

April 9, 2021

The Honorable Tom Vilsack
Secretary of Agriculture
U.S. Department of Agriculture
1400 Independence Avenue, SW
Washington, D.C. 20250

Dear Secretary Vilsack:

On behalf of the commercial banking industry and the more than 52,000 bank locations serving American citizens, we write to share our recommendations on USDA's implementation of Section 1005 of the American Rescue Plan Act related to Socially Disadvantaged Farmers and Ranchers (SDA). This provision requires USDA to pay off direct and guaranteed farm loans in existence as of January 1, 2021 by providing up to 120 percent of the outstanding indebtedness for each SDA borrower. USDA has sent a letter to all guaranteed lenders noting the agency is establishing a process for these loan payments.

The sudden, abrupt payoff of any category of guaranteed loans could have adverse consequences if not implemented in a manner that minimizes disruptions to lenders participating in USDA's guaranteed loan programs or acting as secondary market purchasers of the loan guarantees. USDA's implementation of this provision should help ensure lenders are incentivized to continue meeting guaranteed loan demand in the future while ensuring the overall reliability and predictability of USDA guaranteed loan programs.

Recognizing lenders' costs of funding and servicing loans, USDA should ensure lenders are made whole by being compensated for lost income due to these loan payoffs. Second, purchasers of USDA loan guarantees in the secondary market should be paid for lost premium values and the loans' multi-year payment streams being halted. The Secondary market provides liquidity to lenders allowing additional guarantees to be extended to SDA and other borrowers. Finally, USDA could consider assuming the payments of those loans that are not delinquent and have not been associated with previous legal challenges.

Please see the attachment for an explanation of these recommendations which we would be pleased to further discuss with USDA officials. The fact there are thousands of guaranteed loans from commercial lenders to SDA borrowers demonstrates an ongoing willingness to partner with all farm and ranch borrowers and USDA. Our recommendations will help ensure these partnerships remain intact.

Sincerely,

American Bankers Association
Independent Community Bankers of America
National Rural Lenders Association

Attachment

Recommendations on Relieving Indebtedness of SDA Borrowers

Implementing Section 1005 of the American Rescue Plan Act

The American Rescue Plan Act of 2021 (ARPA) was signed into law on March 12, 2021. Section 1005 of the Act requires USDA to pay off all direct and guaranteed loans to Socially Disadvantaged Farmers and Ranchers (SDA) that existed as of January 1, 2021. Each SDA borrower is eligible to receive up to 120 percent of their outstanding loan indebtedness. The sudden, abrupt payoff of any category of guaranteed loans could result in an interest income loss to banks holding these loans and a loss on the premiums paid by secondary market purchasers/investors. To ensure lenders continue using USDA guaranteed loans to meet future guaranteed borrower demand, USDA should incorporate the following recommendations.

Recognize lenders' costs of funding, maintaining, and servicing loans and ensure lenders are made whole by being compensated for lost income due to the loan payoffs.

For example, a large community bank which has an SDA farm/ranch portfolio of over \$200 million calculates they could lose millions of dollars in net income per year if their portfolio of SDA loans is quickly paid off. A \$200mm-plus loan balance going to zero will have a significant financial impact on the bank's balance sheet, capital position and income statements alarming bank regulators. Such a loss will also undoubtedly reduce the bank's ability to retain employees.

Another example is a smaller community bank with over \$10 million in SDA farm/ranch loans comprising over ten percent of their portfolio. This bank estimates the sudden payoff of these loans will cause an annual loss of net income of over \$300,000 per year for several years and raise concerns alluded to above.

Providing agricultural loans involves a substantial cost for lenders related to the costs of securing funding for loan-making and underwriting activities which include analyzing producers' creditworthiness and ability to cash flow and correctly assessing the value of the farm/ranch assets. Loans must be approved by a loan review committee and lenders' staff must monitor loan payments and asset quality, often with on-site inspections and periodic follow-up and consultation with borrowers and in some cases pursue collection efforts.

If USDA does not compensate lenders for such disruptions or avoid sudden loan payoffs, the likely result will be less access to credit for those seeking USDA guaranteed loans in the future, including SDA farmers/ranchers.

Other than the additional twenty percent to pay SDA taxes, USDA could assume payment of loans that are not delinquent or were not part of previous legal challenges.

Payments of existing loan terms on loans that were not part of the previous court challenges ensures SDA farmers/ranchers who are not delinquent are also immediately relieved from the burden of repaying their guaranteed loans while maintaining the payment schedule originally set up by the bank and agreed to by the farm or ranch customer. Instead, USDA would make the payments. This process protects the banks' investment in loan-making to guaranteed borrowers and would be similar to how some PPP loan payments were made by the SBA.

Purchasers of USDA loan guarantees in the secondary market should be paid for lost premium values and the loans' multi-year payment streams being halted.

The Secondary market provides liquidity to lenders allowing additional guarantees to be extended to farmers and ranchers. Commercial lenders have, over several decades, partnered with USDA to build this reliable and vibrant secondary market to serve all guaranteed loan borrowers. However, there is real concern about the ability of both lenders and investors to continue to facilitate credit availability in the secondary market going forward should consideration not be given to their considerable existing investments.

Presently, lenders can sell the guaranteed portion of their USDA loans to secondary market purchasers, including Farmer Mac, regional brokers, and loan aggregators. By selling the guarantees, lenders replenish their funds when liquidity is tight, allowing them to subsequently make new loans. The secondary market also allows lenders to provide long-term fixed rate loans resulting in longer terms at lower interest rates, reducing costs for farm and ranch borrowers.

Additionally, secondary market purchasers pay a premium for these guarantees based on the expectation of a dependable income stream over a multi-year period (typically 8-10 years). Due to the perception of reliability of payments, the guarantees are considered tradable, thus generating premiums from interested purchasers. The premiums on these loan purchases could disappear overnight with demand for purchasing USDA guarantees drying up.

In sum, the secondary market for USDA guaranteed farm loans provides favorable terms for farm borrowers, needed liquidity for lenders, and consistent, predictable yield for investors. The government guarantees help provide a market for these loans and mitigates credit risk in a vitally important sector filled with great uncertainty. The guarantees also provide bank regulators with assurance of limited risks to the financial institution which made the loan(s). However, if paying off entire categories of guarantee borrowers is not implemented properly, USDA's actions could severely damage the secondary market by making the market unreliable and pricing unpredictable. This would cause a significant loss of available capital for lending under the USDA programs harming all guaranteed borrowers as well as the overall integrity of USDA's guaranteed programs.

Conclusion

The fact there are thousands of guaranteed loans from commercial lenders to SDA borrowers demonstrates an ongoing willingness to partner with SDA borrowers as active partners sharing in the risks of keeping their operations viable for their families and their futures. Commercial lenders should not be hindered from continuing to work with all guaranteed loan borrowers. We urge USDA to assist both SDA farmers/ranchers as required by statute and their lenders who have worked so diligently on their behalf.

Finally, USDA should consider the necessity of maintaining the integrity of their guaranteed loan programs, which can only be accomplished if those lenders dealing with USDA loan guarantees are protected from the sudden, unexpected loss of income from abrupt loan payoffs and detrimental disruptions to the secondary market. Adopting the above recommendations will help accomplish these objectives.