct and guaranteed borrowers who farm in both the U.S. and Canada and 3 cases of borrowers who farm in Texas and Mexico. For these cases, there would be some costs to the borrowers since the proposed rule would necessitate them keeping different sets of records for domestic and foreign farming operations. There are also few current economic incentives for cross-border farming, suggesting that this will likely continue to be an unimportant issue.

Definition of Family Farm

The proposed rule would modify the definition of family farm for purposes of determining FSA loan eligibility. Farms with gross income above a specific annual farm sales threshold would be considered ineligible for FSA loans. The Consolidated Farm and Rural Development Act requires applicants to "*. . .be or will become operators of not larger than family farms*". The presumption is that many large farms are not family-size farms and consequently, should not be eligible for FSA loans. Under current regulations, the determination of eligibility based on farm size is somewhat subjective and can result in inconsistencies in applying the criteria on a nationwide basis. For eligibility, current rules only require that individuals:

> *Be the owner-operator or tenant-operator of not larger than a family farm after the loan is closed, (7 CFR 1941.12(b)(3); 7 CFR 1943.12(b)(3); 7 CFR 764.4(a)(3)).*

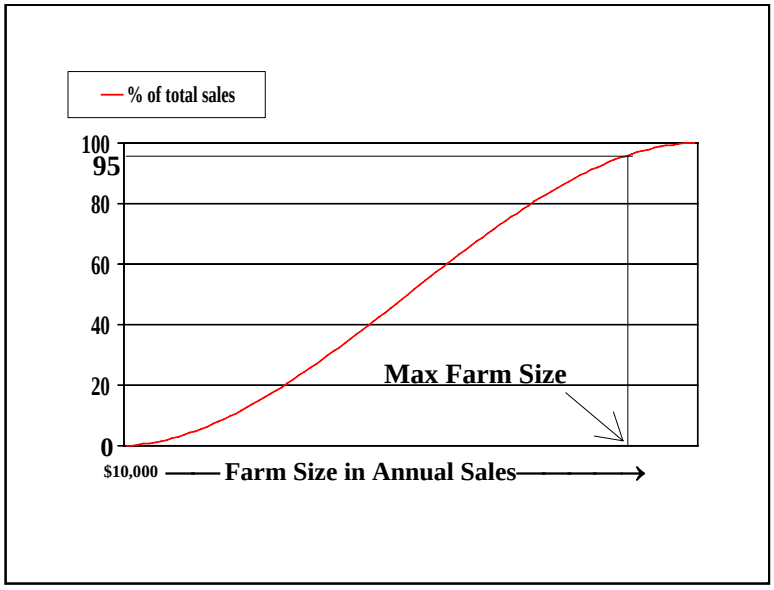
In order to evaluate an applicant's eligibility with respect to farm size, the authorized agency official is directed to:

> *Consider how the applicants farm operation compares to similar farm operations in the community* (*FSA Handbook 3-FLP).*

This definition, however, is subjective and may be applied differently across states. The resulting inconsistencies in applying this definition can lead to confusion for those lenders providing FSA guaranteed loans in multiple states. Also, the existing rule can result in disparaging treatment loan applicants with similar characteristics among states. Without an objective criteria, authorized agency officials are less likely to reject a loan applicant's request based only on farm size. Rather, FSA staff would process the application and evaluate loan eligibility based on measurable factors such as credit history, the ability to develop a feasible repayment plan, provide for adequate security, or the operator's management ability. However, evaluation of such factors may likely to require significant amounts of FSA staff time, especially among larger farms that may have a more complex business organization. Implementation of an objective and measurable criteria to determine farm size eligibility should reduce inconsistencies and save time for FSA staff and farm loan applicants.

Large nonfamily farms would not be denied the opportunity to apply for loans as a result of implementation of the proposed rule. Rather, the proposed rule establishes an objective criteria which shall be used to evaluate loan eligibility as it relates to farm size. Authorized agency officials could utilize this criteria to evaluate an applicants loan eligibility before significant time and effort is spent on processing and evaluating the loan application. In addition, this proposed rule should save time for operators of large farms who could use this criteria to evaluate whether or not to pursue an FSA loan.

However, the income threshold should be selected carefully to avoid excluding *bona fide* family farms. The overall impact of an income threshold would likely vary among production regions and production specialties. For example, large farms are more common in California than in West Virginia. While $1 million in annual sales may be unusual among cash grain farms, it would be fairly common among fruit, vegetable, or nursery farms. Producers of higher valued specialty crops are more common in certain states such as California, Florida, or Arizona. For example, according to the 1997 Census of Agriculture, there were 734 farms with annual sales of over $5.0 million located in California compared to only 3 farms in West Virginia.



2Maximum Farm Size For FSA Loan Program Eligibility Would be Determined Based on the Farm Size Corresponding to the 95 Percentile of Total Farm Sales.

One alternative would be to establish a specific income threshold based on farms in the state with sales in excess of $10,000, based on the most recently published farm data published by the National Agricultural Statistics Service, USDA. Using data from the latest Census of Agriculture, farms within a State could easily be ranked from smallest to largest. The cumulative percent of farm sales contributed by each successive farm could subsequently be estimated. The maximum farm size eligible for FSA loans would be determined where cumulative sales reached 95 percent (Figure 2). However, this procedure would fail to recognize some of the structural differences in farm size among States. Based on the 1997 Census of Agriculture, the 95 percent threshold would range from $135,000 in Montana up to $1.7 million in Arizona (Table 3). To account for these structural differences, the proposed rule would establish an income threshold for FSA direct loan eligibility at the greater of (1) the 95th percentile of farms by sales over $10,000 within a State, or (2) $750,000 of annual sales. Implementation of this higher alternative threshold would result in a higher threshold for loan eligibility in over half of the states (table 3).

Table 3. Upper income eligibility for FSA loan programs by State as determined from 1997 Census of Agriculture, upper 5 and 2.5% percentile of farms with sales greater than 10,000, Option A					
State	**Upper 5%**	**Upper 2.5%**	**State**	**Upper 5%**	**Upper 2.5%**
AL	679,767	1,044,992	MT	135,246	431,235
AK	280,803	349,960	NE	443,987	645,583
AZ	1,649,642	3,214,765	NV	639,745	1,218,240
AR	670,263	1,034,415	NH	333,886	572,929
CA	1,483,079	2,924,235	NJ	562,462	915,998
CO	495,591	873,233	NM	675,978	1,406,714
CT	623,356	1,302,545	NY	406,359	638,187
DE	1,006,386	1,247,589	NC	1,040,146	1,386,069
FL	1,123,221	2,043,143	ND	297,186	409,713
GA	879,070	1,286,548	OH	316,426	506,547
HI	342,438	788,551	OK	294,020	484,725
ID	694,793	1,247,529	OR	608,068	1,034,143
IL	415,742	586,601	PA	370,771	620,844
IN	427,658	608,508	RI	394,797	513,793
IA	407,741	598,914	SC	807,697	1,227,188
KS	363,102	601,623	SD	240,947	531,185
KY	192,716	333,771	TN	298,820	496,231
LA	609,587	861,262	TX	425,214	650,418
ME	410,992	629,936	UT	769,464	1,376,464
MD	594,387	824,318	VT	334,690	594,349
MA	485,874	812,569	VA	478,214	658,434
MI	417,510	640,154	WA	888,227	1,358,717
MN	409,188	611,075	WV	375,694	665,638
MS	919,269	1,218,633	WI	306,799	487,852
MO	206,459	516,098	WY	333,335	564,545

/For States in blue, the threshold for farm size loan eligibility would be of $750,000 in annual sales per year.

Any procedure used to evaluate eligibility based on farm size should be designed so as not to preclude too many *bona fide* family farms A summary of the financial characteristics of farms excluded from eligibility is presented, providing additional insights as to the impacts the proposed rule. It is estimated that implementation of the loan eligibility requirements mentioned in the proposed rule would exclude about 25,000 farms from FSA loan eligibility (Table 4). Of those farms excluded from FSA loan eligibility, 5,500 or 22 percent are likely to be operated as a

full-time family farm.[1]

Table 4. Characteristics of Farms Determined to be Ineligible for FSA Direct Loans Using Various Upper Income Thresholds.		
Item	95th percentile or $750,000	97.5th percentile or $750,000
Farms ineligible for FSA Direct Loans	24,445	19,127
Farms likely to be family farms	5,509	4,250
Farm assets	3,597,738	3,734,118
Farm debt	767,030	806,867
Farm net worth	2,830,708	2,927,252
Gross farm sales	1,907,529	2,050,930
Net farm income	428,717	477,766
Average household income	355,760	382,754
Farm organization		
Sole proprietorship	40	41
Partnership	29	27
Family corporation	31	32
Operator share of labor	1.9	1.8
Share financially stressed	5	7
Share of farms ineligible by farm type		
Corn-soybean	D	D
Wheat	D	D
Cotton/peanut/rice	1.7	1.0
Fruit/vegetable/nursery	4.0	3.1
Hog	1.2	1.2
Poultry	1.5	1.2
Dairy	6.3	5.1
Cattle	D	D
D/ Less than 0.5 %. Source: 1998 ARMS and Census of Agriculture		

[1]For the purposes of this analysis, a farm operator was considered more likely to be a full-time family-owned and family-operated farm if they considered farming to be his or her primary occupation, the family provided most of the total farm labor and the farm business was organized as a sole proprietorship, partnership, or a family corporation. Exceptions were made for fruit, vegetable, and nursery farms where a full-time farm was considered one where the family contributed at least 10 percent of the total farm labor. For dairy farms, a full-time farm was one where the family contributed one-third of total farm labor.

Also, this option would result in the ineligibility of a greater share of dairy, fruit, vegetable, or nursery farms. Meanwhile nearly all corn-soybean, cattle and/or wheat farms would remain eligible. Raising the threshold to 97.5 percent results would not be expected to have any meaningful impacts relative to 95th percentile threshold. Using a higher income threshold would still result in about 19,000 farms excluded from FSA loan eligibility, of which 22 percent are likely to be full-time family-owned and family-operated farms. And as was the case for 95th percentile threshold, a larger share of dairy and fruit-vegetable-nursery farms would be excluded from loan eligibility. Therefore, there appears to little gained, or lost, by increasing the threshold level to the 97.5th percentile.

Benefits would arise from denying loan eligibility to large non-family farm applicants early in the application process. In the estimation of benefits it was assumed that the proportion of large non-family farms applying for FSA loans is approximately equal to the share of all indebted farms that apply to FSA. Approximately 2 percent of indebted farms annually apply for FSA credit. If the same percentage of the 24,445 farms considered ineligible for FSA loan programs apply for FSA loans, there would be about 500 applications denied per year based on the revised eligibility criteria (table 5, line 1). Based on FSA studies, it is estimated that an average of 18.8 work hours are required to process an application. Individuals denied eligibility based on farm size may have a greater proclivity to appeal. Given that the criteria for evaluating farm size eligibility will be measurable and absolute, loan applicants denied eligibility based on farm size may find limited grounds on which to appeal. Nonetheless, it was estimated that as many as 20 percent of those rejected based on farm size appeal the decision. FSA studies estimate that, on average, each appeal requires 8.8 hours of staff-time. Upon considering the aforementioned work-load requirements, the proposed rule should still result in a labor savings, with respect to processing of the loan application, for FSA. Nationwide savings of 4.7 FTE's are projected under the proposed rule (see table 5, row 5). The dollar savings are based on the estimated salary with benefits of a farm loan officer, (FLO) (table 5, row 6).

Table 5. Benefits and Costs of Excluding Very Large Farms from Loan Program Eligibility.

Row #	Item	95th percentile or $750,000
1	# of large farms expected to apply for FSA direct loans which would be ineligible under new rule (2%)	489
2	FSA work hours saved [Row. 1 * 18.8 work-hours per application]	9,191
3	Rejected applicants projected to appeal [Row 1 * 0.20]	98
4	FSA hours handling appeals [Row 3 * 8.8 work-hours per appeal]	864
5	Net FSA FTEs saved [Row 2 - Row 4)/ 1,776 hr per FTE]	4.7

6	Savings @ $50,000/FTE	234,443
	Cost of Implementation:	
7	Hours required to determine eligibility	0.30
8	# of direct loan applications	20,000
9	FTEs required [(Row 7 * Row 8)/ 1,776] hrs/FTE	3.8
10	Costs @$50,000 per FTE ($)	187,688
11	Net Benefits	46,755
12	NPV for 10 yrs @ 6% ($)	$0.3 Mi
13	# of likely full-time family farmslikely to face credit constraints [2% of full-time family farms considered ineligible (table 3, line 2)	110

There would be some costs involved in implementing this proposed change. Specifically, FSA personnel would need to be trained in the evaluation of applications with respect to the revised criteria. The procedure would have to be incorporated into the data processing procedures. For these purposes, it was assumed that there would be 20,000 applications, or prospects, per year. Further, it is assumed that the process used to evaluate farm size eligibility would add 20 minutes per case. This would result in an additional 3.8 FTEs being required nationwide. After considering the implementation costs, the proposed rule would result in a net savings of about 1 FTE per year.

While implementation of the proposed rule would limit the pool of farmers eligible for FSA loans and result in time savings, there are possible risks. Some of the large farms excluded from FSA loan eligibility could still be owned and operated by individuals that consider themselves to be family-size farms. Large family farms that are experiencing financial stress could face a credit crisis if they are unable to obtain commercial credit as a consequence of the proposed rule change. This risk, however, appears to be rather minimal. In addition to meeting the family-size eligibility criteria, an applicant must be unable to meet other loan eligibility requirements. One of the major eligibility criteria is that the applicant must be unable to obtain credit elsewhere at reasonable rates and terms. It would appear that many of the farms considered ineligible using the farm size criteria are unlikely to meet the credit elsewhere test. By conventional standards, most farms excluded would be considered large and financially successful. Among farms likely to be excluded from eligibility, average household incomes of more than $350,000 and average net worth exceeding $2.5 million indicates that most of these farms are financially resilient, and in less need of FSA direct loan programs. Only 5 percent would have been considered financially vulnerable (debt/asset ratio > 0.40 and negative income). Plus, most are family corporations and partnerships where the applicant may not be the primary supplier of the farm

labor. Considering these factors, the number of family-owned and family-operated farms that may be adversely affected by the proposed rule would likely be negligible.

A farmer would considered to be adversely affected if they were a full-time, family-owned, and family-operated farm that would be excluded from FSA loan program eligibility and would be unable obtain credit from commercial lenders. Assuming that 2 percent of the larger full-time family farms will apply for direct loans each year, the proposed rule may result in FSA denying credit to about 100 of these full-time, family-owned, and family-operated farms each year (table 5, line 13). Exclusion of these *likely to be family farmers* from FSA loan programs does not necessarily mean they would be forced out of farming. Rather, they could pursue alternative financial strategies which may include partial liquidation, alternative financing options such as those provided by the Small Business Administration or by individuals.

With a calculated positive NPV of only $300,000, the net benefits of the proposed rule would be considered minimal. Much of the gains obtained from denying eligibility to large non-family farms early in the application process would be absorbed by costs of implementing the additional criteria. However, one should also consider the non-measurable benefits associated with implementation of the proposed rule. There would be less confusion among farm applicants and FSA personnel as to what constitutes a family-size farm. The proposed rule would not only save time for FSA, but also for operators of large nonfamily-size farms. These large farms could used the established criteria to determine whether or not to devote the time to applying for FSA loans. For those field offices which are more likely to receive applications from large non-family farms, there would be significant benefits because the large amount of work required to process a loan for one of these large farm operations would no longer occur.

Subpart C - Requirements for All Direct Program Loans

FSA Lien on Non-Essential Assets

Non-essential assets are those assets that are deemed not be essential to the farming operation and which do not contribute income to pay family living expenses. This would mainly include assets such as boats, trucks and tractors modified for use in the hobby of pulling, snowmobiles, mobile homes, vacation homes, etc. It does not include financial assets such as equity investments in cooperatives. FSA prefers that an applicant sell non-essential assets and reduce the amount of the loan request. However, there are circumstances where the applicant cannot or will not convert non-essential assets to cash. Under current rules, FSA may take a lien on non-essential assets with an aggregate value in excess of $5,000 only for Emergency Loans. The proposed rule would extend this requirement to all direct loans and would change the value of the non-essential assets from an aggregate value exceeding $5,000 to an individual value for each non-essential asset in excess of $5,000. This is done to avoid spending an inordinate amount of time securing liens on small assets which add little to enhance FSA's security position.

In 1999, USDA's ARMS collected information on non-farm assets including (1) off-farm houses, (2) recreational vehicles, (3) household share of trucks and cars, and (4) real estate and businesses not part of the farm. These assets represent the most likely types of non-essential assets. Many of these assets such as cars and trucks are likely to already be pledged as security for installment loans. Therefore, the net value of non-essential assets which could be pledged as security was estimated as:

Non-essential assets which could be offered as security =

$$1 - \left[\frac{\text{Total nonfarm debt}}{\text{(Value of nonfarm real property)}} \right] * \text{Non-essential assets,}$$

where non-essential assets would be the sum of all recreational vehicles, nonfarm share of cars and trucks, nonfarm real estate and businesses.

Table 6. Share of borrowers by amount of nonfarm assets.

Aggregate value of non-essential assets less nonfarm debts	FSA Direct Program Only	FSA EM Borrowers	All other borrowers
Less than $5,000	70	60	50
$5,001 to $15,000	5	10	7
$Over $15,000	25	10	43

Source: 1999 ARMS

About 30 percent of all FSA direct borrowers have non-essential assets with an aggregate value in excess of $5,000 which could be pledged as security for loans (Table 6). However, not all of these borrowers would likely be affected by the proposed rule because some will not have a *single* non-essential asset with a value over $5,000. About one-fourth of all FSA borrowers have non-essential assets in an aggregate value in excess of $15,000. It is likely that most of these borrowers would have some assets individually-valued at over $5,000 which would require the filing of an additional lien under the proposed rule. However, this should not contribute much to work load requirements. In most cases, a lien on non-essential assets can be perfected through an addition to the security agreement.

The ability to collect against non-essential assets may have a notable impact on loss rates. If FSA could have collected an additional $5,000 from one-fourth of the borrowers with write-offs of loans made during the 1990's, loan losses would have been reduced by about 9 percent or about $520 million (Table 7). However, given that borrowers receiving write-offs are likely to have already liquidated most of their assets, this estimate may be high. Still, assuming only $2,500 of non-essential assets for borrowers with write-offs, losses would have been reduced

from $569.2 to $543.0 million. Sometimes borrowers experiencing financial stress may attempt to shift their equity into assets which have not been pledged as loan security. The proposed rule would curtail borrowers from using non-essential assets for such purpose.

Table 7. Possible impact on losses with ability to collect on non-essential assets.

	Losses on FO and OL loans originated since 1991 ($ 000)	Loss rates on FO and OL loans originated since FY 91 (%)
Total write offs	569,263	7.7
Non-essential assets per borrower used to offset losses \1		
$1,000	511,211	6.9
$2,500	496,039	6.7
$5,000	474,323	6.4
$10,000	441,512	5.6

1\ Assuming one-fourth of borrowers with write-offs had non-essential assets which could have been used to reduce losses.

Source: DSTH Database, October 2001

A reduction in subsidy rates would increase loan authority or lower the budget outlay for the same amount of loan authority. If this provision had been in place during the 1990's, subsidy rates used for current years would be lower. Assume that a 4.5 percent reduction in loss rates would reduce subsidy rates by about the same amount. In this case, the FO subsidy rate for FY 2002 would have been 2.5 percent rather than 2.63 percent. Likewise, the OL subsidy rate for FY 2002 would have been 8.5 percent rather than 8.93 percent. The lower subsidy rates would have resulted in a annual budget savings of $2.3 million in FY 2002, to fund the same program level.

Subpart D - Farm Ownership Loan Program

Capital Improvements on Leased Property

Under current rules, FO loan funds may be used for capital improvements to leased land if the term of the lease is long enough to allow the borrower to use the improvement over its useful life. The proposed rule would eliminate this option as an allowable use of FO funds. The existing provision has seldom been used, mostly because borrowers have found it difficult to meet the lease requirements. FSA believes a better use of funds would be to reserve FO loan funds for capital improvements for borrowers who own the land.

The proposed rule is expected to result in higher quality loans because there is a greater incentive to maintain improvements on owned property. Theoretically, capital improvements on leased property may actually cost the farmer who is currently leasing the property because

improvements could increase rent payments. Also, by increasing the value of the property, improvements may make it more difficult for the lessor to purchase the property.

FSA only makes about 50 FO loans per year where loan funds are used for capital improvements. Thus, this proposed change is likely to impact only a small number of farmers. Based on prior experience, about one-third of direct FO loans are made to beginning farmers. Though FSA's database does not track the number of loans made for improvements on leased property, it is likely that the proposed change will adversely impact fewer than 20 beginning farmers annually.

Within the same subpart, FSA also clarifies the interest rate that can be used in joint financing arrangements. The proposed rule reaffirms that the rate charged by FSA in a joint financing arrangement shall not be less than 4 percent. This represents no change over existing practices, as the rate FSA currently charges on joint financing arrangements is 4 percent.

Subpart F - Operating Loan Program

Real Estate Improvements

Current rules allow OL funds to be used to make improvements or repairs to farm land or buildings. Under the proposed rule, OL funds could still be used for minor repairs and improvements, provided that the total costs do not exceed $15,000 per borrower annually. Improvements of greater than $15,000 per year would have to be made using FO loans. Under this provision, borrowers would benefit from a longer amortization period. For example, increasing the amortization period from 7 to 30 years would reduce the borrower's annual debt service obligation by $3,400 (based on a loan amount of $32,000, a 6 percent rate and going from a 7 to 30 year amortization).

The proposed change would have minimal impacts given that OL loans are rarely used to make capital improvements. Fewer than 2 percent of all OL loans, or between 150 and 200, are made each year for repairs or capital improvements, about one-half of which are for amounts over $15,000. Thus, the proposed rule should affect less than 100 borrowers each year who would have to obtain FO loans rather than OL loans to finance capital improvements. The average size of these loans has been $32,000. Thus, the proposed change would result in $3.2 million of loans being made as FO rather than OL loans.

Since the FO loans have a lower subsidy rate, the proposed change would have a small budgetary impact.

OL subsidy rate for FY 2002= 8.93
FO subsidy rate for FY 2002= 2.63

$3.2 Million * (0.0893 - 0.0263) = $204,600 in less budget outlay required.

FSA would experience a slight increase in workload as more time is required to process an FO loan rather than a OL loan. This would mostly involve the extra work to process the mortgage, such as title work and appraisals. Assuming 5 additional hours are required to process each real estate loan, the rule would increase nationwide workload by the inconsequential amount of about 500 hours.

A drawback of the proposed rule is that because FO funds are more limited than OL funds, borrowers may find it more difficult to obtain direct loans to finance capital improvements. For FY 2002, there is $600 million available to fund direct OL loans and $128 million to fund direct FO loans. Also, much of the FO funds are targeted to beginning and socially disadvantaged farmers.

Non-Supervised Bank Accounts

For some borrowers, FSA deposits OL funds into a supervised bank account. Doing so has allowed FSA to monitor and control the use of funds for family living and operating expenses. Prior to the Federal Agriculture Improvement Act of 1996 (Pub. L. 104-127), regulations required that 10 percent of the amount of an annual operating loan, or $5,000, whichever was less, be placed in a non-supervised bank account to be used for family living expenses at the borrower's discretion. Maintaining supervised and non-supervised accounts was burdensome to both borrowers and FSA, and it was unclear if OL funds could be used to meet family living expenses except through the use of a non-supervised bank account. The 1996 Act amended section 312(a) of the Consolidated Farm and Rural Development Act (CONACT) to specifically allow OL loan funds to be used for "farm, ranch, or home needs, including family subsistence". This clarified that OL funds could be used for family living expenses regardless of whether the account was supervised or non-supervised. Thus, there is no need for requiring a non-supervised bank account for family living expenses. The proposed rule clarifies this change by removing references to the 10 percent and $5,000 and simply stating that OL funds may be used for family living expenses.

This change is expected to make it easier for FSA to administer OL loans. Borrowers with supervised bank accounts would benefit by not being constrained by the $5,000 or 10 percent limit which could be used for family living expenses. In many instances, family living expenses would exceed this amount. With family living expenses an approved use of OL funds, borrowers could use a larger share of the OL proceeds to meet family living expenses.

The proposed rule requires the use of supervised bank accounts only in circumstances where "special supervision is needed". However, since supervised credit is used sparingly, few borrowers would be affected. Within its automated data system, FSA does not track the number of borrowers with supervised bank accounts. Borrowers with limited resources and limited education would be the most likely candidates for supervised bank accounts. Limited resource farmers can be defined as those with less than $100,000 in annual sales, less than a high school education, for whom farming is considered their primary livelihood, and who had household income less than $20,000. According to USDA ARMS data, limited resource farmers represented fewer than 2 percent of all indebted farmers in the US in 1999. From this we can

infer that there probably always be a few borrowers which need special supervision and would benefit from the proposed change. But, the vast majority of FSA borrowers should be able to operate without the need for supervised bank accounts and, therefore, will not be impacted.

Subpart G- Youth Loan Program

Under the Youth Loan Program, FSA may make direct loans up to a maximum of $5,000 to rural youth to establish and operate modest income-producing projects under the guidance of 4-H clubs, Future Farmers of America, and similar organizations. Under current rules, this program is available to young people residing in rural areas or in towns with less than 10,000 population. Also, applicants must be between the ages of 10 and 20 and be unable to obtain a loan from other sources. Applicants must sign a promissary note and provide security. Repayment terms can be tailored to the needs of the project.

The loans can be used to finance nearly any kind of income-producing project. However, the project must be planned and operated with the assistance of an organization supervisor, such as a FFA instructor or Cooperative Extension Agent. Applicants must demonstrate that the project will produce sufficient income to repay the loan. Examples of projects include the production of livestock or crops, lawn or garden services, repair shops, and roadside stands.

Youth loans are treated as direct OLs. However, these loans represent a small share of annual direct OL obligations. Since 1993, FSA has lent about $6.4 million annually to about 1,800 youth. The typical loan is small, averaging only $3,500 (Table 8). The current amount outstanding is about $19 million. The approval rate on applications received for youth loans is about 88 percent, with about 1 percent rejected and 11 percent withdrawn by the applicant.

There is considerable geographic variation in the usage of the youth loan program. Demand is much greater in rural regions such as the Corn Belt or the Delta States than in the more heavily populated Northeast or Pacific Coast regions. Demand is especially heavy in Arkansas, Kentucky, Mississippi, Tennessee, Oklahoma, Utah and Iowa (Figure 3). This may be a consequence of current program regulations that do not allow youth loans to youth residing in cities or towns of over 10,000 population.

Table 8. Annual Applications Received, Loans Obligated, and Write-offs for Youth Program Since 1993.					
Calendar Year	**Applications received**	**Loans made**	**Amount obligated ($)**	**Loan size ($)**	**Write-off ($)**
1993	1,799	1,590	5,701,760	3,586	177,162
1994	2,471	2,183	8,101,836	3,711	343,634
1995	1,429	1,263	4,539,210	3,594	155,181
1996	1,554	1,373	4,675,240	3,405	91,942
1997	2,098	1,854	6,132,025	3,307	172,540
1998	2,622	2,317	8,223,698	3,549	53,973
1999	2,399	2,120	7,375,285	3,479	24,768
2000	2,446	2,160	7,471,572	3,459	331
2001	1,873	1,675	5,924,967	3,537	0
Source: FSA OBFN Database, October 2001.					

Youth loans have tended to perform better than other FSA loan programs. Delinquency rates and write-offs are less than for other loan programs. The loss rate has averaged only 2.25 percent of all dollars lent (Table 8). Delinquency rates are about 12 percent compared to about 16 percent for all FSA loan programs (Table 9). About 90 percent of all youth loan borrowers are white, which is the same as for all FSA farm loan programs. Delinquency rates are higher for non-white youth, reflecting trends evident in other FSA farm loan programs.

Table 9. Amount Owed and Delinquency Rate for the Youth Loan Program.				
Borrower Race	Number of Borrowers	Amount of Unpaid Principal ($)	Loans Delinquent (%)	Loans Over 90 Days Past Due(%)
All	6,784	19,177,948	11.5	8.3
Race/ethnicity				
White	5,961	16,734,496	9.3	6.1
Black	459	1,307,258	31.8	30.5
Asian/Pacific Islander	30	131,891	10.0	10.0
American Indian	266	850,448	24.4	15.0
Hispanic	68	153,852	29.4	14.7
Source: FSA's Kansas City PLAS and R540 Database, October 2001.				

Extending Eligibility to Cities and Towns With Population of Over 10,000

The proposed expansion of the Youth Loan Program to youth residing in cities with population between 10,000 and 50,000 is likely to increase the number of potential applicants. Demand for youth loans is much heavier in rural regions. While rural residents in counties with towns of over 10,000 in population have always been eligible, these counties have exhibited a lower demand for youth loans. Relaxation of the population restriction is expected to affect youth eligibility in about one-fourth of all US counties, many of which are located near population centers such as the Northeast and California.

The current and proposed restrictions on eligibility applies only to youth residing in cities or towns with populations between 10,000 and 50,000. The eligibility of youth residing outside of the city limits would not be affected. In recent years, however, the trend followed by municipalities has been to expand their jurisdiction in a way that city limits may now encompass farms. This is very common in the Northeast and may partially explain their lower participation

3. Youth loans made since 1993 through December 2000. Each dot represents one loan.

in the Youth Loan Program.

The presence of cities of over 10,000 population appears to curtail the use of the Youth Loan Program. In counties with towns of under 10,000 population, it was estimated that 1.34 percent of youth participate in the Youth Loan Program (Table 10). For counties with towns of over 10,000 residents, the rate of participation is lower at 0.59 percent of youth residing on farms. Population growth has led to a larger share of farm youth residing in counties with cities of over 50,000 population. Currently, over one-third of all farm youth reside in counties where there is a city with a population between 10,000 and 50,000. Because the proposed rule would expand the number of youth eligible for this program, the change is likely to increase demand for youth program loans.

If it is assumed that participation rates in the Youth Loan Program in counties with cities of populations between 10,000 and 50,000 will increase from 0.68 percent to 1.34 percent of farm youth, an additional 1,337 youth loans would be added to the portfolio (see Box). Since the average term of a youth loan is 4.3 years, 23 percent more loans (an additional 308 loans), are expected to be made each year. Given an average loan size of $3,500, this would increase annual demand for loan funds by a little over $1 million over the long run. Given the subsidy rate on OL loans from the President's 2002 budget of 8.93 percent, this proposed change could require an additional budget outlay of only $96,000 (Table 11). If additional budget outlay is not provided, the proposal would result in slightly less money available for regular OL loans. The subsidy rate used to estimate expected additional budget outlays is based on historical performance of regular OL loans.

BOX. Estimating the Number of Farm Youth.
Step 1. Estimate the number of youth between 10 and 20 years of age who are living on farms.

$$\text{Number of farm youth} = \frac{\text{Number of youth (ages 10-20) in county}}{\text{County population}} * \text{Estimated farm population within county}$$

The number of youth in a county and the county population are obtained from the Bureau of the Census Current Population Survey. The estimated farm population is derived from the Census of Agriculture.

Estimated farm population= (Number of sole proprietorships operated by farmers between the ages of 25 and 55) *(4.25 people per farm) +(Number of sole proprietorships operated by farmers over the age of 55) * (1.75 people per farm) + (Number of partnerships and corporations) * (8.5 people per farm).

Step 2. Estimate the share of farm youth receiving youth loans.

$$\text{Youth receiving youth loans (\%)} = \frac{\text{Number of youth loans}}{\text{Number of farm youth in county}} * 100$$

Step 3. Estimate the share of farm youth receiving youth loans in counties with towns/cities of population of :

(1) Under 10,000
(2) 10,000 or more
(3) Under 50,000
(4) 50,000 or more
(5) Between 10,000 and 50,000

Step 4. Assume that the same share of farm youth in counties with towns/cities between 10,000 and 50,000 is expected to receive youth loans as the share has been in counties with no towns of over 10,000.

Table 10. Farm Youth by City/County Size and Participation Rate in the Youth Loan Program.						
	Total population	Number Residing in Counties With Cities/Towns With Populations of				
		Under 10,000	Over 10,000	Under 50,000	Over 50,000	10,000-50,000
Farm population	4,394,401	2,428,153	1,966,248	3,753,142	641,259	1,324,989
Number of farm youth	664,633	363,626	301,007	567,779	96,854	204,153
Youth Loan borrowers	6,639	4,867	1,772	6,265	374	1,398
Share of youth participating in Youth Loans (%)	1.00	1.34	0.59	1.10	0.39	0.68
Source: 1997 Census of Agriculture; Bureau of Census Population Survey						

Table 11. Estimated Additional Demand for Youth Loans And Additional Budget Outlay Required.	
Farm youth in counties with cities of population between 10,000 and 50,000	204,153
* Share expected to receive youth loans	1.34%
= Total youth loans expected	2,735
- Number already receiving loans	1,398
=Total number of additional youth loans	1,337
* Share receiving loans each year	0.23
= Expected additional youth loans/yr	308
* Average loan size	$3,500
= *Total annual additional demand*	***$1,076,808***
* Subsidy rate for OL loans	.0893
= Additional annual budget outlay required (under these assumptions)	**$96,159**

The additional loans would result in marginally more workload for FSA staff. From USDA work measurement studies, it is estimated that 25.7 hours are required to process each youth loan application. This includes application processing, borrower meetings, farm visits, and credit checks. Also, this estimate incorporates the time savings achieved by streamlining the youth loan application process, which is also proposed in this rule. Processing the additional loans would increase the workload by the equivalent of 4.5 FTE's, nationwide. Given that the additional workload would be spread out over 2,000 county offices, the increase would be inconsequential (Table 12).

Table 12. Estimated Additional FTE's Required and Cost.

Expected additional applications per year	308
* Estimated work-time for application, determination of eligibility, loan feasibility, and closing	25.7 hours per application
= Total additional hours required	7,915
) Work-hours per FTE	1,776
= Additional FTE's required	4.5
* Annual salary, including fringe benefits, for FLO (GS-11, Step 5)	$50,000

= Annual Additional Salary Cost	$222,850

This proposed change may result in intangible benefits accruing to highly populated counties where farm youth otherwise not financially capable would be able to undertake 4-H or FFA projects. This experience is likely to expand their opportunities to accept responsibility and practice financial management.

Streamlining the Youth Loan Application Process

The proposed rule would eliminate some application requirements which are not considered necessary for youth loans. The proposal would eliminate the requirements to obtain 3 years of production records, verify off-farm income, obtain a credit report, verify the applicant's debts, and obtain legal documentation of real property or leases. Youth applying for these loans typically have no credit background, no farm production history, no off-farm income, and do not own any real property. Thus, the requirements which would be eliminated are expected to have minimal impact on eligibility. Under the proposed rule, a complete application would include a forecast of income and expenses for the project, a recommendation and plan of supervision by a project advisor, and consent of a parent or guardian.

The streamlining of the application process for youth loans is expected to result in time savings to both applicants and FSA. Based on USDA work measurement studies, it was estimated that the proposed rule would save about 7 hours from the time currently required to process an application, determine eligibility, and disburse funds for each youth loan. Based on an expected annual demand for youth loans of 2,000, the proposed rule is expected to save 14,000 staff hours for FSA resulting in a savings of about 8 FTEs (Table 13). Since this represents nationwide savings, most county offices are expected to be unaffected by the proposed rule. But as shown by figure 3, some county offices process more youth loans than others. The reduced time requirement should enable FSA employees to spend more time with applicants and borrowers in need of assistance. Applicants would benefit because they would have to spend less time in assembling the application package. For a typical youth loan, it was estimated that the proposed rule would save 3 hours, resulting in a total annual savings of 6,000 hours to the public (Table 13).

Table 13. Estimated Time Savings and Benefits Achieved Through Streamlining the Youth Loan Application Process.	
Expected applications per year	2,000
* Estimated time-savings for application, determination of eligibility, loan feasibility, and closing (hours per application)	7
= Total time savings (hours)	14,000
) Work-hours per FTE	1,776
= Number of FTE's saved	7.9
* Annual salary including fringe benefits for FLO (GS-11, Step 5)	$50,000
= FSA Annual Salary Savings	**$394,144**
Estimated applicant time savings (hours per application)	3
= Applicant time savings (hours)	**6,000**

Other Provisions Affecting Youth Loans

The proposed rule would lessen collateral requirements for youth loans. While this proposal would make it easier for youth to obtain loans, it would increase FSA's risk exposure. However, it is not expected to result in any notable increase in loan losses. As previously noted, losses on youth loans are relatively low, averaging 2.25 percent. The provision that would require youth loans to support agricultural related projects should decrease demand and assure that loans are used for purposes more in line with FSA's intent. This provision should also assure that the proposal to expand youth loans to cities with a population of 50,000 does not result in loans for non-farm purposes. Since data is not collected as to specific loan purposes for youth loans, the specific impact of this provision cannot be determined.

Subpart I

Loan Decision and Closing After Loan Denial is Overturned

Under current rules, loan approval is not automatic after a loan denial is overturned. FSA must reevaluate the request based on the findings of the appeal hearing officer and take the next step toward processing the loan application. Current regulations do not specify the process that occurs after an appeal is overturned.

Under the proposed rule, FSA would consider the following for possible loan approval after the loan denial is overturned:

(1) A satisfactory review of current financial information and determination of whether changes in the applicant's financial condition would adversely affect the applicant's repayment ability;
(2) A determination that the applicant will be able to produce a crop in the production cycle for which the loan was requested (specifically for production loans);

(3) A determination that the applicant's operating plan, as modified based on the appeal decision, projects a feasible plan.

The benefit of the proposed change is that it would create an efficient and consistent process for FSA and applicants. However, the impacts are expected to be minimal, given the limited number of applicants this is expected to affect. In recent years there have been fewer than 15 loan denials overturned, annually.

Satisfaction of Total Credit Needs

Loan limits and limited availability of direct loan funds can make it difficult for FSA to satisfy an operation's total credit needs. Some farms may have credit needs in excess of the $200,000 limit for OL and FO loans. Hence, for many applicants direct FSA loans may provide only a share of the farm's total credit needs. Under current regulations loans may be approved based on a plan of operation which includes an infusion of debt capital (loan) from a non-FSA source in order for the plan to be feasible. For example, approval of an FO loan or an OL loan may be contingent on the applicant obtaining non-FSA financing for annual operating expenses. Current FSA regulations do not require the applicant to document their ability to obtain a non-FSA loan. The proposed rule changes this, since FSA believes current regulations put some loans at risk.

To some, this proposed change may appear to be in conflict with the test for credit that requires FSA applicants to demonstrate an inability to obtain credit at reasonable rates and terms. But, the ability of an applicant to obtain some of their credit from non-FSA sources is not an indication that an applicant is ineligible for FSA loan programs. A provision of credit from non-FSA sources may be based on the applicant's ability to obtain some credit from FSA, and vice versa. FSA's terms and, in some cases, subordination of lien priority may enable commercial lenders to make loans to applicants to whom they would not otherwise be able to serve.

For applicants obtaining much of their credit from other sources, the proposed rule does not represent any major change. Applicants most likely to be adversely impacted are those who have historically relied on FSA for their total credit needs. While over half of all FSA direct borrowers receive 75 percent of their credit using FSA direct loans, most of these only reported 1 loan (Table 14). FSA borrowers with only one loan tend to be smaller and less likely to have needs for additional credit. Among FSA borrowers with only 1 loan, average annual farm sales were only $73,000 and average FSA indebtedness was $66,616. Thus, it may be necessary to exempt from this rule smaller size loan requests.

Farmers in regions where there are fewer commercial credit sources are more likely to be adversely affected by the proposed change. USDA studies have shown that there about 900 rural counties, many of which are in the Northeast and South, where FSA serves over one-third of all farmers. With limited credit sources, it may be more difficult for farmers in these regions to obtain credit from other lenders, possibly resulting in some of these farms being ineligible for FSA loan programs. On the other hand, counties with few commercial credit sources can be

characterized by limited farm production and an overall low demand for farm credit. However, the proposed change would only apply to those applicants who indicate that their operating plan to be feasible they have to obtain additional credit from other sources to satisfy their total credit needs.

Table 14. Characteristics of Borrowers by Degree of Reliance on FSA for Credit Needs.					
	FSA borrowers with only 1 loan	FSA direct borrowers with multiple loans			
		75-100	50 - 75	25 - 50	Under 25%
Item	Percent				
% of FSA Borrowers	37	20	15	16	12
% of FSA Direct Debt	15	20	15	29	21
	Dollars per farm				
FSA Debt	66,616	145,655	108,378	117,959	43,288
Farm Sales	73,205	131,588	285,682	219,080	323,203
	Percent market share				
FSA	100	90	63	40	15
Bank	0	10	23	20	40
FCS	0	--	6	11	22
Source: 1999 ARMS					

Part 765
Direct Loan Servicing

Subpart B- Limited Resource Interest Rates

Under current regulations, the interest rate on a limited resource loan may not be changed more than once per quarter. This policy was established when interest rates were higher and more volatile. The proposed rule allows FSA to change the interest rate for a borrower receiving a limited resource rate at any time it becomes aware of an increase in the borrower's income and repayment ability. The proposed rule would continue to require that FSA review limited resource rates annually. Under current policy, limited resource interest rates are typically changed only at this annual review. Since the proposed rule does not change the regularity of these reviews, it is likely that the regularity at which limited resource rates are changed will not be impacted. Thus, while there are over 24,000 borrowers with limited resource interest rates, very few if any would be impacted by the proposed rule.

Subpart D- Borrower Payments

Current rules are not clear as to how a borrower's payments are applied in cases where a borrower has multiple loans. The proposed rule would clarify that payments would be applied in the following order:

X Annual operating loans;

X Delinquent FLP installments, paying least-secured loans first;

X Non-delinquent FLP installments due in the current operating cycle in order of security priority, paying least-secured loans first; and

X Any future FLP installments due.

The proposed change is intended to assure that regular payments would be applied to protect FSA's security interest. In most cases, borrower's payments are already being applied in this manner. However, there may be some instances where borrowers desire to pay installment loans before operating loans in order to protect any equity they have in the collateral. This would most likely occur among the 8,000 borrowers with multiple loans who are currently delinquent. Given the large number of delinquent borrowers with multiple loans, implementation of this change is important to insure protection of FSA's security interest.

Subpart E - Protective Advances

FSA is authorized to approve vouchers, or protective advances, to pay costs, including insurance and real estate taxes, to preserve and protect the security, the lien, or priority of the lien. FSA makes protective advances to about 3 percent of its borrowers each year. In most cases, FSA makes protective advances for delinquent real estate taxes. When real estate taxes are delinquent, counties, or other municipalities, file tax liens which have priority over claims filed by mortgage lenders, including FSA. Thus, it is generally in the lender's interest to pay delinquent real estate taxes in order to protect their security interests. The amount of the protective advance is added to the outstanding principal when a loan is rescheduled or reamortized, except for advances to pay prior or junior liens other than real estate tax liens. Also, advances may be made to pay for repairs and maintenance necessary to preserve the value of the property in the case of abandonment or liquidation.

Under current rules, a borrower's eligibility for further FLP assistance is not affected by a protective advance. Under the proposed rule, FSA would continue to make protective advances; however, FSA would now make a distinction between circumstances within and those beyond the borrower's control. For example, a natural disaster, low yields, or low prices may have left the borrower with insufficient resources to pay their real estate taxes or insurance premiums. Protective advances made for circumstances within the borrower's control would occur when the borrower has the financial resources to meet their obligations but chooses not to meet those obligations. Since real estate taxes and insurance premiums are small relative to the loan payment, it is unlikely that borrowers current on their loan payments to FSA do not have financial resources to pay their real estate taxes and/or insurance. Thus, protective advances to borrowers current on their loan payments are likely due to circumstances within their control. This is reflected by the fact that nearly all borrowers with protective advances, 98 percent, were also delinquent on their FLP loans.

The proposed rule provides that protective advances made due to circumstances beyond the borrower's control would not result in ineligibility for future FLP assistance. However, protective advances made due to circumstances within the borrower's control would make the borrower ineligible for further FLP assistance.

If protective advances occurred only when a borrower did not have the resources to meet their obligations, protective advances should be in direct proportion to delinquency rates. States with the highest amounts of delinquencies would be expected to also have more protective advances.

Expected outstanding protective advances which are within a borrower's control for a State = $EPAWBC_{STATE}$

> *$EPAWBC_{STATE}$ = [(States national share of delinquent borrowers * Total number of outstanding protective advances nationwide)]*

Cases where the actual number of protective advances granted exceeded that which would be expected reflect circumstances within the control of the borrower.

> *Estimated outstanding number of protective advances which are beyond a borrower's control for a State=$EPABBC_{STATE.}$*
>
> *$EPABBC_{STATE.}$ = MAX (0, Total count of outstanding protective advances within a State - $EPAWBC_{STATE}$)*

For example, using the above equations it was estimated that the number of expected protected advances in Alabama would be 19 borrowers (Table 15). However, there were only 9 borrowers with outstanding protective advances. Since the number of expected advances exceeded the actual number, it was estimated that there were 0 advances granted for circumstances within the borrower's control. In contrast, New York reported 143 actual protective advances while only 87 were expected indicating 54 protective advances were within the borrower's control.

States where it appeared that protective advances were occurring for circumstances *within* the borrower's control were California, New York, Mississippi, Texas, and Louisiana (Table 15). The concentration of protective advances in these States may be more reflective of real estate laws within these States rather than economic conditions. Using the aforementioned procedure, it is indicated that at least 600 borrowers nationwide are receiving protective advances for circumstances within their control. Except for the few States mentioned above, most States would likely experience no impacts from the proposed rule. Under the proposed rule these 600 borrowers would have been ineligible for additional FLP assistance if the rule were currently in force. However the implementation of the rule may reduce this number, as borrowers would be more likely to remedy the situation requiring the protective advance rather than risk losing eligibility for future assistance.

Although unlikely, there may also be cases where a borrower has sufficient resources to meet

their obligations but chooses to be delinquent on both their loan payments and their real estate taxes. This would also represent an instance where a protective advance is made for a circumstance likely within the borrowers control.

Table 15. Number of Actual and Expected Protective Advances Outstanding by State.

State	Protective Advances				State	Protective Advances			
	Actual	$ per borrower	Expected	# Within Control		Actual	$ per borrower	Expected	# Within Control
AL	9	454	19	0	NE	34	15,551	46	0
AK	1	170,523	3	0	NV	1	106	2	0
AZ	12	24,955	16	0	NH	3	26,899	2	1
AR	49	29,604	95	0	NJ	31	21,831	22	9
CA.	93	12,156	77	16	NM	19	4,041	18	1
CO	12	11,848	24	0	NY	143	26,017	87	56
CT	320	20,051	3	0	NC	24	15,592	42	0
DE	2	10,265	2	2	ND	54	17,424	72	0
FL	22	2,556	27	0	OH	26	552	24	2
GA	50	19,097	62	0	OK	144	7,265	148	0
GUAM	0	0	1	0	OR	20	5,796	20	0
HI	10	1,638	14	0	PA	27	23,671	37	0
ID	22	3,458	36	0	PR	43	4,084	220	0
IL	23	13,475	26	0	RI	1	443,735	3	0
IN	17	3,302	26	0	SC	25	4,253	27	0
IA	22	48,429	41	0	SD	28	6,296	43	0
KS	24	1,183	42	0	TN	35	1,510	73	0
KY	21	12,710	46	0	TX	696	4,552	393	303
LA	211	816	109	102	UT	4	53,662	19	0
ME	23	18,565	25	0	VT	8	3,224	5	3
MD	5	4,110	9	0	VI	1	153	1	0
MA.	7	59,183	26	0	VA	29	9,375	30	0
MI	16	28,088	25	0	WA	30	16,725	30	0
MN	79	19,587	84	0	WV	8	334	36	0
MS	265	9,332	158	107	WI	16	19,264	35	0
MO	23	38,138	35	0	WY	11	78,561	7	4
MT	18	34,605	26	0					
					TOTAL	2,500	11,055	2,500	608

Source R540 (AFX732.DELALL), OCTOBER 2001
1/ Where LNNBR GT 73

Subpart H -Disposing of a Portion of Real Estate Security

Under certain circumstances, a borrower proposing to sell, exchange, or otherwise dispose of a portion of real estate security must obtain an appraisal prior to disposition. If the estimated value of the real estate security intended for disposition exceeds $10,000, an appraisal is required. FSA

implemented this requirement to ensure that the borrower obtains fair market value for the real estate security, and that FSA's security interest is protected, i.e. the loan-to-value ratio does not increase as a result of the release. In cases where an appraisal is not required, FSA estimates the value of the real estate based on current real estate values for the area in which the property is located. However, increases in farm land values and a growing demand for relatively small land parcels for new housing places a large burden on FSA to have appraisals undertaken.

The proposed rule would increase the maximum value of security which could be released without an appraisal to $20,000. But as with the existing regulations, FSA would still have the discretion, when in its best interest, to require an appraisal when the estimated value is below this limit. The proposed rule would also require an appraisal of the remaining real estate security only when FSA believes its value is diminished by an amount greater than the market value of the property proposed for disposition.

The proposed rule is expected to reduce the number of appraisals required. In some States, land values are sufficiently high that even a $20,000 limit may not reduce the number of appraisals. In most parts of the Northeast where urban sprawl has increased land values, appraisals may be required more often (Table 16). Increasing the minimum to $20,000 would still result in any parcel of 4 acres or more requiring an appraisal. An alternative approach which could be considered is to set the limit higher in States with high land values. The minimum value required for an appraisal could be set at the greater of $20,000 or 5 percent of the average value of farmland and buildings per farm for each State. The latter could easily be determined from the publically available USDA data. This alternative approach would result in the limit being raised above 20,000 in many States with higher land values such as the Northeast and eastern Corn Belt.

FSA proposes modifying this requirement because of the costs of conducting appraisals for real estate properties with values between $10,000 and $20,000. Conducting real estate appraisals can require a significant amount of time. Locating comparable sales, examining public records, travel, and reconciling the value can take over 20 hours. Thus, an appraisal can easily cost $1,000 or more. Given an average FO loan size of $56,000, a $10,000 release would likely represent a small portion of the total value of the secured property. Undoubtedly, there will be cases where the loan-to-value ratio increases because no appraisal is conducted. But as long as the loan remains well-secured, no additional loan losses are expected as a consequence of conducting fewer appraisals.

Partial disposition of real estate security can result in additional losses when FSA's loan becomes under secured. For example, consider a $50,000 loan against a $60,000 parcel of real estate for a 0.83 loan-to-value ratio. Assume the borrower proposed to dispose part of the real estate with estimated value of $10,000. FSA would likely require that at least 0.83 of the $10,000 sale price of the property be applied toward the loan so that FSA's security position is not harmed. The remaining property would have a value of $50,000 to secure a loan of $41,667 for a loan-to-value ratio of 0.83. Under current rules an appraisal would have been conducted to assure that the value of the property is really $10,000 and that the value of the remaining property is

$50,000. Suppose the estimate of the property value is low. Instead of being worth $10,000, it is actually worth $20,000, and the remaining property is worth $40,000. Without an appraisal, FSA would be left with a $41,667 loan secured with real estate valued at $40,000 . If the loan went into default, FSA would risk loss to principal. An appraisal may have uncovered this problem and probably resulted in FSA requiring a greater reduction in the loan balance before the security is released. Thus, appraisals reduce the likelihood that releases will result in future losses.

In most cases, the loan-to-value ratio would be sufficiently low that a $10,000 release would not affect FSA's security position. Thus, even if the value of disposed property were to be understated, FSA would most likely remain well-secured after the release. Moreover, FSA would still have discretion under the proposed rule to require appraisals for releases of under $20,000. As long as FSA can identify cases where a release could result in an unsecured position and require appraisals for those cases, no costs or losses are expected.

Typically, appraisals are not performed by FSA employees but are contracted out. In most cases, FSA pays for such appraisals out of reserve funds known as Type 60 funds, which are funds appropriated by Congress for all contract obligations. In recent years, Type 60 funds have been barely sufficient to cover all appraisal costs. FSA does not have administrative authority to transfer funds into or out of the Type 60 accounts. The proposed rule is expected to help assure that there are sufficient Type 60 funds available throughout the year to pay all contracting costs.

This proposed modification is expected to reduce appraisal costs incurred by FSA and reduce the administrative burden associated with handling borrower requests for disposition of real estate security. Also, the proposal would allow FSA to process a borrower's request for disposition of real estate security in a more timely manner.

Based on the 1999 Agricultural Resource Management Study (ARMS), it is estimated that 80 percent of tracts sold (in 1999) were valued at $10,000 or more, with 65-percent having had a value greater than $20,000 (Table 17). Assuming that estimates of all US farms would apply to FSA, the savings associated with this proposal can be estimated. In recent years FSA has spent from $4-$7 million on appraisals. In addition to partial releases, this amount would include appraisal costs associated with all servicing actions and loan originations. The amount for partial releases can not be exactly determined but is estimated at $500,000 per year in this analysis. This is based on an average appraisal cost of $750 for 600 appraisals for partial releases. The proposed rule is expected to reduce the number of partial releases requiring an appraisal by about 20 percent (1 - (65/80)). This would reduce the number of appraisals from 600 to 488, saving about $85,000 per year. Allowing higher minimums in States with higher land values would reduce the share of tracts requiring an appraisal to 62 percent and would be expected to save over $100,000 in appraisal costs. While this may seem to be a relatively small amount, it would represent a large share of Type 60 funds and could enable the amount appropriated to meet demand.

Table 16. Minimum Value of Real Estate Parcel Requiring Appraisal Under Revised Rule and Minimum Acres Under Revised and Existing Rule.

State	Minimum Acres Requiring Appraisal Under Existing Rule	Minimum Acres Requiring Appraisal Under Proposed Rule	Alternative Proposal \1		State	Minimum Acres Requiring Appraisal Under Existing Rule	Minimum Acres Requiring Appraisal Under Proposed Rule	Alternative Proposal	
			Minimum Value Requiring Appraisal	Minimum Acres Requiring Appraisal				Minimum value Requiring Appraisal	Minimum Acres Requiring Appraisal
AL	6.9	13.8	20,000	13.9	NE	15.5	31	20,000	31.0
AR	8.7	17.4	20,000	17.4	NH	4.4	8.8	20,000	8.9
AZ	10.1	20.2	20,000	20.3	NJ	1.4	2.8	**29,000**	4.1
CA	3.8	7.6	**41,000**	15.7	NM	46.1	92.2	20,000	92.2
CO	16.2	32.4	20,000	32.4	NV	25.5	51	20,000	51.0
CT	1.7	3.4	**26,000**	4.4	NY	7.8	15.6	20,000	15.6
DE	3.8	7.6	**26,000**	9.8	OH	4.9	9.8	20,000	9.8
FL	4.5	9	**25,000**	11.2	OK	16.4	32.8	20,000	32.8
GA	6.6	13.2	20,000	13.2	OR	10.4	20.8	20,000	20.8
IA	5.9	11.8	**27,000**	15.9	PA	4.2	8.4	20,000	8.4
ID	9.8	19.6	**24,000**	20.6	RI	1.5	3	**27,000**	4.2
IL	4.7	9.4	**36,000**	16.9	SC	6.8	13.6	20,000	13.5
IN	4.9	9.8	**23,000**	11.2	SD	28.7	57.4	20,000	57.5
KS	17.3	34.6	20,000	34.7	TN	5.5	11	20,000	11.0
KY	6.9	13.8	20,000	13.8	TX	16.9	33.8	20,000	33.7
LA	8.3	16.6	20,000	16.5	UT	12.4	24.8	20,000	24.8
MA	1.9	3.8	**24,000**	4.6	VA	5.2	10.4	20,000	10.4
MD	3.1	6.2	**26,000**	8.2	VT	6.6	13.2	20,000	13.2
ME	8.4	16.8	20,000	16.8	WA	8.4	16.8	**23,000**	19.3
MI	6.0	12	20,000	12.0	WI	8.1	16.2	20,000	16.1
MN	8.6	17.2	20,000	17.2	WV	9.2	18.4	20,000	18.3
MO	9.3	18.6	20,000	18.7	VA	5.2	10.4	20,000	10.4
MS	9.5	19	20,000	19.0	VT	6.6	13.2	20,000	13.2
MT	34.0	68	20,000	68.0	WA	8.4	16.8	**23,000**	19.3
NC	4.8	9.6	20,000	9.6	WI	8.1	16.2	20,000	16.1
ND	24.9	49.8	20,000	49.9	WV	9.2	18.4	20,000	18.3
					WY	45.0	90	20,000	90.1

1\ Calculation based on the maximum of $20,000 or 5% of the estimated average value of land and buildings for each state as of December 31, 1999.

States with minimums above $20,000 are shown in bold.

*[600 appraisals * $750 per appraisal] - [(65/80) * 600 appraisals * $750 per appraisal] = $84,376 projected annual savings on appraisals by raising the minimums to $20,000,*

where 65 is the percent of land sales over $20,000 and 80 is the percent of land sales over $10,000.

*[600 appraisals * $750 per appraisal] - [(62/80) * 600 appraisals * $750 per appraisals] = $101,250 projected annual savings on appraisals by raising the minimums to $20,000 or higher in States with relatively higher real estate values,*

where 62 is the percent of land sales over $20,000 or the maximum under the alternative proposal and 80 is the percent of land sales over $10,000.

(62/80) * $ spent on appraisals = savings on appraisals by raising the minimums to $20,000 or higher in states with relatively higher real estate values.

Table 17. Share of All Partial Real Estate Sales Requiring an Appraisal in 1999.

Minimum value of tract sold ($)	Share requiring appraisal (%)	Share not requiring appraisal (%)	Estimated # of partial releases requiring appraisals	Estimated annual appraisal costs ($ 000)
10,000	80	20	600	450
20,000	65	35	488	367
20,000 \1	62	38	465	349

\1 For States with higher land values.

Source: 1999 ARMS Data

Based on the above, it would be expected that the number of partial releases requiring an appraisal would be reduced by 20 percent. Even though FSA staff is not likely to perform the appraisals, it would still require some time on the part of FSA to make the necessary arrangements. Work measurement studies indicate that coordinating each appraisal requires 1 hour of work on the part of FSA staff. Thus, the proposed rule should reduce workload by 112 hours per year.

Subpart I - Transfer of Security and Assumption of Debt

Nonprogram Loan Terms

A nonprogram loan represents an extension of credit for the convenience of the Government because the applicant does not qualify for program assistance or the property to be financed is not suited for program purposes. A nonprogram loan has terms which are more stringent than those of a program loan.

Nonprogram loans may be made for such purposes as:

X Sale of inventory property

X Assumption of a program loan on nonprogram terms

X Loans converted to nonprogram status as a result of receipt of unauthorized assistance

X Loans converted to nonprogram status when only a portion of the secured property is transferred to FSA

X Sale of real property that was security for a farm program loan to the previous owner under the leaseback/buyback program on nonprogram terms

X Sale of real property of a farm loan program borrower that is covered under the Homestead Protection program.

Nonprogram loans are ineligible for program entitlements or servicing actions such as subsidy, reamortization, rescheduling, consolidation, deferral, limited resource assistance, buyout, write down, and conservation easement.

The most common use of nonprogram credit has been in financing the sale of inventory property when either the property or the purchaser was ineligible for FLP loans. Because interest rates on nonprogram loans are set at rates comparable to those charged by commercial lenders, other than costs of administration, nonprogram loans represent no budgetary cost to the Federal Government.

Current rules allow nonprogram loans secured by real estate to be amortized over a period not to exceed 15 years. In addition, current rules provide that the State Executive Director has the authority to extent the nonprogram loan term to 25 years, provided the extension is in the Government's best financial interest and FSA retains the same lien position. The proposed rule would base the nonprogram loan term on the applicant's repayment ability, for up to a maximum term of 25 years. Lengthening of loan terms would lower the debt service obligation for nonprogram borrowers, thereby making it easier to qualify for nonprogram loans. The primary benefit of this provision is that it would be easier to dispose of indebtedness when borrowers exit farming. It would also make it easier to dispose of acquired property through credit sales. Though FSA has legal authority to make credit sales, FSA has not received any budget outlay for credit sales since 1995. Thus, this change would most likely only impact nonprogram real estate loans made as a result of servicing actions. While nonprogram loans may be unsecured or secured only by chattels, the proposed rule would not change the amortization of these loans.

Credit sales represent the largest component of outstanding nonprogram real estate loans totaling over $100 million nationwide. Other outstanding nonprogram real estate loans total $29 million. However, since credit sales are no longer funded, originations of nonprogram real estate loans are few with most States averaging less than one per year (Table 18). The increase in loan term may result in a slight increase on the number of assumptions, and therefore, the proposed rule would be expected to have limited impacts on the public. The term for nonprogram loans secured by chattels has remained the same, therefore, no impact on the public is expected.

Lengthening the term for real estate secured nonprogram loans to 25 years should enable FSA to

resolve delinquent accounts quickly. For nonprogram real estate loans, which average only $45,000, the rule would reduce annual payments by $1,000. The proposed rule would also enable inventory property to be sold more readily, if budget authority is granted for credit sales in the future. For an average credit sale loan of $85,000 and interest rate of 8 percent, the additional 5 years would reduce the amount of the annual payment by nearly $2,000. Based on 1999 ARMS data, it was estimated that lowering the annual debt service obligation by $2,000 would result in an additional 50,000 to 100,000 farmers having the repayment capacity to purchase inventory property.

Table 18. Nonprogram Loans Made Since FY 96.

State	Nonprogram loans/yr		Nonprogram loan size		State	Nonprogram loans/yr		Nonprogram loan size	
	Real estate	Non-real estate	Real Estate	Non-real estate		Real estate	Non-real estate	Real estate	Non-real estate
AL	0.2	6	35,890	47,310	MT	0.0	22	0	57,728
AK	0.2	3	23,098	74,231	NE	0.3	64	94,069	43,629
AZ	0.0	1	0	58,478	NV	0.0	1	0	60,427
AR	1.5	40	57,730	56,939	NH	0.3	19	6,636	37,060
CA	0.8	44	65,642	67,628	NJ	0.5	6	28,001	40,483
CO	0.0	10	0	49,986	NM	0.0	4	0	52,267
CT	0.0	1	0	15,007	NY	0.3	98	29,242	58,039
DE	0.2	0	9,829	12,649	NC	2.2	37	59,218	39,933
FL	0.0	9	0	44,456	ND	0.2	88	13,000	70,890
GA	1.5	16	49,939	57,355	OH	0.3	9	7,295	50,727
GUAM	0.2	0	20,000	79,010	OK	1.0	100	39,288	42,961
HI	0.0	11	0	42,696	OR	0.3	13	35,478	57,773
ID	0.0	19	0	58,937	PA	3.3	199	49,693	47,708
IL	1.5	34	25,408	42,158	PR	12.0	51	38,537	43,256
IN	1.2	16	36,534	57,342	RI	0.2	4	55,000	40,123
IA	0.8	58	71,174	45,896	SC	0.8	12	37,386	45,884
KS	1.5	53	36,880	55,957	SD	0.2	29	80,000	58,477
KY	0.5	67	5,861	33,755	TN	0.8	33	90,859	53,425
LA	0.5	59	138,940	47,630	TX	0.2	119	20,300	40,984
ME	0.0	11	0	43,567	UT	0.0	8	0	61,901
MD	0.0	4	0	39,156	VT	0.3	19	53,991	58,683
MA	2.7	28	62,461	33,672	VA	0.7	21	40,276	56,569
MI	0.2	30	78,624	61,439	WA	0.0	11	0	54,635
MN	3.0	92	38,777	50,138	W V	1.2	41	29,829	31,066
MS	1.5	30	35,965	39,073	WI	0.7	73	86,703	69,618
MO	1.5	88	31,656	46,106	WY	0.0	19	0	53,110

Source: FSA's R540 Database October 2001
\Excludes Special Apple Program Loans

Part 766
Direct Loan Servicing Special

Subpart C- Loan Servicing Programs

Financial and Production Records

As with applicants, FSA proposes to reduce the burden on borrowers applying for loan servicing by requiring the borrower to submit only 3 years of historical financial and production documentation when applying for loan servicing. Currently, FSA requires the borrower to submit 5 years of historical financial and production records. As discussed under direct loan making, the additional 2 years of data contributes little additional information beyond the industry standard of 3 years. Implementation of this change would result in minor time savings for FSA since it takes only a few minutes for FLO to verify the fourth and fifth year of production history. The proposed change would have little impact on current borrowers, given that production records most likely are already available in existing borrowers' case files.

Deferral Period Under Primary Loan Servicing

Under primary loan servicing, borrowers can have all or part of their payments deferred for up to 5 years. Under current rules, the borrower is not required to make any installment payments during the deferral period. The loans continue to accrue interest at the contractual interest rate. At the end of the deferral period, loans are rescheduled based on the deferred principal and interest which generally results in higher loan payments than would have existed before the deferral.
Current rules stipulate that a deferral period will not exceed 5 annual payments, but are unclear on how the length of a deferral is determined. Consequently, FSA has often granted borrowers 5-year deferrals in cases where shorter deferrals would suffice. Under the proposed rule, the maximum deferral term would still be 5 years, but FSA would grant the shortest deferral period that would result in a feasible operating plan without debt write-down.

The proposed rule would result in no direct cost to the Government, as regardless of the deferral period, loans continue to accrue interest. Also, the change would require no additional work-load for FSA employees. A shorter deferral period would reduce the risk of loss to the Government, as principal amounts are recovered sooner. A longer than needed deferral period may provide a false indication of improved cash flow and encourage borrowers to incur additional debt, which in turn, may impede the borrowers' ability to repay the FSA loan when the deferral period ends.

The proposed rule would impact some borrowers undergoing primary loan servicing. Over the past 6 years, FSA has granted an average of 2,635 deferrals annually. The total FSA indebtedness for each borrower seeking deferrals has averaged over $250,000 with deferrals occurring on about one-third of this debt. The average size of the note on which payments have been deferred has been about $86,000.

Primary Loan Servicing Deferral Statistics:
Average Number of Deferrals Granted Per Year Since FY94 = 2,635
Average FSA Debt Outstanding for Borrowers Granted Deferrals= $256,569
Average Amount of Interest Deferred Per Borrower= $ 4,328
Estimated Average Size of Loans With Deferrals= $ 86,561
Source: OM3RS December 2000

For the average size loan, there would only be about a $1,500 difference between the 1- and 5-year deferral periods assuming a 5-percent limited resource interest rate and 30 year term (Table 19). For example, a 5-year deferral period would lower the annual cash flow requirements for year 1 through 5 by $5,630 but would result in payments of $7,950 in years 6 through 30. If the deferral period is 3 years, annual cash flow requirements for years 1 through 3 would still be reduced by $5,630 but would result in payments of $7,288 in years 4 through 30.

Table 19. Effects on Annual Loan Installment for a Typical Loan as Deferral Period Is Reduced from 5 Years.

Deferral Period (years)	Annual Loan Payment at the End of Deferral Period
0	$ 5,630
1	$ 6,393
2	$ 6,822
3	$ 7,288
4	$ 7,795
5	$ 7,950

Loan of $86,561 @ 5 percent interest rate for 30 years.

Elimination of Softwood Timber Loan Program (STLP)

STLP allows eligible borrowers to convert all or a portion of their FSA debt to STLP loan. Financially distressed borrowers, who convert 50 or more acres of marginal land to softwood timber production, can reamortize their FSA loans and defer payment for up to 45 years. A borrower must be able to develop a feasible plan which shows that loan payments can be made from income generated from harvesting softwood timber.

FSA currently has only 108 STLP loans outstanding to 38 borrowers. The reamortization to STLP for nearly all of these loans was completed prior to the early 1990's, with none completed in recent years. These existing loans would be unaffected by the proposed rule. Only the ability to convert loans under STLP would be affected. Since no loans are currently being reamortized under this program, impacts would be minimal. Elimination of STLP would eliminate costs associated with maintaining the program. These would include costs for training FSA staff, monitoring STLP loans, maintaining automation programs, and publishing STLP regulations.

Table 20. Softwood Timber Loans Outstanding by State			
State	Number of Loans	Principal Outstanding ($)	Average Loan Size ($)
AL	12	$ 438,502	$36,542
AR	18	$ 612,871	$ 34,048
FL	15	$ 332,154	$ 22,144
GA	28	$ 1,096,315	$ 39,154
LA	2	$ 104,000	$ 52,000
MS	18	$ 985,468	$ 54,748
SC	6	$ 478,349	$ 79,725
VT	4	$ 66,226	$ 16,556
Source: FSA PLAS December 2000			

The limited use of STLP has occurred despite evidence of positive economic incentives to convert marginal cropland to timber. Budgets produced by forest economists at the University of Georgia show that farmers who convert cropland to softwood timber could expect to receive the equivalent of between $30 and $130 per acre annually. That is, the lump sum payment at time of harvest would be the same, in present value terms, as an annual income of between $30 and $130 per acre. This represents a return per-acre which could support a feasible plan for forestry production. For example, a $34-per-acre return would support debt of up to $343 per acre while an $83 return would support the maximum $1,000 debt per acre which is well within the parameters of STLP.

Despite these revenue levels, there is a general lack of interest in STLP, for which there may be several explanations. Softwood timber production is only feasible within certain regions of the country, leaving many borrowers essentially ineligible for STLP assistance. Climatic conditions limit softwood timber production to the southern United States, while most of FSA's loan activity is in the Great Plains. Also, STLP is limited to marginal and highly-erodible crop land, most of which would be classified in capability class IV or greater by the USDA's Natural Resources Conservation Service (NRCS). However, only 15 percent of all crop land is in land capability class IV or greater according to NRCS's 1997 National Resources Inventory. In addition, STLP is limited to 50,000 acres nation-wide.

Large commodity program payments and disaster assistance have helped stabilize the farm sector, supported farm land values, and enabled borrowers to make current interest and principal payments. Thus, many FSA borrowers are able to project positive income and feasible plan from the production of crops or livestock.

In addition, FSA borrowers and FSA loan officers lack the technical knowledge and expertise in timber production. For example, the long planning horizon of 30 to 40 years raises a great deal of uncertainty. Farmers and lenders are unlikely to enter into such a contract unless they have a good understanding of risks and returns. Farmers who need an annual income to support their household would be unwilling to enter into such a long contract. Thus, STLP is likely to

represent a viable alternative only to FSA borrowers experiencing financial distress who can support their household from nonfarm income sources.

STLP requires that all lienholders release their liens on the land to secure the softwood timber loan. Given the increases in land values that occurred during the 1990s, lienholders are likely to have positive value in the security which would inhibit the relinquishment of any lien.

The combination of these factors greatly limits STLP use. While continuing low commodity prices may provide greater incentives to convert cropland to softwood timber, STLP appears to be too restrictive to be useful as a policy instrument to facilitate this conversion.

Accelerated Repayment Agreements (ARAs)

Under an ARA a borrower is required to pay off the loan over a period shorter than the original loan term. This agreement is used in lieu of foreclosure when it is in FSA's best financial interest and when the borrower can meet the accelerated payment schedule. Under current rules, FSA may enter into an ARA with a borrower when FSA considers liquidating an account because the borrower falls into nonmonetary default. Nonmonetary default occurs when borrowers make timely payments but may otherwise fail to abide by the terms of the loan agreement. For example, this provision could be used when a borrower is financially able to refinance their direct loans with private lenders but refuses to do so, or the borrower is no longer farming and refuses to convert their debt to a nonprogram loan.

The proposed rule would eliminate ARAs as a method of dealing with nonmonetary default. The result of eliminating ARAs would be that borrowers in nonmonetary default would have their loans accelerated and FSA could initiate foreclosure proceedings. Because ARAs are rarely executed the impact of the proposed change should be minimal. Borrowers who could have met the accelerated repayment schedule could have likely cured the nonmonetary default. The alternative of acceleration and foreclosure should encourage these qualified borrowers to refinance their FSA debt with commercial lenders and non-farming borrowers to convert their FSA loans to nonprogram status more promptly.

Unauthorized Assistance

Unauthorized assistance is defined as any loan, primary loan servicing action, or interest subsidy for which there was no authorization, for which the borrower was not eligible, or which was obligated from the wrong fund. Under current rules, FSA splits an unauthorized loan into two components: one loan account for the authorized portion of the loan and a second loan account for the unauthorized portion of the loan. The unauthorized portion of the loan is treated as a nonprogram loan. However, current rules are unclear to FSA staff and borrowers especially with respect to splitting the loan into two accounts. The proposed rule clarifies the resolution of unauthorized assistance.

Under the proposed rule, FSA would no longer automatically split the loan into two accounts. The proposed rule would require borrowers receiving unauthorized assistance to repay the unauthorized portion of the loan within 90 days of FSA notice, regardless of whether the fault lay with FSA or the borrower. Borrowers receiving unauthorized assistance could receive a nonprogram loan for the amount of the unauthorized assistance, provided that they can demonstrate that they do not have the financial resources to meet the 90 days repayment requirement and they did not intentionally provide incomplete or false information. Borrowers receiving unauthorized assistance because they knowingly submitted false information would be required to repay the unauthorized assistance back in full within 90 days of FSA notice and would be ineligible for any future assistance.

In some cases, the proposed rule represents little change from current procedures. As under current rules, there can still be two separate loan accounts for those borrowers receiving unauthorized assistance through no fault of their own; a nonprogram loan for the unauthorized portion of the loan, a regular loan for the authorized portion of the loan. However, it is expected that two separate accounts would be needed much less frequently under the proposed rule than under the current rule.

Borrowers able to repay the unauthorized assistance would be adversely affected by the proposed rule. Under current rules the affected borrower would not have had to come up with the resources to repay the unauthorized assistance within 90 days. The requirement to repay the assistance within 90 days is likely to be burdensome to borrowers who may have to liquidate assets or negotiate loans to repay the unauthorized assistance. However, few borrowers are likely to be affected by the proposed rule. Unauthorized assistance has historically been serviced as nonprogram loan. Excluding credit sales, most States execute few nonprogram loans each year. On average, only 25 nonprogram loans have been originated in each State since 1995. Many of these nonprogram loans would be for purposes other than unauthorized assistance. Thus, it is expected that this provision of the proposed rule will affect fewer than 20 farmers per State annually.

Part 767
Inventory Property Management

Subpart D - Disposal of Inventory Property

Chattel Inventory Property Disposition Methods

Current rules allow FSA to sell inventory chattel property through an auction, sealed bid, or regular sale. However, very few chattel properties enter into FSA inventory. Because there is such a large cost associated with managing chattels, FSA attempts to avoid their conveyance. Borrowers are encouraged to sell the chattel and use the proceeds to repay their loans. FSA has taken into inventory only 14 chattels during the 1990s, most of which were sold by FSA without using bids or auctions (Table 21). The proposed rule would eliminate the use of these sale methods and require sale solely by public auction. A public auction is considered the most

efficient and common venue for selling chattel property. It would provide everyone who has the financial resources to do so, an opportunity to purchase the property.

Current rules also state that "beginning farmers or ranchers obtaining special OL assistance . . . will receive priority in the purchase of farm equipment held in government inventory during the commitment period". The proposed rule would eliminate this preference since FSA's statutory authority for providing special OL assistance was eliminated by section 616 of the Federal Agriculture Improvement and Reform Act of 1996, as amended.

Because of the limited amount of chattels FSA takes into inventory, the new provision should have a minimal impact on FSA, beginning farmers and the general public.

Table 21. Chattel properties acquired and disposition methods.	
Number of chattel properties acquired during the 1990s	14
Properties sold by:	
Auction	2
Bid	1
By Agency	10
Sold to beginning farmers	0
Average time held (months)	9
Loss as % of acquired value	2.7%
Source: FSA AQPD Database, October 2001	

Summary

This proposed rule includes numerous changes to the direct loan program. Individually, most have relatively minor economic impacts. Collectively, the changes have net benefits equivalent to about $7 million and would reduce workload for FSA offices (Appendix Table 1). Few individuals would be adversely impacted by the proposed rule changes. The proposal to exclude nonfamily size farms from eligibility could adversely impact some large family farms. FSA borrowers totally reliant on FSA financing may be adversely affected as they may now have to obtain some loans from non-FSA sources. But, this represents only a small portion of FSA current borrowers. Farmers dealing with FSA may experience increased requirements for such things as financing construction, or additional documentation of repayment ability. Various provisions of the proposed rule benefit both current and future applicants. This would include expansion and streamlining of the youth loan program, reducing the years of records required, and reducing requirements for appraisals in the case of partial releases. There are provisions

which reduce losses and thereby, risks to taxpayers. Utilization of nonessential assets as loan security is likely to reduce loan losses. A provision to place more burden on borrowers to demonstrate the soundness of any construction projects would reduce FSA's civil liability and assure the viability of loan security.

Overall, the proposed changes considered in this analysis should result in an improved performance of FSA's Farm Loan Programs with fewer regulations, reduced workload, and decreased risk to taxpayers.