

Annual Report to Congress
Regarding
Term Limits on Direct Operating Loans
as
Required by
Section 5104 of the Agricultural Act of 2014

Prepared by USDA's Farm Service Agency
Summer 2016

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. A vibrant farm economy through 2013 and ample credit availability enabled farmers to be more reliant on commercial credit sources and less reliant on FSA. Expectations of lower incomes and lower land values in upcoming years, however, may reduce commercial credit availability and increase reliance on FSA credit programs, resulting in more borrowers being impacted by term limits. Mid-size family farms and those in more 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 Term Limits Each Year—In 2015, an additional 637 direct borrowers met the term limit compared to 617 reaching term limits in 2014. While greater than the annual average of about 400 borrowers, this represents only 1.3 percent of all borrowers with outstanding DOL indebtedness. Since legislation mandating term limits was passed in 1992 and implemented in 1993, 6,276 of the 104,000 farmers receiving DOLs had reached term limits through December 31, 2015. For most borrowers, direct loans serve as a temporary source of credit that is used for only 1 or 2 years.

Changing Farm Economic Conditions Likely to Influence DOL Demand—Given projections for a weaker farm economy, the number of farmers reaching term limits is likely to increase in upcoming years. Expectations for tighter farm profit margins and lower farmland values will likely cause commercial lenders to exercise more discretion in providing credit, which would reduce credit availability and raise the demand for DOLs. Meanwhile, working capital constraints could lead farmers to rely more heavily on credit to finance annual production expenditures. These factors, when taken together, could reduce existing DOL borrowers' ability to improve their financial status and graduate to private lending. Historically, farm borrowers reaching term limits tend to be larger in terms of annual sales than the average DOL borrower and tend to be located in the Plains States, Lake States, Western Corn Belt, and Appalachia.

Relative to Other Direct Borrowers, Farms Reaching Term Limits Are Not Necessarily Less Financially Sound—Though term-limited borrowers appeared to be financially stressed, their financial condition is not much different from other direct borrowers. Those who remained in FSA’s portfolio for up to 6 years after reaching their term limits had little change in farm sizes as reflected in annual sales adjusted for commodity price changes.

Most Term-Limited Borrowers Would Have Difficulty Obtaining Commercial Credit—Most DOL borrowers who reached term limits, since 2005, do not appear to be sufficiently creditworthy to meet commercial lender underwriting standards. About 15 percent of term-limited borrowers would likely meet commercial underwriting criteria as defined by FSA’s classification of “commercial.” Another 32 percent could be candidates for guarantees.

Term Limits Are More Likely to Impact Mid-Size Family Farms—While most direct borrowers have less than \$100,000 in annual sales, those with at least \$100,000 in indebtedness represent over two-thirds of borrowers either reaching or near their term limits. These mid-size family farms are more dependent on FSA for a larger share of their credit needs, and, therefore, are more likely to be adversely impacted by term limits than other categories of farm borrowers.

Most Term-Limited Borrowers Remain Active FSA Credit Customers—Farm borrowers who reach their term limit can still maintain an outstanding DOL balance and participate in other FSA credit programs. Most term-limited borrowers maintain a loan balance for several years, with more than half of those reaching term limits since implementation in 1993 having a positive loan balance owed to FSA at year-end 2015. On average, only 15 percent of term-limited borrowers have managed to completely pay off their outstanding direct indebtedness each year. More than 19 percent received a direct farm ownership, emergency, or guaranteed loan after reaching the term limit. More than 19 percent had loans that were later restructured. Only 8 percent of term-limited borrowers had liquidated their operations and resolved the remaining FSA debt through debt settlement. More than 85 percent of borrowers reaching term limits, since 1993, still had an active interest in a farm or ranch as indicated by their eligibility to vote in 2015 FSA county committee elections.

Term Limits Have Limited Impacts on Targeted Groups—More than three-fourths of all DOL obligations are targeted to beginning or socially disadvantaged (SDA) farmers. Seventy-eight percent of term-limited borrowers used most of their years of eligibility as beginning farmers. Because beginning farmers receive a term-limit waiver, many continue to receive DOLs beyond the term limit, provided they are still deemed to be beginning farmers. Non-beginning SDA farmers have represented only 15 percent of borrowers reaching term limits.

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 (ConAct) for qualified farmers. Term limits of 6 full years were initially enacted for both direct and guaranteed farm ownership (FO) and farm operating (OL) loan programs by the Agricultural Credit Improvement Act of 1992.¹ Term limits have never applied to emergency loan (EM) borrowers. Subsequent legislation exempted direct FO and all guaranteed loan programs from any term-limit provisions. Microloans made to veterans and beginning farmers are also exempt from term limits. Also, the limitation does not apply if the borrower's farm is subject to the jurisdiction of an Indian Tribe. Waivers are granted in some circumstances, enabling FSA to obligate DOL loans to borrowers beyond the term limit. Waivers are granted to qualified beginning farmers through their 10th year of farming. Non-beginning farmers 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 ConAct to require an annual report on term limits for DOL (see Appendix 1). As directed by the statute, this second-annual study estimates the number and location of current and past direct borrowers who have reached 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 DOL's, 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. Also, 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 making farm loans. Further, FSA's 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 mid-size family farms). Dependence on FSA credit does not necessarily imply economic inefficiencies or a monopolizing of federal benefits.

¹ The ConAct states that an applicant is eligible for a direct operating loan if the applicant received a DOL in 6 or fewer years. 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. A borrower effectively has 6 full years of eligibility, at which point the borrower reaches the term limit. Upon receipt of a direct operating loan at any time during the 7th year, the borrower becomes ineligible for any further assistance. This report uses the terminology of 6 full years of eligibility, in accordance with the ConAct, to define the duration of the term limit.

All qualified direct applicants, regardless of their tenure as an FSA customer, must be unable to obtain commercial credit despite their ability to show a feasible farm-business plan. A feasible plan is defined as a business plan projecting a positive margin after debt service and a positive overall cash flow. Borrowers unable to develop a feasible plan are ineligible for any new direct loans. Direct borrowers are also expected to transition, or graduate, to private sources of credit over time (Section 345 of the ConAct; 7 CFR 765.101).² Farmers considered viable for commercial credit may be required to refinance their direct loans with a commercial lender.

Farm Economic Outlook

In sharp contrast to the record farm income and increasing farmland values that benefited farmers through 2012, the current situation is less optimistic, despite a price rally for soybeans and corn in the spring of 2016. After a sharp drop in incomes for crop farms in 2014, there was a further decline in 2015. The soybean season average price forecast for 2015/16 is at a 9-year low, while corn is forecast to match last year's 5-year low. The 2015/16 wheat price fell to a 6-year low. While a small gain is projected for soybean prices for the 2016 crop, corn and wheat prices are expected to decline again, keeping profit margins tight or even nonexistent.

Dairy farms saw relatively high incomes in 2014, but this changed in 2015 as a decline in milk prices more than offset an increase in production; largely reflecting growing global competition for dairy products and reduced purchases by some major importers. Low milk prices are expected to persist through 2016. Although net farm income is forecast to be down only 3 percent in 2016, this would be the fourth consecutive decline and a 33-percent reduction from the record high achieved in 2012. (USDA, ERS, 2016 Farm Sector Income Forecast, Feb. 2016)

Despite reductions in farm income, the financial health of the farm sector remained strong through 2015. Farmers' median household income dipped 3 percent in 2015 to just below \$80,000, but is forecast to rise 5 percent in 2016 and is about 1.5 times the U.S. average household income. Despite lower incomes, through 2015, farmers overall were able to service their indebtedness. Delinquency rates, as reported by commercial banks and the Farm Credit System (FCS), were mostly unchanged for 2015, remaining at 8-year lows (Federal Reserve Bank of Kansas City, Agricultural Finance Databook; Federal Farm Credit Banks Funding Corporation). With tighter profit margins and weakening farmland values,³ however, farmers took on more debt, and debt-to-asset ratios are expected to increase through 2016. Even so, U.S. farm equity is forecast to decline for only the fourth time in the last 30 years, and remains near historic highs.

² 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>).

³ Eighty percent of overall farm equity is in real estate. A lenders' willingness to use real estate equity to fund operating capital needs is influenced by land values. Since the first quarter of 2014, lender surveys conducted by the Federal Reserve Banks of Kansas City, St. Louis, and Chicago have all reflected steady to decreasing farmland values. In the first quarter of 2016, lenders reported land values to be down between 4 and 6 percent in these regions. Coupled with low incomes, lower land values will likely lead commercial lenders to exercise more discretion in dispensing credit, resulting in increased demand for both FSA direct and guaranteed credit programs.

Lenders' expectations for farm loan repayment in 2016 are weaker, with expectations reaching levels not seen since the early 1990s (Federal Reserve Bank of Kansas City, Ag Credit Survey). Though bankers indicated that they were still positioned to meet credit demand, most expressed increasing concern. Likewise, requests for renewals and extensions of agricultural loans continued to increase through the first quarter of 2016 in all Federal Reserve districts. In the Kansas City and Chicago Federal Reserve districts, lender expectations indicate that demand for non-real estate farm loans in 2016 will be the highest since the data series began in 1980. While lenders are indicating ample loanable funds to meet credit demand, greater collateral requirements and expanded use of FSA guarantees indicate that lending standards are tightening.

As a consequence of farm consolidation, outstanding farm debt has become more concentrated among fewer, more financially leveraged farms (Dodson and Ahrendsen). Even though farm equity remains high, working capital is a constraint for most farms. To bridge the gap between available working capital and total annual operating expenses, farms must increasingly rely on annual operating loans and lines-of-credit. With debt usage concentrated among fewer farms and a greater reliance on operating and non-real estate credit (with associated shorter amortizations), financial risk has increased, particularly, for certain types of producers. Especially susceptible are mid-size family farms for which income variability, tight profit margins, and a greater reliance on debt create a unique vulnerability to credit constraints. Farms with less than \$100,000 in sales comprise most direct borrowers. However, more than 20 percent of indebted single-operator-beginning farms with over \$100,000 in sales had a direct loan in 2014 (Dodson and Ahrendsen).

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 2.4 percent of overall non-real estate farm debt in 2014, direct loans do not currently represent a major source of credit to agriculture (Figure 1). However, this understates USDA's safety-net role, as reflected in its high market shares during the 1980s farm financial crisis, when FSA's share peaked at 24.3 percent.

Aggregate market shares also under-represent the importance of FSA credit to targeted groups and economically depressed regions. Furthermore, FSA is seldom the sole credit provider and works closely with commercial lenders in providing joint financing. Consequently, market shares may under-represent the share of farmers served. In many areas of the Northeast, Appalachia, Southeast, and Mountain West, more than 25 percent of indebted farmers have turned to FSA for credit at least once since 2011 (Figure 2). These are regions where small livestock farms are common, illustrating FSA's importance to this producer group. Since 2005, beef producers represent the largest category of DOL borrowers (Figure 3). FSA credit also tends to be important among targeted groups, such as socially disadvantaged producers (SDAs) and beginning farmers. From 1994–2014, the share of DOL funds going to these targeted groups increased from 25 to 75 percent. In many southern states, a majority of indebted racial minority family farms have received an FSA loan in the past 5 years.

As an aggregate, FSA's market share has declined from peaks reached during the 1980s. Defaults and loan write-offs have likewise declined; reflecting the strength of the farm economy through 2013 as well as changes in Federal credit policies and procedures implemented in

response to the Debt Collection Improvement Act of 1996 and the Federal Credit Reform Act of 1990.^{4,5} Since the mid-1990s, the share of DOL borrowers, who were 30 days or more in default, has declined from more than 25 percent to 10.6 percent through fiscal year 2015 (Figure 4).⁶ Likewise, the share of DOL borrowers receiving write-offs on any direct loan fell from 4.2 percent, in 2005, to less than 1.5 percent by 2015.

Despite relatively low market share, demand for FSA credit programs is increasing. Since 2008, both the amount of dollars lent and number of borrowers receiving DOLs have increased. In real terms, DOL obligations are nearly as high as in the late 1980s (Figure 5). Likewise, the number of borrowers receiving DOLs has been increasing since fiscal 2008. Much of the obligation increase has been due to greater loan size limitations authorized in the 2008 Farm Bill and increasing capital needs among farm businesses. It may also reflect increasing risk in the farm sector. Much of the recent increase in the number of borrowers receiving loans reflects increased marketing efforts and streamlined application processes for smaller loans.

Impacts of Term Limits on FSA Loan Portfolios

Through calendar year-end 2015, a total of 6,276 direct borrowers had reached the DOL term limit since their implementation in 1993 (Table 1; line 1—3,184 + 3,092). This includes an additional 637 borrowers over the 5,639 (2,931 + 2,708) borrowers who had reached the DOL term limit through December 31, 2014.⁷ The number of borrowers reaching term limits in both 2014 and 2015 was above the historical average of about 400 borrowers annually, but that count represented less than 1.3 percent of active DOL borrowers (Figure 6).

Most farmers who reach term limits remain active in FSA programs. Term-limited borrowers may still use other FSA credit programs and maintain outstanding direct loan balances even though they are unable to receive any new DOLs. Of the 6,276 borrowers who reached term limits since their implementation, 3,184 had an outstanding direct loan balance at year-end 2015 (Table 1). In addition to DOLs, this includes borrowers with outstanding direct FO, EM, and/or economic emergency loans. On average, only 15 percent of term-limited borrowers had managed to completely pay off their outstanding direct indebtedness each year.

⁴ The Debt Collection Improvement Act of 1996 provided greater authority in the collection of delinquent federal debts enabling federal lenders to reduce losses. This act centralized the collection of delinquent non-tax federal debt at the Department of the Treasury, enabling information sharing within and among federal agencies. The law also enabled the federal government to satisfy overdue debt by offset of non-tax payment and prohibited individuals who had defaulted on federal debt from receiving any federal loans.

⁵ The Federal Credit Reform Act of 1990 provided greater incentives for agencies to improve program efficiency in order to minimize cost, especially in the management of defaults and loss mitigation. Credit reform changed how the federal budget reports the cost of federal direct loans and loan guarantees (Congressional Research Service). Beginning with FY1992, federal credit reform legislation required that the reported budgetary cost of a credit program equal “the estimated long-term cost to the government of a direct loan or a loan guarantee, calculated on a net present value basis, excluding administrative costs.” Previously, all federal loans were treated as a budget outlay in the current fiscal year, regardless of expected repayment or losses.

⁶ FSA defines default to be \$1 or more past due for a period of 30 days or more.

⁷ The number of borrowers reaching term limits is based on the total number of years DOL funds were received as of December 31, 2015. Beginning farmers who started farming after 2006 were excluded from the total of 6,276 term-limited borrowers.

Table 1 contains additional financial information on term-limited borrowers. More than 19 percent of term-limited borrowers had received an FO, EM, or guaranteed loan after reaching the OL term limit through 2015 (see table 1; column 1; $((60+56+1,084)/6,276)$). Primary loan servicing had been used by 19 percent of term-limited borrowers.⁸ Only about 8 percent of term-limited borrowers appear to have exited farming as indicated by direct loan settlements or guaranteed loss claims. Reflecting the high level of targeting, 78 percent of those reaching term limits through 2015 had last received DOLs as beginning farmers. More than 85 percent of those who have reached term limits still had an interest in a farm or ranch as indicated by eligibility to vote in 2016 FSA county committee elections.⁹

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 Appalachia. Relative to overall demand, term-limited borrowers were most common in the Northern Plains and Appalachian regions. While these regions account for 28 percent of all direct borrowers, they account for nearly one-third (16.9 percent + 17.3 percent) of all borrowers reaching term limits (Table 2). While there are some term-limited borrowers present in all states, clusters occur in Southeast Nebraska, Northwest Minnesota, Eastern South Dakota, Western Iowa, the high plains of Texas, and Central Kentucky (Figure 7).

As was the case in 2014, half of all borrowers reaching their term-limits in 2015 were beef or dairy farms (Figure 8), though their relative shares declined since 2013. Despite lower grain prices and declining profit margins, cash grain farmers as a share of total farms reaching term limits has remained stable at 23 percent since 2013. Cotton, wheat, fruit, nut, and vegetable producers comprised relatively larger shares of term-limited borrowers in 2015 compared to other recent years.

Most DOL borrowers appear to use FSA as a temporary credit source. Since 1993, more than 70 percent of farms used DOLs for 2 or fewer years (Table 3). More than 50 percent ($44,061 + 9,012/103,842$) of DOL recipients had not borrowed from FSA since before 2007. Of all 103,842 borrowers who received DOL loans since 1993, only 6 percent ($6,276/103,842$) had reached their term limits by the end of 2015. Some borrowers had used more than 6 full years of eligibility, reflecting exceptions granted to beginning farmers and to microloan borrowers and the issuance of waivers.¹⁰

Characteristics of All Borrowers Who Have Reached Term Limits

Most DOL borrowers who reached term limits since 2005 do not appear to be sufficiently creditworthy to meet most commercial lender underwriting standards. Only 11 percent of term-

⁸ 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 all outstanding direct FO, OL, and EM loans.

⁹ 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.

¹⁰ 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.

limited borrowers had an FSA score of 1 when they reached the term limit. (“1” indicates a potential for graduation to commercial lending).¹¹ In addition, term-limited borrowers have been more highly indebted than other FSA borrowers. FSA’s Farm Business Plan data indicate that the average debt-to-asset ratios for term-limited borrowers exceeded 50 percent, and a third had debt-to-asset ratios exceeding 70 percent.¹² In comparison, the aggregate debt-to-asset ratio for all U.S. farms was 13 percent in 2015. Farm Business Plan data also indicate that less than a third had positive working capital at the time they reached their term limits. Most had average FICO scores under 700, indicating that they would likely have difficulty obtaining commercial credit on the most favorable terms.

Though term-limited borrowers appeared to be financially stressed, their financial condition is not much different from other direct borrowers. Differences in solvency between term-limited borrowers and all other borrowers have diminished since 2010 (Table 4). In 2015, the debt-to-asset ratio of borrowers reaching their term-limits was the same as that of other FSA borrowers, at 51 percent. Likewise, profitability and term-debt-coverage ratios are comparable to all other direct borrowers. The overall FSA score, which reflects debt coverage and liquidity in addition to solvency, indicates that term-limited borrowers, since 2007, have been slightly more financially sound than all other FSA direct borrowers (Table 5).¹³

The more favorable FSA scores for term-limited borrowers may reflect their larger size, and, consequently, economies of scale. Term-limited borrowers tend to operate larger farms with larger asset bases and production. Since 2011, term-limited borrowers have averaged nearly \$330,000 in gross revenue compared to less than \$250,000 for all other borrowers (Table 5). A farm that meets FSA farm eligibility criteria and averages \$300,000 in gross revenue would likely be considered a mid-size family farm. Other research has found that mid-size family farms operated by a single operator and a spouse tend to be vulnerable to economic downturns and are more likely to participate in FSA credit programs (Dodson and Ahrendsen).

The term-debt-coverage ratio, which does not include non-farm income, averaged less than 1 for both term-limited and all other direct borrowers, indicating tight cash flows and the importance of off-farm income for debt servicing. Most direct borrowers had non-farm income, but it probably is not sufficiently high to alleviate tight cash flows, given the need to also cover family

¹¹ 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).

¹² 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.

¹³ The FSA score is a borrower account classification used to determine borrowers’ 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-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).

living expenses. Thus, term-limited borrowers are susceptible to changes in the overall economy, as well as the farm economy.

Despite their financial shortcomings, there is no evidence to indicate that many term-limited borrowers were forced to downsize their operations. Those who remained in FSA's portfolio, for up to 6 years after reaching their term limits, had little change in farm sizes as reflected in annual sales adjusted for commodity price changes (Table 6). 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 for 6 years after reaching the term limit, the average FSA score actually increased slightly, from 2.2 to 2.3, which may reflect the graduation of more creditworthy borrowers to commercial credit. The data, however, did not provide any information on opportunities, which a term-limited borrower had to forego because they did not have access to credit.

Characteristics of Active Borrowers by Remaining Years of DOL Eligibility

Active borrowers, defined as those with outstanding FSA direct loan indebtedness, are most likely to be impacted by term limits. For example, 4,962 borrowers with outstanding DOLs (3,166 + 1,796)—about 10 percent of current OL borrowers—had either reached their term limits or had only 1 more year of eligibility remaining as of December 31, 2015 (Table 7). More than one-third are located in just five states: Nebraska (385 borrowers), Kentucky (357 borrowers), Texas (328 borrowers), Iowa (315 borrowers), and Wisconsin (262 borrowers). Nearly one-fourth of DOL borrowers in several states had either reached the term limit or had 2 or fewer years of eligibility remaining (Iowa, Nebraska, North Dakota, Maine, and South Carolina).

Representation of racial and ethnic minorities among term-limited borrowers for the most part reflects the overall distribution of borrowers. Racial minorities and Hispanics comprised 11 percent of all direct and 8 percent of term-limited DOL borrowers (Table 8). With approximately 18 percent of all borrowers, but only 6 percent of those with 1 or fewer years of eligibility remaining, women borrowers were relatively less likely to be facing term limits.

The credit shortcomings of active borrowers facing term limits is reflected in their default rates. The default rate for active borrowers with 0 or 1 year of eligibility was 15.0 percent compared to 12.6 percent for all active DOL borrowers (Table 9—see “Current and Amount Delinquent” section). Further, over half of active DOL borrowers with 0 or 1 year of eligibility remaining had FSA scores greater than 2 (standard), further illustrating the credit shortcomings that could restrict their ability to obtain a commercial loan (Table 9—see “FSA Classification Score” section). FSA classification scores of commercial (1) suggest that 15.7 percent of borrowers reaching or approaching term limits could obtain credit on their own merits. Another 32 percent had a classification score of standard (2) and could be candidates for guarantees.

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 about one-third of those borrowers who have either reached the term limit or have only year of eligibility remaining (Table 9—see “Total Indebtedness” section). In contrast, borrowers with at least \$100,000 in indebtedness represent more than two-thirds of borrowers either reaching or near their term limits. This outcome is consistent with historical trends indicating that mid-size operations dependent on FSA credit are more likely to reach their term limits.

Summary and Recommendations

While term limits do not currently appear to be having any notable impacts on the DOL portfolio, reduced farm incomes and falling land values are likely to cause greater dependence on DOLs as a credit source. In turn, the number of borrowers affected by term limits on an annual basis is likely to increase. Given that term-limited borrowers have historically not met commercial lenders' underwriting standards, borrowers reaching term limits will likely face challenges relying completely on commercial lenders for their farm credit needs.

One of the roles of FSA credit programs has been to serve as a safety net, providing credit to those adversely impacted by economic downturns. The presence of term limits, however, can impair FSA's ability to provide such assistance. Mid-sized family farms are most likely to be adversely impacted. While most direct borrowers have used FSA only as a temporary credit source, mid-size family farms tend to be more reliant on FSA as a credit source. Also, regions of the country where FSA has a greater market penetration will more likely be adversely impacted.

While FSA has the ability to provide temporary waivers of term limits on a case-by-case basis, such requirements can be burdensome to agency workload, especially if farm sector financial stress becomes more widespread. 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.

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

5) ANNUAL REPORT ON TERM LIMITS ON DIRECT OPERATING LOANS.—

(A) IN GENERAL.—The Secretary shall prepare a report annually that describes—
(i) the status of the direct operating loan program of the Department of Agriculture; and

(ii) the impact of term limits on direct loan borrowers.

(B) DEMOGRAPHIC INFORMATION.—

(i) IN GENERAL.—The report shall provide a demographic breakdown, on a State-by-State basis, of—

(I) all direct loan borrowers; and

(II) borrowers that have reached the eligibility limit for direct lending programs during the previous calendar year.

(ii) 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.
