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

Notice FLP-540

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For: State and County Offices

Guidance for Making and Servicing Direct and Guaranteed Loans to Poultry Producers

Approved by: Acting Deputy Administrator, Farm Loan Programs

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1 Overview

A Background

FSA has a significant risk exposure, primarily through loan guarantees, with producers who grow poultry under contract to integrators; that is, companies that contract for production, and process and market poultry products. Historically, this has been a stable industry and both direct and guaranteed poultry loans have performed well. The vast majority of borrowers have paid their loans as agreed and made financial progress.

Over the past several months, however, the poultry industry and poultry growers have encountered a variety of economic difficulties. Dramatic increases in energy costs, high feed costs, reductions in demand, and the recent global economic turmoil have affected integrator profit margins and returns. In response to these conditions, some integrators have closed processing plants, reduced flock placements, and declined to renew grower contracts.

While it is understandable that companies must make business decisions based on financial conditions, these changes have a direct and material effect on FSA direct and guaranteed loan borrowers in the poultry business, and also on risk exposure. As a result, the impact of the integrator's operational changes on growers must be assessed and consideration of poultry production contracts based upon recent actions and contract management in the poultry industry must be adjusted.

B Purpose

This notice:

- provides guidance:
  - on the analysis and evaluation of new direct loan applications and/or requests for guarantee for contract poultry growers

Disposal Date	Distribution
October 1, 2010	State Offices; State Offices relay to County Offices

1 Overview (Continued)

B Purpose (Continued)

  - for servicing direct and guaranteed loans to contract poultry growers

- obsoletes Notice FLP-535.

C Contact

If there are questions about this notice:

- County Offices shall contact the State Office
- State Offices shall contact the:

  - Guaranteed Loans Branch, LMD, at 202-720-3889 with concerns about loan making issues

  - Guaranteed Loan Servicing and Inventory Property Branch, LSPMD, at 202-720-1984 with concerns about loan servicing issues.

2 General

A Developing Business Plans for Poultry Growers

Sometimes, business plans supporting loan and loan guarantee requests for poultry producers are based upon standard production budgets developed by integrators, consultants, or extension specialists. These budgets are acceptable starting points, but loan approval officials must ensure that the business plans reflect realistic performance assumptions under current operating conditions for the individual situation, including the following:

- increased energy costs
- reduced bird weights
- fewer birds per flock
- increased idle time between flocks
- other relevant factors that effect net income.

With loans to purchase or refinance existing facilities, the impact of age, condition, and potential obsolescence of the facilities must be assessed. Operating projections must factor in any reduced efficiency and the potential costs for required modernization of existing facilities to comply with production contract requirements. These factors should be considered in the real estate appraisal as well.

Note: This notice does **not** apply to facilities involved in the production of eggs, including breeder and pullet operations.

2 General (Continued)

B Dependable Source of Income

The direct loan applicant's proposed operation must project a feasible plan according to 7 CFR 764.401(a)(1)(i) and as defined in 7 CFR 761.2(b). FSA regulations require that income sources be dependable and likely to continue.

This is also true for loan guarantees, as provided in 7 CFR 762.125(a)(8) as follows:

> "When a feasible plan depends on income from other sources in addition to income from owned land, the income must be dependable and likely to continue."

For direct loans, the dependability of income is covered by 7 CFR 761.104(c), and 1-FLP, paragraph 241. The farm operating plan will be based on the following accurate and verifiable information:

- historical information will be used as a guide

  Note: The authorized FSA official will review the farm operating plan to ensure that it is reasonable, relative to historical performance and local practices and conditions.

- positive and negative trends, mutually agreed upon changes and improvements, and current input prices will be taken into consideration when arriving at reasonable projections.

Note: The primary focus should always be on developing a realistic projection.

3-FLP, subparagraph 261 C provides additional guidance for evaluating feasibility for direct loans, which requires the authorized FSA official to document that the operating and living expenses, nonfarm income, and farm and other income included in the farm operating plan are realistic.

C Dependability of Income From Production Contracts

Production contracts are the basis of grower income and facility value. As a result, the dependability of production contracts has a profound impact on the prospects for loan repayment and the value of the borrower's investment in production facilities. Until recently, growers could rely on integrators to place birds in their houses on a regularly scheduled, on-going basis, even though in many, if not most cases, the contracts were on a "flock-to-flock" basis; that is, there is no commitment for using the facilities beyond the current flock of birds being produced. However, as discussed in subparagraph 1 A, integrators have changed their flock production schedules in response to historically unique economic conditions.

2 General (Continued)

C Dependability of Income From Production Contracts (Continued)

The recent actions taken by integrators have made it apparent that flock-to-flock operating arrangements may no longer be automatically presumed to be a dependable source of income for business planning and loan repayment purposes.

D Direct and Guaranteed Borrowers

Poultry growers with existing direct or guaranteed loans have established a production and financial history either directly or through a guaranteed lender. In evaluating loan or guarantee requests for existing borrowers, loan officials shall rely on this history, with current information according to applicable sections of:

- 7 CFR 761.104 and 1-FLP, paragraph 241 for direct loans
- 7 CFR 762.125 and 2-FLP, paragraph 151 for guaranteed loans.

E Applications From Growers Not Indebted for Direct or Guaranteed Loans

New applicants do **not** have a performance history with FSA. As a result of the uncertainty in the poultry industry, FSA will no longer consider "flock-to-flock" type arrangements alone to be a dependable source of income or a reasonable projection of income when an applicant does **not** have a current financial performance history in FSA FLP. For income from a poultry production contract to be considered dependable, the contract must:

- be for a minimum period of 3 years

- provide for termination based on objective "for cause" criteria only

- require that the grower be notified of specific reasons for cancellation

- provide assurance of the producer's opportunity to generate income with which to develop a cash flow budget and repay the loan. This assurance must be stated in the contract, which will incorporate requirements, such as a minimum number of flocks per year, minimum number of bird placements per year, or similar quantifiable requirements.

Note: When contract income **cannot** be determined to be dependable and likely to continue, that is, **cannot** be used to reasonably project future income, loan approval officials shall:

- inform the direct loan applicant or guaranteed lender of the contract provisions that result in the determination

2 General (Continued)

E Applications From Growers Not Indebted for Direct or Guaranteed Loans (Continued)

- provide an opportunity for submission of a revised contract before a final decision on the request.

Note: Whenever possible, loan or guarantee requests should be approved subject to modification of unacceptable contract provisions.

Denials of loan and guarantee requests because of such contract terms should reference the rationale and regulatory citations in this notice, as applicable.

F Impact on Lenders

The requirements in this notice apply to Preferred Lender Program (PLP) lenders unless the lender's Credit Management System (CMS) specifically addresses how the lender will consider production contract terms in evaluating and analyzing financial feasibility. Every CMS includes language that states, in part that "…Requirements for loan administration, servicing and reporting activities not specifically addressed in this attachment are governed by the attached Form FSA 2201, "Lender's Agreement," and 7 CFR 762." This notice clarifies policies and requirements in 7 CFR Part 762, and thus applies.

G Refinancing Nonguaranteed Loans

Because of increased volatility and uncertainty in the poultry industry, some lenders will request guarantees to refinance nonguaranteed loans of their existing customers. Lenders should be reminded of the requirements of 7 CFR 762.120 and 2-FLP, subparagraph 108 J about the test for credit. 2-FLP, subparagraphs 122 E and 123 B also require loan officials to evaluate whether the terms of the proposed loan will improve the applicant's cash flow and likelihood of success. These evaluations shall be documented in the loan file.

H Pending Applications

The requirements in this notice apply to any direct loan application or request for guarantee received by FSA after April 28, 2009.

3 Direct Loan Servicing

A Releasing Contract Proceeds

For borrowers whose number of bird placements has been reduced, proceeds from the contract assignments may be released according to 7 CFR 765.303(b), and 4-FLP, subparagraph 163 B, and any additional guidance in approved State Supplements. Any portion of the proceeds planned for FLP debt reduction may be released as needed for essential family living or farm operating expenses. County Offices should revise FBP's and FSA-2040 to account for the release of proceeds according to 4-FLP, subparagraph 162 E.

3 Direct Loan Servicing (Continued)

B Notifying Borrowers in Financial Distress of Servicing Options

Borrowers who are in financial distress, or request servicing, will be notified of all Primary Loan Servicing options available according to 7 CFR Part 766 and 5-FLP, Part 3. Debt restructure may 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 payment deferrals are considered to give the borrower adequate time to recover from the present situation without undue interest accrual on the deferred balance.

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

For borrowers whose contracts have been canceled, it is critical that another integrator is found for any long-term payment projections to be feasible. Borrowers who are in financial distress will be provided with a list of all known integrators whose territory covers the location of the borrower's operation.

4 Guaranteed Loan Servicing

A General

FSA officials should immediately inform affected lenders that a 90-calendar-day forbearance, extension, or loan modification can be approved if the lender believes the problem (loss of contract or reduction of bird placement) can be resolved in a timely manner. This 90-calendar-day forbearance will be considered only if all other servicing actions, such as rescheduling of debt, deferral, or writedown, will **not** resolve the problem. At the end of the 90-calendar-day period, the lender **must** resume their regular servicing actions. If the problem is **not** resolved and the loan account is delinquent, the lender will proceed with default servicing. If the loan is in nonmonetary default (loss of contract), the lender will review the promissory note and determine whether they may proceed with default servicing. If the lender is **not** pursuing liquidation for loans in nonmonetary default, the lender and borrower must be actively seeking other sources of income.

4 Guaranteed Loan Servicing (Continued)

A General (Continued)

Most guaranteed loans impacted have lender's agreements that require interest accrual to cease 90 calendar days from the date of the decision to liquidate. The agreement to exercise forbearance allows for a liquidation decision to be made, if necessary, when the forbearance period is complete. However, in all cases, the loan guarantee will **not** cover interest beyond 210 calendar days from the payment due date.

B Deferral

A deferral may be used for the following reasons:

- to postpone the payments of principal and interest on FSA guaranteed loans and should be considered according to 7 CFR 762.145 and 2-FLP, paragraph 327

- borrowers who have lost contracts with 1 integrator but have obtained a contract with a new integrator that will **not** begin immediately.

Note: The borrower must be able to resume full payments at the end of the deferral period.

C Writedown

A lender may only writedown a delinquent guaranteed loan in an amount sufficient to permit the borrower to develop a feasible plan of operation according to 7 CFR 762.145 and 2-FLP, paragraph 328.

The loan **cannot** be written down below the Net Recovery Value of the collateral. Lenders should consider writedown as an option for borrowers who have lost contracts and cannot obtain another, but have sufficient off-farm income to cash flow the written down loan.

D Appraisals for Liquidation

When submitting loss claims, liquidation appraisals for poultry must determine the "highest and best use" value when considering the demand for poultry facilities and the availability of integrators. If integrators are available in the area, appraisals for poultry facilities shall **not** be appraised for the "liquidation or salvage" value by the lender. The "highest and best use" and best use value should be used during the period the lender is responsible for continued recovery for the Government (3 years), unless the lender can document that all efforts to secure a contract have been unsuccessful, in which case "liquidation or salvage" value may be used.

Note: State and County Offices shall see 2-FLP, Exhibit 15 for policy about poultry facility liquidation appraisals and loss claims.