

BL-058

Financing Agricultural Land in Transition (in the Path of Development) -- Eligibility and Scope of Financing Considerations

May 28, 2009

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

Chief Executive Officer
All Farm Credit System Institutions

From: Leland A. Strom
Chairman and Chief Executive Officer

Subject: Financing Agricultural Land In Transition (in the Path of Development) – Eligibility and Scope of Financing Considerations

This Bookletter provides guidance on how institutions should ensure compliance with the eligibility and scope of financing regulations when loan funds will be used to purchase or refinance land in transition. Land in transition is agricultural land that lies in the path of development. In some cases, this may involve land changing ownership several times before ultimately transitioning out of agriculture. Questions frequently arise concerning the application of eligibility and scope of financing regulations when evaluating an applicant's request for financing. While financing land in transition may occur, the Farm Credit Administration (FCA) has consistently directed that Farm Credit System (FCS or System) institutions may not provide development financing that converts agricultural land to non-agricultural uses, except in very rare instances.

This Bookletter also provides useful information for making other scope of financing decisions and supplements the guidance found in the Examination Bulletin FCA 2006-2. The Examination Bulletin was developed to provide examiners guidance for evaluating programs that System institutions use in meeting the other (i.e., non-agricultural) credit needs of farmers, ranchers, and producers or harvesters of aquatic products.

It is important to note that neither Examination Bulletin FCA 2006-2 nor this Bookletter were developed to address the safety and soundness risks associated with financing land in transition. The FCA plans to issue further safety and soundness guidance in this area in the near future.

Eligibility and Scope of Financing Rules

The eligibility and scope of financing rules contained in 12 C.F.R., Part 613, Subpart A, address System funding for farmers, ranchers, and aquatic producers or harvesters. More specifically, § [613.3005](#) addresses the System's lending objective and provides parameters for financing the agricultural and non-agricultural needs of full- and part-time farmers (see Attachment). These parameters primarily focus on the applicant's status as a full- or part-time farmer, which is determined by analyzing the totality of the farmer's existing operation and the impact of the loan request. After a System institution has completed the eligibility analysis, it is able to determine the appropriate scope of financing (i.e., amount and type)

that can be offered.

Section 613.3005 of FCA's regulations specifically notes that System institutions should only finance the agricultural credit needs of an applicant "whose business is essentially other than farming." However, the factors for making these determinations are not always readily apparent, making these determinations challenging – particularly when land in transition is involved. Accordingly, this Bookletter serves to provide additional guidance for determining whether an applicant's business is essentially other than farming; whether the property purchased is agricultural land; and whether the purpose of the loan request meets an agricultural need.

Policy Guidance – Controls Over Financing Land In Transition

Scope of financing determinations must be evaluated on a pro forma or "forward looking" basis. In other words, an institution's lending staff should determine what the applicant's operation would look like if the loan is approved and funded. Therefore, System institutions should ensure their lending policies and procedures require that the following determinations be made prior to financing land in transition:

- Is the person (i.e., an individual, or a legal entity, which may comprise multiple owners) applying for the loan a full- or part-time farmer or an applicant "whose business is essentially other than farming?"
- Will the property being purchased with the loan proceeds (or refinanced) continue to meet the regulatory definition of "agricultural land?"¹
- Will the purpose of the loan fulfill an "agricultural need?"

To help guide these determinations, the following sections outline more specific guidance in evaluating the person, property, and purpose.

Analysis of the Person

As previously noted, § 613.3005 requires that a lender make a determination about an applicant's involvement in agriculture before financing a request for credit, including those involving land in transition. An institution's eligibility and scope of financing policies and procedures should address the following considerations in making this determination:

- An appropriate and supportable definition for an "applicant whose business is essentially other than farming" should be consistently applied. Factors to consider when developing this definition include the applicant's:
 - Percentage of farm income to nonagricultural income;
 - Percentage of time devoted to the vocation of farming or ranching;
 - Percentage of agricultural assets to nonagricultural assets;
 - Education, work experience, and current employment situation; and,
 - Past experience converting land from agricultural use to residential and commercial uses.
- A close evaluation of the factors used to determine if the applicant is a person "whose business is essentially other than farming" is needed. The more tenuous an applicant's ties to farming, the greater the need for justification and supporting documentation for land-in-transition financing

decisions.

- If the applicant is a person “whose business is essentially other than farming” and is involved in land development, loan approvals should be on an exception basis and only after the institution determines that the loan purpose clearly meets an agricultural need. (See **Analysis of the Purpose** section below.)
- A careful evaluation of loan requests from an existing or former borrower is needed to determine whether the applicant’s operations have evolved into land development ventures. If so, appropriate scope of lending determinations must be made before any future loans can be made.

Analysis of the Property

Section 619.9025 of FCA’s regulations defines agricultural land as “land improved or unimproved which is devoted to or available for the production of crops and other products such as but not limited to fruits and timber or for the raising of livestock.” Determining whether the property being purchased (or refinanced) meets this regulatory definition is important in establishing the eligibility and scope of financing for an applicant. To aid in making this determination, an institution’s eligibility and scope of financing policies and procedures should address the following factors:

- System institutions should carefully evaluate any application that involves a request to finance real estate in close proximity to an urban area where high per acre land values are driven by the land’s future development value rather than its agricultural value.
- Financing for the purchase or refinance of land in transition for an applicant “whose business is essentially other than farming” is appropriate only when all or substantially all of the land will continue to meet the definition of agricultural land.
- FCS institutions must fully understand and document what an applicant intends to do with the property financed (or refinanced). Any indication the land will no longer be available for the production of crops or other agricultural products should remove the property from consideration as “agricultural land.”
- FCS institutions must thoroughly analyze and document the overall agricultural nature of a property. Land that will be used for both agricultural and non-agricultural purposes would only meet the regulatory definition of agricultural land when the land substantially retains its agricultural nature.
- Although zoning laws vary across the country, a review of the designation (i.e., agricultural, residential, or commercial) can help an institution determine whether a property should be considered “agricultural land.”

Analysis of the Purpose

An analysis of the purpose of the loan is critical to evaluating financing for less than full-time farmers. FCS institutions must fully analyze and document to what extent the loan will fulfill an agricultural need. This analysis is critically important once an FCS institution has determined that an applicant requesting a loan for land in transition is a person “whose business is essentially other than farming.” An institution’s eligibility and scope of lending policies and procedures should address the following issues to help lending staff make these determinations:

- FCS institutions must fully understand and document what the applicant plans to do with the property. The documentation provided by the applicant and developed by the loan officer should clearly explain and support why the loan is for an agricultural need. The institution may require that the applicant(s) sign a “statement of intent” to document future plans for farming or improving the real estate in question. Nonetheless, having a signed “statement of intent” does not eliminate the institution’s responsibility to perform and document a thorough evaluation of the application based upon the totality of the circumstances (i.e., the person, property, and purpose of the loan).
- System financing of residential or commercial development projects should only be done as a policy exception, with most, if not all, exceptions reserved for full-time farmers, or upon rare occasions, those part-time farmers with significant agricultural activities, assets, and/or income. Policies should address the proper level of authority within the institution needed for granting exceptions and require periodic reporting of policy exceptions to the board or a board committee.
- System institutions should make sure that appropriate validations and controls are maintained to ensure that loan advances are not used to fund purposes associated with commercial or residential development.
- Loan terms and structures should reflect the applicant’s agricultural needs. For example, requests for loans that have minimal down-payment or amortization requirements, interest-only repayment schedules, and short-term balloon payments, may suggest that the applicant’s financing needs are not agricultural. When financing an applicant who is essentially other than a farmer or a part-time farmer whose real estate has a high probability of being developed, a System institution should structure the loan in a manner that provides for the institution to exit the relationship before any development occurs.
- Plans for repaying the loan should be consistent with the intended agricultural use of the property. For example, applicants that propose loan repayment from the sale of real-estate collateral or other real-estate properties may be indicating that their needs are not agricultural. Further, if projected agricultural income is minimal compared to the loan repayment terms, this may suggest that the loan does not fulfill an agricultural need.
- FCS institutions should carefully evaluate any improvements that an applicant plans to make to a property. Improvements that enhance an agricultural operation (e.g., drainage tiling, fencing, irrigation) are considered to be agricultural purposes, while improvements that enhance the property’s non-agricultural appeal are considered non-agricultural purposes (e.g., paved roads, street lights, utilities).
- FCS institutions should carefully scrutinize any plans to divide a property into smaller parcels. The purchase of a large tract of agricultural land and its division into smaller agricultural tracts may be consistent with an agricultural purpose under certain very limited circumstances. As noted above, use of the property must remain predominantly agricultural and development on the property must be kept to a minimum for the loan purpose to be considered as fulfilling an agricultural need.

Decisions Based on the Totality of the Circumstances

System institutions must ensure that their policies and procedures provide adequate guidance to lending

staff for the analysis of eligibility and scope of financing determinations. The analysis supporting these determinations should be documented and encompass the totality of the circumstances surrounding the loan request, including the person, property, and purpose as outlined above.

In conclusion, the guidance contained in this Bookletter does not prevent a board of directors from establishing conservative policy direction for land-in-transition financing. Each FCS institution board of directors needs to continue to evaluate its policy direction in consideration of their institution's current lending environment, risk bearing capacity, and appropriateness of land-in-transition financing for its chartered territory.

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 (mardockb@fca.gov), or Andrew Jacob, Director, Office of Regulatory Policy at (703) 883-4356 (jacoba@fca.gov).

Attachment

¹See 12 C.F.R. § [619.9025](#).

Attachment

PART 613 - ELIGIBILITY AND SCOPE OF FINANCING

Subpart A - Financing Under Titles I and II of the Farm Credit Act

§ 613.3005 Lending objective.

It is the objective of each bank and association, except for banks for cooperatives, to provide full credit, to the extent of creditworthiness, to the full-time bona fide farmer (one whose primary business and vocation is farming, ranching, or producing or harvesting aquatic products); and conservative credit to less than full-time farmers for agricultural enterprises, and more restricted credit for other credit requirements as needed to ensure a sound credit package or to accommodate a borrower's needs as long as the total credit results in being primarily an agricultural loan. However, the part-time farmer who needs to seek off-farm employment to supplement farm income or who desires to supplement off-farm income by living in a rural area and is carrying on a valid agricultural operation, shall have availability of credit for mortgages, other agricultural purposes, and family needs in the preferred position along with full-time farmers. Loans to farmers shall be on an increasingly conservative basis as the emphasis moves away from the full-time bona fide farmer to the point where agricultural needs only will be financed for the applicant whose business is essentially other than farming. Credit shall not be extended where investment in agricultural assets for speculative appreciation is a primary factor.