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

Guaranteed Loan Making and Servicing 2-FLP (Revision 1)	**Amendment 60**

Approved by: Deputy Administrator, Farm Loan Programs

Amendment Transmittal

A Reasons for Amendment

Subparagraph 244 A has been amended to update the FY 2024 guaranteed loan limit.

Exhibit 4.5 has been amended to update guidance on the content to include in a lender’s loan narrative.

Page Control Chart		
TC	**Text**	**Exhibit**
	10-1, 10-2	4.5, pages 1-7 pages 8-21 (add)

Part 10 Processing Approvals and Issuing the Guarantee

244 Loan Approval (7 CFR 762.122)

A Loan Limits

[7 CFR 762.122 (a)] The agency will not guarantee any loan that would result in the applicant's total indebtedness exceeding the limits established in § 761.8 of this chapter (1-FLP, paragraph 29)**.**

The maximum FO, CL, or OL levels outlined in this subparagraph include the guaranteed loan being made plus any outstanding direct or guaranteed principal balances, as indicated, owed by anyone who will sign the promissory note.

The total outstanding combined guaranteed FO, CL, SW, and OL principal balance cannot ***--**exceed $2,236,000.

The total outstanding direct and guaranteed FO, CL, and SW principal balance cannot exceed $2,236,000.

The total outstanding direct and guaranteed OL principal balance cannot exceed $2,236,000.

The total combined outstanding direct and guaranteed FO, CL, SW, and OL principal balance cannot exceed $2,836,000.

The total combined outstanding direct and guaranteed FO, CL, SW, OL, and EM principal balance cannot exceed $3,336,000.

Notes: The maximum loan levels established in this subparagraph are for FY 2024.**--***

The dollar limit of guaranteed loans is adjusted annually based on inflation.

FSA personnel should see 1-FLP for information on loan approval authorities.

B Submitting FSA-2231 to the Approval Official

When the loan exceeds the authorized agency official's approval authority, the authorized agency official should send the approval official all information the approval official needs to evaluate the loan request, including the following:

- a completed FSA-2231
- GLS Loan Approval Screens
- Application for Guarantee for all applicants

244 Loan Approval (7 CFR 762.122) (Continued)

B Submitting FSA-2231 to the Approval Official (Continued)

- Conditional Commitment with recommended changes
- the balance sheet and cash flow statement (for SEL applicants)
- the loan narrative
- any other information the approval official requests.

The authorized agency official should verify the lender has a Lender's Agreement in effect.

Once the loan approval official executes FSA-2231, the authorized agency official may then proceed to execute all other loan-related documents, unless otherwise specified by the loan approval official.

C Lender Notification of Authorized Agency Official Decision

The lender and applicant should be informed of the approval decision in writing.

- If the application is approved and funds are available, the authorized agency official shall prepare a letter to the lender (subparagraph D), with a copy to the applicant, and a Conditional Commitment, and proceed to paragraph 245.
- If the application is approved and funds are not available, the authorized agency official shall prepare a letter (subparagraph E) to the lender with a copy to the applicant, informing them the loan is approved, subject to the allocation of funding. This letter should inform the lender that funding is being requested and the loan should not be closed until they receive the Conditional Commitment, agree to the conditions, and execute the document.

Notes: Under certain circumstances a lender may find it necessary to close a loan that has been approved but funds are not available. These closings shall not be construed as an indicator that the guarantee is not needed. Any lender who decides to close an approved loan before funds are available should contact FSA before closing to determine whether there will be any additional closing conditions that would have been on the Conditional Commitment. Lenders should be aware that:

- the closing is at their own risk and there are circumstances that could result in FSA not issuing the guarantee once funding becomes available, such as any material change in the borrower's condition, financial or otherwise, since submission of the application
- all interest accrued on the lender's loan before guaranteed loan closing (execution of the allonge), will not be covered by the guarantee.

--**Accrued interest is any interest documented on the allonge.**--

*--Lender's Loan Narrative

A Content and Level of Detail

All guaranteed loan requests, except EZ Guarantee loan requests, must include a lender's loan narrative that addresses the 5 "Cs" of credit found in 2-FLP, subparagraph 66 C. The following is a summary of:

- the content FSA expects a typical loan narrative to contain
- factors to consider
- applicable 2-FLP references.

This document is not meant to be all-inclusive and is provided to assist lenders and FSA personnel prepare proper loan narratives. The loan narrative must provide the FSA loan approval official with the information required to ensure that the:

- guaranteed loan applicant meets the eligibility requirements
- proposed use of funds is authorized
- applicant's proposed operation is viable
- proposed security for the loan is sufficient to adequately secure the loan.

Note: Every guaranteed loan application is unique and the level of detail required in the lender's loan narrative will vary.

Example: A loan narrative for an existing FLP customer may have fewer details than an application for a new customer who is refinancing the lender's existing debt. FSA officials must use judgment to determine the appropriate level of detail in the lender's loan narrative.

B Eligibility

2-FLP References	
Subparagraphs: 66 C 66 I 67 A 69 B	Paragraphs: 108 109 (OL) 110 (FO) 111 (OL and FO Entity Applicants) 112 (CL)

The lender's narrative should address how the loan applicant meets FSA's eligibility regulations found in 2-FLP, paragraphs 108-112. Some of these requirements must be addressed with each loan application, and some only need to be discussed if the lender has particular relevant information. The following describes what must be addressed in all cases, what is relevant only in certain cases, and the elements to include in each.--*

***--Lender's Loan Narrative**

B Eligibility (Continued)

Key Eligibility Requirements Lenders MUST Address for Each Loan

[1] Description of the Farming Operation. FSA relies heavily on the lender's description of the operation to determine whether the loan applicant meets the program's statutory requirement to be an owner/operator or tenant/operator of a farm not larger than family size. Without direct knowledge or interaction with the loan applicant, FSA depends on the lender's description of the applicant and operation to make this decision. The following should be discussed:

- What products are raised?
- In what quantities (acres, head, etc.)?
- How are they marketed?
- What is the legal structure of the operation (sole proprietorship, LLC, S corporation, partnership)?
- Who are the owners and what are their roles?
- Who else is involved in the daily management structure?
- How much labor is hired and how much is provided by the owners?
- What are their roles?
- **Entity Example:** Joseph John Farmer and Jane Elizabeth Farmer are the sole members of Down by the Bay Farms, LLC. Down by the Bay Farms, LLC is located at 12345 Farm Town Road, Ranch City, Louisiana and is legally registered to operate in the state of Louisiana. The LLC operates 1,000 acres on a no-till corn/soybean rotation and 500 head cow/calf operation. Joe is primarily responsible for the farming operation while Jane manages the finances and record keeping. The LLC employs one full-time hired hand and two seasonal hired hands.**--***

***--Lender's Loan Narrative**

B Eligibility (Continued)

Other items to include in a description of the operation:

- General description of the owned and rented real estate (location, acres, owner, cost/acre, etc.)
- General description of the equipment and other facilities. What key items are owned and rented? What is the condition?
- A list of the location of all land to be farmed (unless submitted separately as part of the application). FSA needs this information for environmental review.
- What are the short-term and long-term goals of farming operation?
- What changes are planned for the farming operation?
- What environmental issues are present (if any) and what is their impact?

Less detail may be required for…	**More detail may be required for…**
traditional farming enterprises	multiple and/or non-traditional farming enterprises
sole-proprietorships or joint operations	partnerships, LLC's, embedded entities, etc.
there are no changes in the farming operation	there are changes in the farming operation

[2] Credit History. FSA relies on the lender's ability to adequately demonstrate their acceptable credit history. A history of failures to repay past debts when the ability to repay was within the applicant's control will demonstrate unacceptable credit history. FSA does not consider isolated instances of late payment or lack of credit history as unacceptable credit history. The following should be discussed:

- Explain any history of late payments; were they beyond or within the applicant's control?
- Explain low credit score or lack of credit history.
- Describe lending relationship with the financial institution.

Example: Bob and Betty Farmer have a good relationship with ABC Savings Bank. They have had some credit issues in the past. Bob's credit score is 600 and Betty's is 595. Five years ago, Bob and Betty had premature twins who required significant medical care. This led to bills becoming past due and medical debt. Since then, Bob and Betty have worked hard to improve their financial standing by paying extra on debt and regularly communicating with the bank. Most of the medical debt has been paid off and their credit scores are showing marked improvement.--*

***--Lender's Loan Narrative**

B Eligibility (Continued)

Less detail may be required if…	More detail may be required if...
no debt refinance	prior debt refinancing
no credit issues beyond the applicant's control	credit issues beyond the applicant's control
no late payments or isolated instances of late payment	significant number of late payments

[3] Test for Credit. FSA depends on lenders to explain why they cannot make the applicant a loan at reasonable rates and terms without a guarantee.

- The need for the guarantee must be based on a weakness, such as cash flow, new enterprise, irregular performance history, rapid expansion, poor market, net worth, current capital position, limited collateral, new operator.

  Example: A guarantee is required because the applicant does not meet lender standards for capital and repayment capacity. Applicant has a repayment capacity of 1.01 and debt/equity of 55 percent. Internal lending standards require repayment capacity of 1.10 or higher and debt/equity of 50 percent.

- Selling the guaranteed portion on the secondary market alone for just a fixed rate and term is not adequate. Explain how the secondary market rates and terms are necessary for the operation's success.

  Example: Without a guarantee to sell on the secondary market, the lender is not able to offer a fixed interest rate which will benefit the customer's repayment capacity in the long term as well as reduce the overall risk in the future of potential rate increases. This will also allow the customer's repayment capacity to meet internal lender standards.

Less detail may be required if…	More detail may be required if…
meets internal lending standards	does not meet internal lending standards
no debt refinance	there is refinance of debt
no current or recent delinquencies	there are current or recent delinquencies

<u>Other Eligibility Rules to Discuss If Necessary</u>

The following eligibility requirements **typically** do not need to be addressed in the lender's loan narrative, since the lender or applicant self-certifies on the loan application and/or FSA loan official can check on the status of the following items. The following items only require further explanation in unusual circumstances.**--***

***--Lender's Loan Narrative**

B Eligibility (Continued)

Does or is the applicant:

- a U.S. citizen, a U.S. non-citizen national, or a qualified alien under applicable Federal immigrations laws?

  Note: Only discuss if applicant is a U.S. non-citizen national or qualified alien.

- meet all the requirements of prior FSA debt forgiveness?
- not delinquent on any Federal Debt?
- not have any outstanding judgments obtained by a Federal Agency?
- have the legal capacity to incur the obligations of the loan?
- have any past convictions of planting, cultivating, growing, producing, harvesting, storing, trafficking, or possessing a controlled substance within the last 5 crop years?

C Loan Proposal

2-FLP References	
Subparagraphs: 66 C 67 A 69 B	Paragraphs: 135 (interest rate) 137 (loan term and payment schedules) 122-123.5 (loan purposes)

The lender must adequately describe the proposed loan that includes a description of:

- loan type, amount, term, rate, and purpose

  Note: For loans containing a balloon payment, include loan renewal conditions.

- the original loan purpose if the loan request is for refinancing
- other proposed loans or loan restructuring (such as non-guaranteed, FSA direct loans, or other) including loan type, amount, term, rate, purpose, and security
- Conservation Plan or Forest Stewardship Management Plan and the need for a qualifying conservation practice (CL only).**--***

***--Lender's Loan Narrative**

C Loan Proposal (Continued)

Example: Because of the dry crop year with reduced yield/income and the customer's inability to cover all expenses and debt payments, XYZ Savings Bank is requesting a $345,000 guaranteed operating loan to refinance $100,000 in carryover operating debt, $100,000 in machinery loans from outside sources, and $145,000 existing machinery/livestock loans. This loan will be fixed at 4.5 percent for 7 years.

Example: Savings and Loan Federal Bank is requesting a $700,000 guaranteed line of credit to finance farm operating expenses for the next 5 years. This loan will be a variable rate loan at 5.5 percent for 5 years. At the end of each operating cycle, the credit will be reviewed to determine that cash flow is feasible before funds will be advanced for the next year.

Less detail may be required if...	**More detail may be required if...**
equally amortized loan installments	unequal loan installments and/or balloon payment
no debt refinance	debt refinance
no plans to sell the guaranteed portion of loan	selling the guaranteed portion of loan on secondary market

D Collateral Analysis

2-FLP References	
Subparagraphs: 66 C 67 A 69 B	Paragraphs: 166 (amount and quality of security) 181 (appraisal requirements) 182 (chattel security appraisal requirements) 183 (real estate security appraisal requirements)

The lender must adequately describe security for proposed loan, including:

- assessment of the adequacy of the security being offered to secure the proposed loan (both primary and additional)
- explanation of how the ratios for the operation meet or do not meet internal standards by documenting strengths and weaknesses of the operation
- additional details or clarification on the security value and proposed lien position not apparent on the loan application
- explanation of the method used to establish the market value of the security - evaluation or appraisal and when it was completed**--***

***--Lender's Loan Narrative**

D Collateral Analysis (Continued)

- description of remaining useful life for highly specialized buildings

- explanation of how junior liens meet the 85 percent security rule (see 2-FLP, subparagraph 166 D).

Example: Primary security for the proposed loan is a first lien position on all machinery, equipment, and livestock. The bank will require 3rd party appraisals on all items prior to closing to support loan requirements. Additional security offered for the loan proposal is a second lien position on the 160 acres "The south farm" subject to the existing bank loan of $150,000. An internal evaluation will be completed on the additional security.

Less detail may be required if...	**More detail may be required if...**
first lien	shared or junior lien
real estate security	chattel or crop security

E Capacity Analysis

2-FLP References	
Subparagraphs: 66 C 67 A 69 B 122 E (OL debt refinance) 123 B (FO debt refinance)	Paragraphs: 151-154 (feasibility)

The lender must thoroughly support how the applicant meets their repayment capacity standards, including an explanation or discussion of:

- the method used to determine how repayment capacity standards were met

- how the ratios for the operation meet or do not meet internal standards by documenting strengths and weaknesses of the operation

- the applicant's projected cash flow (including deviations from previous history, strengths and weaknesses, addressing any changes in the pro-forma capacity not shown in the cash flow details)

- the source for the information, adjustments made, and any considerations made for changes in the operation or changes in the farm economy if capacity analysis was based on actual cash flow history (CLP and PLP lenders only)**--***

***--Lender's Loan Narrative**

E Capacity Analysis (Continued)

- the lender's standards and how the applicant meets those standards if a credit scorecard model was used (PLP lenders if allowed in CMS)

- assumptions made and basis for commodity prices and yields used to develop the cash flow budget

- why rescheduling or alternative payment schedules are not being offered (if refinancing debt held by lender).

Example: Joe and Jane Farmer's repayment capacity is derived from three prior years tax returns, and one internally prepared 11-month profit and loss statement. Tax returns in all three years show large losses from the Sugar Co-op deductions and patronage loss. These were tax events and not cash events. The tax returns were reconciled and then sugar deductions and losses were added back. The debt service coverage ratio (DSCR) for 2016 was just above 5. The 2017 DSCR was above 1 at 1.46. The 2018 DSCR was .27 with beet income the main driver for farm income loss. Just like in 2019, there was a large amount of crop inventory carried over from 2018. At the end of 2018, $224,000 in crop inventory was carried over into 2019. If those crops were sold at end of 2018 prices, the 2018 DSCR would have been 1.89.

The internal 2019 numbers show the additional farm ground taken on resulting in a 1.15 DSCR. Only expenses that had been paid were used on internal numbers. Last year when this credit was reviewed, the customer had projected a .46 DSCR. Actual DCSR was .27, so their projections were .19 higher. Those projections were actual end of 2019 numbers as of 12/1/2019. The lender concludes that 2019 numbers are accurate and estimates a 1:1 DSCR for 2019. An additional $117,893 in term debt was due before end of year 2019. On the 12/1/2019 balance sheet provided to the lender, there were $309,870 in accounts receivable and $297,000 in accounts payable, resulting in $12,870 additional income. That, along with crop inventory of $539,725, was more than enough to service all debt.

Projections for 2020 have a 1.18 DSCR which exceeds the bank's 1.15 capacity standard. This includes sugar beet income of $35/ton, which is a deviation from past years because full payment of beets has not happened. All commodity prices used on cash flow are based on the bank's established prices. Only bean prices have been modified to $28 based on the customers full contract with Northeastern Bean. An FSA guarantee is required because of capacity shortfall history from sugar beet underpayment. Positive cash flow for 2020 is $158,245.46 on 2020 cash flow.--*****

***--Lender's Loan Narrative**

E Capacity Analysis (Continued)

Less detail may be required if…	More detail may be required if…
high debt repayment margin	low debt repayment margin
balance sheet, cash flow projection, and financial and production histories are part of application	balance sheet, cash flow projection, financial or production histories are not part of application

F Capital Analysis

2-FLP References	
Subparagraphs: 66 C 67 A 69 B	Paragraphs: 151-154 (feasibility)

The lender must adequately describe capital position of operation, including a discussion or explanation of:

- applicant's financial condition (in addition to just stating financial ratios, lender should provide context for the type of operation or the life stage of the operation – startup, new enterprise, preparing for retirement)
- ratios for the operation back to internal standards to help document strengths and weaknesses of the operation
- effect of new debt on financial condition
- non-essential assets, if any
- consolidation of balance sheets, if applicable.

Example: Over the last 3 years, the borrowers have shown steady progress in their overall financial condition. Their working capital, debt to asset (D:A), and net worth have all shown marked improvement. Their working capital sits at $250,575, up from $200,000. D:A ratio is 60 percent, down from 63 percent. Net worth is $755,895, up from $735,000. While those improvements have not been large, they have been steady from the major financial uncertainty of the 5 years before these past 3 years. The pro-forma balance sheet shows a small decrease in all these ratios. With the continued financial monitoring implemented over the past few years, this should be a one-time decrease.**--***

***--Lender's Loan Narrative**

F Capital Analysis (Continued)

Less detail may be required if…	**More detail may be required if…**
strong equity position	little or no equity
strong working capital	weak working capital

G Loan Conditions and Servicing Plan

2-FLP References	
Subparagraphs: 66 C 67 A 69 B	

The lender must adequately describe loan conditions and servicing plans, including:

- an explanation of the loan servicing plan describing borrower's financial reporting requirements, limitations and conditions, and other borrower supervision (not required if described in another loan application document)

- the name, and current address of any guarantors or co-signers required to execute the promissory note (not required if this information is listed on the loan application or another application document).

Example: For the line of credit, the borrower will be required to obtain at least catastrophic level crop insurance coverage and give ABC Bank an assignment of crop insurance and government payments. The bank will also require the customer to submit invoices before advancing on the line of credit to manage funds properly since this has been an issue in the past. Customer will agree to a yearly farm inspection and a financial review twice a year. Cash flow will be developed and analyzed annual to determine if the budget is feasible and funds can be advanced for the following year.

Less detail may be required if…	**More detail may be required if...**
real estate security	equipment, livestock or crop security
FO	OL or LOC
financially strong farming operation	financially weak farming operation

--*

***--Lender's Loan Narrative**

H Loan Narrative Guide Checklist

	Eligibility: **Description of Operation** • What products are raised? • In what quantities (acres, head, etc.)? • How are they marketed? • What is the legal structure of the operation (sole proprietorship, LLC, S corporation, partnership)? • Who are the owners and what are their roles? • Who else is involved in the daily management structure? • How much labor is hired and how much is provided by the owners? • What are their roles? **Credit History** • Does the applicant have an acceptable credit history? • Describe your relationship history with the applicant. • Address any negative aspects of their credit history. **Test for Credit** • Why can't the lender make the loan without a guarantee?
	Loan Purpose: • Description of loan type, amount, term, rate, and purpose, (for loans containing a balloon payment, include loan renewal conditions) • Description of any other proposed loans or loan restructuring (non-guaranteed, FSA direct loans, other), including loan type, amount, term, rate, purpose, and security • Description of Conservation Plan or Forest Stewardship Management Plan, and the need for a qualifying conservation practice (CL only)

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***--Lender's Loan Narrative**

H Loan Narrative Guide Checklist (Continued)

	Collateral Analysis: • Assessment of the adequacy of the security being offered to secure the proposed loan • Discuss the ratios for the operation back to internal standards to help document strengths and weaknesses of the operation • Any additional details or clarification on the security value and proposed lien position not apparent on the loan application • Method used to establish the market value of the security - evaluation or appraisal
	Capacity Analysis: • Discuss applicant's projected cash flow (including deviations from previous history, strengths and weaknesses, addressing any changes in the pro-forma capacity not shown in the cash flow details) • Discuss the ratios for the operation back to internal standards to help document strengths and weaknesses of the operation • Discuss assumptions made and basis for commodity prices and yields used to develop cash flow • Discuss why rescheduling or alternative payment schedules are not being offered (if refinancing debt held by lender)
	Capital Analysis: • Discuss applicant's financial condition (in addition to just stating financial ratios, lender should provide context for the type of operation or the life stage of the operation – startup, new enterprise, preparing for retirement) • Discuss the ratios for the operation back to internal standards to help document strengths and weaknesses of the operation • Effect of new debt on financial condition • Discuss non-essential assets, if any • Discuss consolidation of balance sheets, if applicable
	Loan Conditions and Serving Plan: • Lender loan servicing plan describing borrower's financial reporting requirements, limitations and conditions, and other borrower supervision (not required if described in another loan application document) • The name and current address of any guarantors or co-signers required to execute the promissory note (not required if this information is listed on the loan application or another application document)

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***--Lender's Loan Narrative**

I Sample Lender Narrative

Loan proposal:

Describes:
- ✓ The type of loan request
- ✓ Uses of loan funds
- ✓ Interest rate and terms
- ✓ Reasons for refinance if applicable
- ✓ The original loan purpose if refinancing

Sunshine Farm and Ranch and Rural Town Bank are requesting FSA guaranteed loan assistance. Their wheat yields over the past few years were substantially reduced because of late freeze, excessive flooding, hail, and heavy rains. Additionally, excessive repairs to irrigation equipment and excessive heat have affected their corn yields. Even though crop insurance paid, the yield issues have caused carry-over debt on the LOC. The family needs to restructure their balance sheet and term out carry-over debt to overcome this negative set back.

The plan for this proposal was discussed on February 1, 2023, during the pre-application farm visit with all members of the operation. During that visit, Rural Town Bank loan officer Frank Banker was able to:

- view the farming operation and potential security
- conduct an environmental inspection of the property and found no noted ground disturbance or environmental concerns
- discuss a plan on successfully moving forward.

Loan #1: Rural Town Bank requests loan # 8745 be refinanced, along with debt of 3 other creditors. The loan amount requested is $400,500 with a 7-year term and a 3-year adjustable interest rate of 8.75 percent.

Refinance Rural Town Bank (8745)	$229,856
Refinance John Deere Credit	$ 51,200
Refinance Rural Town Coop	$ 22,000
Refinance carry over crop debt	$ 90,000
Additional accrued interest	$ 2,037
FSA guarantee fees	$ 5,407
Total	**$400,500**

Payment will be made annually with the first payment due following fall harvest in the amount of $78,910. Overall term loan payments will be reduced by $25,000 annually with the extended terms.**--***

***--Lender's Loan Narrative**

I Sample Lender Narrative (Continued)

Loan #2: Rural Town Bank also requests an LOC for the upcoming operating year in the amount of $250,000. This will be an annually renewable note for 5 years.

Loan proceeds:

Crop input costs	$195,000
Feed	$ 50,000
Partner withdrawals (Bob and Anne)	$ 5,000
Total	**$250,000**

All income from farm proceeds will be applied to principal as grain or livestock are sold or government payments collected. Annual paydown will occur on the LOC to prevent carry over.

Interest is prime + 1.5 percent paid by December 1 annually or at note maturity. Initial rate projected to be set at 9 percent.

Rural Town Bank is requesting a 90 percent guarantee on both loan requests.

Description of the Farming Operation:

Describes:
- ✓ Who the owners of the operating entity are
- ✓ What percentage they own
- ✓ Who the owners of the land are if they are different from the operating entity
- ✓ Their responsibilities
- ✓ What they raise
- ✓ Size of the operation
- ✓ If any additional hired labor is required

Sunshine Farm and Ranch is a general farm partnership consisting of a father and mother, Bob and Anne Sunshine, and their two sons, Joe and Mike. The following table displays the partnership breakdown.

<table>
<tr><th>Partner</th><th>Title</th><th colspan="2">Ownership</th></tr>
<tr><td>Bob Sunshine</td><td>Partner</td><td rowspan="2">50%</td><td>General Management</td></tr>
<tr><td>Anne Sunshine</td><td>Partner</td><td>Bookkeeping</td></tr>
<tr><td>Joe Sunshine</td><td>Partner</td><td>25%</td><td>Daily management and labor</td></tr>
<tr><td>Mike Sunshine</td><td>Partner</td><td>25%</td><td>Daily management and labor</td></tr>
</table>

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***--Lender's Loan Narrative**

I Sample Lender Narrative (Continued)

Most strategic business decisions are made by Bob, with Anne assisting with the bookkeeping. Bob and Anne jointly own a 50 percent interest in the partnership. Additionally, Joe and Mike provide all day-to-day labor and management of the operation holding 25 percent interest each. The operation hires occasional seasonal labor. Sunshine Farm and Ranch, located in East and West Counties, farms approximately 2,400 acres of dryland wheat, irrigated corn, and milo, and runs a small cow/calf operation of about 100 head of cows and 4 bulls. Bob individually owns two 160-acre parcels of irrigated farm ground and 300 acres of pasture. Bob and Anne Sunshine reside on one of those parcels. Joe and his wife Mary jointly own 80 acres of pasture and reside there as well. Mike is single and lives in Rural Town, Kansas. Sunshine Farm and Ranch also rents an additional 100 acres of pasture to rotate the cattle throughout the year to help with feed costs. The Sunshine's have been customers of Rural Town Bank since 2004 borrowing for term loans and then expanding the relationship with a revolving LOC as the operation grew larger.

<u>Character</u>:

Describes:
- ✓ If the credit acceptable
- ✓ What the credit report shows
- ✓ If any potential problems have been resolved
- ✓ What credit sources have been investigated
- ✓ The reasoning behind credit issues
- ✓ If the credit issues are within the applicant's control or not

The members of Sunshine Farm and Ranch display strong character and meet lending standards for character despite lower credit scores. They have shown their willingness to communicate openly with the bank about their financial issues.

Bob and Anne's credit score is 790. Their only farm debt is to Rural Town Bank on their owned 320 acres and home.

Joe and Mary's credit score is 689. A hospital bill from an auto accident their oldest son was in showed up on the credit report as a collection account. Auto insurance was slow to resolve the dispute involved in that bill, but it has now been paid in full. Joe and Mary's loan to Rural Town Bank is reported in good standing. They have several credit cards with small balances that are usually resolved in 3 to 6 months.

Mike's credit score is 620. His FMC pickup loan reported 5 late payments in the past 12 months but none over 30 days past due.

Their overall credit history appears satisfactory. Debts over $5,000 not reflected on the credit report have been verified.**--***

***--Lender's Loan Narrative**

I Sample Lender Narrative (Continued)

<u>Goals</u>:

Describes ✓ Short-term goals ✓ Intermediate goals ✓ Long-term goal

The main goal of the operation is to heal from the past few years of financial setbacks. Over the next 5 years, Bob and Anne would like to complete the process of transferring ownership and management of the operation to their boys. After the transition, Bob would continue to assist harvesting spring crops, planting wheat, and helping as needed with the cattle.

Joe sees considerable potential in increasing the operation's profitability and Mary would like to devote more time to chores and bookkeeping after shifting from fulltime teaching to substitute teaching. Joe and Mary's oldest son wants to come back after college and join the operation.

Mike enjoys crop adjusting and has no desire to quit his day job but is willing to put more hours into the operation once Bob cuts back. Mike has indicated that he'd like to move into the country and purchase a small tract of ground.

These are all long-term goals until the operation can correct itself from prior setbacks. The ultimate goal of the operation is to operate profitably on a cash basis. For now, the bank is willing to continue with them using the guaranteed loan program.

<u>Eligibility</u>:

This farm operation meets the loan eligibility requirements outlined in 2 FLP, paragraph 108. The applicant has self-certified to applicable eligibility questions on the application. Credit history and operator of a family farm are addressed in the Character section. The need for the guarantee is addressed in the Capacity, Capital and Collateral sections. Rural Town Bank has determined there are no conflicts of interest present with this application.**--***

***--Lender's Loan Narrative**

I Sample Lender Narrative (Continued)

Capacity:

Describes:
- ✓ Farm Income Sources, such as crops or livestock
- ✓ Lease information
- ✓ Expenses
- ✓ Marketing strategies
- ✓ Non-farm income sources
- ✓ Cash flow ratio information
- ✓ Scorecard model

A review of the financial information for this application indicates that the debt service margin of 1.05 percent does not meet the internal lending standard of 1.15 percent, therefore generating the need for the guarantee.

The cash flow projection provided with the application is for the upcoming crop year and reflects a typical year.

The cash flow is tight with their debt service margin at 1.05 percent. Their operating expense ratio is in line with their 3-year history of 77 percent. This return is good considering the increase in fuel expenses and prior year setbacks. The weakness is offset by grain contracts in place for the upcoming operating cycle, assignment of government payments and crop insurance, as well as established off-farm income.

Acres and yields: Sunshine Farm and Ranch's operation consists mainly of 1,200 acres of dryland wheat with average yields over the past 3 years around 42 bushels/acre. Irrigated corn is planted on 480 acres (2 owned and 1 rented with annual cash rent of $115/acre) with average yields of 220-240 bushels/acre. The remaining 720 acres are planted to milo with average yields ranging 50-80 bushel/acre. Soybeans are planted into the rotation every 3 years on 320 of the irrigated rented acres.

All irrigated croplands have good wells. The owned land wells average about 900 gpm, and the rented land wells averaging between 600-750 gpm. The crop ground has good soils, and the terraces are maintained. Some of the newer rented ground had bindweed problems over the past few years, but it has been mostly eradicated. None of the ground has been classified as HEL or Wetland.**--***

*--Lender's Loan Narrative

I Sample Lender Narrative (Continued)

Cattle: A smaller part of the operation's income comes from 75 head of calves being sold/retained. The plan utilizes a 2 percent death loss. The operation practices a cull rate of 10 percent with an equal retention rate to keep the average age of the overall herd. Calving rate is based on State historical information of 55 percent. Sunshine Farms sells all the calves to the local cattle feeder. For breeding purposes, the operation primarily utilizes AI with a cleanup bull. The cattle operation is supported by adequate pastures with good water sources. Pastures consist of native grasses and are plentiful in a good rainfall season. The pastures are relatively close together and there is good pond located on Joe's 80 acres. A pond and a creek run through the rented pasture. They would like to eventually add and grow their breeding cattle numbers and have increased from 75 to 100 over the past few years. Additional pasture is always a concern.

Leases: The sprinklers are provided by the landlord with the crop share and expenses split at 50/50. The balance of the rental arrangements are 1/3 landlord and 2/3 tenant.

Expenses: All expenses are in line with the 3-year history (provided) with adjustments made in seed, fertilizer, chemicals, and other inputs to an increase in input expenses.

Marketing: The operation does exercise forward contracting when feasible. The cash flow represents a history of forward contracting, and a typical year plan has also been developed using FSA's farm planning prices.

Nonfarm income and withdrawals: Bob and Anne receive social security income as well as a small partnership draw from the farming operation of $5,000 each year. Joe doesn't work off the farm and Mary is a schoolteacher. Mike works part-time as a crop insurance adjuster. The lender has not injected any off-farm income into the cash flow or personal debt. All members personal cash flows can stand alone. Joe's withdrawals from the farm show up under "labor" for $24,000/year. The operation supports this expense. Mike is paid as "seasonal labor" when necessary; otherwise, no withdrawals are made by Mike.

The family isn't planning any changes to their operation which had been working well until the last few years.**--***

***--Lender's Loan Narrative**

I Sample Lender Narrative (Continued)

Collateral:

Describes
- ✓ The primary security for the loan
- ✓ Details about additional security
- ✓ Appraised values
- ✓ When appraisals were completed
- ✓ Any items not to be included as security
- ✓ Prior liens
- ✓ Non-essential/personal assets to be included in security

Sunshine Farm and Ranch meets the security requirements for internal lending standards of 70 percent. For additional collateral, the lender is requiring all personal ownership in real estate be pledged as security.

Both loans will be secured by a first lien on all farm chattels. The line of credit will have first priority lien on the crops and calves to be produced. Sunshine Farm and Ranch owns the farm equipment used in the operation, except for 2 sprinklers owned individually by Bob. That debt owed to We R Irrigation is included in the cash flow. An appraisal was completed by Ralph Appraiser during a field visit on XX-XX-XXXX, estimating $490,830 in equipment market value. The cattle were inspected at the same time and valued at $1,400/pair or $1,000/cow. Currently, they own 4 bulls valued at $2,000/each. Refer to the chattel appraisal for additional specifics. There are no plans for capital purchases. The collateral offered is adequate to secure the loan at a 70 percent Loan/Appraised Value. Rural Town Bank's underwriting standard is 70 percent, which requires that partners pledge their interest in real estate, subject to prior liens in place to Rural Town Bank. All loans will be cross collateralized.

Capital:

Describes
- ✓ What financial measures were taken into consideration
- ✓ How the new debt affects the operation
- ✓ Post-Close balance sheet analysis
- ✓ Non-essential assets

Given the past financial issues and carryover debt, Sunshine Farm and Ranch's current ratio of 50 percent and debt to asset ratio of 72 percent do not meet Rural Town Bank's internal lending standards for capital, making restructuring necessary.**--***

***--Lender's Loan Narrative**

I Sample Lender Narrative (Continued)

The partnership balance sheet reflects a current ratio of 50 percent ($100,000 Current Assets/$200,000 Current Liabilities); however, this will correct itself shifting carry-over debt to intermediate thus creating a longer pay-out. Debt to asset ratio of 72 percent is higher than preferred because of the carry-over debt taken. After restructuring, the balance sheet will reflect a current ratio of 113 percent which is lower than Rural Town Bank's internal lending standards allow but within the requirements for a new loan with a FSA guarantee. Separate balance sheets for the individuals are enclosed for test for credit determinations and information on reserve equity but have not been included in our analysis.

<u>Conditions & Servicing Plan</u>:

Describes:
- ✓ Financial reporting requirements
- ✓ Borrower supervision requirements
- ✓ Name, SSN, address of any co-signors
- ✓ Any limitations or conditions

<u>Servicing plan</u>: Rural Town Bank's servicing plan includes annual farm visits and requires the borrower to submit annual financial statements, cash flow projection, and tax returns. If the borrower can't make all of their debt payments, an interim balance sheet and cash flow will be developed. LOC advances will be requested either by email or phone and itemized closely to document the expenses, supported by repair, fuel, fertilizer, seed, chemical and feed statements.

Additional conditions are:

1. No capital purchases without lender approval.

2. Assignment of government payments.

3. No advances for future years' operating until the lender has completed an analysis of the previous year or accounted for inventory and a feasible cash flow has been projected.

4. Assignment of MPCI policy to the Bank.

5. Subject to prior liens, Bob and Anne Sunshine and Joe and Mary Sunshine will pledge their real estate as collateral for the loans.

6. All partners and their spouses will sign the security documents.**--***

***--Lender's Loan Narrative**

I Sample Lender Narrative (Continued)

7. Family living expenses drawn from the entity are limited to Bob and Anne Sunshine and not to exceed $5,000 annually. All other family living expenses will be covered from non-farm sources.

8. All entity members are required to sign the promissory note as individuals.

Rural Town Bank believes Sunshine Farm and Ranch is on the upward trend financially. Over time, the conditions, servicing plan, and proposed loan structure will assist in the long-term viability of the operation.**--***