**UNITED STATES DEPARTMENT OF AGRICULTURE**
Farm Service Agency
Missouri State Office
Columbia, MO 65203

| **MO NOTICE FLP-412** |
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2-FLP

**For:** County Offices

# Financing of Integrated Livestock Production Loans

**Approved by:** State Executive Director

Acting: [signature]

## 1 Overview

### A Background

The Notice replaces MO Notice FLP-347 (2-FLP) dated 10/30/2006 with an expiration date of 10/1/08. Farm Service Agency guaranteed loan assistance is being requested to finance new construction or refinance debt where the loan applicant is proposing to utilize a contract with an integrator. The most common type of contract would involve a poultry or swine integrator, where the integrator retains ownership of the poultry or swine, but contracts with a grower to provide the labor, facilities, utilities, etc.

### B Purpose

The purpose of this Notice is to ensure uniformity in the application of policies and requirements so that the best interests of the loan applicant, lender and government are served. All applications will be evaluated individually and must meet eligibility, feasibility, and all other Agency requirements that are to be spelled out in the Conditional Commitment before approval, loan closing, and issuance of the Loan Note Guarantee.

### C Contact

Any questions concerning this Notice should be directed to the Farm Loan Programs Section in the State Office.

### D Filing Instructions

A copy of this Notice should be filed preceding 2-FLP Handbook.

| **Disposal Date** | **Distribution** |
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| October 1, 2009 | Farm Loan Teams, County Offices, AFLSs, DDs, CORs |

## 2 Implementation

### A Contract Review Requirements

Use the following as a guide in reviewing integrated livestock contracts:

1. The contract must provide for adequate production volume and/or payment terms to allow the loan applicant to pay loan installments and cash expenses related to the enterprise (utilities, hired labor, insurance, maintenance, etc.) Any incentive or penalty clauses must be clear as to what standards will be used to determine the incentive or penalty. The means to determine whether the standards are met or exceeded must also be specified.
2. Loan terms shall be limited as to the term/length of the contract of similar type operations and the strength of the integrator.
3. The contract cannot contain any provisions that would give the integrator control or possession of the facility for any longer period of time than to allow the integrator to care for and market the livestock on hand. This would cause the borrower to cease being the farm operator, which is in violation of statutory program requirements.
4. Any provisions regarding modernization of equipment must be reviewed for impact on projected cash flow and loan feasibility. Mandatory modernization clauses are usually not acceptable.

### B Conditional Commitment Requirements

1. The Conditional Commitment will state that the lender will take an assignment on the contract proceeds to assure repayment of the guaranteed loan(s).
2. The Conditional Commitment will state that the borrower is required to obtain "Collapse Insurance" on the building(s) and that the lender must be listed as a lienholder. A State Office waiver can be granted, if the unpaid principal balance of the loan is less than the present market value of the real estate excluding the value of the integrated livestock facility and equipment.
3. Site and facility must conform to all federal and state laws, and meet all requirements. The FSA-1980-15, "Conditional Commitment," must require that the lender obtain a copy of all necessary permits, easements, and/or leases.
4. **DO NOT** issue the FSA-1980-27, "Loan Guarantee," on construction loans until the construction is 100% complete and ALL of the conditions/requirements of the FSA-1980-15, "Conditional Commitment," have been met. If the guaranteed loan is being sold on the secondary market and the lender needs to lock an interest rate, contact the State Office for guidance and/or possible exception.

## C Integrator Strength

The Agency's instructions require a dependable source of farm and/or non-farm income in its evaluation, assessment, and analysis of guaranteed loan applications from family farms by the loan approval official. An integrator needs to be financially strong and have a proven history for similar type contracts. Information from the integrator should be evaluated and used as an indicator of the strength and weakness of the integrated livestock production contract.

Prior to loan approval, the State Office Farm Loan section needs to review the financial position and contract of any integrator in the following situations:

1. For which we currently do not have an existing guaranteed loan(s) with,
2. When it is evident that an integrator has recent history of and/or are currently experiencing financial difficulties.

## D Repayment Capacity

Where depreciation and/or security may be a concern, the loan approval official should consider approving a lesser loan term than the lender requested when the cash flow margin is > greater than 110%.

## E File Documentation of Loan Terms versus Useful Life of Security

When loan funds will be used to refinance and/or purchase existing specialized buildings/integrated livestock facility, the loan approval official must document that the proposed guaranteed loan repayment terms do not exceed the useful remaining life (equipment and/or buildings) of the proposed collateral as determined in the appraisal. Loan terms shall be limited as to the:

- term of the contract
- strength of the integrator
- approved animal waste/nutrient management plan
- contributory value and remaining economic life of the proposed collateral
- amount of equity in the proposed collateral.

The loan approval official must document the case file to support that the loan(s) will be secured throughout the life or term of the FSA guaranteed loan(s). We recommend that the loan approval official use the MO 2-FLP Guide 33, "Depreciation – Loan Term Calculator," found on the FSA Missouri Intranet website at:

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## F Contingent Income Tax Liability Versus Term of Loan

2-FLP Par.151 B states that the loan applicants proposed operation must project a feasible plan throughout the term of the loan. Depreciation expense potentially can have an adverse effect on future repayment ability. Therefore, in order to determine if the loan applicant can project a feasible plan throughout the term of the loan the lender needs to address future income tax liabilities associated with the depreciation of the integrated livestock facilities versus the term of the loan for the facilities. IRS rules allow for the buildings to be depreciated over a 10-year MACRS recovery period and equipment depreciated over a 7-year MACRS recovery period. FSA's concern is having the buildings/equipment depreciated out for tax purposes and the borrower ending up with a tax problem with several years of debt repayment left. Therefore, as a prudent lending practice, depreciation expense needs to be looked at as a farm expense and repayment capacity analyzed over the term of the loan to determine if debt repayment capacity would be affected when depreciation expense is reduced or exhausted.

Mitigation options acceptable to FSA include:

- Depreciating the equipment and/or buildings over the term of the loan
- Shorten the term of the loan to match the MACRS GDS/ADS depreciation
- Escrowing the operation's cash flow margin in a funds held account to be used solely for farm expenses and/or tax liability issues.

Failure to address the future income tax liability associated with the depreciation of the integrated livestock facilities by the lender may affect the borrower's eligibility for loan servicing and/or result in a reduction and/or denial of a guaranteed loss payment.

In summary, the FSA loan approval official must document the case file to support that the loan(s) has adequate repayment capacity throughout the life or term of the FSA guaranteed loan(s). We recommend the automated MO 2-FLP Guide 34, "Loan Term-Depreciation-Feasibility Tool." It can be found on the FSA Missouri Intranet website at:

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**G Required Integrator Information**

The following information must be on file prior to loan approval of an integrated livestock facility:

1. Minimum of three years of actual historical performance (actual income and expenses) for similar type livestock contracts/facilities that the integrator is involved with. This information needs to be used as a guideline in supporting the cash flow projection for the enterprise.
2. Complete copy of the proposed integrator contract.
3. Copy of the integrators projected income and expense worksheet for the proposed facility/contract.
4. [new construction] - Copy of the integrators proposed loan terms for the proposed facility/contract.
5. [new construction] - Detailed/Itemized estimated cost projections on how much it will cost to build the facility from start to finish. Building and equipment cost projections must be separated.

6. [existing facility] – Obtain a copy of the existing operation three years of actual historical performance (actual income and expenses).
7. [existing facility] – For appraisal and loan terms purposes, obtain from the integrator's representative the following (operation audit) information:
   - Copy of the integrator requirements (i.e. any repairs or upgrades) to the buildings and/or equipment/fixtures that will be required to obtain the contract. Request a detailed list of improvements/requirements.
   - Lender or loan applicant to inform the integrator of the proposed loan terms on the buildings. Copy of the estimated integrator requirements (i.e. any repairs or upgrades) to the buildings that will probably be required to maintain the contract during the term of the proposed loan.
   - Lender or loan applicant to inform the integrator of the proposed loan terms on the equipment/fixtures. Copy of the estimated integrator requirements (i.e. any repairs or upgrades) to the equipment/fixtures that will probably be required to maintain the contract during the term of the proposed loan.

## H Appraisal Requirements on Existing Specialized Buildings/Integrated Livestock Facilities

1. The lender and/or loan applicant needs to provide the appraiser the following:
   - Integrator requirements (i.e. any repairs or upgrades) to the buildings that will be required to obtain the contract. Provide a copy of the detailed list of improvements/requirements.
   - Integrator requirements (i.e. any repairs or upgrades) to the equipment/fixtures that will be required to obtain the contract. Provide a copy of the detailed list of improvements/requirements.
   - Estimated integrator requirements (i.e. any repairs or upgrades) to the buildings that will probably be required to maintain the contract during the term of the proposed loan.
   - Estimated integrator requirements (i.e. any repairs or upgrades) to the equipment/fixtures that will probably be required to maintain the contract during the term of the proposed loan.
2. When the appraisal is ordered, the appraiser will be instructed to provide the following information within the appraisal report or to provide a completed MO 2-FLP Guide 32, "Appraisal Data Information - Specialized Buildings/Integrated Livestock Loans." found on the FSA Missouri Intranet website at:

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   - The contributory value of the real estate as though unimproved.
   - The contributory value and remaining economic life of each improvement, taking into account physical, functional and external obsolescence and any planned repairs to the improvements.

- The contributory value and remaining economic life of equipment/fixtures associated with each improvement, taking into account physical, functional and external obsolescence and any planned repairs to the equipment/fixtures.
- For integrated livestock facilities, documentation reflecting the availability of collapse insurance and the availability of an integrated livestock contract is available for the facilities and under what terms and/or conditions the contract is subject to (i.e. any repairs or upgrades to the facilities that may be required to obtain the contract).
- The Income Approach should be completed using direct capitalization method rather than other methods such as Band of Investment. (By using Direct Capitalization, factors such as entrepreneurial profit will be reflected within the capitalization rates indicated by the sales.)

3. FSA will complete an appraisal review on all loans involving existing specialized buildings/integrated livestock facilities using the most current version of the MO 2-FLP Guide 5 "Farm Loan Programs Guaranteed Loan Administrative Real Estate Appraisal Review." The form can be found at:

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## I Environmental Requirements

As part of its environmental policy, follow MO Notice FLP-261 (1940-G) Environmental Assessments and Other Environmental Concerns, dated 09/7/2005.

A loan request to refinance an existing integrated livestock facility in production less than 1-year will not qualify for a Categorical Exclusion (CATEX).

## J Comprehensive Nutrient Management Plan (CNMP) Requirements

1-EQ Par. 671C states that applicants for FSA benefits and/or financial assistance that have plans to construct, purchase, alter, enlarge, and/or refinance AFO/CAFO must provide a CNMP.

FSA National Office policy has been amended to require a CNMP only on a concentrated animal feeding operation (CAFO).

## K Animal Waste/Nutrient Management Plan Disposal Requirements

A lien must be taken on all land owned by the borrower where the discharge, effluent, and solid waste is being spread. If land owned by a party other than the loan applicant/borrower is being utilized to dispose of discharge, effluent and solid waste as per the Animal Waste/Nutrient Management Plan, a legally binding spreading EASEMENT AGREEMENT must be obtained that:

1. Matches the minimum requirements of the Animal Waste/Nutrient Management Plan
2. "Filed of Record," for the term of the Loan Guarantee
3. Transferable to another Grantee without having to obtain Grantor's consent including transfer via a foreclosure trustee and/or, if property acquired, resale by lender.

A Spreading Agreement would be acceptable when the unpaid principal balance of the loan is less than the present market value of the real estate excluding the value of the integrated livestock facility and equipment.

**L DNR Requirements**

The lender must obtain an environmental approval for all concentrated animal feeding operations (CAFOs). Prior to issuing the FSA-1980-27, "Loan Guarantee," the integrated livestock facility must be in compliance with the rules and regulations of the Missouri Code of State Regulations (CSR) for Concentrated Animal Feeding Operations and Missouri Department of Natural Resources (DNR) Guide to Animal Feeding Operations.

DNR has ended it Letter of Approval (LOA) program for animal feeding operations. NRCS and their conservation practice standards will be utilized as a replacement for the LOA process.

To be in compliance the loan approval official must obtain:

1. For FSA Environmental Categorical Exclusions and Class I Assessments, either a "Professional Engineer Certification" or a "NRCS Certification" is required.

   "Professional Engineer Certification" shall mean a certification made by a Professional Engineer registered in the state of Missouri that an installed component would meet conservation practice standards and specifications contained in the NRCS Field Office Technical Guide.

   "NRCS Certification" shall mean a certification issued by the United States Department of Agriculture, Natural Resources Conservation Service (NRCS), for the installation of a conservation practice that meets NRCS conservation practice standards contained in the Field Office Technical Guide.

2. For FSA Environmental Class II Assessments, a DNR Operating Permit is required.