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

Notice FLP- 554

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

For: State and County Offices

Guidance on Direct and Guaranteed Loan Making and Loan Servicing Actions for Dairy Operations in FY 2010

Approved by: Deputy Administrator, Farm Loan Programs

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1 Overview

A Background

Historic declines in the price of milk in 2008 and 2009 have dramatically increased financial stress in the dairy industry. Without assistance, many FSA direct and guaranteed dairy farm borrowers will find it difficult or impossible to survive this decline. FSA is committed to use all available authorities, consistent with prudent lending practices, to assist borrowers in surviving this period of short term unprofitability.

B Purpose

This notice provides guidance on:

- extending repayment terms for annual OL's for dairy farmers
- extending unequal repayment schedules for term OL's for dairy farmers
- releasing milk proceeds for essential family living and farm operating expenses
- notifying borrowers of servicing options
- continuing guidance established in Notice FLP-528, except as modified in this notice.

C Contact

If there are questions about this notice:

- County Offices shall contact their State Office
- for loan making inquiries, State Offices shall contact LMD, at 202-720-1632
- for loan servicing inquiries, State Offices shall contact LSPMD, at 202-720-4572.

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

2 Direct Loan Making

A Repayment Terms

3-FLP, subparagraph 174 B, 7 CFR 764.254(b)(1)(ii), allows repayment of annual OL's to be scheduled beyond 18 months under extenuating circumstances, including recovery from economic reversal. This provision is intended as a means to help borrowers survive through unique periods of financial difficulty. It is appropriate to use this provision for dairy operations under current market conditions. When using this provision, repayment terms for annual OL's:

- shall be repaid in the shortest timeframe possible, and consistent with cash flow projections
- may be extended beyond 18 months, only when necessary for a feasible plan
- will **not** exceed 7 years.

In assessing the decision to extend the repayment period beyond 18 months, according to 7 CFR 764.254(b)(1)(ii), the loan **must** be secured by **basic security**. 3-FLP, subparagraph 174 C, 7 CFR 764.254(b)(2), allows repayment of term OL's to include unequal repayment schedules under extenuating circumstances including recovery from economic reversal. This provision is intended as a means to help borrowers survive through unique periods of financial difficulty. It is appropriate to use this provision for dairy operations during the current market conditions.

Note: As provided in 3-FLP, paragraph 174, an annual OL repayment period exceeding 18 months or term loans with unequal installments are to be used only in unusual situations, and with either of these repayment schedules there must be adequate basic security. Using these provisions can deplete borrower equity and reduce FSA's ability to provide additional loan assistance. FLP staff should have a candid discussion with borrowers about the implications of these payment structures for their operation during FBP development.

2 Direct Loan Making (Continued)

B Determining Repayment Period

In addition to the current year FBP developed for applicants, the definition of a “feasible plan”, 7 CFR 761.2(b), requires the development of a typical FBP in situations when the FBP is atypical and the loan approval action exceeds 1 production cycle. Therefore, **two FBP’s** will be prepared to:

- determine a feasible repayment period
- show the long-term viability of the operation as follows:

    - current year FBP:

        - use $3 above the 2009 average price received by the applicant or as directed by the State Office

        - using a $3 adjustment, do not include MILC payments

    Note: USDA agricultural economists have projected the 2010 second and third quarter all-milk price to be approximately $3 above the 2009 second and third quarter average all-milk price. This price is to be used as a guide. State Offices should issue guidance for any regional variances.

    - typical year FBP:

        - no MILC payment

        - use average milk price received by the applicant for the previous 3 years, or as directed by the State Office.

C DLS

When obligating an annual operating loan for more than 18 months, Field Offices shall:

- use the Type of Assistance code for OL-Term loans (051, 106, 211 or 212)
- select Loan Purpose Code “08” to indicate annual operating expenses.

2 Direct Loan Making (Continued)

D MILC

MILC was reauthorized and modified in the 2008 Farm Bill. Three notable changes include the following:

- a "feed cost adjuster" that is triggered whenever the monthly National Average Dairy Feed Ration Cost calculated from the "entire month" prices published by NASS is greater than $7.35 per cwt. beginning January 1, 2008, through August 31, 2012

- payment rates and per-operation poundage limits based on when the milk is produced

  Note: The production limit per operation increases to 2.985 million pounds for each FY from October 1, 2008, through August 31, 2012.

- changes to the provisions for payment eligibility to add an AGI limit. If the individual or entity has annual nonfarm AGI for the relevant base period greater than $500,000, the individual or entity is **not** eligible for MILC benefits.

  Although MILC is authorized through 2012, it is projected that milk prices combined with the "feed cost adjuster" will not be low enough to trigger MILC payments in 2010.

  See the Cornell Program on Dairy Markets and Policy at **www.dairy.cornell.edu**/.

  Notes: On the right side of the screen is a list of prices, which are updated based on the Chicago Board of Trade and Chicago Mercantile Exchange futures prices for corn, soybeans, and milk.

  FSA is unable to endorse a specific commercial site or attest to the accuracy of the information contained on the web site. The Cornell University information was found to be very useful. These MILC calculators are to be used only as a guide in projecting possible MILC payments. State Offices should provide additional guidance particular to the State, when appropriate.

3 Direct Loan Servicing

A Releasing Milk Proceeds

Proceeds from milk sales may be released according to 4-FLP, subparagraph 163 B, and any additional guidance in approved State Supplements. Any portion of the proceeds planned for FSA FLP debt reduction may be released as needed for essential family living or farm operating expenses. County Offices shall revise the FBP and FSA-2040 to account for the release of proceeds according to 4-FLP, subparagraph 162 E.

3 Direct Loan Servicing (Continued)

B Notifying Borrowers of Available Servicing Options

Borrowers who are in financial distress, or request servicing, will be:

- notified according to 5-FLP, Part 3
- given all primary loan servicing options allowed.

Debt restructure may be considered while the borrower is still current if it would help retain their satisfactory credit rating. All restructuring options available for distressed borrowers will be considered, including the following:

- rescheduling
- consolidation
- reamortization
- deferral for 1 to 5 years.

Attention should be given to the deferral authorities and procedures in 5-FLP, paragraphs 159 and 160 to ensure that deferral is considered in a manner that provides the borrower adequate time to recover from the present situation while limiting interest accrual on the deferred balance.

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

4 Guaranteed Loans

A Guaranteed Loan Making

Authorized loan officials shall contact guaranteed lenders to explain the:

- loan making and loan servicing policies in this notice
- options they have in assisting guaranteed loan borrowers.

2-FLP, paragraph 137, 7 CFR 762.124, allows lenders to schedule repayment of annual OL’s and lines of credit for up to 7 years when recovering from an economic reversal and to schedule unequal installments on term loans if needed to recover from an economic reversal. These extreme measures are authorized to assist dairy producers with long-term viability in obtaining operating capital in these difficult times. These policies are temporary and should be used with care and caution. Consistent with direct loan policies, the requirement to meet the definition of “feasible plan” using a typical plan also applies to guaranteed loans. Lenders shall structure repayment over the shortest period of time practical, based on these cash flow budgets.

4 Guaranteed Loans (Continued)

A Guaranteed Loan Making (Continued)

2-FLP, subparagraph 166 B, 7 CFR 762.126, provides that:

- the lender **must** ensure that adequate collateral is obtained and maintained to protect the interests of the lender and government

  Note: When repayment of an annual production loan is scheduled over multiple years, the:

  - borrower's expected normal income security will **not** be sufficient
  - loan must be secured with basic security.

- additional security may be required if the cash flow is below average, such as in the current dairy environment.

  Note: The amount of basic security needed above a 1:1 collateral ratio is dependent on the particular operation, considering the requirement for the lender to maintain adequate security. In no case will a loan or line of credit be extended beyond the current operating cycle without adequate basic security.

Lenders are to be cautioned against extensive use of refinancing their own debt to transfer risk of loss to the government. In cases where a lender is refinancing their own debts, 2-FLP, subparagraph 195 A, 7 CFR 762.129(a), authorizes FSA to reduce the percent of guarantee based on the credit risk to the lender and FSA both before and after the transaction. 2-FLP, subparagraph 195 A specifies that guarantees to CLP and Perferred Lender Program lenders will not be less than 80 percent. Authorized agency officials should consider this authority during this period of stress to minimize undue risk to the FSA portfolio.

4 Guaranteed Loans (Continued)

B Guaranteed Loan Servicing

Lenders:

- may consider all options under 2-FLP, Part 12, including deferral and write down
- are permitted to temporarily release milk assignments.

However, any releases beyond what is necessary to make the annual payments will require the lender to prepare a cash flow budget showing repayment in the year of the release or a typical year cash flow budget reflecting loan restructuring, including deferrals that will be necessary to keep the operation in business. Document submission requirements will be according to the lender status requirements of 2-FLP.

Requests for a subordination from lenders to advance additional funds against basic or additional security will be immediately forwarded to DAFLP for exception authority consideration according to 2-FLP, subparagraph 278 A. In addition to the requirements of 2-FLP, subparagraph 278 B, the request must document that it is for a dairy operation experiencing distress.