TITLE V
CREDIT

SUMMARY OF CREDIT TITLE REFORM

Recommendations In Brief

Improve farm bill financial credit policies for farm borrowers, particularly beginning and socially disadvantaged producers.

Problem

The average age of farmers continues to climb, creating questions about whether the next generation of producers is equipped to replace the wave of aging farmers as they retire. Barriers to entering production agriculture are high, which is especially burdensome for beginning and socially disadvantaged farmers who have limited financial assets. For example, in 2002, the value of land and buildings averaged $595,000 per principal operator 35-years-old and younger. Access to adequate loan funds can help to level the playing field for these farmers. Loans authorized through the farm bill credit title can play a unique role in supporting first-time farm buyers.

Finally, certain legislative requirements of farm loan programs have not been updated in decades. With the changing dynamics of today's production agriculture, these policies require updating. For example, the two direct loan limits of $200,000 are too rigid and outdated, not having been updated since the 1970s and 80s. Much has changed in over two decades – land prices are higher, equipment is larger and more expensive, and fuel, fertilizer, and other input costs are higher – yet the limits have remained stagnant.

These issues were discussed nationwide during the USDA Farm Bill Forums. For example, Ed from Ohio stated, "The challenges facing new farmers is nearly impossible to overcome…Come up with something innovative that will allow my kids to reach their dream of farming." And Andy, from Idaho, spoke from personal experience, "as a young farmer I used the FSA Guaranteed Loan Program. I recently was able to purchase my first piece of ground with the help of it. However, I'm up to the ceiling, and if I want to expand like I need to, to stay economically viable, I think it would help to raise the ceiling."

Recommended Solution

The Administration is recommending changes to Title V – entitled "Credit." Following is a list of the major components of the package.

1. Double the statutory target for the percentage of USDA direct operating loans that will be prioritized to assist beginning and socially disadvantaged farmers. Prioritize 100 percent of direct farm ownership loans to first meet the needs of beginning and socially disadvantaged farmers. Overhaul the federal repooling procedures to ensure that these targets are reserved only for beginning and socially disadvantaged farmers to the maximum extent possible. (For further information, see the proposal entitled "Loans Targeted to Beginning and Socially Disadvantaged Farmers" on pages 108 – 109.)

2. Enhance the existing Beginning Farmer and Rancher Downpayment Loan Program to increase the opportunities for the next generation of production agriculturalists. Reduce the four percent interest rate to two percent. Defer the first annual payment for one year. Eliminate the $250,000 cap on the value of property that may be acquired. Decrease the minimum producer contribution from 10 percent of the property purchase price to five percent and add socially disadvantaged farmers and ranchers as eligible applicants. (For further information, see the proposal entitled "Beginning Farmer And Rancher Downpayment Loan Program" on pages 110 – 111.)
3. Increase the existing limits of $200,000 for direct ownership (FO) loans and $200,000 for direct operating loans (OL) to a maximum of $500,000 indebtedness for any combination of the two loan types. (For further information, see the proposal entitled "FSA Direct Loan Limits" on pages 112 – 113.)

LOANS TARGETED TO BEGINNING AND SOCIALLY DISADVANTAGED FARMERS

Recommendation in Brief

Double the statutory target for the percentage of USDA direct operating loans (OL) that will be prioritized to assist beginning farmers and socially disadvantaged (SDA) farmers. Prioritize 100 percent of direct farm ownership (FO) loans to first meet the needs of beginning and SDA farmers. Overhaul the federal repooling procedures to ensure that these targets are reserved only for beginning and SDA farmers to the maximum extent possible.

Problem

The barriers to entering production agriculture are high. With an increasingly aging farm population, these barriers threaten our next generation of agriculturalists. Access to adequate loan funds is a significant barrier to entry for beginning and SDA farmers. These farmers frequently have limited financial means, or have a limited track record in business operations. As a result, commercial loans can be difficult to obtain for beginning and SDA farmers. During USDA Farm Bill Forums, young producers and commercial lenders alike addressed the issue of equity. Brad in Wisconsin said, "The biggest challenge I face as a banker when we address young farmers is lack of equity as it relates to the amount of capital investment it takes you to get into agriculture."

Recommended Solution

The Administration recommends doubling the statutory target for direct OL funds for beginning and SDA farmers from 35 percent to 70 percent. Additionally, we propose increasing the direct FO target for beginning and SDA farmers from 70 to 100 percent. Increasing the target levels would provide additional assurance that beginning and SDA farmers have financing options to purchase farmland and then operate those farms.

Under current law, thirty days before the end of the fiscal year, any unused beginning and SDA direct loan funds are repooled from the States. Section 5315 of the 2002 farm bill required that repooled SDA operating loans must first be re-distributed to those states that have unmet SDA operating loan need. The Administration proposes to expand this repooling method to all other USDA SDA loan programs – direct FO, guaranteed FO, and guaranteed OL. Additionally, we propose a similar repooling regime for all types of USDA beginning farmer loan programs – direct OL and FO as well as guaranteed OL and FO.

Under the new policy, unutilized targeted loan funds would be repooled from the states on the established lifting date and re-distributed in the following order –

1. Unmet SDA or beginning farmer need in other states within type of loan (i.e. repooled SDA direct FO funds used only to address SDA direct FO unmet needs within other states)
2. Unmet SDA or beginning farmer need in other states within category of loan (i.e. repooled SDA direct FO funds used only to address unmet need for any

type of SDA loan within other states – direct OL as well as guaranteed FO or OL)

3. Unmet SDA or beginning farmer need in other states between the two categories (i.e. repooled SDA loan funds could be used to meet unmet beginning farmer loan needs and vice versa)
4. Unmet general need within the state of origin
5. Unmet general need nationwide

This new repooling strategy will require additional time for USDA to administer; thus we recommend the target lifting date for these loans be changed from September 1st to August 15th.

Background

USDA loan funds are appropriated by Congress each year. The amount appropriated in some years does not allow USDA to fund all the loan applications received. Beginning farmers often have more difficulty obtaining financing because they cannot meet commercial lender financial requirements. A relatively small number of beginning farmers are entering production agriculture, and they often experience financial difficulties attempting to get established.

Existing beginning farmer funding targets for USDA loans are specified by law as follows:

Program	Funds Targeted	Proposed New Target	Current Date Target Lifted	Proposed New Date Target Lifted
direct FO	70 percent	100 percent	September 1	August 15
direct OL	35 percent	70 percent	September 1	August 15
guaranteed OL (regular)	40 percent	40 percent	April 1	April 1
guaranteed OL (interest assistance)	15 percent	15 percent	March 1	March 1
guaranteed FO	25 percent	25 percent	April 1	April 1

BEGINNING FARMER AND RANCHER DOWNPAYMENT LOAN PROGRAM

Recommendation in Brief

Enhance the existing Beginning Farmer and Rancher Downpayment Loan Program to increase the opportunities for the next generation of production agriculturalists to succeed.

Problem

In 2002, farms with over $10,000 in annual sales and that were operated by individuals under 35 years of age accounted for less than 7 percent of all farms, as compared to 19 percent in 1982. Meanwhile, the share of farms with over $10,000 in sales operated by farmers over 65 increased from 14 to 25 percent. The sharp decline in young farmers has raised concerns that an insufficient pool of new entrants will be available to replace a large and growing pool of retiring farmers.

The cyclical and highly variable nature of farm income creates major challenges for highly leveraged first-time farm buyers. Even when such producers make diligent use of available risk management tools, they experience significant difficulty servicing high levels of debt. This debt service burden often consumes needed operating capital, and results in poor performance or failure.

The existing "Beginning Farmers and Ranchers Downpayment Loan Program" was designed to help mitigate this situation. However, several statutory requirements have limited its use among some beginning agriculturalists. Concerns expressed during USDA Farm Bill Forums included the interest rate being too high, the term being too short, the initial out-of-pocket investment of the beginning producer being too high, and the maximum loan value cap being too low to start a commercially viable farm. For example, the current maximum property value of $250,000 would only allow a beginning farmer to purchase 105 acres of cropland on average (i.e. average cropland value of $2390 per acre times 105 acres equals approximately $250,000). This situation often relegates beginning farmers into an untenable position – forced to purchase the cheapest, most marginal land or attempt to make a living on a less than commercially-viable-sized farm.

In addition, socially disadvantaged (SDA) citizens face many of the same barriers to entry as beginning farmers and ranchers, yet federal programs designed to provide assistance are not always effective.

Recommended Solution

The Administration proposes enhancing the existing Beginning Farmers and Ranchers Downpayment Loan Program in several ways.

1. Change the four percent interest rate to two percent.
2. Defer initiation of first annual payment for one year (i.e. Current law requires repayment in 15 equal installments starting on year one; this proposal would

defer the first installment to year two allowing the loan to be repaid in 16 years, instead of 15.)

3. Eliminate the $250,000 cap on the value of property that may be acquired by a beginning farmer wishing to obtain a downpayment loan. Replace it with a maximum downpayment loan amount of $200,000. This proposal at a minimum doubles the potential beginning farmer or rancher's buying power. (Current law allows a downpayment loan of no more than 40 percent of the $250,000 property value cap, which equates to a downpayment loan of no more than $100,000.)
4. Decrease the minimum beginning farmer or rancher contribution from 10 percent of the property purchase price to five percent.
5. Add socially disadvantaged (SDA) farmers and ranchers as eligible applicants for this program.

Background

Many have raised questions about the adequacy of the future workforce to farm the nation's agricultural lands. There is concern about the fact that there are fewer young, new farm entrants than there are older retiring farmers. Establishing succeeding generations of farmers is an on-going concern. Potential new farmers often face significant barriers to entry. An enhanced federal downpayment program would allow beginning farmers more flexibility to cope with income volatility and increase the likelihood of establishing new successful farm businesses.

Section 310E of the Consolidated Farm and Rural Development Act (CONACT) authorizes the "Beginning Farmers and Ranchers Downpayment Loan Program." This program allows beginning farmers and ranchers to borrow up to 40 percent of the lower of the purchase price or appraisal value. Interest rates are statutorily set at four percent for a maximum loan period of fifteen years. Under the program, the beginning farmer or rancher must contribute a downpayment of at least ten percent of the farm or ranch purchase price. Additionally, the maximum value of the property to be acquired cannot exceed $250,000. Socially disadvantaged farmers are currently not eligible for the program unless they meet the beginning farmer and rancher criteria.

FSA DIRECT LOAN LIMITS

Recommendation in Brief
Increase the existing limits of $200,000 for direct farm ownership (FO) loans and $200,000 for direct operating loans (OL) to a maximum of $500,000 indebtedness for any combination of the two loan types.

Problem
The maximum amount an individual may receive in FSA Farm Loan Programs is specifically prescribed in the Consolidated Farm and Rural Development Act (CONACT). The maximum direct loan amounts specified in the CONACT have not kept pace with increases in the cost of farm land and production inputs. The CONACT direct operating loan limits were last increased in 1984 when the limit went from $100,000 to its current $200,000 limit. Direct FO loan limits were increased from $100,000 to $200,000 in 1978. These loan levels have become insufficient to meet the credit needs of medium-sized family farmers.

During the USDA Farm Bill Forums, producers from across the country commented on the limiting effects of decades old loan limits. Mike from Ohio said, “The current limits of $200,000 for farm loans and $200,000 for operating loans were set over 20 years ago. Production costs and real estate values have greatly increased over the past 20 years…we think the loan limit should be increased.”

Recommended Solution
Increase the existing limits of $200,000 for direct FO and $200,000 for direct operating loans to a maximum of $500,000 for any combination of the two loan types. The higher, combined limit will allow a better matching of loan type, amount, and purpose to an individual applicant’s credit needs. It will also improve access to capital, and therefore the competitiveness, of beginning farmers and other FSA loan applicants.

A similar action taken in 1998, to establish a combined total limit for guaranteed loans, has been effective.

Background
Since the last increase in the direct FO limit, farmland values have increased significantly. The current loan limit in the direct FO program places many FSA farm loan applicants at a disadvantage when competing with other potential buyers for farmland. FSA applicants characteristically have limited equity and lower net incomes, which prevent them from securing commercial loans.

Input costs for production agriculture and the price of machinery have risen dramatically since the last increase in the direct operating loan limit in 1984. These higher outlays equate to elevated levels of capital investment needed to initiate and sustain a family farming operation. Access to financial capital for beginning farmers is limited by the level of risk and return compared to other lending opportunities for rural banks. The

present direct OL limit does not meet the credit needs of an increasing number of farm families and inhibits their efforts to operate and improve the competitiveness of their farm operations.