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Agricultural Loans: Rural Economic Development Could Be Right Outside Your Door

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Over the past 20 years, USDA Farm Service Agency loan guarantees have helped commercial banks increase their share of total U.S. farm loans from 25 percent over 40 percent.

Banks looking for opportunities to support rural economic development may not need to look much further than the nearest farm. Almost every region of the country has a significant population of farmers and ranchers, and they need credit. There are real opportunities for banks to make profitable loans, to manage credit default risk, and — most important of all — to help members of their communities grow and prosper.

Banks, especially those with urban-oriented lending portfolios, may be inclined to think of farm lending as too specialized for them. Farm lending *is* somewhat specialized. But when you examine the business cycle of a farming operation, it is clear that most farming and ranching operations are small businesses that manufacture and market finished goods along a defined production cycle. (Over 80 percent of the farms in the United States are, in fact, very small businesses with gross annual sales under $250,000.) They offer essentially the same opportunities and challenges as are involved in lending to other small businesses.

Providing credit to farmers and ranchers can yield many positive dividends for the bank, particularly in building long-lasting relationships. Farmers, like other consumers, need checking, savings, consumer credit, insurance, and trust services. More than half of all U.S. farms have some non-farm income, and they need help with banking services related to this income.

A Public-Private Partnership that Works

If you feel that a farm or ranch loan request may create undue risk for your bank, you should consider taking advantage of the tools that are available to bankers to manage credit and interest-rate risk on farm and ranch loans. The U.S. Department of Agriculture's Farm Service Agency (FSA) offers a range of unique programs designed to help small, mid-sized, start-up and socially disadvantaged family farmers and ranchers get credit through banks. Collectively they are known as the Guaranteed Farm Loan Programs. Any bank chartered in the U.S. can access them.

- **Guaranteed Farm Ownership (FO) Loans:** Banks can get up to a 90 percent guaranty from FSA on loans to finance real estate purchases (including buying farmland, constructing or repairing buildings, and developing farmland to promote soil and water conservation) or to refinance debt. Loans may be structured for up to 40 years. The interest rate must be the same that the bank would charge on a non-guaranteed loan.
- **Guaranteed Operating Loans (OLs):** Banks can get up to a 90 percent guaranty from FSA on loans for non-real estate purposes (e.g., crop inputs, livestock, equipment, debt refinancing). Loans can be scheduled for up to a 7-year repayment. As with FOs, the interest rate that the bank charges must be no higher than the rate it would charge a non-guaranteed customer loan. FSA can guarantee OLs or FOs up to $759,000 (the amount is adjusted annually based on inflation).
- **Guaranteed Operating Loans with Interest Assist:** For a limited number of guaranteed farm and ranch loans, FSA offers a unique interest subsidy. If your customer demonstrates, through a cash flow projection, that he cannot make the payments at the market rate of interest, FSA may approve a 4 percent interest-rate buy-down.
- **Loans for Socially Disadvantaged Farmers:** FSA has funds reserved for guaranteed and direct loans to socially disadvantaged farmers and ranchers (including women, African Americans, American Indians and Alaskan Natives, Hispanics, and Asians and Pacific Islanders). Terms are the same as for regular OLs and FOs. FSA is anxious to increase credit opportunities for such farmers, and can provide you and your customer with technical assistance in addition to assistance with financing.
- **Loans for Beginning Farmers and Ranchers:** FSA has a targeted FO loan program to help start-up farmers and farmers. Applicants must be able to make at least a 10 percent cash downpayment; FSA provides a 10-year, 4 percent loan for 30 percent of the purchase price or appraised value, whichever is less; and the remaining balance may be obtained from a commercial or private lender, with FSA providing up to a 95 percent guarantee to commercial lenders.
- **Low Documentation Guaranteed Loans:** For all guaranteed loans under $125,000 (real estate and non-real estate secured), FSA has an abbreviated application process that greatly reduces your paperwork burden. With the low documentation package, you can efficiently process loan applications for small loans, while still obtaining up to a 90 percent guaranty that greatly reduces your credit risk exposure.
- **Secondary Market for FSA Guarantees:** Backed by the full faith and credit of the United States, the guaranteed portion of FSA farm loans is highly saleable. If your bank makes a long term real estate loan to a farmer with a guaranty, you can readily sell the guaranteed portion either in private markets or through the Federal Agricultural Mortgage Corporation (Farmer Mac). By selling the loan, you can offer your customer a fixed-rate product, and you protect your institution from interest-rate risk. In most cases you can retain the servicing rights to the loan and keep your relationship with the customer (see the electronic article "Partnering with Farmer Mac to Promote Rural Development").

As this brief overview suggests, many proven public-private partnership tools are available to any bank with a commitment to agricultural lending. Providing credit to farmers and ranchers in your community will pay many dividends — to your bank as well as to the community — and at acceptable risk.

For more information on these programs, contact John Blanchfield, American Bankers Association, at (800) 226-5377, or visit the USDA Farm Service Agency website: www.fsa.usda.gov.