USDA, Farm Service Agency Guaranteed Lending: The High-Volume Approach

by:
Michael Bonnett and Dennis A. Everson

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Presentation by Michael Bonnett:

I've been involved with my bank for the past 12 years. In that time we've gone from a $75 million bank to a $3 billion organization, are traded on NASDAQ and have gone through five name changes. I can understand change, and if you're not willing to change, you won't survive. Remember, change is what got you where you are today.

Gold Bank has 61 locations across Oklahoma, Kansas, Missouri and Florida. A lot of our growth has come through acquisitions and mergers and then growth. We are the largest ag bank in the regions served, we are the third largest ag bank in the United States and we are committed to ag lending. In Oklahoma, specifically, we are the largest ag bank and the largest Farm Service Agency (FSA) lender. That is something we did not seek to do; it just happened.

We also are the first Oklahoma bank to become an FSA Preferred Lender (PLP) lender, which has allowed us to do what we've done. Being a PLP has its pluses and its minuses; it means more responsibility for us and less dependence on FSA, so you have to make sure whatever you do, you do it correctly.

In addition to Oklahoma, we are a PLP lender in Kansas, Texas, Colorado and New Mexico.

Michael Bonnett is senior vice president, Guaranteed Lending, Gold Bank, Enid, Okla., and Dennis Everson is President, Agri-Business Division, First Dakota National Bank, Yankton, S.D.

Approximately 25 percent of our ag portfolio is guaranteed. That is not a goal we tried to reach; it just evolved that way.

Why do guaranteed loans? When someone doesn't make their payment, you wonder, "Why are we doing this?" Or, when FSA is asking 14 questions about a loss claim you may have had, you ask, "Why did we even do this in the first place?"

The primary reason for Gold Bank's doing guaranteed loans is that we see it as a risk management tool. That's what guaranteed lending is. Invariably, if it's a guaranteed loan, it's not going to be your No. 1 ag credit customer in the bank, because your No. 1 ag credit customer will not want to do a guaranteed loan. You will be dealing with a lower quality loan, so, for you, it's a risk management tool.

If you have a customer who's having some difficulty with a loan, it's an opportunity for them to improve their credit. You may be at the point that you can't go forward with a normal loan, but you can with the guaranteed loan.

We also do a lot of lines of credit because we have a lot of production loans. A lot of these loans are for wheat and stocker cattle, and those are our two main lines of credit. A nice thing about the guaranteed program is it's a five-year line of credit, so we don't have to rewrite the note every year. You make sure you do the review, he clears, and you can go on. Not having to do the paperwork again is a big plus for us.

It also controls the credit relationship. We look at the guaranteed loan as putting a little more teeth in the loan process because you have the government in there with you.

What About Bankruptcy?

If you are in ag lending, you've been in bankruptcy court before. If a guaranteed loan customer comes in, throws up his hands and says, "I don't care. Call my attorney, I'm going into bankruptcy!" we know we're going to get paid. We know we have a guarantee backing it.

Another benefit is the guaranteed portion is not counted as part of your lending limit, so you can make a larger loan in your bank. The same holds for a criticized loan. Only the unguaranteed portion get criticized and not the whole loan.

It's also a good source of revenue on the secondary market. If you sell your guaranteed loan on the secondary market, you know how much profit and return you can get on the piece you keep in your bank.

Identifying Candidates

The first candidates we look at are new customers. They tend to be the riskier customers because they are new in the relationship for some reason. Maybe they've had problems with another bank, didn't want to do what the bank said, or whatever. So we would look to new customers first. If they would qualify, we'd look at them as a guarantee.

A guarantee also could be very appropriate if you have existing customers who are having problems with existing credit – maybe they want to expand the operation. The same is true if they are carrying a lot of leverage. Or collateral margins – they may have had a bad year, lost the equity in their cattle, and they don't have the margins any more to bank that as a normal loan. This could be a good guaranteed loan. The same is true with marginal cash flow, or a downgrade in credit quality, for whatever reason. You need to look for the opportunities for a guarantee.

You also sometimes get some customers who just don't want to cooperate. We feel that with a guarantee, we have a little more teeth and we can control the credit.

Some Key Principles

We view a guaranteed loan as a partnership with our customer and the government through FSA. This means everyone has to be on the same page at the same time. We're all in this together, from the very beginning to the very end, and everyone has to do his part. Everyone has a responsibility in the guarantee. This also means you have to keep communications open with your customer and with FSA.

Also make sure you can back up whatever you do. I feel that in working with the guaranteed program, the No. 1 thing is credibility. That means you do what you say.

Getting the guarantee approved is the easy part of a guaranteed loan. The majority of the work begins when the loan is booked – servicing the loan. I look at every loan we have as a loss claim. Just think of it in these terms – whatever you do with that loan, what would FSA say? You might get the opportunity to explain to them what you did or didn't do. My ultimate goal is that if I have a problem, I want to collect.

Get Centralized!

Because we have so many locations with our bank, one thing we have done is develop a guaranteed loan department where that's what we do. I am responsible for all guaranteed loans that come through our bank. Whether it's an FSA loan, a Small Business Administration loan, or whatever, it comes by my desk.

We centralized all this and one of the major benefits has been consistency. I want all the packages that go to FSA looking the same. I don't want 10 different officers doing it 10 different ways.

We also want things to be uniform. I want everything the same because FSA wants it that way, too. Our department also meets all the reporting requirements of FSA. We fill out all loan status reports, all default reports, any type of reporting requirement that comes through us. And, ultimately, if we do have a loss claim, I get the opportunity to process it.

Another benefit of departmentalizing is responsiveness. Because we're a PLP lender, we don't have to ask FSA about every servicing action. If I have an officer, or a branch, that has a question about a guaranteed loan, they can just call me. If I don't have the answer, I'll call the state office. That way we don't have every branch calling every FSA office and getting every different answer.

To keep track of all the information for our guaranteed program, we developed a database by customer. If we have a customer who wants to get involved with a guaranteed loan, we open a file in our database and develop a complete loan history. We keep track of all advances, every payment, and where the money comes from for each payment. We require all tickets on cattle purchases and sales, and the same is true for crops. We want to have elevator receipts. The reason we do this is if we have a loss claim, FSA is going to ask for the same information, so we get it up front and make it part of the file.

We process all loan requests, and we submit them to FSA for approval. It goes from my desk to FSA, and if they have any questions, they call me.

When we get ready to close the loan, my department prepares all the documents – everything that is involved with that guarantee. Again, because it all comes through our department, it is always consistent and uniform. I also go to every loan closing and sit down with the customer and the officer anticipating questions. As you know with a guaranteed loan, if you've got an approval and it's a few months later before you get your funding, you may have to reverify all that information. Invariably, with a loan closing, there is always something that occurs. Being there just helps avoid problems.

Let's talk about problem loans for a second. If we get in a situation where the customer can't make his payment, I meet with the officer and meet with the customer. We tell the customer what his options are, what he can and cannot do, and lay out up front what the bank can and cannot do.

Presentation by Dennis Everson: First Dakota National Bank is a $400 million community-owned bank. We have about $300 million-plus in loans today and are 103 percent loaned up. We have a $122 million ag portfolio, and our customer operations are pretty diversified.

We got into this high volume business because we had these management issues before us:

- Loan to deposit ratio
- Tremendous loan demand
- We needed loan portfolio liquidity
- We needed geographic and portfolio diversity
- We needed better credit risk management
- We needed some interest rate volatility checks for both ourselves and our customers
- I wanted a niche market

There were a number reasons for establishing this multi-state FSA Guaranteed origination and packaging business. First of all, let me explain that we have approval to operate in South Dakota, Nebraska and eastern Colorado. We are in the process of making the application to expand to include northwest Iowa, all of Minnesota, North Dakota, Wyoming and Montana.

What made this possible for us was our PLP status. That is the reason we went to this high-volume approach. Yes, we did it for liquidity, profitability, efficiency, risk management and geographic diversification.

The key is centralization. You have to have centralization to do high volume. And for us to expand our program beyond just guaranteed loans, we chose to go out into the market, be aggressive in that market and find guaranteed loans. In doing so, we established this centralization. How did we do that?

We already had DakotaMac on board. DakotaMac originally was designed in 1993 and was put together to originate FarmerMac I loans. When we started our program, they already had personnel specialized in the business of making loans, especially long-term real estate loans. They do principally guaranteed lines of credit and we do principally Farm Ownership (FO) and Term Operating loans (OL) and not a lot of guaranteed lines of credit. So, because we already had the real estate staff in place, it only made good sense to put a centralized guaranteed loan program in the DakotaMac shop.

In mid-1998 we became the first PLP lender in the United States. In the beginning we moved into the guaranteed loan program slowly and used it pretty much internally. We originated $20.2 million in loans in the last five years, but about $12 million of that has been originated under the PLP which has been going strong for about two years now. So we've picked up the pace considerably now and moved it to a whole new arena by getting aggressive and looking for guaranteed FO and OL term loans.

One of the things we did in our strategy was take a look at ourselves. We're a small community bank with five branches in southeast South Dakota. There are only so many guaranteed loans you can do in that area. So we chose to find the right people and we got two specialists, each of which runs a loan production office for us – one in Elgin, Neb., and one in Hastings, Neb. They work for us and they work for DakotaMac, and, outside doing origination of some FarmerMac I loans, all they do principally is work on guaranteed loans.

Timeliness

The PLP, in conjunction with using specialized people and loan production offices, gave us the opportunity to expand our service territory into what has turned out to be a really nice niche market for us. The PLP gives us the maximum authority we can get and that provides us with timeliness. If we couldn't have gotten the PLP, I don't think we would have done this process. To us, timeliness is a minimum of paperwork as it regards the application. It doesn't cut down on the paperwork at the home office, but what you send to them is the application form and the five C's: character, collateral, capacity, cash flow and creditworthiness.

The basics of a multi-state PLP are:

• Centralized underwriting. Two people in my shop do all the underwriting of these loans.

• Centralized loan processing. All those documents come out of one shop. The closings are done either by our personnel or by someone hired to do them for us.

• Specialized loan servicing, all out of the same shop or under the direction of our shop.

You also need to have a long-distance lender mentality. As a small bank in southeast South Dakota, we had to adopt this mentality and the FarmerMac I business started us with that. It then became natural for us to advance into the FarmerMac II business.

What do I mean by that "mentality?" Technology. Technology. Technology. We've got our own database in development that includes our own binders built under Excel. When we make advances off a line of credit, or even for term loans, it monitors our inventory. It tells us where we're going.

You have to get your people organized in the direction of high tech in order to utilize all the numbers and data that you have to do to comply with your PLP agreement. A major side benefit has been that it has helped increase our bank portfolio efficiency. And the more you do it, the better you get at it, and that's the key to high volume loan origination in the guaranteed loan business. If you only do two or three guaranteed loans a year, it is too easy to fall out of bed with the things you promised to do under the PLP agreement. And it is the Gospel for a guaranteed lending program in your shop.

One of the things we've done by getting aggressive, going out to new territory and originating new guaranteed loans, is become better at maintaining our PLP loan agreement.

Just a quick comment on collections. We're reasonably new in this high-volume guaranteed loan business project, but I also would centralize collections to maintain consistency in the collection process. It has to help you as you are dealing with FSA personnel and they know you've tried to follow the letter of the law. They will know you've done what you could to collect it – that you've watched your inventory and sometimes there are just things beyond the lender's control.

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