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

Notice FLP-579

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

For: State and County Offices

Expanded Guidance on Direct and Guaranteed Loans to Poultry and Hog Producers

Approved by: 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 and hogs under contract.

Currently, the poultry industry and poultry growers are encountering a variety of economic difficulties. Dramatic increases in energy costs, high feed costs, reductions in demand, and the recent global economic turmoil have affected profit margins and returns.

It has become increasingly evident that the pork industry and hog producers have been experiencing a variety of similar economic difficulties through increased input costs, improvements in mortality rates resulting in an oversupply of product, decline in exports, and the harmful implications of the H1N1 virus. In response to these conditions, some poultry and hog contractors have closed processing plants, reduced flock and hog placements, and declined to renew grower contracts.

While it is understandable that suppliers 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 and hog business, and also on risk exposure. However, based upon recent actions and contract management in the poultry and hog industries, the impact of the contractor's operational changes on growers must be assessed and the consideration of production contracts must be adjusted.

Disposal Date	**Distribution**
October 1, 2011	State Offices; State Offices relay to County Offices

1 Overview (Continued)

B Purpose

This notice:

- continues the policies in Notice FLP-563
- provides guidance:

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

  - for servicing direct and guaranteed loans to contract poultry and hog growers.

C Contact

If there are questions about this notice:

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

  - LMD at 202-720-3889 with concerns about loan making issues
  - LSPMD at 202-720-1984 with concerns about loan servicing issues.

2 General

A Developing Business Plans for Contract Growers

Sometimes, business plans supporting loan and loan guarantee requests for contract growers are based upon standard production budgets developed by contractors, 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 but not limited to the following:

- increased input costs
- changes in unit numbers and weights
- increased idle time between flocks of poultry or turns of hogs
- other relevant factors that affect 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.

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.

These requirements also exist 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 agency 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 351 C provides additional guidance for evaluating feasibility for direct loans, which requires the authorized agency official to document that the operating and living expenses, nonfarm income, and farm and other income included in the farm operating plan are realistic. Authority for requiring this information is under 7 CFR 764.51. In particular, 7 CFR 764.51(b)(13) allows the requirement for "any additional information deemed necessary by the Agency to effectively evaluate the applicant's eligibility and farm operating plan".

2 General (Continued)

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. In the past, growers could rely on contractors to place birds in their houses or hogs in their barns on a regularly scheduled, on-going basis, even though in many, if not most cases, the contracts were on a "flock-to-flock" or "turn-by-turn" basis; that is, there is no commitment for using the facilities beyond the current flock or turn being produced. However, as discussed in subparagraph 1 A, contractors have changed their production schedules in response to economic conditions.

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

D Direct and Guaranteed Borrowers

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, authorized agency 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 both the poultry and pork industry, FSA will no longer consider "flock-to-flock" or "turn-by-turn" 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 FLP.

2 General (Continued)

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

For income from a grower 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 enough income to develop a cash flow budget and repay the loan.

  Note: This assurance must be stated in the contract, which must incorporate requirements, such as a minimum number of flocks or turns per year, minimum number of bird or hog placements per year, or similar quantifiable requirements.

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

- inform the direct loan applicant or guaranteed lender of the contract provisions that result in the determination
- 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 CFR 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 currently considers 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 when the lender’s CMS does **not** specifically address production contract terms.

2 General (Continued)

G Refinancing Nonguaranteed Loans

Because of increased volatility and uncertainty in the poultry and hog industries, 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. In addition, 7 CFR 762.121 and 2-FLP, subparagraphs 122 E and 123 B require authorized agency officials to evaluate whether the terms of the proposed loan for refinancing 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:

- hog producer's direct loan application or request for guarantee received by FSA **after May 3, 2010**
- any poultry producer's 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 or hog 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. Authorized agency officials should revise FBP's and FSA-2040 to account for the release of proceeds according to 7 CFR 765.302 and 4-FLP, subparagraph 162 E.

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 if the borrower is still current and restructuring would help retain a 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.

3 Direct Loan Servicing (Continued)

B Notifying Borrowers in Financial Distress of Servicing Options (Continued)

Attention should be given to the deferral authorities and procedures in 7 CFR 766.109 and 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: According to 7 CFR 766.111(a)(2) and 5-FLP, subparagraph 172 A, borrowers who become delinquent will also immediately be considered for debt writedown. 7 CFR 766.101(a)(2) and 5-FLP, subparagraph 66 A provide that 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

Authorized agency 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 or hog placement) can be resolved in a timely manner. The 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
- loan is in nonmonetary default (loss of contract), the lender will review the promissory note and determine whether they may proceed with default servicing
- lender is **not** pursuing liquidation for loans in nonmonetary default, the lender and borrower must be actively seeking other sources of income.

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.

4 Guaranteed Loan Servicing (Continued)

B Deferral

A deferral under 7 CFR 762.145(d) may be particularly useful:

- to postpone the payments of principal and interest on FSA guaranteed loans and should be considered according to 7 CFR 762.145(d) and 2-FLP, paragraph 327
- for borrowers who have lost contracts with their current contractor but have obtained a contract with a new contractor 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 write down 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(e) and 2-FLP, paragraph 328.

Under 7 CFR 762.145(e)(4), 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 loan after writedown.

D Appraisals for Liquidation

When submitting loss claims, liquidation appraisals for poultry or hog facilities must determine the “highest and best use” value when considering the demand for the type of facility, the availability of contractors, and any alternative use of the facility. If contractors are available in the area, the facilities shall **not** be appraised for the “liquidation or salvage” value by the lender. The “highest 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: 2-FLP, Exhibit 15 provides the policy for poultry and other Concentrated Animal Feeding Operation facility liquidation appraisals and loss claims, as authorized by 7 CFR 762.149(b)(1)(iii) and 7 CFR 762.127(d)(2).