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[1] Bruce Ahrendsen and Bruce Dixon are Associate Professor of Agricultural Economics and Professor of Agricultural Economics, University of Arkansas, Fayetteville; Steve Koenig and Charles Dodson are Agricultural Economists, USDA, Farm Service Agency, EPAS; and Latisha Settlage is Assistant Professor of Economics at the University of Arkansas, Fort Smith. The assistance of Nan Ma and Chris Bacchus is greatly appreciated. This material is based upon work supported by the Economic Research Service, U.S. Department of Agriculture, under Agreement No. #43-3AEL-2-80068.

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Section 5313 of The Farm Security and Rural Investment Act of 2002 made permanent the interest assistance (IA) program for the Farm Service Agency's (FSA) guaranteed loans. The Act authorizes the Secretary of Agriculture to fund this program up to $750 million in lending per year, a considerable increase from amounts authorized in previous years. Moreover, the Act states that not less than 15 percent of annual funding shall be reserved for beginning farmers and ranchers. Even though the program has been in existence for more than 15 years, little is known about its impact and utilization.

This research provides a basic descriptive analysis of past IA use. In particular, borrower data for Federal fiscal years 1985 through 2002 are examined in several dimensions. First, the geographical distribution of IA payments is documented. It is known that the distribution throughout the 1990s of IA use was not uniform across the United States. The analysis updates this distribution. Moreover, it is not known what types of borrowers use the IA program. The analysis investigates how the use of IA is distributed over beginning farmers, socially disadvantaged farmers (SDA) and borrowers who are not in either of the two prior groups. These outcome data are examined across the categories of beginning, SDA, and other farmers. Use of interest assistance by lender type are also explored with lender categorization being commercial bank, Farm Credit System, savings and loan, Credit Union, mortgage company, and other lenders.

Another aspect of the analysis examines interest rate differentials between loans to borrowers not receiving interest assistance and those that do. According to the FSA Handbook, *Guaranteed Loan Making and Servicing*, interest rates charged on guaranteed loans cannot "…exceed the rate the lender charges its average agricultural loan customer." This applies to loans receiving interest assistance as well as loans not receiving interest assistance. The research investigates if the average rate charged to IA borrowers before the subtraction of IA differs from the rate charged to those guaranteed borrowers not receiving IA.

Finally, analysis compares the success rates of IA users versus non-users where success is defined as completing the loan without having a loss claim paid. This finding has significant policy implications because a primary objective of the program is to assist borrowers in avoiding default.

History of Interest Assistance Program

Interest rate assistance was originally enacted with the Food Security Act of 1985 (P.L. 99-198). Section 1716 authorized an interest rate reduction program for 3 years, ending on September 30, 1988 to be administered by the U.S. Department of Agriculture's Farmers Home Administration (FmHA).[2] This program was originally established to make payments to "legally regulated" lending institutions that reduce interest rates of borrowers of loans guaranteed by the Secretary of Agriculture. Stipulations were that (1) borrowers that participate in this program must meet the established eligibility requirements which include that they operate a "not larger than family size farm" after the loan is closed and they demonstrate an inability to obtain credit from other lenders at reasonable rates and terms; (2) a borrower must not have been able to make payments on the loan in a timely manner without the benefit of the interest rate reduction; (3) the borrower must have a projected cash flow after the interest rate reduction of at least 100%; and (4) the lender must agree to reduce the interest rate by a minimum amount established by the

[2] FmHA's farm loan programs were moved to the newly formed FSA in 1994 and FmHA ceased to exist.

Secretary. In return, the Secretary would make payments to the lender equal to the amount of the interest reduction up to 2 percentage points. Thus, the program was commonly referred to as the buydown program. The terms were to be not more than 3 years or for the term of the loans, whichever is less [Ref: House Conference Report 99-447; Senate Report 99-145].

In the original House and Senate reports, there is little explanation as to the thoughts of policymakers in initiating this legislation. But, during this time period there were two issues affecting credit policy that may have influenced the passage of this legislation. One was the desire to increase the use of guaranteed credit among lenders and reduce direct lending by the U.S. Department of Agriculture. Secondly, there were concerns about the impacts relatively high interest rates were having on farmers' financial conditions. The drafters of this legislation may have envisioned the buydown program as an inducement to lenders to utilize the guaranteed loan program to refinance farmer loans at lower interest rates and longer terms, thereby providing borrowers some relief from their relatively high debt service obligations.

The buydown program was addressed again in the Agricultural Credit Act of 1987 [P.L. 100-233]. In the House Conference Report, it is acknowledged that lenders were not using the buydown program. Hence, the Agricultural Credit Act of 1987 attempted to encourage greater participation in this program. This included (1) an extension of the program from September 30, 1988 until September 30, 1993; (2) the General Accounting Office (GAO) was directed to conduct an evaluation of the interest buydown program whereby they would survey banks as to why they were not utilizing the program; (3) GAO was directed to evaluate program eligibility and make recommendations as to encourage greater participation in debt restructuring; and (4) GAO was to evaluate administrative procedures of the FmHA guaranteed loan programs and make recommendations for improvements in time and efficiency.

To encourage greater participation in the program, cash flow requirements were reduced. Borrowers would have to show a projected cash flow after the interest rate reduction of at least 100% over a 24-month period, rather than 12 months. Also, FmHA county supervisors were required to make available to farmers, upon request, a list of approved lenders that participate in FmHA's guaranteed loan program [Reference House Report no 100-295].

The Omnibus Budget Reconciliation Act of 1990 [P.L. 101-508] made substantial changes to the interest assistance program. The requirement of a matching reduction in the interest rate by lenders was deleted and the amount of the subsidy provided was increased from 2 to 4 percentage points. Also eliminated was the 3-year term of assistance making interest assistance only available in 1-year increments. And the program was extended to September 30, 1995. The program was later extended to September 30, 2003 by the Freedom to Farm Act [P.L. 101-127] of 1996 before being made permanent by the Farm Security and Rural Investment Act of 2002.

Interest Assistance Usage

Interest assistance with FSA guaranteed loans has been used by lenders to lower the cost of borrowing for their clients since 1985. Interest assistance was originally made available for farm ownership (FO) and operating (OL) guaranteed loans. However, since 1991 the policy has been to target interest assistance to OL loans. The primary reason for this change in policy is the large subsidy associated with FO interest assistance loans because of the long-term nature of these loans.

The numbers of FO guaranteed loans and those that received interest assistance are shown in Figure 1. The number of FO guaranteed loans increased from 415 in 1985 to 2930 in 1993. The percentage of these loans that received interest assistance also increased from 4.8 percent in 1985 to 17.9 percent in 1991. The change in policy away from interest assistance for FO loans can be seen by the sharp drop in the number of these loans with interest assistance from 1991 to 1992. Since the interest assistance program is targeted to the guaranteed OL loan program, the rest of the paper will focus on OL loans.

The numbers of OL guaranteed loans and those with interest assistance are shown in Figure 2. There are many more guaranteed OL loans than guaranteed FO loans made in a year. The number of guaranteed OL loans has varied over the years. The largest number of loans, 14,166, was made in 1986, one year after the program was emphasized. The fewest number of loans was 8,144 in 1998. Only 0.8 to 3.6 percent of guaranteed OL loans received interest assistance from 1985 to 1990. However, the 1990 Act's removal of the lender requirement to match interest assistance and the increase in federal interest assistance from two to four percentage points spurred an increase in program usage in 1991. Since 1991 at least 12.4 percent of guaranteed OL loans have received interest assistance with 38.8 percent receiving interest assistance in 2000.

The regional numbers of guaranteed OL loan interest assistance are presented in Table 1. The Lake States, Corn Belt, and Northern Plains regions have received the most guaranteed OL loans with and without interest assistance. However, the percentages (19.02, 20.34, and 22.22) of guaranteed OL loans that received interest assistance in those three regions are nearly twice that of the next highest region (10.15). The Pacific, Delta States, and Southeast regions only had 063, 0.76, and 1.16 percent of their guaranteed OL loans receive interest assistance. Additional investigation of the potential sources of regional variation in the interest assistance program is needed.

One characteristic about the borrower in the data is if the borrower is an SDA farmer, beginning farmer, or neither SDA or beginning farmer. FSA began recording SDA and beginning farmers that received guaranteed loans in 1991 and1994. But few SDA farmers were recorded in 1991 and 1992. Therefore, data on SDA and beginning farmers for 1993 through 2002 are presented in Table 2. As would be expected since FSA targets a portion of interest assistance funds toward beginning farmers, a greater percentage of non-SDA, beginning farmers that received a guaranteed OL loan also received interest assistance (23.02 percent) than did non-beginning and non-SDA farmers (20.90 percent). However, it was surprising to see that lesser percentages of non-beginning, SDA farmers (15.92 percent) and beginning, SDA farmers (15.61 percent) received interest assistance than did non-beginning, non-SDA farmers (20.90 percent). Further analysis is needed to explain these differences.

Table 3 contains data on type of lender making guaranteed OL loans and guaranteed OL loans with interest assistance. By far the lender category with the most guaranteed OL loans is Commercial Banks with 86,500 loans for 1993 through 2002. The next largest category is the Farm Credit System with 15,148 loans, followed by the Other category with 1,314 loans, Savings and Loans with 1,252 loans, Credit Union with 641 loans, Mortgage Company with only 65 loans. Although Credit Unions did not make that many guaranteed loans, it is interesting to note that 45 percent of those loans received interest assistance, almost twice the percentage of all other lender categories.

It is interesting to see if interest rates on guaranteed OL loans not receiving interest assistance are similar to interest rates on those loans receiving interest assistance (borrower charged rate plus interest assistance rate). Figure 3 shows the average interest rates that lenders were to receive for non-interest assistance loans and interest assistance loans and the difference in these two rates for 1985 through 2002. Notice that the non-interest assistance rate is approximately two percentage points more than the interest assistance rate for 1985 through 1990. After 1990 there is hardly any difference between the two rates. This can be explained by the 1990 Act that removed the up to two percentage point interest rate match requirement. It appears that since 1990 lenders are charging about the same rate of interest on guaranteed loans, whether the interest is charged just to the borrower as on guaranteed loans without interest assistance or the interest is charged both to the borrower and FSA as on guaranteed loans with interest assistance.

The data presented in Table 4 shows the FSA guarantee percentage for guaranteed loans. The vast majority of guaranteed OL loans (90.85 percent) are written at a 90 percent guarantee. An even higher percent of guaranteed loans with interest assistance (94.50) are written at the 90 percent guarantee. Also note that 41.75 percent of the guaranteed loans with more than a 90 percent guarantee received interest assistance.

Figure 4 shows the percent of guaranteed OL loans made in a given year that had at sometime claimed a loss by March 2003. The loss claim percentages are for non-interest assistance loans and interest assistance loans. The percent of loans claiming a loss have trended downward over the period. But much of this downward trend in loss claim rates is likely the result of the loans made in recent years have not had enough time to incur and claim a loss. The loss claim percentage is greater for non-interest assistance loans than interest assistance loans in every year. This may indicate that the interest assistance program is successful in assisting farmers repay their loans. However, the intent of the program may be to allow farmers that qualify for interest assistance to have the same success with repaying loans as those farmers with guaranteed loans that do not qualify for interest assistance.

Figure 5 shows the percent of guaranteed OL loans made in a given year that are still active as of March 2003. There is an upward trend in the percent of active loans since more recent loans have not had as much of an opportunity to be repaid or incur a loss as the loans made in earlier years. A higher percentage of guaranteed loans with interest assistance are still active in every year than guaranteed loans without interest assistance. Besides differences in loss claim rates, another potential reason for the difference in active status is that farmers are less likely to pay early on below-market rate, interest assistance loans than on at-market rate, non-interest assistance loans.

Summary

The Farm Security and Rural Investment Act of 2002 made permanent the interest assistance program for the Farm Service Agency's guaranteed loans, authorized a significant increase in funding for the program, and targeted funding for beginning farmers and ranchers. The research presented here provided a basic descriptive analysis of past use. In particular, borrower data for Federal fiscal years 1985 through 2002 were examined in several dimensions. These dimensions included geographic, borrower type, lender type, interest rate differentials, percent guarantee, and the status of the loan as to whether a loss claim was paid or the loan remained active.

Even though the program has been in existence for more than 15 years, little is known about its impact and utilization. This research is an initial step in documenting usage of the program. More detailed analysis is needed to explain regional variation, borrower type, and lender type usage. Also, additional research is needed to explain interest assistance program successes and losses at the loan level.

Table 1. Guaranteed OL Loans by Region, 1985-2002

Regions	IA	Total	Percent IA
Northeast	722	7,347	9.83
Lake States	5,437	28,587	19.02
Corn Belt	8,896	43,733	20.34
Northern Plains	7,864	35,391	22.22
Appalachian	1,059	11,568	9.15
Southeast	91	7,874	1.16
Delta States	149	19,509	0.76
Southern Plains	2,143	21,122	10.15
Mountain	1,024	11,087	9.24
Pacific	43	6,857	0.63

IA = Interest Assistance Loans

Table 2. Guaranteed OL Loans by Borrower Type, 1993-2002

Borrower Type	IA	Total OL Loans	Percent IA
BF Only	2,564	11,139	23.02
SDA Only	503	3,159	15.92
BF & SDA	130	833	15.61
Non-BF, Non-SDA	18,778	89,868	20.90
Total	21,975	104,999	20.93

BF = Beginning Farmer
SDA = Socially Disadvantaged Farmer
IA = Interest Assistance Loans

Table 3. Guaranteed OL Loans by Lender, 1993-2002

Lender Type	IA	Total OL Loans	Percent IA
Commercial Bank	19,841	86,500	22.94
Farm Credit System	2,111	15,148	13.94
Savings and Loans	217	1,252	17.33
Credit Union	290	641	45.24
Mortgage Company	5	65	7.69
Other	91	1,314	6.93
Total	22,555	104,920	21.50

IA = Interest Assistance Loans

Table 4. OL Loans by Percent Guarantee, 1985-2002

Percent Guarantee	IA	Total	Percent IA of Total	IA as Percent of IA Column Total	Total as Percent of Total Column Total
<60	6	227	2.64	0.02	0.12
60-69	8	1,644	0.49	0.03	0.86
70-79	300	5,983	5.01	1.09	3.12
80-89	958	9,135	10.49	3.49	4.76
90	25,923	174,434	14.86	94.50	90.85
>90	238	570	41.75	0.87	0.30
Column Total	27,433	191,993	14.29		

IA = Interest Assistance Loans

Figure 1. Guaranteed FO Loans

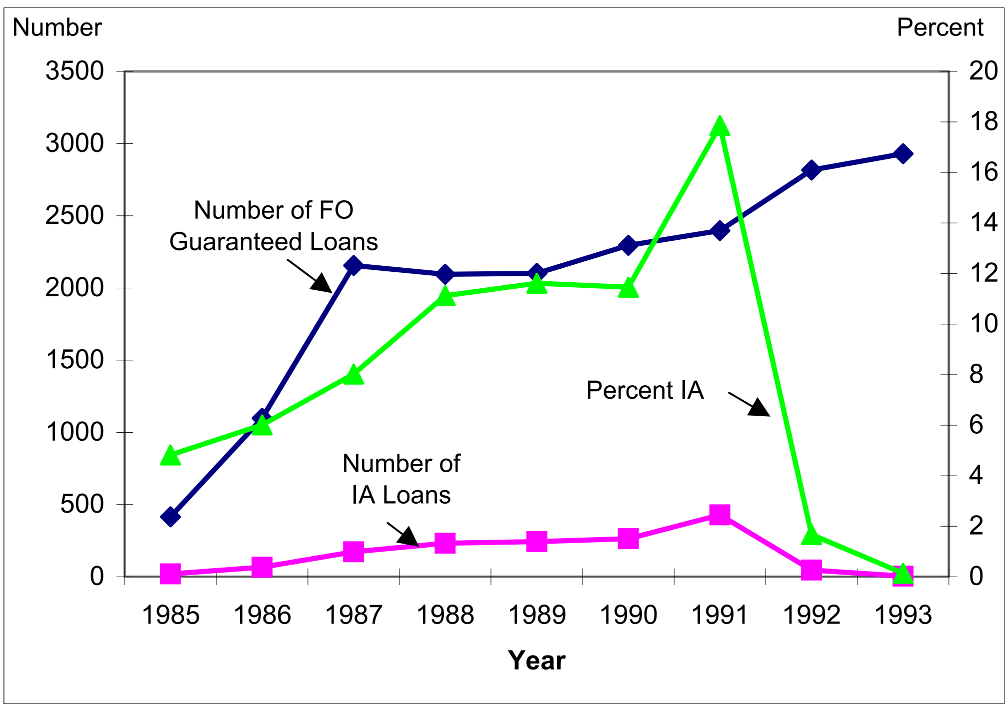

Figure 2. Guaranteed OL Loans

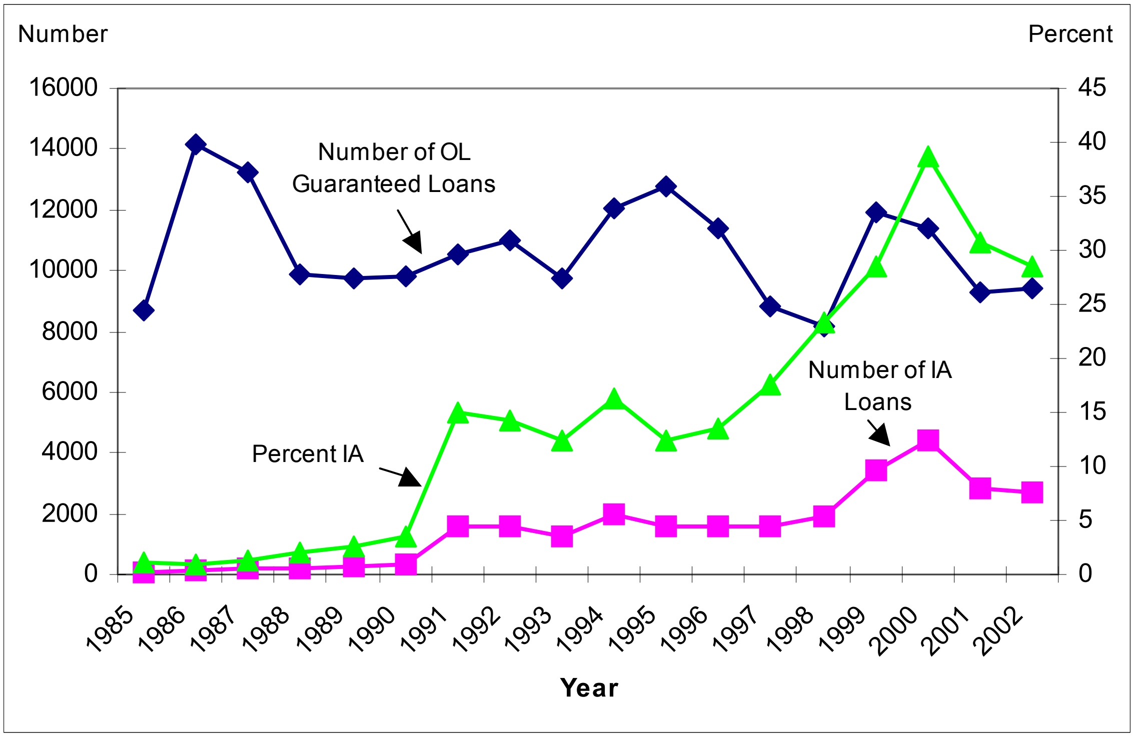

Figure 3. OL Interest Rate Average

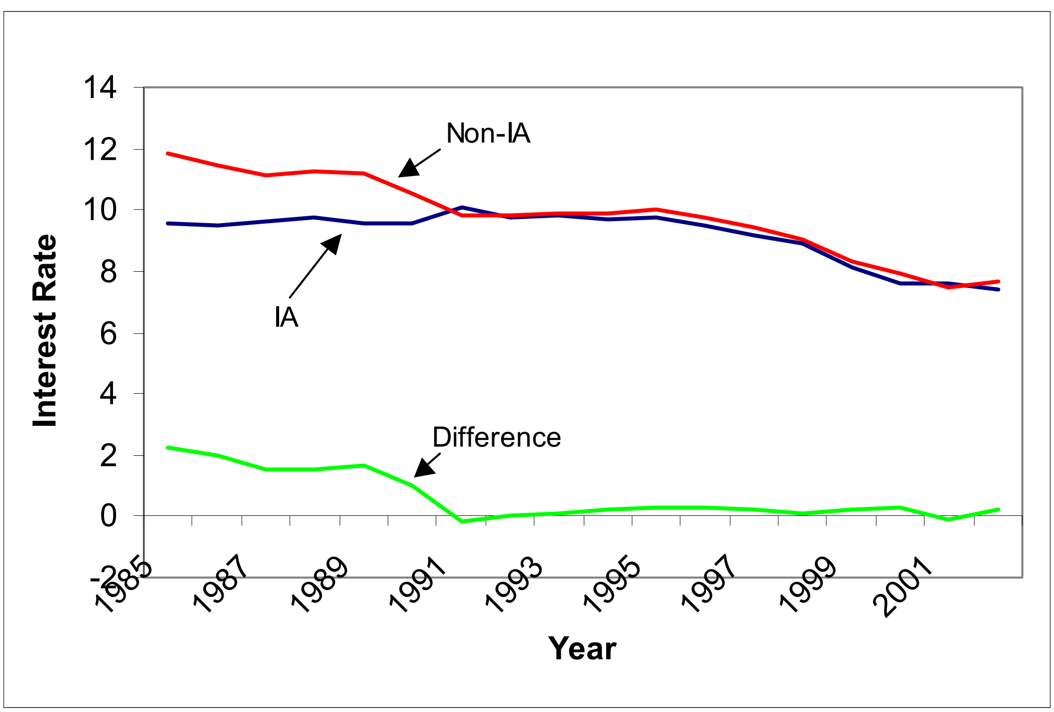

Figure 4. Percent of Guaranteed OL Loans Claiming Loss

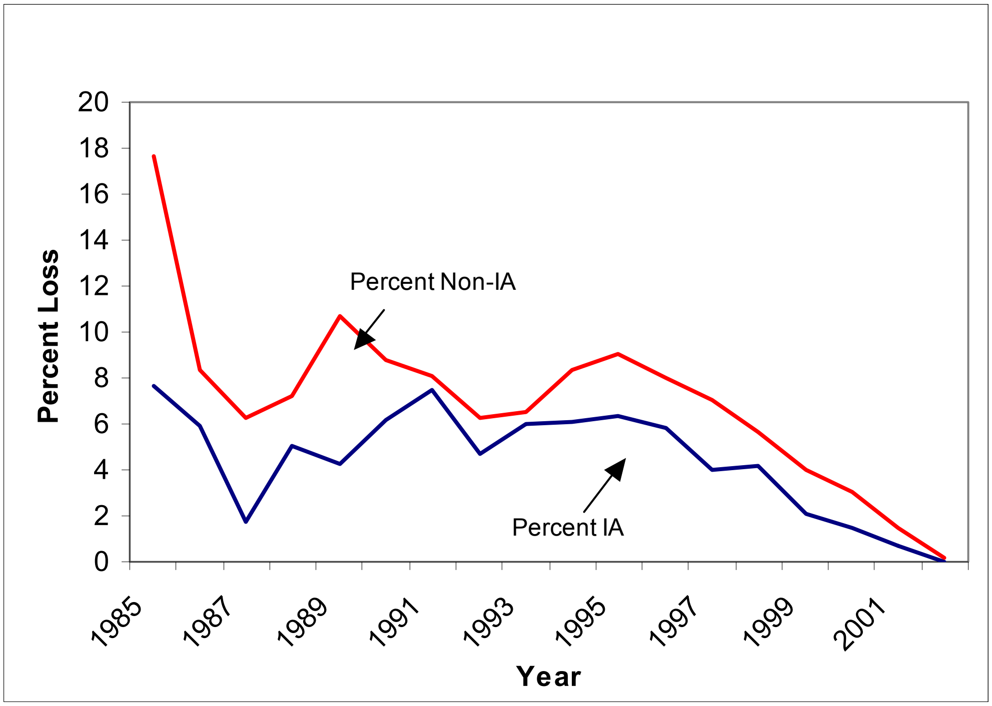

Figure 5. Percent of Guaranteed OL Loans Active