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

Regular Direct Loan Servicing 4-FLP	Amendment 40

Approved by: Deputy Administrator, Farm Loan Programs

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Amendment Transmittal

A Reasons for Amendment

Subparagraph 20 A has been amended to clarify the completion of FSA-2040 involving basic security.

Subparagraph 22 A has been amended to correct handbook reference for YEA.

Paragraph 164 has been added to clarify requirements for multiple releases of normal income security proceeds for farm operating expenses within the term of an Annual OL.

Subparagraph 196 A has been amended to delete duplicate language.

Subparagraph 247 D has been amended to add examples of new entity transfers and assumption types.

Subparagraph 248 C has been amended to clarify eligible rates and terms for new entity transfers and assumptions.

Subparagraph 250 A has been amended to clarify application of down payment funds for transfers and assumptions.

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20 Agreement for Using Proceeds

A Planning

[7 CFR 765.302(a)] The borrower and the Agency will execute an agreement for the use of proceeds.

Using the FBP prepared in subparagraph 16 C the agency official will complete the FSA-2040 to describe plans for disposition of security and use of proceeds during the next operating year. Borrower will review the FSA-2040, initial, date, and sign in the designated places.

For established operations, where significant changes are not planned and with the borrower's input and consent, the FBP prepared in subparagraph 16 C may be used to complete the FSA-2040 for a second operating year.

For borrowers with:

- normal income security, the agreements will be updated at least biennially
- ***--**basic security only, the agreement will be completed when disposition is planned during the period covered by the operating plan.

  Note: Voluntary liquidation should be handled according to 5-FLP, Part 13.**--***

Disposition of security will be reported according to paragraph 162 and 163.

If the farm operating plan prepared for the operational review is not feasible, the account will be serviced according to 5-FLP.

21 Limited Resource Review

A Borrower Account Reviews

[7 CFR 765.51(a)] At least every two years, a borrower with limited resource interest rate loans is required to provide the Agency the operation's financial information to determine if the borrower can afford to pay a higher interest rate on the loan. The Agency will review the information provided in accordance with §761.105 of this chapter.

The authorized agency official will usually review borrower accounts during the operational review *** * *;** however, reviews may be completed at any time. The limited resource interest rate review process will be documented in FBP and tracked and monitored within DLS Operational Review workflow.

*** * ***

Based on results of the review, the authorized agency official may adjust the interest rate, if the:

- borrower's debt service margin shows that the borrower can afford to pay a higher interest rate according to subparagraph B
- borrower makes a request to be removed from limited resource rates according to subparagraph C
- borrower defaults on the loan agreements according to subparagraph D.

The authorized agency official must approve the interest rate change by completing the Limited Resource Review section in the applicable FBP Credit Presentation. The interest rate change will be accomplished by completing the Operational Review workflow in DLS.

When a review is completed and no change is to be made to the borrower's interest rate, the authorized agency official will document the review in the applicable FBP Credit Presentation. This review will also be documented in the Operational Review workflow in DLS.

21 Limited Resource Review (Continued)

F Sending Notification Letters

The authorized agency official must notify a borrower of any decision to change an interest rate with a letter similar to Exhibit 25. The letter must inform the borrower of:

- the new interest rate
- the authorization and reason for the change in interest rate
- the effective date of the new rate
- the amounts of new payments and dates due
- appeal rights unless the borrower requested the rate increase.

--**The letter must be sent by certified mail to the last known address of the borrower. If the certified mail is not accepted, the notice will be sent immediately by first class mail to the last known address. A copy of the notification letter shall be attached to the original promissory note and a file copy of the promissory note shall be maintained in the borrower's case file. The authorized agency official will not apply the increased interest rate until 30**-- calendar days after the letter is sent to the borrower. If the borrower appeals FSA's decision to increase the interest rate, the rate will not be changed until the appeal is concluded.

G Change in Regular Interest Rate

If the rate is being changed to the regular rate, and as of the effective date the regular rate of interest is something other than the rate noted in Exhibit 25, the borrower will receive the lower of the 2 rates.

22 Year-End Analysis

A Summary of Year-End Analysis

--Refer to 1-FLP, Part 8 for guidance on year-end analysis.--

The following is a summary of year-end analysis to be completed with Operational Review and level of documentation and analysis.

- **New Loan/Assumption, New Subordination, or PLS Being Approved or Rejected**

  - The level of financial review for year-end analysis will be an in-depth analysis and documentation.

  - If there was a cash flow prepared in the previous production cycle, the year-end analysis will compare previous year projections to the actuals. If there was not a cash flow prepared in the previous production cycle, use previous year actuals to assure projections are realistic.

- **No New Loan – Biennial Operational Review**

  - The level of financial review for year-end analysis will be mid-level analysis and documentation.

  - If there was a cash flow prepared in the previous production cycle, the year-end analysis will compare previous year projections to the actuals. If there was not a cash flow prepared in the previous production cycle, utilize previous year actuals to assure projections are realistic.

- **Annual Assessment Update Only**

  - There will be no year-end analysis completed.
  - Documentation of discussion for annual assessment will be completed.

163 Using Proceeds From Chattel Security

A General Requirements

[7 CFR 765.303(a)] (1) Proceeds from the sale of basic security and normal income security must be remitted to lienholders in order of lien priority.

(2) Proceeds remitted to the Agency may be used as follows:

(i) Applied to the FLP loan;

(ii) Pay customary costs appropriate to the transaction.

(3) With the concurrence of all lienholders, proceeds may be used to preserve the security because of a natural disaster or other severe catastrophe, when funds cannot be obtained by other means in time to prevent the borrower and the Agency from suffering a substantial loss.

(4) Security may be consumed as follows:

(i) Livestock may be used by the borrower's family for subsistence;

(ii) If crops serve as security and usually would be marketed, the Agency may allow such crops to be fed to the borrower's livestock, if this is preferable to marketing, provided the Agency obtains a lien or assignment on the livestock, and livestock products, at least equal to the lien on the crops.

B Releasing Normal Income Security for Essential Family Living and Farm Operating Expenses

[7 CFR 765.303(b)] In addition to the uses specified in paragraph (a) of this section, the agreement for the use of proceeds will allow for release of proceeds from the sale of normal income security to be used to pay essential family living and farm operating expenses. Such releases will be terminated when an account is accelerated.

See Exhibit 2 for the definition of essential family living and farm operating expenses. FSA may not consider all of the examples included in the definition as essential for every family and farming operation. The authorized agency official must consider all of the following:

- the individual borrower's operation
- what is typical for that type of operation in that area
- what is an efficient method of production considering the borrower's resources.

163 Using Proceeds From Chattel Security (Continued)

B Releasing Normal Income Security for Essential Family Living and Farm Operating Expenses (Continued)

The borrower must contact FSA for approval if the borrower wants to use proceeds to pay for farm operating expenses for future operations not included in the current FBP, so that FSA may work with the borrower to develop a feasible FBP. When the borrower and FSA cannot agree on security releases for essential family living and operating expenses, the borrower must request the release in writing. If rejected, the authorized agency official will notify the borrower, in writing, why the requested release was denied, including why the expenses requested for release are not basic, crucial, or indispensable to the family, the farming operation, or both. Appeal rights will be included with the notification. See 1-APP for appeal procedures.

C Basic Security

[7 CFR 765.303] (c) In addition to the uses specified in paragraph (a) of this section:

(1) Proceeds from the sale of basic security may not be used for any family living and farm operating expenses.

(2) Security may be exchanged for chattel property better suited to the borrower's needs if the Agency will acquire a lien on the new property at least equal in value to the lien held on the property exchanged.

Note: Insurance proceeds not being used immediately to replace the security should be kept in a supervised bank account according to 1-FLP, Part 4. If an account is not established, SED may request an Administrator's Exception under paragraph 4.

(3) Proceeds may be used to purchase chattel property better suited to the borrower's needs if the Agency will acquire a lien on the purchased property. The value of the purchased property, together with any proceeds applied to the FLP loan, must at least equal the value of the Agency lien on the old security.

*--164 Multiple Releases for Farm Operating Expenses Within the Term of an Annual OL

A Review of Production Cycles

FSA may, on a case-by-case basis for annual OL's only, authorize normal income security releases for the purpose of reinvestment within a 24-month period in accordance with the farm business plan associated with the annual OL at the time of loan approval. These releases may be specifically beneficial for operations with multiple growing and marketing seasons within the term of the annual OL. These releases may be outside of other planned releases for authorized annual OL purposes (e.g., family living expense).

Example 1: A cattle feeder operation plans to purchase and feed 6 sets of calves within a 24-month period (1 set every 4 months with $125,000 of associated credit needed for each rotation). FSA approves a $125,000 direct annual OL request to purchase and feed the initial set of cattle. When the first set of calves are sold, FSA may release the sale proceeds in accordance with the approved farm operating plan and FSA-2040. The sale proceeds will be used to purchase the second set of calves and inputs. This may continue through the fifth set of calves. The sale proceeds from the sixth set of calves would be used to pay the direct annual OL in full.

Use of this provision is not authorized to exceed a 24-month period.

Authorizing releases under this subparagraph will require substantial planning and analysis throughout the term of the annual OL. Releases considered under this subparagraph must have been projected as part of the approved farm business plan reflecting releases for purposes of reinvestment pursuant to 3-FLP, subparagraph 201 D.

Before release of normal security for reinvestment for a subsequent growing or marketing season, the borrower must submit the following for the purpose of analyzing the previous and the upcoming production cycles:

- current balance sheet
- actual financial and production performance for the previous production cycle
- revisions, if necessary, to projected income/expense for the next production cycle.

Loan officials must conduct a review of the operation's performance using the established guidelines for Operational Reviews. See Paragraph 22 for additional details. The review can be limited in scope to coincide with the previous production and marketing cycle.**--***

*--164 Multiple Releases for Farm Operating Expenses Within a Production Year (Continued)

B Determination to Release

The authorized agency official will determine if, based on the results of the review of the previous production cycle and current projections, a release for reinvestment is authorized. The FBP "Ending Cash On Hand" must be positive for each production cycle under this subparagraph. If there are significant changes to the operation or projections from the original approved FBP cash flow budget, then an updated FBP cash flow projection may be necessary to demonstrate a feasible plan is still achievable. The agency official will discuss with the borrower the benefits of paying the outstanding accrued interest on the annual OL before releases for a subsequent production cycle. The agency will release only the amount necessary to fund the reinvestment as determined in the income/expense projection for the next production cycle. Releases for a subsequent operating cycle will not exceed the original note amount. Before releases for the final production cycle within the annual OL term, the income/expense review must show the borrower will be able to pay the direct OL loan installment due at annual OL maturity.

During the term of the annual OL, the authorized agency official and borrower will revise, if necessary, FSA-2040 in accordance with subparagraph 162 D.

If a request for a release of proceeds under this paragraph is rejected, the authorized agency official will notify the borrower, in writing, why the requested release was denied. Appeal rights will be included with the notification. See 1-APP for appeal procedures.**--***

165 (Reserved)

Section 3 Real Estate Security Releases, Exchanges or other Disposition of Portion or Interest

196 Requirements

A General

[7 CFR 765.351] The borrower must obtain prior consent from the Agency for any transactions affecting the real estate security, including but not limited to, sale or exchange of security, a right-of-way across security, and a partial release. The Agency may consent to such transactions provided the conditions in this section are met.

Notes: This section also applies to subordinations and non-disturbance agreements made for nonlending purposes.

This section also covers the sale of water and water rights.

The borrower must:

- complete and sign FSA-2061 with the assistance of the authorized agency official
- provide a written contract or an agreement for the property indicating the price and terms of the transaction
- sell the property for not less than the appraised value unless FSA is being paid in full.

* * *

247 Types of Transfers and Assumptions (Continued)

B Adding a New Member to a Borrower Entity (Continued)

- FSA-2489 or FSA-2026, or both
- new FSA-2026's, if needed
- FSA-2476, if applicable
- security instruments, as appropriate.

The transaction will be completed under subparagraph 248 C.

C Withdrawing a Member and the Remaining Members Are Not Jointly Liable

If a personally liable party withdraws from an entity and all remaining entity members are not jointly liable for the debt, FSA will process the transfer and assumption according to this part. Accordingly, all transferees will become personally liable for the debt and assume the full responsibilities and obligations of the debt transferred when the transfer and assumption is complete. If all remaining entity members are jointly liable, the withdrawal is processed according to Part 8.

The borrower and the proposed transferee should contact their local FSA office and submit or participate in completion of the documents to initiate the transfer and assumption process. The completed documents may include:

- FBP, for the new entity demonstrating the repayment ability and management capacity of the remaining borrower entity
- updated farm assessment
- documents identifying the reason for the withdrawal such as a death certificate, a divorce decree, or a change in the composition of a corporation or partnership
- documentation of the transfer of the property such as a "deed" or "bill of sale" to the remaining members of the borrower entity
- narrative by the authorized agency official describing and recommending the proposal
- FSA-2025
- FSA-2489, FSA-2026, or both
- FSA-2080, if applicable
- FSA-2476, if applicable
- new security instruments, as appropriate.

247 Types of Transfers and Assumptions (Continued)

D Adding New Entity

When an existing individual borrower forms an entity, the borrower should contact their local FSA office and submit or participate in the completion of the documents to initiate the transfer and assumption process.

***--Example 1:** Existing individual borrower has created a sole proprietor LLC. Borrower will now operate the farm under this new LLC.

Example 2: Existing sole individual borrower is requesting to add his son as a co-borrower. The primary borrower (father) will remain the same, but there will now be 2 individual co-borrowers. As a result, the operation will be considered an entity as the definition within handbook 4-FLP consists of an exception to include any arrangement in which more than 1 person is party to the debt.**--***

The completed documents may include:

- FSA-2001
- narrative by the authorized agency official describing the proposal
- FBP demonstrating the repayment ability
- new security instruments, as appropriate
- FSA-2489, FSA-2026, or both
- FSA-2476, if applicable.

The transaction will be completed under subparagraph 248 C.

E NP Applicant

FSA may allow NP assistance only when it is in FSA's best interest.

FSA allows NP assistance only to accommodate enhanced collection potential for outstanding loans.

The documents FSA requires for a NP transfer and assumption are the same as for a program eligible applicant, except FSA does not need to determine the borrower's eligibility.

248 Assumption Terms

A Basic Policy

Loans will generally be assumed on new rates and terms. A loan may only be assumed on the same rates and terms according to paragraph C.

B Eligible Applicant - New Rates and Terms

[7 CFR 765.403(e)] The interest rate and loan term will be determined according to rates and terms established in part 764 (3-FLP) **of this chapter for the type of loan being assumed.**

C Eligible Applicant - Same Rates and Terms

A transfer and assumption of all debt and security processed at the same rates and terms does not require an appraisal.

[7 CFR 765.402] An eligible applicant may assume an Agency loan under the same rates and terms as the original note if:

(a) The original borrower has died and the spouse, other relative, or joint tenant who is not obligated on the note inherits the security property;

(b) A family member of the borrower or an entity comprised solely of family members of the borrower assumes the debt along with the original borrower;

***--Note:** Includes an existing individual borrower that has created a sole proprietor entity and will now operate the farm under the new entity.--*

(c) An individual with an ownership interest in the borrower entity buys the entire ownership interest of the other members and continues to operate the farm in accordance with loan requirements. The new owner must assume personal liability for the loan;

(d) A new entity buys the borrower entity and continues to operate the farm in accordance with loan requirements; or

Note: The new entity must replace the present entity and consist of the same members.

248 Assumption Terms (Continued)

C Eligible Applicant - Same Rates and Terms (Continued)

(e) The original loan is an EM loan for physical or production losses and persons who were directly involved in the farm's operation at the time of the loss will assume the loan. If the original loan was made to:

(1) An individual borrower, the transferee must be a family member of the original *--borrower or an entity in which the entity members are comprised solely of family--* members of the original borrower.

(2) A trust, partnership or joint operation, the transferee must have been a member, partner or joint operator when FSA made the original loan or remain an entity *--comprised solely of people who were original entity members, partners or joint--* operators when the entity received the original loan.

***--(3) A corporation, including limited liability company, cooperative, or other legal business organization, the transferee must:**

(i) Have been a corporate stockholder, cooperative member, or other member of a legal business organization, when the Agency made the original loan or will be an entity comprised solely of entity members who were entity members when the entity--* received the loan; and

(ii) Assume only the portion of the physical or production loss loan equal to the transferee's percentage of ownership. In the case of entity transferees, the transferee must assume that portion of the loan equal to the combined percentages of ownership of *--the individual stockholders or entity members in the transferee.--*

D Transfer and Assumption of Types of Loans No Longer Made by FSA

[7 CFR 765.403(c)] Real estate loan types the Agency no longer makes (i.e. EE, RL, RHF) may be assumed and reclassified as FO loans if the transferee is eligible for an FO loan under part 764 of this chapter (3-FLP) **and the property proposed for transfer meets program requirements.**

249 Reviewing Transfer Request (Continued)

E Approving the Transfer and Assumption (Continued)

The authorized agency official will use FSA-2025 to notify the applicant that the transfer and assumption has been approved.

If FSA rejects the transfer and assumption request, the authorized agency official will notify the borrower of appeal rights according to 1-APP.

250 Closing the Transfer

A Basic Policy

[7 CFR 765.405] The transferor and transferee are responsible for paying transfer costs such as real estate taxes, title examination, attorney's fees, surveys, and title insurance. When the transferor is unable to pay its portion of the transfer costs, the transferee, with Agency approval, may pay these costs provided:

(a) Any cash equity due the transferor is applied first to payment of costs and the transferor does not receive any cash payment above these costs;

(b) The transferee's payoff of any junior liens does not exceed $5,000;

(c) Fees are customary and reasonable;

(d) The transferee can verify that personal funds are available to pay transferor and transferee fees; and

(e) Any equity due the transferor is held in escrow by an Agency designated closing agent and is disbursed at closing.

The authorized agency official will prepare closing documents according to 3-FLP, Part 16 and State and local requirements. Closing documents will be filed according to State law and as described in the State supplement.

B Final Processing

The authorized agency official will follow the flowchart in DLS Loan Servicing Users Guide, Section 5.2, to determine if a "1M", "4A", or "4D" transaction is needed in DLS to record the transfer and assumption of the loan or loans.

The signed documents in the transfer docket will be placed in the transferee's case file and the transferor's file shall be maintained according to 32-AS.

--**In situations where the transferee provides a down payment to the transferor, the down payment funds will be applied towards the transferor's existing balance prior to processing the transfer and assumption within DLS per subparagraph 250 B.**--

251 Determining Transferor Liability After Closing

A Full and Complete Transfer

[7 CFR 765.406(b)(1)] The Agency may release the transferor from liability when all of the security is transferred and the total outstanding debt is assumed.

B Transfer and Assumption of a Portion of the Indebtedness

[7 CFR 765.406(a)] Agency approval of an assumption does not automatically release the transferor from liability.

[7 CFR 765.406(b)(2)] If an outstanding debt balance will remain and only part of the transferor's Agency security is transferred, the written request for release of liability will not be approved, unless the deficiency is otherwise resolved to the Agency's satisfaction.

[7 CFR 765.406(b)(3)] If an outstanding balance will remain and all of the transferor's security has been transferred, the transferor may pay the remaining balance or request *--debt settlement in accordance with subpart B of 7 CFR part 1956. (7-FLP, Part 12)**--***

If all security has been transferred, the remaining debt will be considered for debt settlement instead of release of liability under this Section.

In partial debt and partial security transfer cases, the transferee may pay any sale price or security shortfalls to resolve deficiencies as approved by the authorized agency official by any of the following:

- cash contribution
- participation credit
- subsequent FSA loans.

If only a portion of the indebtedness is to be assumed by the transferee, the authorized agency official must recommend and SED must approve or deny settlement of the remaining indebtedness.