BL-059
Determining Eligibility and Scope of Financing for Limited Liability Companies

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To: Chairman, Board of Directors
All Farm Credit System Institutions

Chief Executive Officer
All Farm Credit System Institutions

From: Leland A. Strom
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Subject: Determining Eligibility and Scope of Financing for Limited Liability Companies

The purpose of this Bookletter is to provide answers to frequently asked questions about eligibility and scope of financing for a limited liability company (LLC). An LLC is a common legal entity being used today by America's farmers and ranchers for various reasons, including risk management and tax and estate planning. LLCs are often established by farmers and ranchers to maintain legal separation of their agricultural and nonagricultural businesses. As a result, the Farm Credit Administration (FCA or Agency) continues to receive questions regarding application of the eligibility and scope-of-financing rules to LLCs. The following *Questions and Answers* provide guidance in this area.[1]

What is a limited liability company?
An LLC is a state-chartered business entity that combines certain characteristics of a corporation and a partnership. Like a traditional corporation, the LLC structure limits the liability of its owners; like a partnership, it provides for pass-through income taxation. As in a corporation, an LLC's owners'/shareholders' personal assets are protected from claims of the LLC's creditors. Under state law, an LLC is generally considered to be a separate legal entity or "person" that can sue and be sued in its own name.

Can an LLC be an eligible borrower?
Yes. An LLC can be an eligible borrower. Under FCA rule § 613.3000(a), an LLC (and other legal entities) can qualify as a "person" eligible for financing as a "bona fide farmer or rancher" if it owns agricultural land or is engaged in the production of agricultural products, including aquatic products under controlled conditions.

Is an LLC treated like an individual for determining its eligibility and scope of financing?
Yes. An LLC is treated just like an individual for determining its eligibility and scope of financing because an LLC is considered to be a "person" for eligibility determination. Just like an individual farmer, an LLC must own agricultural land or engage in the production of agricultural products to be eligible to borrow from the Farm Credit System (System). As with any eligible borrower, determining the scope of financing depends on the level of the LLC's agricultural involvement in accordance with the scope-of-lending rule at 12 C.F.R. 613.3005.

Can an LLC formed for nonagricultural purposes borrow from the System?
It depends. An LLC that owns agricultural land but was not formed for the purpose of farming or ranching would be considered an applicant "whose business is essentially other than farming." Under § 613.3005, if an LLC's business is "essentially other than farming," financing is restricted to "agricultural needs" only. An agricultural "need" would not include developing agricultural land for residential or commercial purposes, and it would not include other nonagricultural business activities or other types of nonagricultural loan purposes.

However, if an LLC planned to purchase agricultural land and devote it to, or maintain its availability for, agricultural production, financing the purchase of the land would be considered an agricultural "need" and the LLC would be eligible to receive financing for this purpose. In this instance, just like with individual farmers whose businesses are "essentially other than farming," the loan should be structured to require it to be paid off at such time that the LLC decides to develop or use the land for a nonagricultural purpose. See FCA Bookletter BL-058, dated May 28, 2009, for additional guidance on financing land in transition.

Could an LLC receive financing for "other credit needs"?
Yes. Just like an individual farmer, if an LLC qualifies under an institution's lending policy and FCA regulations as a "full-time farmer," the LLC can receive other credit needs financing for any constructive purpose, commensurate with its creditworthiness. An LLC qualifying as a "part-time" farmer also could receive other credit needs financing, commensurate with its level of agricultural involvement. However, as stated earlier, an LLC whose business is "essentially other than farming" would not be eligible for other credit needs financing. Please refer to Examination Bulletin FCA 2006-2 for FCA's expectations regarding lending programs for farmers' other credit needs.

For determining eligibility for agricultural credit, does it matter that an LLC is owned by farmers, nonfarmers, or a mix?
No. Ownership of an LLC is of no consequence in determining eligibility when the LLC's purpose and needs are agricultural. For example, an LLC formed for the purpose of operating a crop farm would be eligible for System financing regardless of whether it was owned by farmers, non-farmers, or any combination thereof. However, as stated previously, an LLC whose purpose and only financing "need" is nonagricultural is not in itself eligible to borrow from the System.

Can a farmer's nonagricultural business interests be financed in an LLC?
Yes. A farmer may receive credit that will be used by a nonagricultural LLC, but only if the farmer-owner signs as an obligor on the promissory note. In this instance, the loan would be considered as a loan to the farmer, and the activities of the LLC would constitute the farmer's "other credit needs." The caveat, of course, as noted above, is that "other credit needs" financing must be commensurate with the farmer's involvement in agriculture and his or her creditworthiness. Without the farmer's signature, the association would be extending credit to an ineligible borrower, in violation of FCA regulation § 613.3000. While the farmer's signature on the promissory note addresses eligibility requirements, institutions must ensure that loans to the LLC are structured and underwritten in a safe and sound manner. Loans to the LLC should be underwritten with credit standards and requirements commensurate with the type of business activities and business risks undertaken by the LLC.

Would a 100 percent guarantee by a farmer on a loan to a nonagricultural LLC equate to a farmer signing as an obligor for determining eligibility?

No. We do not consider a guarantee to be the equivalent to the farmer signing as an obligor for the loan. While a guarantee can help ensure safe and sound lending, it does not provide a direct legal contract with the farmer for establishing borrowing eligibility on behalf of an LLC.

Can "farmer ownership tests" used for loans to legal entities formed for processing and marketing operations be used for determining eligibility and scope of financing for an LLC as a farmer-borrower under § 613.3000?

No. The "farmer ownership tests" under FCA regulation § 613.3010 for determining the eligibility of legal entities are only applicable to loans for processing and marketing operations. When determining the eligibility for a legal entity under § 613.3000 and the eligibility and scope of financing for an LLC outside of processing and marketing operations, one must look to the LLC itself, not to the owners of the LLC, as previously discussed.

Conclusion

In summary, an LLC is treated as a separate entity and as a separate "person" for purposes of determining eligibility and scope of financing. The owners of the LLC do not affect the LLC's eligibility or its scope of financing limitations under FCA regulation § 613.3000. The LLC itself may qualify as a "full or part-time farmer, or a person whose business is "essentially other than farming" and the scope of financing, including "other credit needs" financing, would then be determined commensurate with the LLC's involvement in agriculture and creditworthiness. In order for an association to make a loan to a farmer that would be used by a nonagricultural LLC, whose purpose and "need" are nonagricultural, the farmer-owner must sign as an obligor on the promissory note. Under such an arrangement, the activities of the LLC would constitute the farmer's "other credit needs." Additionally, the amount of "other credit needs" financing should be commensurate with the farmer's involvement in agriculture and creditworthiness. Please refer to Examination Bulletin FCA 2006-2 for FCA expectations regarding lending programs for farmers' other credit needs.

While eligibility and scope of financing issues can be effectively addressed by following the guidelines discussed in this Bookletter, an institution must also ensure that loans to LLCs are structured and underwritten in a safe and sound manner. Loans to an LLC should be conservatively underwritten with credit standards and requirements commensurate with the type of business activities and business risks undertaken by the LLC. Moreover, the institution must ensure that it has the appropriate staffing, controls, and policy framework to competently underwrite, understand, and control the risks associated with lending to an LLC.

Please distribute copies of this Bookletter to your board of directors, discuss its contents, and make adjustments, as appropriate, to your policies and procedures as discussed above.

If you have any questions about the guidance contained in this Bookletter, please contact Barry Mardock, Associate Director, Office of Regulatory Policy, at (703) 883-4456, or at mardockb@fca.gov, or Andrew Jacob, Director, Office of Regulatory Policy, at (703) 883-4356, or at jacoba@fca.gov.

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[1] This Bookletter does not apply to the financing of processing or marketing operations governed by FCA regulation § 613.3010 or to financing farm-related service businesses governed by FCA regulation § 613.3020.