Annual Report to Congress

Regarding

Term Limits on Direct Operating Loans

as

Required by

Section 5104 of the Agricultural Act of 2014

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Executive Summary

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Term limits, which impose a statutory maximum on the number of years a farmer may receive a Farm Service Agency (FSA) direct operating loan (DOL), do not appear to have had a major impact on FSA borrowers in the past two decades. Despite significant declines in farm income since 2012, farmers appear to be, for the most part, reliant on commercial credit sources and the increase in the number of farmers reaching their term limits is, so far, modest. Expectations of lower incomes and declining land values, however, may reduce commercial credit availability and increase reliance on FSA credit programs, resulting in more borrowers being affected by term limits in future years. Mid-size family farms and those in economically depressed regions appear to be the most vulnerable to term limits.

FSA may obligate DOL funds to an eligible farmer in 6 calendar years before the term limit is reached. The years need not be consecutive, and multiple loans received during a year count only against one year of eligibility. The enforcement of term limits is waived for beginning farmers through their 10th year of farming. Waivers for two years are also provided on a case-by-case basis, provided that borrowers continue to meet all other eligibility criteria. Youth loans and microloans to beginning farmers and veterans are exempt and do not count against the limitation.

Key findings are:

- **Only a small share of DOL borrowers reach their term limits in any given year--** Through calendar year-end 2016, a total of 3,805 DOL borrowers with an outstanding direct loan balance had reached the term limit. This represents an additional 639 borrowers over the 3,166 borrowers with an outstanding balance who had reached the DOL term limit through December 31, 2015. A total of 7,427 current and past borrowers have reached their term limits since term limits were first implemented in 1993. While the number for 2016 is above the historical average, it only comprises 7 percent of total borrowers with an outstanding DOL loan balance at year-end.

- **Even though a borrower may have reached his or her term limit, many continue as an FSA borrower and benefit from other FSA loan provisions--**
  - Of the 7,427 borrowers that have reached term limits, 51 percent still had an outstanding direct loan balance at the end of 2016.
  - Further, DOL term limits do not affect eligibility for other loan types nor loan servicing provisions. For example, over 6 percent of all term-limited borrowers since 1993 received a direct farm operating (FO) or emergency (EM) loan after reaching their term limits. In addition, 18 percent of all term limited borrowers received guaranteed loans after reaching their term limits. Loan restructuring was received by over 16 percent of term-limited borrowers after they reached their term limits.

- **Reaching the term limit does not imply that a producer is being forced out of farming**—Less than 8 percent of all borrowers who have reached their term limits received either a direct debt settlement or guaranteed loss claim. Another 5 percent were deceased. In fact, over 86 percent of all living term-limited borrowers were still active producers as indicated by their eligibility to vote in elections for the 2017 FSA County Committee.

- **There is no evidence that term-limited borrowers have been forced to down-size their operations due to a lack of access to FSA credit**--Those who remained in FSA's portfolio for up to 10 years after reaching their term limits had little change in farm sizes as reflected in annual sales adjusted for commodity price changes. The average FSA score for term-limited borrowers remaining in FSA's portfolio after reaching their term limits did not appear to deteriorate.

- **While it does not appear that lack of access to new DOLs has had adverse impacts, term-limited borrowers remain financially vulnerable**--Most DOL borrowers who reached their term limits since 2005 do not appear to be sufficiently creditworthy to meet most commercial lender underwriting standards. Because of limited working capital, high indebtedness, and low FICO scores, most would have difficulty obtaining commercial credit on favorable terms. Also, these borrowers are more susceptible to economic downturns or reductions in credit availability.

- **While term limits appear to affect only a small proportion of all DOL borrowers, some groups are likely to be more adversely affected**—This is because term-limited borrowers tend to be concentrated among certain farm-size groups and regions.
    - Small and mid-size family farms, defined as those with \$100,000 to \$1 million in annual sales, were more likely to be term limited. This group represented less than half of all DOL borrowers, but approximately 75 percent of all term-limited borrowers.
    - Term-limited borrowers were more concentrated in the Northern Plains and Corn Belt. While about 26 percent of all borrowers live in these regions, they represent nearly one-third of all term-limited borrowers.
    - Also, some locations could be considered 'credit deserts' where FSA supplies a relatively larger share of credit and term limits could have a greater adverse impact. These locations include portions of Appalachia, Indian Country, the Southeast, and the Red River Valley of Minnesota/North Dakota.

Introduction

Term limits impose a statutory limit on the number of years that a farm borrower may receive loan funds through programs administered by the U.S. Department of Agriculture (USDA). Direct operating loans (DOLs) were established under Section 311(c)(2) of the Consolidated Farm and Rural Development Act (Con Act) for qualified farmers. Term limits of 7 years were initially enacted for both direct and guaranteed farm ownership (FO) and OL programs by the Agricultural Credit Improvement Act of 1992.[1] Term limits have never applied to emergency loan (EM) borrowers.

Subsequent legislation exempted all guaranteed loans from any term limits. DOL microloans made to veterans and beginning farmers are also exempt from term limits. Further, the limitation does not apply if the borrower's farm is subject to the jurisdiction of an Indian tribe. FSA can obligate, in certain circumstances, DOLs to borrowers beyond their term limit. For example, waivers are granted to qualified beginning farmers through their 10th year of farming. Non-beginning farmers who have reached the term limit may receive a 2-year waiver, provided the operation is viable, the borrower has or will complete financial training, and commercial credit is unavailable.

Section 5104 of the Agricultural Act of 2014 amended Section 311 of the Con Act to require an annual report on term limits for direct operating loans (see Appendix 1). As directed by the statute, this third annual study estimates the number and location of current and past direct borrowers who have reached their term limits, and their structural, demographic, and financial characteristics. Economic impacts on farm borrowers who have thus far reached term limits are also examined, as well as potential impacts on future borrowers. The study also addresses how expected farm economic conditions may affect the future demand and role of FSA direct loan programs.

Term limits were enacted to ensure FSA's role as a temporary credit source. By limiting the total years of eligibility for DOLs, borrowers are encouraged to pursue credit from commercial lenders. Some have concerns, however, about possible adverse impacts from term limits. Specifically, term limits could adversely affect the Government's ability to serve as a safety net to agricultural credit markets should large numbers of farmers become ineligible for assistance as a result of worsening farm financial conditions.

Others indicate that term limits could adversely affect some groups and/or regions that may be more dependent on FSA credit. For example, FSA tends to be more important as a source of credit in regions where a relatively small number of farms discourages commercial lenders from providing agricultural credit. Further, FSA credit programs tend to be more important among groups considered socially disadvantaged and among mid-size family farms (see Hoppe and MacDonald for a discussion of the ERS Farm Typology classification of family farms).

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[1] The regulations (7 CFR 764.252), which were implemented in 1993, state that an applicant is not eligible if the applicant has closed a DOL in 7 or more years. The net impact is that a borrower has 6 full years of eligibility before reaching the term limit. In this report, a borrower was considered to have reached term limits after receiving DOL loan funds in 6 calendar years. Upon receipt of one direct operating loan at any time during the 7th year, the borrower becomes ineligible for any further assistance.

The case for having term limits can also be made. One argument is that long-term dependence on FSA credit can lead to economic inefficiencies. But, since all qualified loan applicants must show a feasible business plan[2], a borrower's long-term dependence on FSA credit does not necessarily imply economic inefficiencies. Borrowers unable to develop a feasible plan are ineligible for any new direct loans regardless of the years of eligibility they may have used. Also, there is no evidence that long-term borrowers are any more or less creditworthy than other FSA borrowers.

Another concern contributing to term limits is that long-term borrowers might monopolize benefits at the expense of young and beginning farmers. Specifically, some have thought that favorable terms may encourage more established borrowers to pursue FSA credit even though they may qualify for commercial credit. However, there are already provisions requiring borrowers considered viable for commercial credit to refinance their direct loans with a commercial lender. Direct borrowers are expected to transition, or graduate, to private sources of credit over time (Section 345 of the Con Act; 7 CFR 765.101).[3]

Farm Economic Outlook

Both U.S. farm income and farmland values declined in 2016, increasing farm sector financial stress, especially for those receiving direct loans through FSA. Net farm income declined in 2016 for the 3rd consecutive year and has dropped nearly 45 percent from its peak in 2013 (USDA, ERS). While crop prices declined, producers benefited from record yields for corn and soybeans. Significant price declines also impacted the cow-calf sector in 2016 due to lower margins for feeder cattle. Margins for dairy farms remained tight, as milk prices remained near break-even levels.

The farm economic outlook for 2017 is similar to 2016, with net cash farm income expected to remain unchanged to down slightly. As has been the case over the past 2 years, low commodity prices will continue to squeeze profit margins and cash flows, especially for direct borrowers who tend to be more highly leveraged. For cash grains, a combination of large production, large carryover stocks, and a strong dollar will combine to limit the potential for price increases. While net returns for poultry and dairy are expected to slightly improve in 2017, lower cattle prices will reduce overall livestock receipts.

The reliance of borrowers on nonfarm income, combined with the expansion of microloans, has increased FSA's vulnerability to changes in the general economy.[4] Microloans have increased FSA's presence in consumer-sensitive enterprises such as direct retail sales and fresh market

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[2] A feasible plan is defined as a business plan projecting a positive margin after debt service and a positive overall cash flow.

[3] The process for evaluating a borrower's potential for graduation to commercial credit is described in Section 4 of 4-FLP Direct Loan Servicing (http://fsaintranet.sc.egov.usda.gov/dps/services/downloadhandler.ashx?fileid=17989).

[4] The microloan program was implemented in 2013 and provides for a more streamlined application process for borrowers with under $50,000 of FSA direct OL indebtedness. These loans are mostly made to small farms that rely more heavily on non-farm income.

vegetables and fruits. Many direct borrowers rely on income from nonfarm earnings to support household income, which tends to be lower in rural counties (Kusmin).

U.S. farmland values, which buoyed farm balance sheets for several years, have remained stable since 2014 (USDA, NASS). But while remaining stable nationwide, many States have seen declines, especially in regions where crop production is prevalent. In Iowa, for example, surveys by Iowa State University indicate a 6-percent decline for 2016 compared to the prior year and an 18-percent decline from 2013 to 2016 (Iowa State University). University of Nebraska-Lincoln (UNL) surveys showed a 10-percent decline in Nebraska for 2016 compared to the prior year and a 15-percent decline from 2013 to 2016 (UNL). Likewise, surveys by Purdue University indicated an 8-percent decline in Indiana farmland values from 2015 to 2016 (Dobbins and Cook). Similar results have been found in surveys undertaken by the Chicago, St. Louis, Minneapolis, and Kansas City Federal Reserve Banks (Kansas City Federal Reserve Bank, Agricultural Finance Databook).

For the immediate future, lenders' expectations will be tempered by concerns about higher interest rates, lower land values, low farm incomes, and uncertainty surrounding Government support for agricultural programs. In addition, prospects for economic growth in many rural counties is tempered, especially those more dependent on mineral extraction or manufacturing. Consequently, agricultural lenders can be expected to maintain a level of risk aversion that would contribute to greater demand for FSA credit programs.

Status of Direct OL Program

FSA administers direct and guaranteed loan programs through 2,124 service centers. Guaranteed loans are made and serviced by commercial lenders, but are federally guaranteed through FSA. Supplying only 2.6 percent of overall non-real estate farm debt in 2016, direct loans do not currently represent a major source of credit to agriculture (Figure 1)[5]. However, this overlooks USDA's safety-net role, as reflected in its high market shares during the 1980s farm financial crisis, when FSA's nonreal estate debt share peaked at 24.3 percent

In addition, aggregate market share understates the importance of FSA credit to targeted groups, economically depressed regions, and small and mid-size family farms. In most circumstances, FSA is not the sole credit provider and works closely with commercial lenders in providing joint financing. This results in the share of farmers served being greater than the share of debt provided. In many areas of the Northeast, Appalachia, Southeast, and Mountain West, over 20 percent of indebted farmers have turned to FSA for credit at least once since 2014 (Figure 2). Some of these regions, such as West Virginia, Indian Country, or New England, could be considered 'credit deserts.'[6] Also, these tend to be regions where small livestock farms are more common, illustrating FSA's importance to this producer group. Since 2005, beef producers have

[5] At the end of calendar year 2016, an additional 2.4 percent of farm nonreal estate debt was guaranteed through FSA, resulting in a total market share for FSA of 5.0 percent.

[6] Credit deserts are geographic regions with very few lenders and/or areas where economic conditions create circumstances where commercial credit is difficult to obtain. See FSA Notice FLP-708 (https://www.fsa.usda.gov/Internet/FSA_Notice/flp_708.pdf) for a discussion of FSA policies for lending in credit deserts.

consistently represented the largest category of DOL borrowers (Figure 3). FSA credit is also important among targeted groups, such as socially disadvantaged producers (SDAs) and beginning farmers who tend to operate smaller farms.

Mid-size family farms, defined by USDA as farms with annual sales between $350,000 and $999,999, tend to be most dependent on FSA credit programs. At the end of 2015, nearly 17 percent of indebted mid-size family farms had either a direct or guaranteed farm loan (Figure 4)[7]. Given loan size limits and limited loan funds, borrowers commonly use FSA credit in conjunction with other credit sources. In many cases, the use of FSA credit for a portion of an operation's total credit needs may reduce a borrower's overall risk to the extent that a commercial lender may be more willing to provide the balance of the needed credit. This is particularly true for many mid-size to large family farms and explains why market penetration for farms in this size category are larger than for aggregate market share.

As expected, the combination of lower farmland values in many areas and tight profit margins are affecting commercial credit availability. Lenders in the Kansas City, Minneapolis, and St, Louis Federal Reserve Bank regions have indicated increasing demand for farm loans. Lenders in the Kansas City Federal Reserve district, which includes the highest concentration of farm banks, indicate less credit available in early 2017 than at any time since 2008 (Federal Reserve Bank of Kansas City, Ag Credit Survey). Recent surveys conducted by the Federal Reserve have found that agricultural banks across the country generally anticipate greater demand for renewals and increases in existing operating loans while loan repayments are expected lower (Federal Reserve Bank of Kansas City, Agricultural Finance Databook). In response to financial conditions, lenders are expected to maintain relatively high collateral requirements through 2017.

With tighter profit margins, nonperforming asset measures increased since 2014. DOL default rates increased by nearly 2 percentage points, and commercial lender delinquency rates have been increasing as well (Figure 5). Delinquency rates for guaranteed OLs increased from 3 to 5 percent from 2014 to 2016, while Farm Credit System and commercial bank delinquency rates increased slightly. In all lending categories except for guaranteed OLs, the percent of nonperforming loans remained below levels reached from 2009 through 2010.

Impacts of Term Limits on FSA's Loan Portfolio

Through calendar year-end 2016, a total of 3,805 DOL borrowers with an outstanding direct loan balance had reached the term limit (Table 1). This represents an additional 639 borrowers over the 3,166 borrowers with an outstanding balance who had reached the DOL term limit through December 31, 2015.[8] The number of borrowers reaching term limits since 2013 has been increasing and is above the historical average of 450 annually. Still, only 7 percent of active DOL borrowers were at the term limit at year-end 2016 (Figure 6). In addition there are 3,622 individuals without any current outstanding DOL indebtedness who have reached their term

[7] This estimate was developed using USDA ARMS data, for which 2015 was the latest available data.
[8] The number of borrowers reaching term limits is based on the total number of years DOL funds were received as of December 31, 2016. Beginning farmers who started farming after 2006 were excluded from the total of term-limited borrowers.

limit, resulting in a total of 7,427 current and former FSA borrowers that have reached the DOL term limit since term-limit implementation in 1993 (Table 1).

There is little evidence that term limits adversely force borrowers out of farming. Even though some borrowers have reached the DOL term limit, many continue to benefit from other FSA loan provisions. On average, only about 7 percent of term-limited borrowers completely pay off their outstanding balance each year, which translates into a span of 15 years before current term-limited borrowers would be out of the FSA's loan portfolio. Of the 7,427 borrowers who had reached term limits since 1993, over half (52 percent, or 3,844 borrowers), still had an outstanding direct loan balance at year-end 2016. Term-limited borrowers are still eligible to receive direct FO and EM loans, which 9.5 percent ((447 + 257)/7,427) of term limited borrowers had received after reaching term limits (Table 1). Additionally, 18.3 percent (1,357/7,427) of term limited borrowers received guaranteed loans after reaching term limits.

Since 2005, over 75 percent of term-limited borrowers have made payments as agreed. While this implies one-fourth have been delinquent at least once, most have avoided liquidation. Only 8 percent ((460 + 103)/7,427) of term-limited borrowers received either a direct debt settlement or guaranteed loss claim after reaching their term limits. Reaching the term limit does not preclude a borrower from receiving loan servicing benefits, such as loan restructuring, which were received by over 16 percent (1,204/7,427) of all term-limited borrowers.[9]

Characteristics of Term Limited Borrowers

While the number of term-limited borrowers continues to be relatively small, they have tended to be more concentrated among small- and mid-size family farms. These farms include those with annual sales of $100,000 to $1 million and where the operator either is fully employed by the farm business or considers farming as their primary occupation. While 37 percent of DOL borrowers receiving loans from 2012-2016 had less than $100,000 in sales, farms in this size class represented less than one-fourth of all term-limited borrowers with outstanding DOL indebtedness in 2016 (Figure 7). Those reaching term limits in 2016 averaged nearly $300,000 in annual gross revenue compared to $213,000 for all other direct loan borrowers (Table 2).

Although about half of term-limited borrowers are no longer FSA borrowers, a high proportion are still active in farming. Nearly 87 percent (6,459/7,427) of term-limited borrowers still living had an interest in a farm or ranch as indicated by eligibility to vote in 2017 FSA county committee elections (Table 1).[10] About 5 percent of term-limited borrowers were deceased by 2016, leaving an estimated 8 percent that are living but no longer farming.

The geographic distribution of term-limited borrowers reflects overall program demand, with most direct borrowers located in the Plains States, Lake States, western Corn Belt, and

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[9] Direct program borrowers who are 90 or more days in default and financially distressed are eligible to receive primary loan servicing under 7 CFR 766.101. Under this provision, an eligible borrower may receive loan consolidation, rescheduling, re-amortization, interest rate reduction, deferral, write-down, or any combination of these actions. A borrower qualifying for primary loan servicing is entitled to receive these restructuring provisions on any outstanding direct loan indebtedness.

[10] Eligible voters in FSA county committee elections include individuals of legal voting age who have an interest in a farming operation that participates or cooperates in any FSA program (.https://www.fsa.usda.gov/Internet/FSA_File/ccoeligib_10.pdf)

Appalachia. Relative to overall demand, term-limited borrowers are most common in the Northern Plains and Corn Belt regions. While these regions accounted for nearly 25 (13.81 + 11.1) percent of all direct borrowers receiving loans since 1993, they accounted for nearly one-third (18.4 + 13.7 percent) of all borrowers that have reached term limits (Table 3). While there are some term-limited borrowers present in all states, clusters occur in southeast Nebraska, southwest Minnesota, eastern South Dakota, western Iowa, the high plains of Texas, and central Kentucky (Figure 8). Over one-third of all term-limited borrowers were located within 12 Congressional districts (see Appendix 2).

A large proportion of DOL borrowers have used FSA as only a temporary source of credit. About half (50,201/102,915) of all farms receiving DOLs since 1993 have only received DOL funds for 1 year, while nearly 70 percent ((50,201 + 21,054)/102,915) had used DOLs for 2 or fewer years (Table 4). Over 50 percent of DOL recipients had not borrowed from FSA since 2006. Of all 102,915 borrowers receiving DOLs since 1993 that were subject to term limits, only 7.2 percent (7,427/102,915) had reached their term limits by the end of 2016. Some borrowers had used over 6 full years of eligibility, reflecting the ability of producers to receive one additional loan after 6 years and the issuance of waivers.[11]

A justification that has been used for term limits is to assure that there is ample loan funds to finance young and beginning farmers. However, this has effectively been achieved through targeting, or reserving, loan funds for beginning and SDA farmers. From 1994 through 2016, the share of non-youth DOL funds going to any targeted group increased from 33 to 80 percent. Over half (3,829/7,427) of all term-limited borrowers received their final DOL as a member of a targeted group (Table 1).

Financial Condition of All Borrowers Who Have Reached Term Limits

Most DOL borrowers who reached their term limits since 2005 do not appear to be sufficiently creditworthy to meet most commercial lender underwriting standards. Only 14 percent of term-limited borrowers in 2016 had an FSA score of 1 when they reached the term limit ("1" indicates potential for graduation to commercial lending), and the average FSA score is slightly above 2 (Table 5).[12] FSA's Farm Business Plan data indicate that the average debt-to-asset ratios for term-limited borrowers exceeded 0.50 (Table 5).[13] In comparison, the aggregate debt-to-asset ratio for all U.S. farms was 14 percent in 2017 (USDA, ERS, Farm Balance Sheet). Farm Business Plan data also indicate that less than half had positive working capital at the time they reached their term limits. With average FICO scores near 700 (as is the case with many FSA

[11] In addition to a borrower being eligible for 1 additional DOL after 6 years, beginning farmers receive a waiver through their 10th year of farming. Also, a borrower may receive a one-time waiver of term limits for up to 2 years provided the borrower has completed borrower financial training and has a feasible plan. The borrower must also be unable to obtain credit from a commercial lender.

[12] The FSA score is a borrower account classification used to determine a borrower's eligibility for graduation. The score is completed using the most current balance sheet and income/expense statements available. It is a weighted index of the current ratio, debt-to-asset ratio, return on assets, and term debt coverage ratio. The score can range from 1 to 4, with 1 being most creditworthy and 4 being the least creditworthy (see paragraph 252 of FSA Handbook 1- FLP).

[13] The Farm Business Plan is a Web-based application used by FSA since 2005 to assist borrowers with obtaining loans and improving their farming business. A completed Farm Business Plan provides the business's financial condition, operating plans, and financial summaries.

borrowers), most would likely have difficulty obtaining commercial credit on the most favorable terms (Table 2).

Though term-limited borrowers appeared to be financially stressed, their financial condition is slightly better than for other direct borrowers. In 2016, the debt-to-asset ratio of borrowers reaching their term-limits was 0.51 compared to 0.58 for other DOL borrowers (Table 6). The overall FSA score indicates that term-limited borrowers since 2007 had slightly better net income and term-debt-coverage ratios than other direct borrowers (Table 2). The financial characteristics of term-limited borrowers suggest that most would likely meet all other loan and feasibility criteria and would be eligible to receive additional DOLs, if term limits were not in effect. Most show repayment ability and have net worth large enough to suggest the availability of unencumbered collateral. While many would meet FSA loan feasibility criteria, commercial lenders would likely be reluctant to provide credit given their financial weaknesses.

Term-limited borrowers appeared to have more favorable financial status relative to other FSA DOL borrowers due to their larger size, and consequently, economies of scale. Term-limited borrowers tend to operate larger farms with larger asset bases and greater farm production than other direct borrowers. Since 2006, term-limited borrowers have averaged nearly $290,000 in gross revenue compared to less than $205,000 for other direct borrowers (Table 2). A farm borrower that meets FSA farm loan eligibility criteria and averages $290,000 in gross revenue would likely be considered a mid-size family farm, a size group which has been shown to be more vulnerable to economic downturns and more likely to participate in FSA credit programs (Dodson and Ahrendsen).

Despite their financial shortcomings, there is little evidence to indicate that many term-limited borrowers were forced to downsize their operations. Those who remained in FSA's portfolio for up to 10 years after reaching their term limits had little change in farm sizes as reflected in gross revenue adjusted for commodity price changes (Table 5). The average FSA score for term-limited borrowers remaining in FSA's portfolio after reaching their term limits did not appear to deteriorate. For borrowers remaining in the portfolio after reaching the term limit, the average FSA score did not change. These data, however, do not provide any information on opportunities which term-limited borrowers had to forego because they lacked access to credit.

Characteristics of Active Borrowers by Remaining Years of DOL Eligibility

Current DOL borrowers that used most of their years of DOL eligibility are most likely to be adversely impacted by term limit restrictions. There were nearly 6,000 borrowers with outstanding DOLs (3,805 + 2,121)—about 11 percent of current DOL borrowers—that had either reached their term limits or had only 1 more year of eligibility remaining as of December 31, 2016 (Table 7). As was the case with all those reaching their term limits since 1993, active term-limited borrowers are geographically concentrated in a few states. About one-third are located in just five states: Nebraska (438 borrowers), Kentucky (403 borrowers), Texas (366 borrowers), Iowa (395 borrowers), and Wisconsin (314 borrowers). About one-fifth of DOL borrowers in several states had either reached the term limit or had one or fewer years of eligibility remaining (including Michigan, Minnesota, North Dakota, and South Carolina).

Racial and ethnic minorities are slightly less common among term-limited borrowers than for the overall distribution of borrowers. While racial minorities comprised 12 percent of all borrowers, they comprise 15 percent of all those with 1 or 0 years of eligibility. Hispanics comprise 5 percent of all borrowers but less than 3 percent of those with one year or less of eligibility remaining (Table 8). With approximately 18 percent of all DOL borrowers but only 7 percent of those with one or fewer years of eligibility remaining, women are less likely to be facing term limits.

Active borrowers (as of 12/31/2016) facing term limits display a higher default rate than all active DOL borrowers. ("Default rate" is defined as loans of $1 or more being past due.) The default rate for active borrowers with 0 or 1 years of eligibility is 25 percent compared to 18.5 percent for all active DOL borrowers (Table 9—see "Current or Loan Amount in Default" section). While their default rates were higher, their FSA scores indicate term-limited borrowers are slightly more financially sound. With over half of active DOL borrowers with 0 or 1 year of eligibility remaining having FSA scores greater than 2, their ability to obtain a commercial loan will likely be hampered (Table 9—see "FSA Classification Score" section). FSA classification scores of "commercial" (e.g., "1") suggest that 13.6 percent of borrowers reaching or approaching term limits could obtain credit on their own merits. Another 31 percent have a classification score of "standard" (e.g., 2) and could be candidates for guaranteed loans.

Borrowers with greater DOL indebtedness are more likely to reach their term limits. Borrowers with less than $100,000 in outstanding DOL loans represent 62 percent of all borrowers, but only 32 percent of those borrowers who have either reached the term limit or have only a year of eligibility remaining (Table 9—see "Total Indebtedness" section). In contrast, borrowers with at least $100,000 in indebtedness represent over two-thirds of borrowers either reaching or near their term limits. This outcome is consistent with historical trends indicating that mid-size family farming operations dependent on FSA credit are more likely to reach their term limits.

Policy Options

This study and the prior two annual studies of the impacts of term limits have not provided notable evidence that the term-limit provision is having an adverse impact on borrowers. While the number of borrowers affected has been increasing, term-limited borrowers represent only 7 percent of total DOL borrowers. Over 90 percent of term-limited borrowers still living are still active in farming and those remaining in FSA's portfolio have not been forced to downsize. This has been a consequence of three factors: the high level of FSA targeting as required by statute; a focus on lending to smaller farms; and, until recently, the strength of the farm economy.

The high share of DOL funds that are targeted to beginning and SDA farmers have made term limits somewhat irrelevant. In recent years, most borrowers reaching term limits received their last loan while still a beginning farmer, a status for which they are unlikely to qualify in subsequent years. With the high level of targeting, the burden of term limits falls on those who are not (or no longer) eligible for waivers or exemptions—e.g., non-beginning producers. The focus on lending to beginning farmers is reflected in high shares of loans going to smaller farms. Despite ongoing farm consolidation, over one-third of direct loan funds have gone to farms with less than $100,000 in sales, which tend to use FSA as a temporary credit source. Loan size limits, targeting, and increased microloan lending mean that this will probably continue to be the case.

The relatively strong farm economic conditions which prevailed through 2013 enhanced farm financial conditions, thus enabling a greater share of operators to obtain commercial credit. A continuation of low commodity prices and decreasing farm asset values could change this scenario. This becomes relevant among small- and mid-size family farms which, because of tight profit margins and smaller scale, are especially vulnerable to a prolonged economic downturn. While FSA direct loans represent a minor overall source of credit to these family farms, there are sub-groups which are more reliant on FSA credit and could be adversely impacted—particularly small- and mid-size family farms operated by younger (but not beginning) farmers and those in 'credit deserts.'

Consequently, it will be necessary to continue to monitor both the financial health of the farm sector and FSA's portfolio quality to determine if, at some point, broader relief from term-limit restrictions may be required. One option is for beginning farmers to be granted an exemption rather than a waiver. Under current law, a beginning farmer counts all years of eligibility used until the borrower is no longer a beginning farmer. If the distinction is changed from waiver to exemption, a beginning farmer's 6 full years of eligibility would not begin until after they are no longer a beginning farmer. An exemption would enable young farmers, who have not yet developed sufficient financial strength to withstand adversity, to access FSA credit during periods of low commodity prices. Another option would be to provide the Secretary the authority to declare term-limit moratoriums in the event of a declared disaster or a period of low commodity prices.

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Appendix 1-- Text of Legislation from Section 5104 of the Agricultural Act of 2014

[illegible]

(A) [illegible]—The report shall provide a demographic [illegible]

[illegible]

(I) direct loan borrowers; and

(II) [illegible] have reached the eligibility limit for direct lending programs during the previous calendar year.

(B) DEMOGRAPHIC INFORMATION.—The available demographic information shall include, to the maximum extent practicable, a description of race or ethnicity, gender, age, type of farm or ranch, financial classification, number of years of indebtedness, veteran status, and other similar information, as determined by the Secretary.

(C) ADDITIONAL CONTENT.—In addition to information described in subparagraph (B), the report shall provide—

(i) a demographic analysis of the borrowers impacted by term limits;

(ii) information on the conditions impacting the direct lending portfolio of the Department of Agriculture, including impacts by region and agriculture sector, and credit availability within those regions and sectors;

information on the status of borrower operations impacted by term limits; and

(iv) recommendations, if appropriate, to address any identifiable unmet credit needs.

(D) SUBMISSION.—The Secretary shall—

(i) annually submit to the Committee on Agriculture of the House of Representatives and the Committee on Agriculture, Nutrition, and Forestry of the Senate a copy of the report; and

(ii) make the report available to the public, including posting the report on the website of the Department of Agriculture.