UNITED STATES DEPARTMENT OF AGRICULTURE
Farm Service Agency
Washington, DC 20250

Notice FLP-528

1-FLP, 2-FLP, 3-FLP, 4-FLP, 5-FLP

For: State and County Offices

Guidance on Direct and Guaranteed Loan Making and Loan Servicing Actions for Dairy Operations in FY 2009

Approved by: Acting Deputy Administrator, Farm Loan Programs

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1 Overview

A Background

Historic declines in the price of milk have suddenly and dramatically increased financial stress in the dairy industry. Without assistance, many FSA direct and guaranteed dairy farm borrowers will find it difficult or impossible to survive the current economic situation. FSA is committed to use all available authorities, consistent with prudent lending practices, to assist borrowers in surviving this period of short-term unprofitability.

B Purpose

This notice provides guidance on the following:

- extending repayment terms for annual operating loans (OL's) for dairy farmers
- estimating Milk Income Loss Contract (MILC) payments
- releasing milk proceeds for essential family living and farm operating expenses
- notifying borrowers of servicing options
- contacting guaranteed lenders to:
  - discuss FSA policies for dairy loans
  - remind them of loan servicing options available under the Guaranteed Loan Program.

C Contact

If there are questions about this notice:

- County Offices shall contact the State Office
- for loan making inquiries, State Offices shall contact LMD at 202-720-1632
- for loan servicing inquiries, State Offices shall contact LSPMD at 202-720-4572.

Disposal Date	Distribution
October 1, 2009	State Offices; State Offices relay to County Offices

2 Direct Loan Making

A Repayment Terms

3-FLP, subparagraph 174 B (7 CFR 764.254(b)(1)(ii)) allows repayment of annual OL's to be scheduled beyond 18 months under extenuating circumstances, including recovery from economic reverses. This provision is intended as a means to help borrowers survive through unique periods of financial difficulty. It is appropriate to use this provision for dairy operations under current market conditions.

When using this provision, repayment terms for annual OL's:

- shall be repaid in the shortest timeframe possible and consistent with cash flow projections

- may be extended beyond 18 months only when necessary for a feasible plan

- will **not** exceed 7 years.

Note: As provided in 3-FLP, subparagraph 174 B, an annual OL repayment period exceeding 18 months is to be used only in unusual situations, and there must be adequate basic security for an annual loan with a multiple year repayment schedule. Using this provision can deplete borrower equity and reduce FSA's ability to provide additional loan assistance. FLP staff should have a candid discussion with borrowers about the implications of this payment structure for their operation during Farm Business Plan (FBP) development.

B Determining Repayment Period

In addition to the current year FBP developed for loan applicants, the definition of a "feasible plan" (7 CFR 761.2(b)) requires the development of a typical FBP in situations when FBP is atypical and the loan approval action exceeds 1 production cycle. Therefore, **two FBP's** will be prepared to:

- determine a feasible repayment period
- show the long-term viability of the operation as follows:

  - current year FBP:

    - include projected MILC payments as outlined in subparagraph D
    - use current milk prices as applicable to the State

2 Direct Loan Making (Continued)

B Determining Repayment Period (Continued)

- typical year FBP:
  - no MILC payments
  - use projected 2010 milk price.

Note: USDA agricultural economists and the 2010 President's budget have determined a national average all-milk price of **$15.74/cwt.** This price is to be used as a guide. State Offices should issue guidance for any regional variance.

In assessing the decision to extend the repayment period beyond 18 months, according to 7 CFR 764.254(b)(1)(ii), the loan **must** be secured by **basic security**.

C Direct Loan System

When obligating an annual OL for more than 18 months, Field Offices shall:

- use the Type of Assistance Code for OL term loans (051, 106, 211, or 212)
- select Loan Purpose Code "08" to indicate annual operating expenses.

D MILC

MILC was reauthorized and modified in the Food, Conservation, and Energy Act of 2008. Three notable changes include the following:

- a new feed cost adjuster that is triggered whenever the monthly National Average Dairy Feed Ration Cost calculated from the "entire month" prices published by NASS is greater than $7.35 per cwt. beginning January 1, 2008, through August 31, 2012

- payment rates and per-operation poundage limits based on when the milk is produced

  Note: The production limit per operation increases to 2.985 million pounds for each FY from October 1, 2008, through August 31, 2012.

- changes to the provisions for payment eligibility to add an adjusted gross income (AGI) limit. If the individual or entity has annual nonfarm AGI for the relevant base period greater than $500,000, the individual or entity is **not** eligible for MILC benefits.

2 Direct Loan Making (Continued)

D MILC (Continued)

In calculating MILC payments, farm loan managers and officers may use 1 of the following:

- a “flat rate” of **$1.50/cwt.**
- the MILC program site at **www.fsa.usda.gov/Internet/FSA_File/milc_cost_adjuster.xls**
- the Cornell Program on Dairy Markets and Policy at **www.dairy.cornell.edu/**.

Notes: On the right side of the screen is a list of prices, which are updated based on Chicago Board of Trade and Chicago Mercantile Exchange futures prices for corn, soybeans, and milk.

FSA is unable to endorse a specific commercial site or attest to the accuracy of the information contained in the web site. The Cornell University information was found to be very useful. These MILC calculators are to be used only as a guide in projecting possible MILC payments. State Offices should provide additional guidance particular to the State, when appropriate.

3 Direct Loan Servicing

A Releasing Milk Proceeds

Proceeds from milk sales can be released according to 4-FLP, subparagraph 163 B, and any additional guidance in approved State supplements. Any portion of the proceeds planned for FSA FLP debt reduction may be released as needed for essential family living or farm operating expenses. County Offices should revise FBP and FSA-2040 to account for the release of proceeds as outlined in 4-FLP, subparagraph 162 E.

B Notifying Borrowers of Available Servicing Options

Field Offices will send Exhibit 1 to **all** dairy operators with direct loans regardless of loan status.

Borrowers who are in financial distress, or request servicing, will be:

- notified according to 5-FLP, Part 3
- given all Primary Loan Servicing options allowed.

3 Direct Loan Servicing (Continued)

B Notifying Borrowers of Available Servicing Options (Continued)

Debt restructure can be considered while the borrower is still current and would help retain their satisfactory credit rating. All restructuring options available for distressed borrowers will be considered, including the following:

- rescheduling
- consolidation
- reamortization
- deferral for 1 to 5 years.

Attention should be given to the deferral authorities and procedures in 5-FLP, paragraphs 159 and 160 to ensure that deferral is considered in a manner that provides the borrower adequate time to recover from the present situation while limiting interest accrual on the deferred balance.

Note: Under 5-FLP, borrowers who become delinquent will also immediately be considered for debt writedown, and those that become 90 calendar days past due will be notified of all options again.

4 Guaranteed Loans

A Guaranteed Loan Making

Authorized loan officials shall contact guaranteed lenders to explain the:

- loan making and loan servicing policies outlined in this notice
- options they have in assisting guaranteed loan borrowers.

Similar to the Direct Program, 2-FLP, paragraph 137 (7 CFR 762.124(b)) provides lenders with the flexibility to schedule annual OL's and lines of credit for up to 7 years when recovering from an economic reversal. These extreme measures are authorized to assist dairy producers with long-term viability in obtaining operating capital in these difficult times. These policies are temporary and should be used with care and caution. Consistent with direct loan policies, the requirement to meet the definition of a feasible plan using a typical plan also applies to guaranteed loans. Lenders shall structure repayment over the shortest period of time practical, based on these cash flow budgets.

4 Guaranteed Loans (Continued)

A Guaranteed Loan Making (Continued)

2-FLP, subparagraph 166 B (7 CFR 762.126) provides that:

- the lender must ensure that adequate collateral is obtained and maintained to protect the interests of the lender and government

  Note: When repayment of an annual production loan is scheduled over multiple years:

  - the borrower's expected normal income security will **not** be sufficient
  - the loan must be secured with basic security.

- additional security may be required if the cash flow is below average, such as in the current dairy environment.

  Note: The amount of basic security needed above a 1:1 collateral ratio is dependent on the particular operation, considering the requirement for the lender to maintain adequate security. In no case will a loan or line be extended beyond the current operating cycle without adequate basic security.

Lenders are to be cautioned against extensive use of refinancing their own debt to transfer risk of loss to the government. In cases where a lender is refinancing their own debts, 2-FLP, subparagraph 195 A (7 CFR 762.129(a)) authorizes FSA to reduce the percent of guarantee based on the credit risk to the lender and FSA both before and after the transaction. FSA loan approval officials should consider this authority during this period of stress to minimize undue risk to the FSA portfolio. However, 2-FLP, subparagraph 195 A specifies that guarantees to CLP and PLP lenders will not be less than 80 percent.

B Guaranteed Loan Servicing

Lenders:

- may consider all options under 2-FLP, Part 12, including deferral and writedown
- are permitted to temporarily release milk assignments.

However, any releases beyond what is necessary to make the annual payments will require the lender to prepare a cash flow plan showing repayment in the year of the release or a typical year cash flow reflecting loan restructuring, including deferrals that will be necessary to keep the operation in business. Document submission requirements will be according to the lender status requirements of 2-FLP.

Requests for a subordination from lenders to advance additional funds against basic or additional security will be immediately forwarded to DAFLP for exception authority consideration according to 2-FLP, subparagraph 278 A. In addition to the requirements of 2-FLP, subparagraph 278 B, the request must document that it is for a dairy operation experiencing distress.

Example Letter to Dairy Operators

<FSA LETTERHEAD>

<Date>

<Addressee>
<Address Line 1>
<Address Line 2>
<City State Zip Code>

Dear <Borrower Name>,

The Farm Service Agency (FSA) is aware that many dairy producers are experiencing financial stress due to recent price downturns. We want to take this opportunity to inform you of several loan servicing options that Farm Loan Programs (FLP) has available to ease the financial stresses you may be experiencing.

FSA will consider releasing milk proceeds so that you can pay essential family living and farm operating expenses, if necessary. Essential expenses are those which are basic, crucial, or indispensable.

FSA may restructure your debt if you are in financial distress or your account is delinquent and the operation can project a positive cash flow. Debt restructuring options are subject to an eligibility determination and may include:

- Lowering your FLP payments on livestock and equipment loans though debt rescheduling and consolidation,
- Lowering your FLP payments on real estate loans though reamortization,
- Deferral of part of your FLP payments from 1 to 5 years,
- Writedown of a part of your FSA debt depending on your eligibility and the value of your security. (Note: If eligible, this is available only once, and could limit your eligibility for future FSA loans.)

If you would like to discuss your current operation, have any questions, or want to review possible options available to you, please call the <County> FSA Office at <area code + telephone number>.

Sincerely,

Farm Loan Manager