

RESTRUCTURING F.S.A. GUARANTEED FARMER PROGRAM LOANS

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- I. **Introduction/ Overview.** Loan servicing options available for F.S.A (formerly FmHA) "guaranteed" loans through a private lender are very similar to those available for F.S.A. "direct" loans. However, loan servicing options for guaranteed loans are discretionary with the private lender, while loan servicing options for direct loans are mandatory.
- A. **Definitions.** A "guaranteed" loan is a loan made through a private lender under which F.S.A. promises to pay the lender up to 90% of the amount owed on the loan if a farmer cannot pay it back.¹ A "direct" (insured) loan is a loan made through F.S.A. where no private lender is involved.
- B. **Guaranteed loan servicing is discretionary.** The major difference between loan servicing of guaranteed loans and direct loans involves the extent to which such servicing is mandatory.
1. In F.S.A.'s direct loan programs, if you meet certain eligibility requirements F.S.A. must give you loan servicing in most cases.²
 2. Under the guaranteed loan program it is left to the discretion of the lender (i.e. the bank) as to whether or not to allow you loan servicing, even if you are otherwise eligible.
- C. **Approval of F.S.A. is required if the lender agrees to restructure.** If the lender agrees to restructure the guaranteed loan, it is still necessary to obtain F.S.A.'s approval. However, F.S.A. must approve if:
1. The restructure is similar to what F.S.A. can do with direct loans;
 2. The restructure requires the borrower to pay the greatest of either,
 - a. the maximum amount the borrower can afford to pay, or
 - b. the amount the lender could reasonably expect to recover in a bankruptcy or liquidation; and
 3. All other eligibility requirements are met, as set out in more detail below.³
- D. **Rules to encourage a lender to restructure.** There are parts of the regulations and the "lender's agreement" with F.S.A. that you can use to encourage a lender to restructure your guaranteed loan.
1. The lender's agreement with F.S.A. requires that the lender negotiate with you in good faith to attempt to resolve any problem and to permit the borrower to cure a default, where reasonable;⁴
 2. The lender must consider the borrower for loan servicing if the borrower is in default (see this outline under "III" for more detail);⁵ and
 3. The lender must perform those services which a "reasonable prudent lender" would do in servicing its own loans. If the lender would otherwise service a loan but still refuses you may be able to argue that it is a violation of the agreement the lender has with F.S.A.⁶

II. **Types of loan servicing.** There are several types of loan servicing available for guaranteed loans. The basic definitions of each and the basic eligibility requirements are discussed below.

A. **Basic definitions** of the options are as follows:

1. **Consolidation.** This allows the outstanding principal and interest balances of two or more operating loans (including some lines of credit), that are not secured by real estate or an outstanding interest assistance agreement or a shared appreciation agreement, to be combined.⁷ Guaranteed loans made before October 1, 1991, cannot be consolidated with those loans made on or after October 1, 1991.⁸ The interest rate for a consolidated OL loan is the negotiated rate agreed upon by the lender and the borrower at the time of the action, subject to the loan limitations for each type of loan.⁹
2. **Rescheduling.** This allows the rates and/or terms to be rescheduled or reamortized on FO, SW, OL and OL line of credit.¹⁰ FO and existing SW may be amortized over the remaining term of the note or rescheduled with an uneven payment schedule, but the maturity date cannot exceed 40 years from the date of the original note.¹¹ An OL note or line of credit must be repaid within 15 and 7 years, respectively, of the date of rescheduling.¹² The lender may capitalize the outstanding interest in certain cases.¹³ **New: Loans secured by real estate and/or equipment can be restructured using a balloon payment--** loans with only livestock and/or crops cannot be rescheduled using a balloon payment.¹⁴ When a loan is rescheduled using a balloon payment, there must be a minimum term of five years for real estate loans and three years for equipment loans before the balloon payment becomes due.¹⁵ The lender must take a lien on all assets and project the loan to be fully secured at the time the balloon payment comes due.¹⁶
3. **Deferrals.** This allows postponement of principal and/or interest payments on FO, SW, RL, OL, EM or OL line of credit loans.¹⁷ Payments may be deferred for up to five years, but in no case beyond the final due date of the note.¹⁸ A partial payment of interest will be required during the deferral period.¹⁹ The principal portion of the payment may be deferred in whole or in part.²⁰ A determination must be made that there are "reasonable prospects" that you will be able to resume full payments at the end of the deferral period.²¹
5. **Refinancing.** This allows you to get a direct loan to buy out the guaranteed loan.
6. **Interest Rate Assistance Program.** This program is for guaranteed loans where the farmer's repayment ability is not sufficient enough to cash flow at the lender's normal interest rate. This program allows your interest rate to be reduced by 4 percent if that will allow you to have a positive cash flow.

F.S.A. pays the cost of the reduction to the lender.²² The maximum period the interest rate reduction may be in place is 10 years.²³

a. A borrower must be informed by the lender of this program when the borrower's note is 30 days past due.²⁴ If the lender and borrower feel that interest assistance in conjunction with loan rescheduling will correct the loan default, they may ask FSA for that help.²⁵

7. **Reduced interest rates.** This can be done in one of three ways. First by refinancing the loan with a direct loan from FSA at "limited resource" interest rate. Secondly, by applying for help under the Interest Assistance Program mentioned above. Thirdly, the lender agrees to reduce the interest rate on its own.²⁶

8. **Debt write-down.** This allows the lender to forgive part of the debt in conjunction with a restructure or liquidation only if certain criteria are met, and only to the extent that it is necessary to develop a feasible plan.²⁷ It should be emphasized that the borrower must be delinquent before this option can be considered, and only after it is shown that rescheduling and deferral will not result in a positive cash flow.²⁸ A lender must also request other creditors to negotiate their debts before writedown is considered.²⁹

The write-down must be approved by F.S.A. if the borrower's cash flow numbers meet a certain formula: The *net recovery* to the lender (the *present value* of the payments under the restructured loan) must be equal to or greater than the *net recovery value* to the lender if the property was liquidated in a bankruptcy, foreclosure or involuntary liquidation.³⁰

If a write-down occurs and real estate is involved, the borrower will be required to sign a shared appreciation agreement, which, under certain circumstances, will allow a lender to recapture a portion of what was written off out of any appreciation in the value of the real estate over a set period of time not to exceed 5 years.³¹

Note: A write-down on a guaranteed loan may make the borrower ineligible for new direct or guaranteed loans through FSA.³² A write-down received after April 6, 1996, makes the borrower ineligible for receiving any new direct or guaranteed loans. Exceptions: i) a new direct or guaranteed loan for annual operating expenses if the borrower was restructured with a writedown, or is current on payments under a confirmed reorganization bankruptcy plan;³³ ii) a new guaranteed loan if the borrower has only received debt forgiveness on or before April 6, 1996, on no more than three occasions;³⁴ and iii) an emergency loan if the borrower has only received debt forgiveness on or before April 6, 1996, on no more than one occasion.³⁵

III. **Rights in the event of default on a guaranteed loan.** A lender must follow certain rules before accelerating and foreclosing on the borrower's guaranteed loan.

- A. **Mandatory meeting.** If the borrower is in default (thirty days or more past due) on a guaranteed loan, then the lender must arrange a meeting within 45 days after the payment due date between the lender and borrower (and F.S.A. if requested), to attempt to resolve any problems and to consider all of the different servicing options mentioned above.³⁶
- B. **Mandatory consideration for interest assistance.** The lender must inform the borrower about the availability of the interest rate assistance program at the meeting mentioned above, and if appropriate request a determination of eligibility by F.S.A.³⁷
- C. **Freeze on foreclosure actions.** The lender may not initiate a foreclosure action on the loan until 60 days after F.S.A. makes a determination on the borrower's eligibility for the interest rate assistance program.³⁸
- D. **Mediation of ag credit disputes.** The lender must participate in a certified farm credit mediation program, if in existence in the state and in accordance with the rules of that state's system. Kansas has a voluntary certified farm credit mediation service. Participation in the mediation program is voluntary in Kansas for both lender and borrower.³⁹
- E. **Appeal of denial of restructuring.** If restructuring of the guaranteed loan is not approved by F.S.A., then it is considered an "adverse decision" and may be appealed through the United States Department of Agriculture's National Appeals Division. It is important to note that the lender must join the borrower in the appeal.⁴⁰

IV. **Important Note--Amount paid by FSA on a guaranteed loan loss claim by a lender constitutes Federal debt owed by the guaranteed loan borrower:** Effective July 20, 2001, the forms used to apply for a FSA guaranteed loan were revised to provide FSA with an avenue to recover losses directly from the borrower, by offset against government payments owed to the borrower, after a loss has been paid by FSA on the guarantee. On July 1, 2002 (see Federal Register, Vol. 67, No. 126, at page 44015), the guaranteed loan regulations were amended, specifically 7 C.F.R. 762.149(m), to establish that any amounts paid on a guaranteed loan loss claim constitute a Federal debt owing to FSA by the guaranteed loan borrower.

- A. The following statement was added to the loan applicant certifications in Part B of Form FSA-1980-25 and -28:
"The loan applicant certifies and acknowledges that any amounts paid by FSA on account of the liabilities of the guaranteed loan borrower will constitute a Federal debt owing to FSA by the guaranteed loan borrower. In such case, FSA may use all remedies available to it, including offset under the Debt Collection Improvement Act, to collect the debt from the borrower."
- B. This offset authority can only be used on losses paid for guarantees issued under the new application form. This does not give FSA any authority to collect the lender's portion of the loss, as it is not Federal debt.

V. **Taxes! Taxes! Taxes!** Always consider the tax consequences of any debt restructure **BEFORE** the restructure is finalized.

- 1 7 C.F.R. Part 762.129 and Par. 195-196 of the FSA Handbook 2-FLP on Guaranteed Loan Making and Servicing govern the amount of the percentage of the guarantee. (Certain circumstances allow the guarantee to be as high as 95%: i.e. loan used to refinance an FSA direct loan; and loan used to participate in the Beginning Farmer Down Payment loan.)
- 2 7 C.F.R. Part 1951.908 and 1951.909.
- 3 7 U.S.C. 2005(b)(2) and generally 7 C.F.R. Part 762.143-.145
- 4 Form FSA 1980-38 "Lender's Agreement" Part E(7)(c).
- 5 7 C.F.R. Part 762.143(b) and Form FSA 1980-38 "Lender's Agreement" Part E(7)(d);
Par. 300 of FSA Handbook 2-FLP.
- 6 7 C.F.R. Part 762.140(a) and Form FSA 1980-38 "Lender's Agreement" Part E(1).
- 7 7 C.F.R. Part 762.146(e)(2)-(6) and Par. 286(A) of FSA Handbook 2-FLP
- 8 7 C.F.R. Part 762.146(e)(5) and Par. 286(A) of FSA Handbook 2-FLP
- 9 7 C.F.R. Part 762.146(e)(8) and Par. 286(C) of FSA Handbook 2-FLP
- 10 7 C.F.R. Part 762.145(c) and Par. 326 of FSA Handbook 2-FLP
- 11 7 C.F.R. Part 762.145(c)(1)(i) and Par. 326(B) of FSA Handbook 2-FLP
- 12 7 C.F.R. Part 762.145(c)(1)(ii) and Par. 326(B) of FSA Handbook 2-FLP
- 13 7 C.F.R. Part 762.145(b)(6) and Par. 326(D) of FSA Handbook 2-FLP; Notice FLP-247
- 14 7 C.F.R. Part 762.145(b)(4), Federal Register Vol. 69, No. 143, July 27, 2004.
- 15 7 C.F.R. Part 762.145(b)(4), Federal Register Vol. 69, No. 143, July 27, 2004.
- 16 7 C.F.R. Part 762.145(b)(7), Federal Register Vol. 69, No. 143, July 27, 2004.
- 17 7 C.F.R. Part 762.145(d) and Par. 327 of FSA Handbook 2-FLP
- 18 7 C.F.R. Part 762.145(d)(1) and Par. 327 of FSA Handbook 2-FLP
- 19 7 C.F.R. Part 762.145(d)(3) and Par. 327 of FSA Handbook 2-FLP
- 20 7 C.F.R. Part 762.145(d)(2) and Par. 327 of FSA Handbook 2-FLP
- 21 7 C.F.R. Part 762.145(d)(4) and Par. 327 of FSA Handbook 2-FLP
- 22 7 C.F.R. Part 762.150 and Par. 224(A)-(C) of FSA Handbook 2-FLP
- 23 7 C.F.R. Part 762.150 and Par. 224(E) of FSA Handbook 2-FLP
- 24 Par. 300D of FSA Handbook 2-FLP
- 25 7 C.F.R. Part 762.145(b)(2)(i) and .150(g)(7); Par. 230(I), 300(D) FSA Handbook 2-FLP
- 26 7 C.F.R. Part 762.146(d) and Par. 284 of FSA Handbook 2-FLP
- 27 7 C.F.R. Part 762.145(e)(1) and Par. 328(B) of FSA Handbook 2-FLP
- 28 7 C.F.R. Part 762.145(e)(1) and (e)(3) and Par. 328(B) of FSA Handbook 2-FLP
- 29 7 C.F.R. Part 762.145(e)(2) and Par. 328(B) of FSA Handbook 2-FLP
- 30 7 C.F.R. Part 762.145(e)(4) and Par. 328 of FSA Handbook 2-FLP See also
- 31 7 C.F.R. Part 762.145(e)(11)-(12) and Par. 328(C) of FSA Handbook 2-FLP. See Form FSA-1980-89.
- 32 7 C.F.R. Part 762.120 and Par. 108(C) of FSA Handbook 2-FLP. Federal Agriculture Improvement and Reform Act of 1996, Section 640(2) and 648(b).
- 33 7 C.F.R. Part 762.120 Par. 108 2-FLP
- 34 7 C.F.R. Part 762.120 and Par. 108(C) of FSA Handbook 2-FLP
- 35 7 C.F.R. Part 762.120 Par. 108 2-FLP
- 36 7 C.F.R. Part 762.143(b)(3) and Par. 300(D) of FSA Handbook 2-FLP
- 37 Par. 230(I) and 300(D) of FSA Handbook 2-FLP
- 38 7 C.F.R. Part 762.143(b)(3)(v) and Par. 300(G) of FSA Handbook 2-FLP
- 39 7 C.F.R. Part 762.149 and Par. 356(A) of FSA Handbook 2-FLP
- 40 7 C.F.R. Part 762.104 and Par. 33(A) of FSA Handbook 2-FLP

*******NOTE TO READER*******

This outline is designed for general informational use only. It is in no way intended as a substitute for the regulations themselves, nor is it intended to substitute for the competent advice of an attorney or advocate. It is absolutely essential that you obtain the services of an experienced attorney or advocate for specific advice about your particular situation.

Future changes in laws and regulations cannot be predicted, and statements made in this outline are based solely on the laws and regulations in force on the date of writing (July 31, 2004). Statements contained in this outline include references to: 1) the "final rules with request for comment" published by the Farm Service Agency Guaranteed Loan Division in the Federal Register on February 12, 1999, streamlining and amending the guaranteed loan program regulations (7 CFR Part 762); 2) the final rule published by the Farm Service Agency in the Federal Register on July 27, 2004, amending the loan servicing regs for guaranteed loans, specifically rescheduling terms (i.e. balloon payments) and loan subordination; 3) the "FSA Handbook: Guaranteed Loan Making and Servicing", Short Reference 2-FLP, which was published on February 12, 1999. 2-FLP explains FSA's policies, procedures, requirements and authorities for administering the guaranteed loan program. Both the regulations and 2-FLP should be consulted for a detailed analysis of your situation.