

Discussion of the Proposed Rule

The first proposed change is in section 762.140(d), regarding payment of loan installments. Currently, the regulations require that guaranteed loan installments always be paid before unguaranteed loans held by the same lender. The Agency has found that this requirement is very difficult to implement. In practice the only way the FSA guaranteed loan payment can be made first is if all the payments come due at the same time. A typical farming operation may have payments coming due from several different creditors throughout the year. It is virtually impossible to get all payments structured so that they come due at the same time. The Agency recognizes that in the normal course of business, lien priority, payment due dates and cash flow are the determining factors in deciding the order in which loans are paid. The Agency's original intent was to assure that lenders were not paying non-guaranteed loans at the expense of the guaranteed loan. However, this risk only occurs at liquidation where proceeds will be applied in accordance with lien priority. Outside of a liquidation scenario, all installments would be paid since the loan would usually be in a current status. FSA proposes to change the wording in this section, to allow loan installments to be paid in accordance with lien priority, the due date, and the cash flow projection, in the normal course of business, which is in accordance with actual commercial lending practices. Therefore, the proposed rule states that when it becomes evident that a borrower will be unable to make all installments, the lender will be required to apply payments to the guaranteed loan before unguaranteed loans held by the same lender. The effect will be to maximize collection on the guaranteed loan, and minimize any loss claim. Lenders are responsible for servicing the entire loan in a reasonable manner.

The second proposed change is section 762.142(c)(3)(ii), regarding the Agency's approval requirements for certain subordinations. Currently, the regulations allow the lender to subordinate its interest in crops, feeder livestock, livestock offspring, or livestock products when no funds have been advanced from the guaranteed loan for their production, so another lender can make a loan for annual production expenses. Approval of subordinations for real estate, machinery, and other basic security can only be granted by the Agency's National Office, if such action is in the Agency's best interest. However, there are situations where

devolution of this approval authority is justified and would lead to more prompt service to Agency borrowers and lenders. The Agency proposes to place the approval authority at the local level for situations when a lender is simply refinancing existing indebtedness secured by a lien superior to the guaranteed loan, and no additional debt is being incurred. This is often done to allow a borrower to obtain better rates and/or terms on the loan, which in turn helps the borrower meet all of the borrower's loan obligations. There is no additional risk to the guaranteed loan, which remains in the same exact lien and security position after the subordination as it was before the subordination. It is not necessary for subordination requests of this nature to be routed to the Agency's national office, which may result in a time lag for approval or rejection.

The third proposed change is in section 762.144(c)(3)(iii), which discusses the payment of interest on loans which the Agency has repurchased. The proposed change will correct the second sentence where the words "holder" and "lender" were inadvertently reversed. The holder, not the lender would be requesting the Agency to repurchase the loan, after requesting the lender to repurchase the loan.

The fourth change proposed would allow balloon payments in restructuring guaranteed loans. Section 762.145 governs the restructuring of guaranteed loans, and paragraph (b)(4) of this section specifically prohibits the use of balloon payments in the restructuring process. FSA is proposing to lift this restriction and allow a lender to restructure a guaranteed loan with a balloon payment. This is standard practice in the lending industry, and lenders participating in the guaranteed program have requested the ability to use balloon payments in restructuring. FSA has made numerous administrative policy changes to enable lenders to service guaranteed loans in the same manner they service their non-guaranteed loans. This proposed change would provide lenders with another tool to use in servicing loans guaranteed by FSA, consistent with tools utilized for non-guaranteed loans.

Current regulations allow lenders to use balloon payments when originating loans, but not in loan servicing. Unequal installments can be used in both loan making and loan servicing, and lenders can use both unequal installments and balloon payments in originating a new loan. These tools are used primarily when establishing new enterprises or building facilities, situations where cash

flow would be inadequate to support full amortization of the loan for some period of time. These same tools would be helpful, and may be necessary in a rescheduling situation such as recovering from a natural disaster, or a barn fire or other calamity, for instance. Definitions of unequal installments and balloon payments will be added in the FSA Handbook 2-FLP upon publication of the final rule.

To insure that this proposal would not result in additional exposure or loss to the Government, a provision requiring adequate security to be available at the time the balloon payment comes due will be included, in 7 CFR 762.145(b)(4). For real estate security a current appraisal would be required, with depreciation projected to the time the balloon payment is due for depreciable property such as buildings and improvements. Also, for equipment security, a current appraisal will be required. The lender will be required to project the security value of the equipment at the time the balloon payment is due, based on the remaining life of the equipment, or using the depreciation schedule on the borrower's Federal income tax return. Under no circumstances may livestock or crops alone be used as security for a guaranteed loan that is to be rescheduled using a balloon payment.

Allowing the restructuring of loans using a balloon payment schedule does not unduly increase the Government's risk. This change will allow more delinquent borrowers to achieve a feasible plan and ultimately be successful in paying their loans in full. FSA estimates that less than 200 loans per year will be rescheduled with a balloon payment. Currently, when a borrower becomes delinquent, a lender may choose to not continue with the loan since a balloon payment schedule is prohibited. Therefore, a viable operation may have to be liquidated due to limited loan servicing alternatives. Use of a balloon payment under those circumstances will reduce the likelihood that FSA will pay a loss under the guarantee and allow the lender to retain the guarantee. As in the current rule, 7 CFR 762.145(b)(4) permits the lender to allow unequal installments so long as a feasible plan can be projected when the installments are scheduled to increase.

As to the fifth change, FSA proposes to revise the security requirements in section 762.145(b)(7) for loans restructured with balloon payments. This change is necessary to prevent undue risk to the Government from adding balloon payment options as a loan servicing tool. Revising the rule to