

# GUARANTEED NEWS

Volume No.5

March 2006

## INSIDE

- 2 Secondary Market Loans
- 2 MO Guaranteed Lender Farm Loan Website
- 2 MU Agricultural Lenders School
- 2 Beginning Farmer Loan Program
- 3 ABA Coalition Opposes Guar Loan Cuts
- 3 Loan Funds Targeted for Outreach

## FSA Security Requirements Changed 11-28-05 in 2-FLP Amendment 24

The third bullet of paragraph 166(D) of 2-FLP Handbook, Amendment 24, has been modified to only allow a guaranteed loan to be in a junior lien position (primary security) when the total indebtedness of the prior lien and the proposed guaranteed loan is less than or equal to 85% of the value of the security. Liens that are junior to the guaranteed loan(s) will not be considered in this limitation.

The third bullet of Paragraph 166(D) does allow for shared lien positions when the total debt of a nonguaranteed and guaranteed loan is greater than 85% of the value of the security.

### Lender proposed:

- 1<sup>st</sup> lien nonguaranteed \$90,000 loan
- 2<sup>nd</sup> lien nonguaranteed \$79,000 loan
- 3<sup>rd</sup> lien FSA \$852,000 guaranteed loan

Total \$1,021,000 loans

Farm Valued at \$1,135,000

Calculates out to an 89.96% loan to market value.

### FSA could only approve a shared lien position.

The lender and FSA must agree that the guaranteed and non-guaranteed loans share equally a 1<sup>st</sup> lien position on the collateral. Neither loan is junior to the other. When shared security is liquidated the net proceeds are to be divided pro-rata based on the total amounts loaned at the initial loan closing.

What is the lender's overall loss potential? Let's look at an example and assume the property was liquidated and sold for \$900,000 two years later.

\$90,000 note gets \$79,333.99 of sale proceeds  
 $\$90,000 \div \$1,021,000 = 8.8148874\%$   
 $\$900,000 \times 8.8148874\% = \$79,333.99$   
Unpaid principal and interest debt = \$92,467.78  
 $\$92,467.78 - \$79,333.99 = \$13,133.79$  bank loss

\$79,000 note gets \$69,637.61 of sale proceeds  
 $\$79,000 \div \$1,021,000 = 7.7375122\%$   
 $\$900,000 \times 7.7375122\% = \$69,637.61$   
Unpaid principal and interest debt = \$81,673.46  
 $\$81,673.46 - \$69,637.61 = \$12,035.85$  bank loss

\$852,000 note gets \$751,028.40 of sale proceeds  
 $\$852,000 \div \$1,021,000 = 83.4476004\%$   
 $\$900,000 \times 83.4476004\% = \$751,028.40$   
Unpaid principal and interest debt = \$875,361.63  
 $\$875,361.63 - \$751,028.40 = \$124,333.22$  bank loss  
 $\$124,333.22 \times 90\% = \$111,899.90$  guar loss payment  
 $\$124,333.22 - \$111,899.90 = \$12,433.32$  bank loss

In summary, the bank would incur a \$37,602.96 loss on all three loans:

- \$13,133.79 loss on the \$90,000 note
- \$12,035.85 loss on the \$79,000 note
- \$12,433.32 loss on the \$852,000 guar loan

This calculates out to a 3.68295% loss on the original \$1,021,000 loan amount.

## Consider Selling Guaranteed Loans on the Secondary Market

Are you meeting your customer's needs? Are rising interest rates a concern? Selling the guaranteed portion of the loan to other investors offers a number of advantages. Retaining the loan servicing responsibilities maintains the relationship with its customer. What are the advantages?

- **Reduced Interest Rate Risk.** Lenders can transfer risk of interest rate increases on the guaranteed portion of a fixed rate loan.
- **Rates and Terms.** Lenders may be able to offer the producer more flexible repayment terms, as well as fixed and/or reduced interest rates to improve cash flow.
- **Increased Liquidity.** Selling the loan on the secondary market frees the funds for additional lending or investing activity.
- **Increased Lending or Investing Capabilities.** Since the guaranteed portion of the loan is generally not applied against a bank's lending limit, it can be used to expand lending capabilities.
- **Increased Return on Investment and Retains Loan Servicing Duties.** The sale of the guaranteed portion of the loan in the secondary market increases the lender's overall return on investment. Each time a bank sells a guaranteed portion, it generally retains a servicing fee of ½ % to 2 % on the guaranteed portion sold on the secondary market.
- **Increase Business** - Lenders can use the secondary market as a sales tool to attract new customers for the reasons above.

## MO FSA Guaranteed Farm Loan Lenders Website is located at:

<http://www.fsa.usda.gov/mo/lenders.htm>

Obtain funding updates, checklists, spreadsheets, notices, fact sheets, forms, handbook updates, etc.

## MU Agricultural Lenders School

The University of Missouri-Columbia Commercial Agriculture Program is offering an Agricultural Lenders School **June 5-9, 2006**. The Agricultural Lenders School offers a unique opportunity for lenders to learn both the detailed mechanics of agricultural credit analysis as well as to learn how the changing structure of agriculture will likely affect their business and their careers.

Main topics:

- U.S. Farm Situation
- Ratio Analysis
- Analyzing Integrated Financial Statements
- Borrower vs. Lender Objectives
- Legal Review
- Emerging Issues in Agricultural Finance
- Completing the Loan
- Interviewing the Client
- Servicing Issues Specific to Agriculture

For more information visit the website at:

<http://agebb.missouri.edu/commag/lenderschool>

Registration deadline is **April 14, 2006**.



## Beginning Farmer Loan Program

This FSA loan program is designed to allow beginning farmers to purchase farm real estate which does not exceed \$250,000.

The program, commonly referred to as the 50/40/10 loan program, has the following requirements:

- Borrower making a 10% downpayment
- FSA providing a 40% direct junior lien loan for 15 years fixed at 4%
- Commercial lender financing the 50% balance amortized over 30 years in a first lien position

Contact your local Farm Loan Manager for more information.

## ABA Coalition Opposing FSA Guaranteed Loan Cuts & Fee Increases

American Banking Association (ABA) is leading a coalition of organizations that will oppose a White House fiscal year 2007 budget proposal to cut funding by \$30 million and increase fees on the Guaranteed Farm Loan Programs administered by the Agriculture Department's Farm Service Agency, the association said.

"The FSA Guaranteed Farm Loan Programs have been a remarkable success story," said John Blanchfield, director of the ABA Center for Agricultural and Rural Banking. "They are one of the best examples of a true public-private partnership. Operating costs and loan losses have been extremely low, and the USDA guarantee has enabled thousands of farmers and ranchers to get the credit they need from their local banks. These programs are vital to the health and well being of agriculture."

Despite the programs' low cost, the administration proposes to increase origination fees on Guaranteed Farm Ownership Loans and Guaranteed Operating Loans from 90 to 150 basis points; charge an annual fee of 75 basis points on Guaranteed Operating Loan lines of credit; and charge up to 200 basis points for Guaranteed Operating Loans with interest assist. USDA statistics show the average guaranteed loan in fiscal year 2005 was \$212,000 at origination.

The fiscal year 2007 proposal would require an average farmer who borrowed \$212,000 under the Guaranteed Operating Loan line of credit to pay \$2,862 more in loan fees, and then come up with an additional \$1,590 annually in loan fees for the remaining four years of the guaranteed line of credit. The total cost to a farmer under the old program was \$1,908. Under the proposed program, it would be \$11,130 -- or an additional \$9,222.

Read an ABA briefing paper on the issue.  
<http://www.aba.com/aba/documents/news/usda.pdf>



## Targeted Funds for Outreach

FSA attempts to reach groups in need of special attention by targeting loan funds for their use. Two of these areas are beginning farmers and socially disadvantaged applicants (SDA).

**Beginning farmer** is defined as: A beginning farmer is an individual or entity who:

- meets operating (OL) or farm ownership (FO) loan eligibility requirements
- has not operated a farm, or who has operated a farm for not more than 10 years; this requirement applies to all members of an entity
- will materially and substantially participate in the operation of the farm
- does not own farm property exceeding 30% of the average farm in the county

**SDA** is defined as: A socially disadvantaged applicant is a loan applicant who is a member of a group whose members have been subjected to racial, ethnic, or gender prejudice because of their identity as a member of a group, without regard to their individual qualities. For entity applicants, the majority interest has to be held by socially disadvantaged individuals. FSA has identified socially disadvantaged groups to consist only of Women, Blacks, American Indians, Alaskan Natives, Hispanics, Asians, and Pacific Islanders.

For additional information on what direct and/or guaranteed funds may be available to targeted groups, contact your local Farm Loan Manager.

**Missouri State FSA Office  
601 Business Loop 70 W  
Parkade Center, Suite 225  
Columbia, MO 65203**

### **Missouri State Office Contacts:**

**Tim Kelley – State Executive Director**

**Dan Gieseke - Farm Loan Chief**

**Email: [daniel.gieseke@mo.usda.gov](mailto:daniel.gieseke@mo.usda.gov)**

**Jim Harms - State Farm Loan Specialist**

**Email: [james.harms@mo.usda.gov](mailto:james.harms@mo.usda.gov)**

**Tel # (573) 876-0980**

**Fax # (573) 876-0935**



---

The U.S. Department of Agriculture (USDA) prohibits discrimination in all its program and activities on the basis of race, color, national origin, age, disability, and where applicable, sex, marital status, familial status, parental status, religion, sexual orientation, genetic information, political beliefs, reprisal, or because all or part of an individual's income is derived from any public assistance program. (Not all prohibited bases apply to all programs.) Persons with disabilities who require alternative means for communication of program information (Braille, large print, audiotape, etc.) should contact USDA's TARGET Center at (202) 720-2600 (voice and TDD).

To file a complaint of discrimination, write to USDA, Director, Office of Civil Rights, 1400 Independence Avenue, S.W., Washington, D.C. 20250-9410, or call (800) 795-3272 (voice) or (202) 720-6382 (TDD). USDA is an equal opportunity provider and employer.