

FLAG



FARMERS' LEGAL  
ACTION GROUP,  
INCORPORATED

46 East Fourth Street Suite 1301  
Saint Paul, Minnesota 55101

Phone: 651.223.5400  
Fax: 651.223.5335

Internet:  
[lawyers@flaginc.org](mailto:lawyers@flaginc.org)

Web site:  
[www.flaginc.org](http://www.flaginc.org)

October 20, 2003

Mr. Craig Nehls  
Branch Chief  
Guaranteed Loan Servicing and Inventory Property Branch  
Loan Servicing and Property Management Division  
Farm Service Agency  
United States Department of Agriculture  
1400 Independence Avenue  
STOP 0523  
Washington, DC 20250-0523

Dear Mr. Nehls:

Re: Comments on Proposed Rule for Guaranteed Loans—Rescheduling  
Terms and Loan Subordinations, 68 Fed. Reg. 49,723 (August 19,  
2003)

Farmers' Legal Action Group, Inc. (FLAG) submits these comments on behalf of the National Family Farm Coalition (NFFC) concerning the proposed rule entitled "Guaranteed Loans—Rescheduling Terms and Loan Subordinations" published at 68 Fed. Reg. 49,723-49,726 (August 19, 2003).

NFFC represents 34 grassroots farm and rural advocacy organizations in more than 30 states. The coalition was formed in 1986 to coordinate the efforts of a growing network of grassroots organizations concerned with maintaining a family farm system of food production. NFFC's work includes education, outreach, and advocacy for stable rural communities, safe food, and the preservation of natural resources through family farming. NFFC has long been interested in USDA's implementation of farm credit, disaster assistance, and conservation programs.

FLAG is a nonprofit, public interest law center dedicated to the preservation of family farms. For over fifteen years, FLAG has provided legal services to thousands of small and mid-sized family farmers throughout the nation in class action lawsuits, administrative proceedings, public education initiatives, and legislative technical assistance involving agricultural credit and farm program issues.

### **Purpose of the Guaranteed Loan Program**

FSA's guaranteed loan program is intended to ensure that credit is available to family farmers and ranchers who are unable to obtain commercial credit at reasonable rates and terms, while imposing a reduced administrative and fiscal burden on the government compared to the direct loan program. Agency efforts to make the program more workable for and attractive to lenders are appropriate so long as the risks and rewards are fairly apportioned among the lender, borrower, and government.

NFFC supports FSA's effort to make the guaranteed loan program regulations reflect the real world of farm credit arrangements, both to facilitate loan making and loan servicing actions and to ensure meaningful enforcement of program requirements. When program regulations do not reflect actual borrower-lender interactions, the agency's oversight of the program is limited, leaving both borrowers and the government at risk of overreaching by lenders.

### **Priority of Guaranteed Loan Installment Payments**

Current § 762.140(d) provides that "guaranteed loan installments will be paid before nonguaranteed loans held by the same lender." The proposed rule would allow payments to be applied according to lien priority, payment due date, and in accordance with an approved cash flow projection until it "becomes evident" that the borrower will be unable to make all payments coming due, at which point the guaranteed loan installment must be paid first.

As acknowledged in the prefatory comments to the proposed rule, payments on different loans come due at different times throughout the year, making a "pay X before Y" requirement unworkable. Although the more narrowed focus of the proposed change is an improvement, the discretion it grants to lenders in close cases could be exploited to the detriment of both borrowers and the government. NFFC urges that the proposal be changed to clarify that when a borrower has indicated that a payment is intended for a guaranteed loan, the lender must apply the payment accordingly. There should be no question that a lender has no discretion to disregard a borrower's direction to apply a payment to a guaranteed loan, regardless of the borrower's financial status or the payment status of nonguaranteed loans.

### **Local Office Approval Authority for Certain Subordinations**

NFFC supports the proposal to authorize local FSA offices to approve subordinations of the agency's interest in any type of security in situations related to refinancing of existing indebtedness. The proposal would facilitate processing of these subordination requests and allow the refinancing arrangement to more quickly improve the borrower's financial situation, to the benefit of all parties.

### **Balloon Payments Authorized**

NFFC supports the proposal to allow balloon payments as a guaranteed loan restructuring option. As noted in the prefatory comments to the proposal, the lack of this restructuring option under the current rule forces liquidation in some cases that could be worked out.

### **Exclusion of Lender Packaging and Outside Consultation Fees**

The proposed new § 762.149(d)(3) would explicitly exclude packager fees and outside fees for loan servicing consultants from the FSA guarantee. As stated in the prefatory comments, guaranteed lenders are required to have experience making and servicing agricultural loans and have the capability to make and service their guaranteed loans. NFFC agrees that to the extent a lender finds it advantageous to hire outside consultants to package or service guaranteed loans, those costs should be borne by the lender.

While the proposed change focuses on FSA's concern for minimizing risk to the government, it is important to recognize that this risk will not be minimized, and the purposes of the guaranteed loan program will not be met, if lenders are allowed to simply shift those costs to borrowers. Lenders are required to have the capability to make and service guaranteed loans with their own staff, the costs of which are presumably reflected in the interest rate and other charges and fees paid by the borrower. If the additional costs are properly viewed as extras, it is no more appropriate for borrowers to bear the costs than for the government in case of loss. Allowing lenders to pass these fees on to borrowers would increase costs to borrowers and increase the likelihood of default, liquidation, and loss to the government. NFFC urges that this proposal be clarified to state that these costs also cannot be passed on to the borrower.

### **Maximum Lender Foreclosure Bids**

NFFC supports the proposal to clarify that when a lender bids at a foreclosure sale, the bid must be the lesser of the net recovery value plus the prior lien amount or the unpaid balance of the loan plus the prior lien amount. As stated in the prefatory comments, it is appropriate to limit a lender's bid to prevent unwarranted inflation of the lender's loss claim. Borrowers are acutely interested in eliminating inflated loss claims because loss payments by the government on a guaranteed loan are collectible against the borrower as a federal debt.

NFFC is concerned that the proposed rule does not give clear direction as to lenders' duty to either limit their bidding or face certain uncompensated losses. The first sentence of proposed § 762.149(h)(3) is stated in mandatory language: the lender "will bid" either X or Y. However the next sentence states that failure to do so "may be" considered negligent servicing and the loss claim "may be" reduced. Similarly, the prefatory comments state at one point that the proposed rule "limits the bid amount" but then later state that a bid over the limit "may be" considered negligent servicing. NFFC urges

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FSA to strengthen the rule language to clarify that the limits are actual limits and lenders will not be able to claim losses for excess bids.

### **Other Program Improvements**

For some time, there has been concern that when direct loss claims are not at issue—such as when a loan is well secured—FSA allows its desire for high lender participation rates to overshadow meaningful program oversight. Again, the guaranteed loan program is intended to *increase credit access* at a reduced cost to the government. This necessarily involves making the program flexible enough to appeal to commercial lenders, but it also necessarily involves FSA's authority and willingness to take action against lenders that abuse their discretion. This is true even when a lender's actions do not directly result in an inflated loss claim to the government. When lenders unreasonably shift costs to borrowers or reject viable restructuring opportunities, the result is *reduced* program participation, *higher* default and liquidation rates, and *more expensive* credit for family farmers and ranchers.

As part of the on-going effort to improve the guaranteed loan program, NFFC urges FSA to consider more consistent and definite requirements for guaranteed loan servicing that ensure lenders have an incentive to make full use of their tools to avoid liquidation and losses, whether to borrowers or the government.

Thank you for your consideration of these comments.

Sincerely,

FARMERS' LEGAL ACTION GROUP, INC.

*s/Karen R. Krub*

Karen R. Krub  
Attorney at Law  
Email: kkrub@flaginc.org