

# CRS Report for Congress

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## Credit Provisions of the Enacted 1996 Farm Bill

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### Summary

The Federal Agricultural Improvement and Reform Act of 1996 (P.L. 104-127, the 1996 farm bill), which was signed into law on April 4, 1996, contains a credit title (Title VI) that directly affects eligibility for USDA farm loans and the servicing of its delinquent loans. Among its provisions, the credit title eliminates a requirement that USDA provide operating loans to farm borrowers who are delinquent on previous loans; denies new farm loans to any borrower who had a delinquent loan on which the debt was forgiven; reduces the mandated period USDA must wait to notify borrowers that they are delinquent and to inform them of their loan servicing options; continues the shift in USDA lending resources from direct loans to guaranteed loans; and expedites the sale of acquired USDA farm property. A provision in the omnibus FY1996 appropriations and rescissions bill (P.L. 104-134) enacted on April 26, 1996, waives the farm bill's tighter qualifications for new USDA farm loans for any applicant who is less than 90 days delinquent and submitted a loan application before April 5, 1996. However, subsequent loan applications are subject to the tighter provisions in the credit title.

### Background

The U.S. Department of Agriculture through its Farm Service Agency (and formerly through its Farmers Home Administration (FmHA)) serves as the Federal lender of last resort to eligible family-sized farmers whose financial condition is too weak to permit them to obtain commercial credit. The Consolidated Farm and Rural Development Act (P.L. 87-128) as amended provides statutory authority for all USDA farm lending programs.

USDA has the budgetary authority to provide both direct and guaranteed loans to eligible farmers. Direct loans are made and serviced by USDA. Guaranteed loans are made by a private lender such as a commercial bank or the cooperatively-owned Farm Credit System. USDA guarantees the lender the timely repayment of the interest and 90 percent of the principal on the loan.

USDA's primary farm loan programs are: 1) farm ownership loans (direct and guaranteed) -- for acquiring, enlarging, or improving farms; 2) farm operating loans (direct

and guaranteed) -- for financing short-term operating expenses such as the purchase of feed, seed, livestock, fertilizer, and farm equipment, and for refinancing existing debt; and 3) emergency disaster loans (direct only) -- which assist farmers with losses associated with natural disasters.

The interest rates that USDA charges for its direct farm ownership and operating loan programs are based on its cost of borrowing from the U.S. Treasury, and thus are lower than private lender rates. Also, many borrowers qualify for lower interest rate farm ownership and operating loans under a "limited resource" program to assist low-equity, low-income, or beginning farmers. In the mid-1980s, Congress and the Administration began to shift USDA's emphasis from "lender of last resort" to "guarantor," as a larger share of ownership and operating loans were made by commercial lenders given a Federal guarantee.

Because USDA is a lender of last resort to those who would not otherwise qualify for a commercial loan, the delinquency and default rate among its farmer borrowers is significantly higher than for borrowers from commercial lenders. The Agricultural Credit Act of 1987 (P.L. 100-233) requires USDA to write down and restructure a severely delinquent farm loan if the cost of restructuring is less than the cost of completing foreclosure action. Many delinquent borrowers have qualified for a loan write-down that requires USDA to forgive debt in the amount that outstanding loans exceed the current value of the collateral securing them. In some cases, if a borrower cannot maintain financial viability with a written down restructured loan, the borrower may be eligible to buy out his indebtedness at the net recovery value of the loan, which is the current market value of the collateral less the cost of foreclosure.

During the debate on the Food, Agriculture, Conservation, and Trade Act of 1990 (P.L. 101-624, the 1990 farm bill), congressional attention was drawn to potential loopholes in the 1987 Act. Provisions in the credit title of the 1990 farm bill amended the 1987 Act by limiting the maximum amount of writedown of a delinquent loan. It also requires a delinquent borrower to act in good faith, meaning that he must comply with all written agreements and cannot sell off any property pledged as collateral without the consent of USDA.

### **The Credit Title of the 1996 Farm Bill**

The Federal Agricultural Improvement and Reform Act of 1996 (P.L. 104-127, the 1996 farm bill), enacted on April 4, 1996, includes a credit title (Title VI) that tightens the qualifications for the servicing of delinquent USDA farm loans as well as eligibility for new and continuing direct and guaranteed loans. Many of the credit provisions, particularly those dealing with delinquent loans, were recommended by the Administration.

Among its major provisions, the credit title of the farm bill:

- *eliminates new loans to delinquent borrowers.* For the last nine years, the law had required USDA to provide operating loans to certain farm borrowers who were delinquent on previous loans. The Administration maintained that this provision was adopted during a time when the farm economy was depressed, and that current economic conditions no longer require such a provision.

- *denies program eligibility to any borrower who received a buyout of a delinquent loan.* The enacted 1996 farm bill allows a farmer who has had a loan restructured to continue as a borrower, but any borrower who had a previous loan that resulted in debt forgiveness no longer will be eligible for a direct or guaranteed Government farm loan.
- *allows delinquent borrowers who are not eligible for loan restructuring to purchase their debt at current market value rather than at the net recovery value (current market value less the cost of foreclosure).* Under previous law, if a borrower who bought out a loan at net recovery value later sold the collateral real estate at a gain, the borrower was required to share a portion of the gain with USDA, an arrangement which is commonly called a recapture agreement. The Administration contended that if the borrower were required to buy out the loan at the current market value rather than net recovery value, USDA would receive a higher portion of the debt at the time of loan settlement. The Administration believes that this will also reduce USDA's administrative costs, since recapture agreements no longer will be necessary and the borrower's collateral will not have to be monitored.
- *reduces statutory deadlines for loan servicing action.* Prior law required USDA to notify a delinquent borrower of loan servicing options when the borrower became 180 days delinquent. The Administration contended that if borrowers were notified sooner, it would allow USDA to more expeditiously resolve the problem loan, and would help minimize the accrual of interest over the term of the delinquent loan. The credit title reduces the notification time horizon by one-half to 90 days after the borrower becomes delinquent.
- *continues to concentrate loan resources on beginning farmers and mandate the graduation of USDA borrowers to commercial lenders.* The credit title restricts eligibility for direct farm ownership (FO) loans to borrowers with less than 10 years farming experience, or a current FO borrower who has been a USDA customer for less than 10 years. Direct farm operating loans (OL) are restricted to those with less than 5 years of farming experience or those who have been direct borrowers for less than 7 years. A transition rule will phase-in these restrictions. The legislation does not affect a current statutory restriction that prohibits operating loan borrowers from receiving either a direct or guaranteed USDA farm loan for more than 15 years. The Agricultural Credit Improvement Act of 1992 (P.L. 102-554) established the recent trend of gearing USDA farm loan funds more toward beginning and minority farmers. The Administration supports this trend, stating that these groups traditionally have limited access to credit. Some farm groups have reservations about this policy shift, stating that it restricts the availability of funding to existing USDA borrowers who have prospects for success but do not currently qualify for a guaranteed or commercial loan.
- *reinforces the shift in USDA lending from direct loans to guaranteed loans.* The credit title provides loan authorization levels for FY1996-2002 that reaffirm the recent trend that more Federal farm loan resources should be concentrated on providing Federal guarantees of qualifying commercial loans and less on providing direct loans. The legislation freezes annual direct farm operating loan levels at \$500 million, and direct farm ownership loans at \$85 million. Guaranteed loan

levels are set at \$1.9 billion for farm operating loans and \$600 million for farm ownership loans in FY1996. However, these guaranteed loan levels would be allowed to increase gradually until FY2000 to \$2.1 billion for farm operating loans and \$750 million for farm ownership loans. USDA farm loan levels are ultimately established in the annual appropriations process. Some believe that the shift away from direct loans has dismantled the financial "safety net" for farm borrowers who may not qualify for commercial credit. Critics of USDA direct loan programs believe that the graduation of borrowers from Federal credit to commercial credit is a laudable goal and that USDA should adhere to its original mission as a "temporary" source of supervised credit.

- *expedites the sale of acquired USDA farm properties.* When a farmer borrower defaults on a USDA farm real estate loan, the agency commonly takes into its inventory the farm property that served as collateral for that loan. When USDA disposes of that property, prior law required the agency to give preference to potential purchasers or lessees of that property in the following order: the immediate previous borrower-owner, his or her family members, previous family-sized owners, qualified beginning farmers, and other qualified family-sized farmers. Prior law also required USDA to make the property available to the most recent owner for 180 days after USDA acquired the property. The credit title changes the law by eliminating the order of preference, and instead requiring that the property be offered for sale to any qualified beginning farmer for 75 days. After that period, the credit title requires USDA to provide public notice and sell the property through competitive methods to the highest bidder. New leases are prohibited and once existing leases expire, USDA is required to sell the property subject to the proposed 75-day condition.

**Clarification of Effective Date of New Provisions.** Following the enactment of the 1996 farm bill, some farm groups expressed concern over whether the new tighter qualifications for USDA farm loans would be applicable to borrowers who had submitted farm loan applications prior to enactment. Section 2002 in the Omnibus Consolidated Rescissions and Appropriations Act of 1996 (P.L. 104-134) enacted on April 26, 1996 waives the farm bill's tighter qualifications for any applicant who is less than 90 days delinquent and submitted a loan application before April 5, 1996. However, the farm bill restrictions become effective for subsequent loans.