What Does It Mean to Get an FSA Loan Guarantee, Direct Loan, or Land Contract Guarantee?

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Introduction

Access to affordable credit is an essential component of managing a business, especially during times of financial distress. This is particularly true in agriculture where high investment costs are common. The Farm Service Agency (FSA), is an important source of credit for agricultural producers across the country. The FSA's farm loan programs primarily target beginning and minority agricultural producers who cannot obtain credit from commercial services, with some exceptions. This article reviews the various loan options available through these farm loan programs and discusses their benefits and drawbacks. We also discuss the land contract guarantees the FSA provides to facilitate the sale of land to beginning and minority agricultural producers.

Background

The FSA is a United States Department of Agriculture (USDA) agency responsible for the administration of a number of important government programs and services targeted towards serving agricultural producers. In this article, we focus on the farm loan programs offered by the FSA (http://www.fsa.usda.gov/programs-and-services/farm-loan-programs/index). Among its many duties, the FSA is responsible for providing credit to agricultural producers who represent profitable investments, but who are not currently being served by the private lending industry. Agriculture is an industry with significant barriers to entry and the FSA loan program promotes the participation of young and beginning farmers by providing loans that they would not otherwise be able to acquire. Similarly, the FSA also targets its loans to other underserved communities such as minorities, veterans, and agricultural producers who have suffered from a natural disaster (USDA-FSA, 2018).

While the FSA's overall market share for direct lending accounts for less than 3% of total farm sector debt (USDA-ERS, 2018), 14% of all indebted beginning farms had either a loan guarantee or direct loan from the FSA. In particular, more than a quarter of beginning farms operated by a single operator and their spouse with $100,000 or more in farm production obtained a direct or guaranteed loan from the FSA (Dodson and Ahrendsen, 2016). Beginning farmers as a group account for approximately 20% of U.S. farms (Ahearn, 2011). Thus, the FSA represents an important source of credit for entry into agricultural production.

Producer Options

Agricultural producers have a number of loan options when dealing with the FSA. These options are detailed extensively in the FSA's handbook, "Your Guide to FSA Farm Loans" (https://www.fsa.usda.gov/Internet/FSA_File/fsa_br_01_web_booklet.pdf). There are two broad categories of loans available: direct loans and guaranteed loans. Direct loans originate from the FSA. Guaranteed loans originate from commercial lenders, but the FSA guarantees up to 95% of the lender's losses on the loan.

Further, the FSA provides land contract guarantees to owners of farmland who intend to sell land via a contract to beginning or socially disadvantaged agricultural producers. Beginning agricultural producers are defined as having started farming or ranching less than 10 years ago. Socially disadvantaged agricultural producers are defined as American Indians or Alaskan natives, Asians, black or African Americans, native Hawaiians or other Pacific Islanders, Hispanics, and women (USDA-FSA, 2012).

FSA loans and land contract guarantees require a comprehensive business plan. There are numerous resources for the creation of a business plan, both online and from your local cooperative extension office.

3.1 Direct and Guaranteed Loans

The FSA's direct and guaranteed loans are intended as a pathway for credit constrained growers to graduate to commercial credit. As a result, the targeted loan audiences are agricultural producers that are young, minorities or women, beginners, and those who have suffered a natural disaster. These loans are designed for clients who cannot obtain credit from a commercial lender. Thus, the FSA either guarantees the majority of the loan for commercial lenders or provides the loan directly. This support is designed to facilitate the entry of underserved groups into agricultural production while simultaneously establishing a strong credit history for this clientele.

There are several subcategories of FSA direct and guaranteed loans that a producer may apply for under the Farm Loan Programs.[1] The following is a brief description of each. Note that the FSA has specific interest rates for direct loans (http://www.fsa.usda.gov/programs-and-services/farm-loan-programs/index), whereas the interest rate on guaranteed loans are determined by the lender.

3.1.1 Farm Ownership Loans

Farm ownership loans are designed to enable the purchase of farmland, construct or repair buildings and other fixtures, pay closing costs, and promote soil and water conservation. These loans are available from both the direct and guaranteed loan programs. The maximum direct farm ownership loan is $300,000. The maximum guaranteed farm ownership loan is currently $1,392,000, but the amount may be adjusted based on inflation. Farm ownership loans are available for up to 40 years. Farm ownership microloans are also available to ease some of the loan requirements for specific clientele. These loans are obtained directly from the FSA, have a maximum loan amount of $50,000, and are available for up to 25 years (USDA-FSA, 2012).

3.1.2 Operating Loans

Operating loans support the purchase of livestock and equipment. These loans may also be used to pay for minor real estate repairs and operating expenses. Loans are available from both the direct and guaranteed loan programs. The maximum direct operating loan is $300,000. The maximum guaranteed operating load is $1,392,000. Operating loans are available for 1 to 7 years. Operating microloans are also available to ease some of the loan requirements for specific clientele. These loans are obtained directly from the FSA and have a maximum loan amount of $50,000 with the same repayment period (USDA-FSA, 2012).

[1]FSA loans such as marketing assistance loans and farm storage facility loans are available outside the FSA's Farm Loan Programs.

3.1.3 Conservation Loans

Conservation loans promote the completion of conservation practices in an approved conservation plan. These loans are available from both the direct and guaranteed loan programs. The maximum value of these loans is determined by your local FSA office. Conservation loans are available for up to 20 years (USDA-FSA, 2012).

3.1.4 Emergency Loans

Emergency loans provide relief for qualifying losses from natural disasters affecting agricultural operations. These loans may replace essential property, pay production costs, pay essential living expenses, and refinances certain debts. These loans are only available from the direct loan program. The maximum emergency loan is the lower of the disaster losses or $500,000. Emergency loans are available for 1 to 7 years, with exceptions up to 40 years (USDA-FSA, 2012).

3.2 Land Contract Guarantees

Land contract guarantees are designed to provide financial security to owners of farmland who are engaging in a land contract sale to beginning or socially disadvantaged agricultural producers. There are two types of land contract guarantees: prompt payment guarantees and standard guarantees. Both land contract guarantees are managed through a third-party agent and may cover a maximum purchase price of $500,000 on a new land contract. These contracts must be amortized for a minimum of 20 years with equal payments during the guarantee period of 10 years and cannot exceed a 6.5% interest rate (USDA-FSA, 2012).

3.2.1 Prompt Payment Guarantee

A prompt payment guarantee ensures the payment of up to three amortized annual payments plus the cost of real estate taxes and insurance (USDA-FSA, 2012).

3.2.2 Standard Guarantee

A standard guarantee ensures 90% of the outstanding principal balance under the land contract (USDA-FSA, 2012).

Why the FSA?

As stated prior, FSA loans are designed to serve those who cannot obtain credit elsewhere. These loans specifically target underserved groups such as beginning and minority farmers. If you are currently unable to obtain commercial credit, have a valid business plan, and qualify as an underserved individual, then you may want to consider applying for a loan guaranteed by the FSA or provided directly by the FSA. Also, you may want to consider participating in the land contract guarantee program if you intend to enter into a land sale contract with a beginning or minority agricultural producer.

There are several benefits to obtaining a loan with the help of the FSA. The most obvious benefit is the ability to obtain a loan if you are not currently able to through commercial lenders. Further, having a loan guarantee from the FSA will enable you to pay a smaller interest rate than you would otherwise due to the repayment security associated with FSA sponsorship. Similarly, the interest rates that the FSA charges when providing a loan directly are very reasonable.

Working with the FSA can also provide useful guidance and business reporting guidelines. At the end of each business cycle, your FSA loan officer will meet with you to review records, plan for the following year's operation, and help review your business plan. In addition, the FSA offers several servicing options to help avoid or resolve delinquent loan repayments. The FSA's disaster set-aside (DSA) program can let you move one annual payment to the end of your loan under certain disaster circumstances. The FSA's primary loan servicing (PLS) program may allow you to restructure your loan if you are unable to make payments due to circumstances outside your control (USDA-FSA, 2012).

There are some drawbacks associated with obtaining an FSA loan. First, the reporting and compliance stipulations may be more stringent than some commercial loans. For example, you may be required to report a variety of performance metrics and attend financial training classes. Second, the purpose of the FSA is to provide temporary credit to agricultural producers who cannot obtain commercial loans. Thus, when you are able to operate without FSA assistance, you will need to refinance your FSA loans with a commercial lender. Third, some FSA loans may not be large enough to support your operation. A common criticism of the direct farm ownership loans is that the maximum loan amount is not sufficient to meet the complete credit needs of many larger commercial farms (Dodson and Koenig, 2007). Lastly, application timing can cause issues with obtaining a FSA loan. Each year, Congress allocates money for FSA farm loans, but these funds may run out before the end of the fiscal year and cause a waiting list to form. The fiscal year begins in October, so that is often the best time to apply for a FSA loan (USDA-FSA, 2012).

Conclusion

The FSA's farm loan programs are an important source of credit for beginning and minority agricultural producers. Knowledge of these programs can help agricultural producers gain access to credit that may not otherwise be able to. These programs can also facilitate the sale of land and ensure payment when a beginning or minority agricultural producer is involved in the purchase. Overall, the purpose of the FSA's role in these credit markets is to correct for market failures and graduate participants to the use of commercial credit. If you think you may qualify for a FSA loan, please consult your local FSA agent and read more about these programs at the FSA farm loan programs website (http://www.fsa.usda.gov/programs-and-services/farm-loan-programs/index).

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