

Current Issues in FmHA Loan Servicing

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INTRODUCTION

This Article discusses issues raised relating to the application of the Agricultural Credit Act of 1987 (Act).¹ The Agricultural Credit Act, passed to provide a format for restructuring and financing the ailing Farm Credit System and to provide protective rights for farm credit system borrowers, included provisions affecting the Farmers Home Administration² (FmHA). Under the terms of these provisions, the FmHA must consider the modification of delinquent loans to avoid losses.³ To avoid losses, the FmHA may write down debt, set aside debt or rely on other primary loan service programs to ensure that borrowers can continue farming or ranching operations.⁴ The implementation of regulations promulgated by the FmHA provide the framework for modifying loans.⁵

FmHA borrowers experienced severe financial difficulties in the early to mid-1980s. Many farmers had delinquent loans with both the Farm Credit System and the FmHA. The resulting tide of farm foreclosures and voluntary deeding back of farm property to the lenders, in conjunction with numerous lawsuits challenging the Farm Credit System's and the FmHA's foreclosure policies, led to the enactment of the Agricultural Credit Act. The FmHA statutory loan servicing require-

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¹ Agricultural Credit Act of 1987, Pub. L. No. 100-233, 101 Stat. 1568 (1988) (codified at scattered sections of 7 & 12 U.S.C.).

² See, e.g., *id.* at Pub. L. No. 100-233, tit. VI, 101 Stat. 1667 (1988).

³ 7 U.S.C. § 2001(a)(1988).

⁴ *Id.* § 2001. The restructuring provisions apply to direct farmer program loans and not to guaranteed loans. For the statutory authority for guaranteed loans, see *id.* § 1922. For the regulations affecting guaranteed loans, see 7 C.F.R. Part 1980 (1989). Guaranteed loans are serviced by the lending institution and have more limited restructuring provisions.

⁵ See 7 C.F.R. §§ 1951.1-.950 (1989).

ments grew out of a realization by Congress that although the FmHA had various loan restructuring options available, the agency tended to foreclose or encourage voluntary liquidation of property rather than to continue the loan through restructuring.⁶ Congress instructed the FmHA to weigh the dollar amount it could realize by restructuring the loan against the amount it could recover through foreclosure.⁷ Congress instructed the FmHA to consider all debt servicing options, including debt write-down and debt set-aside. Net recovery value is essentially the amount the government could recover from involuntarily liquidating the collateral securing the debt. To determine net recovery value, the county supervisor initially determines the current market value of the property based on regulations for appraising real property and chattel property. The supervisor then subtracts the various costs of acquiring, holding, depreciating, and reselling the property.⁸ Finally, the supervisor adds anticipated income, such as rental income to the

⁶ Although the agency had authority to defer debt, *see* 7 U.S.C. § 1981a (1988), it had never promulgated regulations concerning deferral of debt nor did it grant such relief. In *Curry v. Block*, 541 F. Supp. 506 (S.D. Ga. 1982), *aff'd in part*, 738 F.2d 1556 (11th Cir. 1984), the court found that borrowers should be advised of the right to seek deferral relief as authorized by §1981a. *Id.* at 522-23. The agency was required to develop substantive standards for granting deferral relief. *Id.* at 515-22. The same conclusion was reached by the Tenth Circuit in *Matzke v. Block*, 542 F. Supp. 1107 (D. Kan. 1982), *aff'd in part and rev'd in part*, 732 F.2d 799 (10th Cir. 1984). The Eighth Circuit found that personal notice was required, but that the Secretary was not required to implement regulations for the program *See Allison v. Block*, 723 F.2d 631 (8th Cir. 1983) (recognizing that Secretary must somehow insure set of substantive standards to govern §1981a requests). In *United States v. Hamrick*, 713 F.2d 69 (4th Cir. 1983), the Fourth Circuit found that personal notice of deferral relief was required, but stated no opinion regarding the requirement of implementing regulations. Both the Sixth Circuit, in *Ramey v. Block*, 738 F.2d 756 (6th Cir. 1984), and the Seventh Circuit, in *United States v. Markgraf*, 736 F.2d 1179 (7th Cir. 1984), ruled that neither personal notice nor regulations were required. In *Coleman v. Block*, 580 F. Supp. 192 (D.N.D. 1983), a nationwide class action challenged the Secretary's failure to promulgate implementing regulations for deferral relief. The court enjoined further foreclosure or liquidation proceedings until such time as implementing regulations were promulgated and notice of the availability of loan service programs was given to borrowers. *Id.* at 210.

⁷ *See* 7 U.S.C. § 2001(b)(4) (1988). Congress required each farm credit district, *see* 12 U.S.C. § 2002(b)(1988), to develop a debt restructuring policy and to consider restructuring prior to any liquidation action. *Id.* § 22202a(d)(1). Farm Credit System institutions are required to consider whether the cost to the System of restructuring is equal to or less than the cost of foreclosure. *Id.* The calculations used to make this determination vary from calculations used by the FmHA and also vary by district.

⁸ *See* 7 C.F.R. § 1951.909(f)(1)(i)-(v) (1989). For the regulations for appraising real property, *see id.* §1809.1-.8.

amount.⁹ To qualify for primary loan servicing, the calculations must show that the borrower can develop a plan utilizing one or a combination of the FmHA's debt restructuring options that provide for payments with a net present value greater than or equal to the net recovery value of the collateral securing the debt.¹⁰

One significant feature of the Agricultural Credit Act is the establishment of a national appeals division within the FmHA to hear and review appeals of FmHA adverse decisions.¹¹ Although the Act requires only that this system be provided to CONACT¹² borrowers, the FmHA has decided to use the national appeals system for all FmHA applicants and borrowers, as well as holders of loans guaranteed by the FmHA.¹³ The national appeals division is an independent branch within the FmHA and has its own staff. The Director of Appeals reports directly to the Administrator of the FmHA.

Prior to the passage of the Act, FmHA hearing officers were usually district directors within the state agency. Generally, the hearing officers previously had worked with, or knew, the county supervisor involved in the initial decision. Hearing officers are now employees of the national system rather than the state FmHA office. This removes the appearance of inherent bias present in the prior system.

The loan restructuring provisions have generated many administrative appeals; so many that additional hearing officers are now being hired in some states to handle the large volume of hearings. The following discusses some of the issues that have evolved from the FmHA's loan restructuring process.¹⁴

I. FEASIBILITY OF PLANS

Many FmHA mediations and appeals focus on the "feasibility" of a borrower's plan.¹⁵ Feasibility is the borrower's ability to meet the nec-

⁹ *Id.* § 1951.909(f)(1)(vi).

¹⁰ *See id.* § 1951.909(h)(1).

¹¹ Agricultural Credit Act of 1987, Pub. L. No. 100-233, § 608, 101 Stat. 1568, 1667-68 (1988) (codified at 7 U.S.C. § 1983b(d) (1988)).

¹² *See id.* § 1951.906 (defining CONACT).

¹³ Adverse decisions regarding guaranteed loans are appealable. However, the lender requesting the guarantee and the borrower must jointly appeal the denial of an application for guarantee. The lender may appeal only the denial of payment on the guarantee.

¹⁴ For additional issues, see Hayes, *FmHA Debt Restructuring Consideration: Recurring Problems in Farm Foreclosure Defense: Administrative and Legal Remedies for FmHA and FCS Borrowers*, (Farmers Legal Action Group Inc., Nov. 10, 1989).

¹⁵ *See* 7 C.F.R. § 1951.909(b) (1988). The Agricultural Credit Act also authorizes

essary family living and farm operating expenses and to service all debts, including those that are restructured.¹⁶ When a delinquent borrower responds to a "Notice of Availability of Primary and Preservation Loan Service Programs,"¹⁷ she completes a "Farm and Home Plan."¹⁸ The borrower provides information on family living, farm operating, and proposed capital expenditures for the year.¹⁹ The borrower also calculates planned income from the farming operation and any additional farm income, such as government deficiency payments or custom farm income. The borrower deducts operating expenses from farm income to produce "net farm income." Any off-farm income is added to "net farm income" to produce a "total income" figure. The borrower deducts family living expenses and planned capital expenditures from the "total income" to determine the "balance available" for payment of debt obligations.

Additionally, the borrower lists all outstanding debt obligations and the existing annual payment for each obligation. By adding these annual obligations to the sum that properly reflects social security and income tax obligations, the borrower determines the total annual "debt repayment" obligation. This amount is compared to the previously determined "balance available."

grants for state mediation programs. If the county supervisor determines that a feasible plan cannot be developed and the borrower has other creditors, the borrower is sent a "Notification of Request for Mediation or Meeting of Creditors." See 7 C.F.R. § 1951 (1989). The mediation or meeting of creditors offers the opportunity for the borrower to negotiate with the other creditors to obtain debt adjustments that will allow the development of a feasible plan. Thus, these issues often first arise in the context of a mediation session. For mediation regulations, see *id.* § 1951.912 (1989).

¹⁶ 7 C.F.R. § 1951.909(d) (1989).

¹⁷ This notice is sent to farmer program borrowers: (1) who are 180 days delinquent, (2) at the time an application for participation in an FmHA loan service program is submitted, or (3) upon written request of the borrower. *Id.* § 1951.907(f). This notice must be sent prior to the FmHA's initiation of any liquidation action, acceptance of a voluntary conveyance of security property, acceleration of payments on the loan, repossession of security property, foreclosure on security property, or commencement of any other collection action. *Id.* The regulations also specify the types of notices required to be sent to borrowers whose accounts were accelerated between November 1, 1985, and May 7, 1987, *id.* § 1951.907(a); whose accounts were accelerated but not foreclosed or liquidated, *id.* § 1951.907(b); and for borrowers with bankruptcies pending on January 6, 1988 (the effective date of the Act) whose accounts had not been foreclosed or liquidated, *id.* § 1951.907(c).

¹⁸ Form FmHA 431-2; see also 7 C.F.R. § 1951.906 (1989) (defining farm plan).

¹⁹ Generally, the plan is developed for the current crop and livestock income year. In some restructuring situations, a plan is developed for a "typical year." In those instances involving deferral, a plan is developed for the end year of the deferral period.

In FmHA loan restructuring situations, the annual debt repayment obligations exceed the "balance available". The extent of the disparity determines whether loan restructuring will be available to the borrower, and if so, what type of loan restructuring will be available.

Primary loan servicing options include:

1. **LOAN CONSOLIDATION:** combining two or more of the same type of loans into one larger loan.²⁰
2. **LOAN RESCHEDULING:** altering the payment schedule of equipment, livestock or crop notes. This also may involve reduction of the interest rate.²¹
3. **LOAN REAMORTIZATION:** altering the payment schedule of real estate notes, which also may involve reducing interest rates.²²
4. **LOAN DEFERRAL:** delaying payments of principal and interest for up to five years. The borrower must demonstrate an ability to repay at the end of the deferral period.²³
5. **DEBT WRITE-DOWN:** reducing both debt principal and interest. Debt write-down is available only when consolidating, rescheduling, reamortizing, reducing the interest rate, or deferring the loan will not show a feasible plan of operation for the borrower.²⁴

In addition, loan restructuring may be available through the soft wood timber loan program, which allows marginal land to be planted in soft wood timber in exchange for deferral of debt for up to forty-five years.²⁵

Conservation easements also provide a means of reducing debt to the FmHA. Conservation easements involve the transfer of highly erodible

²⁰ 7 C.F.R. § 1951.909(e)(1) (1989).

²¹ *Id.*

²² *Id.* § 1951.909(e)(2).

²³ *Id.* § 1951.909(e)(3).

²⁴ *Id.* § 1951.909(e)(5).

²⁵ The softwood timber program began with the Emergency Agricultural Credit Act of 1984, Pub. L. No. 98-258, tit. VI, 98 Stat. 130, 138-141 (codified at scattered sections of 7 U.S.C.), which required the Secretary to consider the feasibility of such a program. *Id.* § 608, 98 Stat. 140-41 (not codified in U.S.C.). The Food Security Act of 1985, Pub. L. No. 99-198, § 1254, 99 Stat. 1354, 1517-18 (codified as amended at 7 U.S.C. § 1981 (1988)), implemented the program. Congress mandated that no more than 50,000 acres nationwide be placed in this program. *Id.* sec. 1254, § 608(g), 99 Stat. 1518. As of June 1988, only five borrowers had been approved for the softwood timber program, involving about 869 acres. GAO REPORT TO THE CHAIRMAN, COMMITTEE ON AGRICULTURE, FARMERS HOME ADMINISTRATION, IMPLEMENTATION ISSUES CONCERNING FOUR SECTIONS OF THE FOOD SECURITY ACT (June 1989). It appears from the GAO report that the FmHA administration feels that the debt restructuring provisions of the Agricultural Credit Act provide more significant relief and that the softwood timber program will be utilized even less in the future. For the full requirements of the program, see 7 C.F.R. § 1951 (1989).

land, wetlands, and wildlife habitats to the Secretary of Agriculture in exchange for a reduction of debt by the value of the transferred land.²⁶

As stated earlier, calculations must demonstrate that the borrower can develop a feasible plan utilizing one or a combination of the FmHA's debt restructuring options that provide a payment that is greater than or equal to the involuntary liquidation value of the collateral securing the debt.²⁷ The FmHA uses the information from the Farm and Home Plan in its computerized DALR\$²⁸ program in making these calculations. Many mediation sessions²⁹ and appeal hearings involve disputes over the calculations of family living, farm operating expenses and planned income.

The borrower's projected income and expenses on the plan must be based on the borrower's proven record of production and financial management.³⁰ The regulations state that existing farmers must use their production and financial history for the past five-year period.³¹ In recent years, however, many agricultural areas have experienced conditions of drought or excessive rain. Consequently, many FmHA borrowers do not feel that their five-year production records accurately reflect their overall production or financial capacity. If a borrower's production history has been affected by a disaster declared by the President or designated by the Secretary of Agriculture, county average yields can be

²⁶ The Food Security Act authorized conservation easements. Pub. L. No. 99-198, § 1318, 99 Stat. 1354, 1530-1531 (codified as amended at 7 U.S.C. § 1997 (1988)). The FmHA is authorized to acquire the right for public use of property of a qualified borrower for not less than 50 years for conservation purposes. 7 U.S.C. § 1997(b) (1988). The purchase is accomplished by cancelling that part of all outstanding loans of the borrower at the same ratio as the number of acres of easement property is to the total number of acres securing the loans. *Id.* § 1997(e). The amount cancelled could not exceed the value of the land on which the easement was acquired. *Id.* The Agricultural Credit Act amended the program by modifying the earlier restrictions on the maximum dollar amounts that could be cancelled for the easement by allowing cancellation for the higher of the value of the easement land or the difference between the amount of the outstanding loan secured by the land and the current value of the easement land. Pub. L. No. 100-233, § 612, 101 Stat. 1568, 1674 (codified in relevant part at 7 U.S.C. § 1997(e) (1988)). A full explanation of this program is found at 7 C.F.R. § 1951 (1989).

²⁷ See *supra* note 7 and accompanying text.

²⁸ DALR\$ is an acronym for Debt and Loan Restructuring System. DALR\$ determines the feasibility of a plan using any combination of FmHA debt restructuring options. See 7 C.F.R. § 1951 (1989).

²⁹ See *supra* note 12.

³⁰ 7 C.F.R. § 1924.57(d)(1) (1989).

³¹ *Id.* The FmHA uses the term "existing" farmer for one who has at least a 5-year history of production.

used for the disaster years.³² The projected future unit prices of agricultural commodities are established on a statewide basis by FmHA state directors and are published to comply with the farm planning season.³³

FmHA borrowers and the county supervisors must agree on the projected income and expense figures and sign the Farm and Home Plan.³⁴ In the first round of FmHA loan restructurings after the enactment of the Act, however, most farmer-borrowers completed the Farm and Home Plans and then submitted them to the county supervisors, who later reviewed the plans. In many instances, the county supervisors modified the plans submitted by the farm borrowers and ran the DALR\$ program using the modified figures. This practice raises the issue of whether these modifications, made without the borrower's consent, are appealable.

The regulations at 7 C.F.R. part 1962 and section 1924.57 address the situation that results when the county supervisor and the borrower cannot reach agreement on the planned uses of proceeds on either form FmHA 431-2³⁵ or 1962-1.³⁶ In these instances, the borrower may appeal. These sections do not address the issue of appeal in cases where the county supervisor and the borrower cannot agree on the projected income and expense figures. Under the new appeal regulations, FmHA decisions that "directly and adversely" affect a person are appealable to the National Appeals Staff.³⁷ The regulations define "directly and adversely affected" as "having a request for FmHA assistance denied in whole or in part or having FmHA assistance reduced, cancelled, or not renewed."³⁸ Clearly, a denial of loan restructuring is a denial of a request for FmHA assistance. If the FmHA denies a loan restructuring request because of "insufficient cash flow" or an "insufficient balance available" for debt repayment, the borrower should be allowed to provide evidence concerning projected income and expenses and to demonstrate why the figures used by the county supervisor are incorrect. A modification of income and expense figures by the county supervisor

³² *Id.*

³³ *Id.* § 1924.57(d)(2). State Directors must consult with agricultural agency representatives, as well as lenders and State Directors in adjoining states, before releasing commodity prices. *Id.* Farmers who have proven records to support premium prices and/or contracts with well established markets can use those prices. *Id.*

³⁴ *Id.*

³⁵ See *supra* note 15 and accompanying text.

³⁶ Form FmHA 1962-1 is the Agreement for the Use of Proceeds/Release of Chattel Security. For a reprint of form 1962-1, see 7 C.F.R. § 1962 (1989).

³⁷ *Id.* § 1900.55(a).

³⁸ *Id.* § 1900.52(i).

that harms the borrower's ability to demonstrate a feasible plan is a direct and adverse decision. The appeals division have allowed such appeals.

II. APPRAISALS

Another area of frequent dispute in loan servicing situations is the underlying appraisal of real estate, crops, and chattel property. The local county supervisor or a local appraiser hired by the FmHA usually conducts appraisals. The appraisal serves as the base figure for various calculations that determine net recovery value of FmHA security property. A borrower who has been denied primary loan servicing has the right to request an independent appraisal of any property securing the loan.³⁹ The borrower can select an appraiser from a list of three appraisers approved by the county supervisor.⁴⁰ The borrower must bear the expense of this appraisal.⁴¹ If the two appraisals vary by no more than five percent, the FmHA uses the initial appraisal.⁴² In the appeal hearing, the borrower bears the burden of demonstrating why the original appraisal was in error.⁴³ The independent appraisal must conform to agency appraisal regulations.⁴⁴

In determining a recommended market value for farm property, the FmHA may consider both the agricultural value and the market value.⁴⁵ Agricultural value is the amount a purchaser would be willing to pay with the expectation of receiving typical net earnings from the farm.⁴⁶ Market value is the amount a purchaser would be willing to pay considering both agricultural and nonagricultural uses of the property.⁴⁷ To determine market value, the FmHA uses a three-way approach, consisting of the market data approach, the capitalization approach, and the summation approach.⁴⁸ The market data approach involves a review of recent sale prices of comparable tracts in the area.⁴⁹ Generally, the FmHA lists and describes two or three comparable tracts. The capitalization approach involves an estimate of earnings, ei-

³⁹ 7 U.S.C. § 2001(j) (1988).

⁴⁰ *Id.*

⁴¹ *Id.*

⁴² 7 C.F.R. § 1900.53(b) (1989).

⁴³ *Id.*

⁴⁴ *Id.*

⁴⁵ *See id.* § 1809.2 (defining agricultural and market values).

⁴⁶ *Id.* § 1809.2(a).

⁴⁷ *Id.* § 1809.2(b).

⁴⁸ *Id.* § 1908.4.

⁴⁹ *See id.*

ther by rental income or cash flow analysis, capitalized at an appropriate rate.⁵⁰ The summation approach involves adding the value of essential buildings to the market value of the land.⁵¹ The appraiser usually reviews all three values and makes certain adjustments to reach a recommended market value.⁵² The appraiser must consider the strong and weak points of each approach and correlate the three values by considering the spread between the minimum and maximum figures.⁵³

In challenging appraisals, the borrower needs to examine each section of the appraisal to determine if assumptions made by the appraiser do not correspond with the facts. An appraisal is described by the FmHA as follows:

An appraisal is a determination of value based on facts which have been judiciously interpreted to arrive at a sound conclusion about the property. It is a written statement which identifies the property, adequately describes it and expresses an opinion as to its value. The dependability of the opinion is based on the thoroughness and accuracy with which facts are gathered and examined as well as the skill and experience of the person who interprets them.⁵⁴

The regulations also establish guidelines for making the appraisal.⁵⁵ A borrower seeking to challenge the appraisal should review these regulations and seek to determine in the appeal the extent to which the original appraisal followed these procedures. If the appraisal has been made in adherence with the stated procedures, there is little chance of a successful challenge to the appraisal. Similarly, when the independent appraisal conforms more closely to the procedures than the original appraisal, the hearing officer should give greater weight to the independent appraisal.

⁵⁰ See *id.* In her discussion of debt restructuring problems, Lynn Hayes discusses the use of the capitalization value in the calculation of the net recovery value. See Hayes, *supra* note 14. She argues that the Act requires the FmHA to take a realistic look at the amount it could recover through involuntary liquidation and that the FmHA is prohibited from reselling farmland at a price higher than that which reflects its productive value as a farming operation. *Id.* Therefore, the capitalization value should be used in the net recovery value calculation. *Id.* For the requirements regarding resale of inventory property, see 7 U.S.C. § 1985(c)(1), (e)(4) (1988).

⁵¹ 7 C.F.R. § 1809.4(c) (1989).

⁵² *Id.* § 1809.4(d).

⁵³ *Id.*

⁵⁴ *Id.* § 1809.1(a).

⁵⁵ See *id.* § 1809.6.

III. COLLATERAL FOR RESTRUCTURED LOANS

Another issue that has developed concerning the FmHA's loan restructuring is the extent to which the FmHA can require additional collateral and cross-collateralization of loans as a condition of restructuring. Presently, the FmHA rarely provides additional operating loans for borrowers in the debt restructuring process. Consequently, borrowers generally need to borrow operating funds from some other source, usually private banks. Normally, borrowers pledge crop and/or livestock proceeds for the season as collateral for operating loans. Many FmHA borrowers in the debt restructuring process with both real estate and chattel notes would like to pay in full the chattel debt and to extinguish the lien on crops and livestock so that this property can be pledged as collateral for the new operating funds. However, the FmHA does not allow buyout at net recovery of the separate notes. The FmHA also claims that all notes held by it per borrower are cross-collateralized.

The FmHA points to the language contained in its security agreement,⁵⁶ which states:

Whereas Debtor is justly indebted to Secured Party as evidenced by one or more certain promissory note(s) or other instrument(s), and in the future may incur additional indebtedness to Secured Party which will also be evidenced by one or more promissory note(s) or other instrument(s), all of which are herein called "note," which has been executed by Debtor, is payable to the order of Secured Party, and authorizes acceleration of the entire indebtedness at the option of Secured Party upon any default by Debtor.

The FmHA interprets this language as meaning that all existing notes or future notes are secured by the property listed on the agreement. This holds true whether the notes are for farm ownership loans (usually secured by real estate) or for operating and emergency loans (usually secured by chattels), without regard to the execution dates of the notes.

Both the operating loan regulations⁵⁷ and the farm ownership regulations⁵⁸ require adequate security to assure repayment of the loan.⁵⁹ Generally this has meant that the value of the secured property must be equal to or greater than the present value of the loan. Chattels are used to secure real estate loans only if the value of the real property is less

⁵⁶ Form FmHA 440-4.

⁵⁷ 7 C.F.R. §§ 1941.1-.96 (1989).

⁵⁸ *Id.* §§ 1943.1-.50.

⁵⁹ *Id.* §§ 1941.19, 1943.19.

than the value of the loan,⁶⁰ and real property is only to be used to secure operating notes if the value of the chattel security property is less than the value of the operating loan.⁶¹

Statutory authority allows a borrower to use the same collateral to secure two or more loans, as long as the outstanding amount of the loans does not exceed the total value of the collateral used.⁶² The Secretary may not require a borrower to provide additional collateral to secure a farmer program loan if the borrower is current in the payment of principal and interest on the loan.⁶³ In addition, the Secretary may not bring any action to foreclose or liquidate a loan because a borrower refuses to provide additional collateral for a loan, as long as the borrower was current in the payment of principal and interest when the Secretary requested the collateral.⁶⁴

Borrowers argue that the plural "note(s)" as it appears in the security agreement refer to subsequent notes on loans on the same type of loans, but not to different types of loans. For example, a production loan and a farm ownership loan are of different types. Because authority for securing real estate notes with crops always has existed. Thus, borrowers contend that the FmHA's intent to cross-collateralize all notes must be evidenced by specific reference in the real estate note to any security agreement that serves as evidence of any chattel property securing the real estate note. The FmHA's Promissory Note⁶⁵ states only that any security instruments taken in connection with the note will not be affected by consolidation, rescheduling, or reamortization, and its real estate mortgage⁶⁶ only describes real property located within the given state.

There are few references to security property on restructured loans in the interim regulations.⁶⁷ In loan restructuring that involves write-down of FmHA loans, the borrower must sign a shared appreciation agreement if the loan is secured by real estate.⁶⁸ Shared appreciation

⁶⁰ See *id.* § 1943.19(c)(1).

⁶¹ See *id.* § 1941.19(b).

⁶² 7 U.S.C. § 1927(c) (1988).

⁶³ *Id.* § 1927(e)(1).

⁶⁴ *Id.* § 1927(e)(2).

⁶⁵ Form FmHA 1940-17.

⁶⁶ Form FmHA 427-1.

⁶⁷ The effective date of the Agricultural Credit Act was January 6, 1988. Proposed regulations were published in the Federal Register on May 23, 1988. See 53 Fed. Reg. 18,392 (1988). On September 14, 1988, the FmHA published what it designated as "interim" regulations. See *id.* at 35,638.

⁶⁸ 7 C.F.R. § 1951.909(e)(5)(iii)(D) (1989). The shared appreciation agreement al-

allow the FmHA to recoup the funds written off if the real property appreciates in value. The FmHA maintains real estate liens during the shared appreciation period so that the liens of priority lenders will not be increased during this time.⁶⁹ In addition, mortgages executed pursuant to restructuring contain clauses securing both described real estate and any amounts due under the shared appreciation agreement. Thus, the shared appreciation agreements serve as security beyond the present market value of the real property and provide more than adequate security on those notes.

In addition to using shared appreciation agreements pursuant to debt write-down, the regulations state that a separate "Promissory Note" will be used for each note being reamortized.⁷⁰ These are the only references to security or promissory notes on restructured loans appearing in the interim regulations.

Under the proposed regulations, the borrower would have been required to offer for sale nonessential assets, and if that was not possible, to sell these nonessential assets and to pledge them as security for existing FmHA loans.⁷¹ If write-down of FmHA loans occurred, the borrower must have agreed to a shared appreciation agreement if the loan(s) were secured by real estate.⁷²

In its "Discussion of the Revisions and Comments Received" at the publication of the interim rules, that FmHA states that section 1951.910 has been moved to section 1951.909.⁷³ The section lists all of the types of property that can be used to secure a reamortized or re-scheduled loan. The comments further state:

Several respondents commenting on this section stated that while this section does not specifically state that FmHA is going to require that the borrower place all of his/her property as security when the loan is rescheduling [sic] or reamortized, the section implies that FmHA will be asking for additional security in order for the borrower to obtain

lows the FmHA to recapture some of the debt written down if the value of the real property securing the loan increases and the borrower subsequently sells the property, quits the farming operation, or pays the loan in full. *Id.* § 1951. Shared appreciation agreements expire after 10 years, at which time the FmHA recaptures any appreciation. *Id.* The recapture amount is a percentage (either 75% within the first four years of the agreement or 50% within the final six years of the agreement) of the difference between the value of the real property at the time of the agreement and the value of the real property at the time of the event which ends the agreement. *Id.*

⁶⁹ *Id.* § 1951.909(k).

⁷⁰ *Id.* § 1951.909(j)(l).

⁷¹ 53 Fed. Reg. 18,392, 18,458 (1988) (not codified in C.F.R.).

⁷² *Id.* at 18,461. (codified at 7 C.F.R. § 1951.909 (e)(5)(iii)(D) (1989)).

⁷³ *Id.* at 35,638, 35,652.

rescheduling and reamortization. The respondents state that Congress in no way intended that as a condition for any type of servicing or debt restructure, FmHA require that the borrower provide additional collateral for the restructured loan. Under FmHA's other regulations, it is described as an exceptional circumstance under which chattel will be taken to secure a real estate-type loan and real estate will be taken to secure a chattel-type loan. The respondents state this should remain the practice. The Agency agrees that FmHA farmer program borrowers should not be required to further secure their loans as a condition for restructuring.⁷⁴

These comments clarify that FmHA determined that borrowers should not be required to provide additional security as a condition of restructuring their loans. In many restructuring situations, however, the FmHA requires borrowers to cross-collateralize their notes. This raises the issue of to what extent cross-collateralization may be construed as taking additional security or further securing the loan.

In recent loan restructuring situations, the FmHA instructs the borrower that cross-collateralization of notes is a requirement of loan restructuring. The agency also has attached copies of the security agreement to each restructured note and has referred to the agreement in the note.

At the outset it should be pointed out that the requirement of cross-collateralization upon restructuring is inconsistent with the FmHA's position that all notes are cross-collateralized by virtue of the language contained in the security agreement. The fact that the agency now specifically cross references each restructured note seems to indicate that the agency has conceded its previous position with respect to the language contained in the security agreement.

Whether cross-collateralization constitutes the taking of additional collateral can be determined by comparing what occurs to the debt and underlying collateral in restructuring with what occurs to the debt and underlying collateral in involuntary liquidation or bankruptcy.

As previously stated, the entire thrust of the loan restructuring requirements for the FmHA is to require a determination of the net recovery from the involuntary liquidation or foreclosure of a loan and to compare that value to the value of a restructured loan.⁷⁵ Statutory language further mandates the FmHA to determine net recovery by calculating the recovery value of the collateral securing the loan.⁷⁶ All statutory language refers to "loan," not "loans."

The FmHA's internal loan restructuring regulations, however, direct

⁷⁴ *Id.*

⁷⁵ See *supra* note 6 and accompanying text.

⁷⁶ 7 U.S.C. § 2001(c)(1)(A) (1988).

county supervisors to determine the net recovery by calculating the amount available from the involuntary liquidation of the collateral securing the FmHA "debt." "Debt" includes all of the borrower's loans with the FmHA. Thus, the net recovery, value buyout amount is a combination of the amounts available from the involuntary liquidation of all security property. This combined amount is sometimes higher than the amount the government would receive if the FmHA actually foreclosed on the secured property.

In most current loan restructuring situations, the value of the real property securing the real estate loan is either lower than the amount owed to the FmHA or is lower after the value of prior liens has been deducted. In these situations, the net recovery value is fairly reflective of the actual amount the FmHA could recover through involuntary liquidation or foreclosure. For example, if a borrower owes the FmHA \$100,000; the valuation of the property is \$87,000 with a prior lien of \$30,000; and a willing buyer pays the full market value of \$87,000; \$57,000 is available to the FmHA on its real estate loan. If the borrower also has an FmHA operating note for \$23,000 with value in the underlying collateral of \$11,000, the FmHA would be able to recover \$11,000 through liquidation of the machinery. The total amount recovered would be \$68,000 minus costs. These sums would be available to the FmHA whether or not the notes were cross-collateralized. This amount matches the net recovery buyout amount that would be calculated pursuant to the regulations.

If a borrower, however, has a \$23,000 operating note secured by machinery with a current value of \$11,000, and a real estate note of \$20,000 secured by real property with a current value of \$87,000 that has a \$30,000 prior lien, the FmHA could foreclose on the mortgage, pay the prior lienholder, and satisfy its \$20,000 note. It also could move separately to liquidate the chattel security and could recover \$11,000 by selling the machinery, leaving a deficiency of \$12,000. If the loans are cross-collateralized, the FmHA could recover this deficiency from the excess funds available from the sale of real estate and could recover the total amount of the indebtedness (\$43,000). If the notes are not cross-collateralized, the FmHA would merely stand in line with other creditors for payment of the deficiency from the excess funds. Depending on the claims of other creditors, the FmHA's total recovery could be limited to \$31,000, considerably less than the calculated net recovery buyout amount of \$68,000.

Comparing net recovery calculations and calculations of amounts recoverable through foreclosure demonstrates that in some instances, the FmHA's method of determining net recovery value is not truly reflec-

tive of the amount the agency could recover from involuntary liquidation. Actually, the agency would not recover more than the amount of the outstanding indebtedness; in this example, a total of \$43,000. The example further demonstrates that the requirement of cross-collateralization of restructured notes provides the FmHA with security it does not presently have were the borrower to go through an involuntary liquidation or bankruptcy proceeding.

Promissory notes that contained no specific reference to other notes were not cross-collateralized. Cross-collateralization provides the FmHA with additional security property. The FmHA's cross-collateralization requirement for restructured loans is the taking of additional collateral and is contrary to the intent of Congress.

IV. PRESERVATION LOAN SERVICING AND THE SALE OF INVENTORY PROPERTY

The FmHA offers preservation loan servicing to a borrower if primary loan servicing is not available and the borrower does not exercise the option of net recovery buyout. The purpose of preservation loan servicing is to allow the borrower to retain all or a portion of her real property that has been pledged as collateral for an FmHA loan. Preservation loan servicing includes leaseback/buyback of the entire acreage and homestead protection — retention of the home and up to ten acres. The same borrower can obtain the homestead through the homestead protection program⁷⁷ and the balance of the acreage through the leaseback/buyback program.⁷⁸ An agreement for one or both may be executed prior to voluntary liquidation or foreclosure.⁷⁹ The FmHA notifies borrowers of the availability of preservation loan service programs when a borrower becomes 180 days delinquent on an FmHA loan.⁸⁰ If the borrower does not exercise her right to preservation loan programs prior to voluntary conveyance, and the FmHA later acquires the property, the FmHA must send the borrower notice of the availability of preservation loan programs within thirty days after acquiring the farm property.⁸¹

The leaseback/buyback program gives the immediate previous owner the first opportunity to acquire the property through a lease with an

⁷⁷ See 7 C.F.R. § 1951.911(b) (1989).

⁷⁸ *Id.* § 1951.911(a).

⁷⁹ *Id.* § 1951.911(a)(5).

⁸⁰ *Id.* § 1951.911(a)(1)(i).

⁸¹ *Id.* § 1951.911(a)(1)(ii).

option to purchase.⁸² If the owner is not interested in leaseback/buyback, the spouse or children, if actively engaged in farming, must be offered the opportunity for leaseback/buyback.⁸³ The FmHA gives third priority to the immediate previous family-size farm operator of the secured property, usually a cash-rent or crop share tenant.⁸⁴ The regulations state:

The rights afforded individuals under the leaseback/buyback program will only be offered once after the property comes into FmHA inventory. These individuals, however, may lease or purchase the property when it becomes available for lease or sale in accordance with Subparts B and C of Part 1955 of this chapter.⁸⁵

The regulations further state that:

The authorities contained in this section supplement Subparts A, B and C of Part 1955 of this chapter and provide information that is necessary to administer the leaseback/buyback program.⁸⁶

7 C.F.R. Part 1955 provides regulations for property management.⁸⁷ Subpart B involves property management.⁸⁸ Subpart C involves disposal of inventory property.⁸⁹ Subpart B includes instructions for the lease of real property:

Any property which secures an insured loan made under the CONACT and which contains a dwelling (whether located on or off the farm) that is possessed and occupied as a principal residence by a prior owner who was personally liable for a Farmer Program loan must first be considered for Homestead Protection in accordance with Subpart S of Part 1951 of this chapter. In addition, the former owner, spouse and child(ren) of the former owner and any entity members must first be considered for leaseback/buyback in accordance with Subpart S of Part 1951 of this chapter.⁹⁰

Before such farm property can be sold from the FmHA inventory, the county supervisor must attempt to dispose of the property pursuant to the leaseback/buyback and homestead protection programs.⁹¹

The FmHA classifies its inventory property in two categories: suitable and surplus. Suitable property includes property in inventory that could be used to carry out the objectives of an FmHA loan program

⁸² *Id.*

⁸³ *Id.*

⁸⁴ *Id.* § 1951.911(a)(2).

⁸⁵ *Id.* § 1951.911(a)(2)(V).

⁸⁶ *Id.* § 1951.911(a).

⁸⁷ *See id.* § 1955.1-.150.

⁸⁸ *See id.* §§ 1955.51-.100

⁸⁹ *See id.* § 1955.101-.150.

⁹⁰ *Id.* § 1955.66(a)(2)(iii)(A).

⁹¹ *Id.* § 1955.106(a).

based on financing provided through that program; for example, land that could be used for general farming purposes.⁹² Surplus property is real property that is neither farmland nor suitable for general farming purposes.⁹³ Surplus also includes chattel property and suitable real property that has not been sold within three years of acquisition.⁹⁴

Prior to the disposition of farm property, the FmHA must determine whether the property is suitable for disposition to persons eligible for assistance through the FmHA.⁹⁵ The county committee must make this classification decision.⁹⁶ Suitable farm property may be sold only to operators of family-sized farms, with priority given to persons eligible for farmer program loans.⁹⁷ The county committee selects the buyer if two or more eligible operators of family-sized farms wish to purchase the property.⁹⁸ Other real property not so classified or otherwise suitable property which has not been sold within a three-year period, such as surplus property, must be sold publicly by sealed bid or auction.⁹⁹

The FmHA contends that previous owners of farm property will only be considered for leaseback/buyback and/or homestead protection prior to voluntary conveyance or foreclosure or in the 180-day period following the FmHA's acquisition of the property.¹⁰⁰ If the previous owner does not choose to exercise her option or the FmHA denies preservation loan servicing, the FmHA asserts that it does not have to give priority to the previous owner in a subsequent sale or lease.

Borrowers contend that even if they do not enter into a leaseback/buyback or homestead agreement with the FmHA prior to acquisition or within 180 days of acquisition, they have a preference if the FmHA later decides to lease or sell the farm property. This argument is based on their understanding of 7 U.S.C. Section 1985(e).

7 U.S.C. Section 1985(e)(1) has five subparagraphs, (A) through (E). Subparagraphs (A)(i), (ii), and (iii) refer to the 180-day period beginning on the date of acquisition of farm property. During this period, the FmHA must allow the borrower from whom it has acquired

⁹² *Id.*

⁹³ *Id.* § 1955.103.

⁹⁴ *See id.*

⁹⁵ *See supra* note 69 and accompanying text.

⁹⁶ *See* 7 C.F.R. § 1955(c)(1) (1989).

⁹⁷ *Id.*

⁹⁸ *Id.*

⁹⁹ *Id.* § 1955.108.

¹⁰⁰ This 180-day period should not be confused with the 180-day delinquency period previously mentioned that triggers the beginning of primary loan servicing programs.

the real property to purchase or lease the property.¹⁰¹ Subparagraph (B) refers to the purchase or lease under subparagraph (A) and states that such purchase or lease “shall be on such terms and conditions as are established in regulations promulgated by the Secretary.”¹⁰²

Subparagraph (C) requires the FmHA to “give preference in the sale or lease, with option to purchase, of property that has been foreclosed, purchased, redeemed, or otherwise acquired . . . to persons in the following order: (i) The immediate previous borrower-owner of the acquired property.”¹⁰³

Subparagraph (D) refers to the case where the property described in subparagraph (A) is located within an Indian reservation.¹⁰⁴ Subparagraph (E) states that all rights provided in the subsection are in addition to any state law right of first refusal.¹⁰⁵

Borrowers argue that subparagraph (C) does not refer back to subparagraph (A). Thus, it adds to any rights afforded within the first 180-day period after the FmHA's acquisition of the property. Borrowers argue that the FmHA must offer priority persons identified in subparagraph (C) the first opportunity to buy or lease if the FmHA decides to lease or sell the property subsequent to the 180-day period. Further support for this argument is that subparagraph (A) only provides the opportunity to purchase or lease to the borrower from whom the FmHA acquired the property. Whereas subparagraph (C) provides the opportunity for purchase or lease to the immediate previous owner, the spouse or child(ren) of the immediate previous owner, the immediate previous family-sized farm operator of the property, or operators of not larger than family-size farms. The FmHA's present regulations encompass this priority scheme within the leaseback/buyback offered within the 180-day period, but not at any later offering for sale or lease. The FmHA's present regulations apparently conflict with the Act in this respect.¹⁰⁶ Borrowers should be given an opportunity to apply for leaseback/buyback and homestead protection prior to conveyance or within the first 180-day period after the FmHA acquires the real property. All priority individuals (to the extent that a higher priority individual does not apply), should be given the opportunity to apply if the FmHA later decides to sell or lease the property.

¹⁰¹ 7 U.S.C. § 1985(e)(1)(A)(i) (1988).

¹⁰² *Id.* § 1985(e)(1)(B).

¹⁰³ *Id.* § 1985(e)(1)(C).

¹⁰⁴ *See id.* § 1985(e)(1)(D).

¹⁰⁵ *Id.* § 1985(e)(1)(E).

¹⁰⁶ *Compare id.* § 1985(e) with 7 C.F.R. § 1951.911(a).

CONCLUSION

Although many issues have arisen pursuant to the Agricultural Credit Act, most FmHA borrowers agree that the FmHA borrower's restructuring rights provisions have increased the likelihood that they will be able to continue in their farming operations or at least to retain their homesteads. Thus, despite disagreements on the points discussed in this Article, the legislative desire to allow FmHA borrowers to retain their land and to continue their farming operations has in many cases been realized.

