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BOOKLETTER

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To: Chair, Board of Directors
Chief Executive Officer
Each Farm Credit System Institution

From: Kevin Kramp
Director, Office of Regulatory Policy

Subject: Providing sound and constructive credit to young, beginning, and small farmers, ranchers, and producers or harvesters of aquatic products (Revised bookletter 040)

This bookletter provides guidance to the Farm Credit System (System) on meeting the credit needs of young, beginning, and small (YBS) farmers, ranchers, and producers or harvesters of aquatic products.[1] The Farm Credit Administration issued this bookletter originally in 1998, and we revised it in 2007. We have again revised the bookletter — mainly to reflect a change in the definition of a "small" farmer.

This bookletter continues to provide guidance on interpreting the phrase "sound and constructive credit," which is used both in § 4.19 of the Farm Credit Act of 1971, as amended (Act), and in our YBS regulation at § 614.4165. This interpretation is important for ensuring that the System is fully engaged and using all available authorities to help YBS farmers begin, grow, or remain in agricultural or aquaculture production.

YBS mission

The Act requires direct lender associations (associations) to establish programs for furnishing "sound and constructive credit and related services to young, beginning, and small farmers and ranchers." The YBS regulation, which implements the Act's YBS provision, requires the YBS programs of associations to have certain minimum components to ensure that the associations can successfully fulfill their YBS mission.

All agricultural producers face significant challenges, such as access to capital and credit; the impact of rising costs on profitability; urbanization; the availability of resources, like land, water, and labor; globalization; and competition from larger or more established farms. These challenges are even greater for many YBS farmers due to their lack of

[1] Throughout this bookletter, we use the term "farmer" to refer to farmers, ranchers, and producers or harvesters of aquatic products.

agricultural production history, their inexperience in production agriculture, low capital position, and limited credit history. The System's YBS mission is therefore crucial to enabling YBS farmers to begin, grow, or remain in agricultural production and to facilitating the transfer of agricultural operations from one generation to the next.

When developing YBS programs, associations must consider marketing to all populations of YBS farmers. Associations should identify underserved communities and groups so they aren’t overlooked or excluded from marketing, education, and outreach efforts. Underserved groups include those who, because of their identity as members of underserved groups, have been subjected to racial, ethnic, or gender prejudice without regard to their individual qualities.

Associations can reach underserved communities in schools, universities, professional and social organizations, community gatherings, and at local events. Associations should make every effort to reach all creditworthy YBS farmers in their territories and to work with other governmental and private sources to break down barriers to entry.

YBS definitions

To account for economic factors, effective January 1, 2024, the threshold in the definition of a “small” farmer will increase from $250,000 to $350,000 and change from measuring gross sales to gross cash farm income. Additionally, in the “young” and “beginning” definitions, the date at which YBS status is determined will change from “as of the loan transaction date” to “as of the date the loan is originally made.” All of the categories remain separate and distinct, and a loan to one farmer may meet the definition for any or all of the categories, but a loan does not have to meet all three to be considered a YBS loan.

Following are the definitions of the three YBS categories:

- **Young:** A farmer, rancher, or producer or harvester of aquatic products who is 35 years old or younger as of the date the loan is originally made.
- **Beginning:** A farmer, rancher, or producer or harvester of aquatic products who has 10 years or less of farming, ranching, or aquatic experience as of the date the loan is originally made.
- **Small:** A farmer, rancher, or producer or harvester of aquatic products who normally generates less than $350,000 in annual gross cash farm income[2] of agricultural or aquatic products.

We provide additional guidance on these definitions in our annual YBS call report instructions.

[2] We define annual “gross cash farm income” as crop and livestock sales, government payments, receipts from custom work, and other farm-related income, including but not limited to machine hire, livestock grazing fees, timber sales, and production contract fees. If cash basis information isn’t available, associations may use the accrual gross farm income instead.

Providing sound and constructive credit to YBS farmers

Most YBS farmers need diverse sources of income and assets (both agricultural and nonagricultural) for their operations to be viable. Therefore, we determine sound and constructive credit as credit that YBS farmers can use to begin, grow, or remain in agricultural production. Sound and constructive credit may include credit for both nonagricultural and agricultural purposes.

Applying credit parameters for bona fide farmers

FCA regulation § 613.3000(a)(1) defines a bona fide farmer as "a person owning agricultural land or engaged in the production of agricultural products. ..." According to § 613.3005, the objective of each bank and association is to provide financing for the full credit needs of full-time farmers and more conservative agricultural credit and restricted nonagricultural credit for less-than-full-time farmers. For those bona fide farmers whose business is essentially other than farming, the rule calls for only agricultural credit.

Determining a YBS farmer's commitment to agricultural production

The degree to which a YBS farmer is, or intends to be, engaged in agricultural production determines the type and amount of credit that is available to the farmer. Associations should analyze each application to determine the applicant's commitment to agricultural production and therefore the type and amount of agricultural and nonagricultural credit the applicant needs to begin, grow, or remain in agricultural production.

To determine a farmer's commitment to agricultural production, associations should consider the following criteria:

- The degree of day-to-day involvement the borrower must have in agricultural production, through either labor or management, or both.
- The intent of the borrower to actively engage in agricultural production. For example, does the borrower have agricultural education, training, or experience? Does the borrower have a business plan?
- Actual or projected gross cash farm income or production.
- The terms and structure of the loan, as well as the planned use of loan proceeds.

By considering such criteria, associations can determine how best to meet the unique needs of each YBS farmer. For example, an applicant's lack of agricultural asset ownership may be offset by their considerable experience as a farm manager with production responsibilities. This experience would demonstrate a commitment to agricultural production, and this commitment may make them a strong candidate for credit under an association's YBS lending program.

Offering credit enhancements to YBS farmers

One of the most significant challenges for many YBS farmers with little or no agricultural income or assets is complying with an association's traditional loan underwriting standards. Typically, YBS farmers have little or no assets to pledge as collateral, little or no historical production records, and little or no on-farm management experience.

To provide sound and constructive credit, associations should consider creating a program of reasonable credit enhancements and credit coordination programs for this often less financially stable, yet crucial, group of farmers. Credit enhancements could include more flexible

- interest rates or fees,
- underwriting standards, and
- collateral requirements.

Credit enhancements could also include obtaining guarantees from entities such as the U.S. Department of Agriculture's Farm Service Agency.

Associations should also consider whether making new loans classified by the Uniform Classification System (UCS) as less than acceptable to a subset of YBS farmers is within their risk capacity. If a YBS farmer has mitigating credit factors, such as projections that support a viable business after the initial start-up, associations may choose to extend less-than-acceptable UCS credit.

To mitigate the risk of making less-than-acceptable YBS loans, associations may use capital set-asides. We consider capital set-asides to be a sound practice, and we discuss them further below. While safety and soundness remain the highest priority, associations can make less-than-acceptable YBS loans without compromising overall safety and soundness, provided they use the right set of risk parameters.

Associations may also want to consider a YBS lending policy that treats a subset of YBS farmers as bona fide, full-time farmers. The subset would consist of those farmers with a high degree of commitment to begin, grow, or remain in production agriculture and a demonstrated intent to progress toward agricultural production as their primary business and vocation.

The phrase "primary business and vocation" is used in FCA's lending objective rule at § 613.3005 to define a "full-time, bona fide farmer." It is up to each association to select a method for determining who meets the definition of a full-time farmer. In most cases, associations will have to use qualitative, rather than quantitative, criteria to determine who should be considered full-time. Qualitative criteria could include an applicant's education, training, experience, business plan, or another indicator that shows the YBS farmer's commitment or intent to progress toward production agriculture as their primary vocation. Whatever method is chosen to determine who may be treated as a "full-time" farmer, it is critical for the association to base the method on reasonable criteria.

Providing these YBS farmers with all the credit and services available to full-time farmers would be considered another type of credit enhancement. Generally, we consider any credit enhancement reasonable if it improves a YBS farmer's prospects for success in agricultural production. Nonetheless, associations should consider their risk-bearing capacity in determining whether a credit enhancement, or combination of credit enhancements, is reasonable.

Setting aside capital for the YBS mission

To provide for the types of credit enhancements needed to adequately serve the YBS markets (which typically pose more risk), associations should consider setting aside capital they are willing to put at risk to support programs that meet the credit needs of YBS farmers.

Associations should base the amount of capital made available on the strength of their financial position, their risk management tools, and their safety and soundness controls. We recognize that designating capital for YBS lending will require an association to exercise considerable judgment to ensure that it balances the credit needs of YBS farmers with its own risk-bearing capacity.

Coordinating YBS credit with other entities

As required by § 614.4165 and to reduce the risk associated with YBS programs, associations should consider increasing coordination with other System institutions, government agencies, and the private and public sectors to make use of all risk mitigation tools, such as state and federal loan guarantees or other such programs (both government and privately sponsored). This regulatory section also requires associations to develop outreach initiatives that could include, but are not limited to, using YBS advisory committees.

Sharing best practices

To ensure that associations implement the most effective YBS programs possible, we encourage the sharing of best practices. This will help ensure that the System provides all YBS farmers with the credit they need to begin, grow, or remain in agricultural production.

YBS farmers with minimal involvement in agriculture

The credit enhancements and capital designated for YBS programs are not intended to apply to those applicants whose business is essentially other than farming. As we explain in "Lending Programs for Farmers' Other Credit Needs" (Examination Bulletin 2006-2 (PDF)), each association should include in its lending policies and procedures a reasonable definition of the phrase "other credit needs" that could also apply to YBS farmers.

Lending policies on YBS and other credit needs

We ask associations to review and modify their YBS policies and programs in response to the guidance in this bookletter. For example, associations may want to include in their YBS lending policies a description of the types of credit enhancements available to YBS farmers and how these enhancements are measured and controlled. When updating YBS policies and programs, we encourage associations to do the following:

- Update the definition of a small farmer.
- Ensure that the criteria used to determine whether a person qualifies as a full-time farmer includes those part-time YBS farmers with a demonstrated intent to progress toward farming as their primary business and vocation.
- Document risk parameters and criteria for loans to YBS farmers that may be a less-than-acceptable UCS credit.

- List the factors that must be documented in the loan file to demonstrate the YBS farmer's commitment or intent to progress toward agricultural production as their primary business and vocation (see "Determining a YBS farmer's commitment to agricultural production" above).
- Include a set of internal controls, including an audit program, to ensure that the YBS policies and program are implemented for the benefit of YBS farmers to begin, grow, or remain in agricultural production.

The guidance in this bookletter also complements the guidance we issued on "other credit needs" in Examination Bulletin 2006-2. Therefore, we also ask associations to review their lending policies and programs to ensure that they include criteria for determining the amount of financing available to YBS farmers for their other credit needs. Such criteria should take into consideration the factors used to determine the degree to which a YBS farmer is, or intends to be, engaged in agricultural production.

Examples

The following examples highlight how an association may implement the guidance in this bookletter. These examples illustrate the types of loans that would likely be consistent with a sound and constructive YBS program. To ensure that the credit remains sound, associations should consider supporting YBS loans by using risk mitigation tools.

1. Beginning corn and soybean farmer seeks $45,000

Facts: A beginning farmer applies for a $45,000 loan to rent 300 acres of corn/soybean cropland. He works for a local corn and soybean farmer and has a written agreement with his employer to rent the equipment necessary to farm this acreage. He will also market his product with his employer. His goal is to use this acreage to work toward becoming a full-time farmer. His loan application includes a business plan describing how he plans to grow his business.

Analysis: This YBS farmer does not own any assets to pledge as security; however, he has considerable farming experience in the type of operation that he is proposing to begin and an educational background in agriculture. Thus, this farmer has a demonstrated intent to progress toward farming as his primary business and vocation.

Result: This beginning farmer could be treated as a full-time farmer. The association may need to rely more heavily on the applicant's education and farming experience to make this loan. However, this loan would likely be consistent with a sound and constructive YBS program.

2. Recent college graduate seeks $75,000 for cattle operation

Facts: A recent college graduate with a degree in animal science applies for a $75,000 loan to rent land, purchase cattle, and cover operating costs to start a cattle operation. The applicant worked on a cattle ranch before and during college. She will also work for the local feed dealer in town. Her loan application included a business plan describing how she plans to grow the business.

Analysis: Beyond the cattle being purchased, this YBS farmer does not own any assets to pledge as security; however, she has both education and farm experience in the type of cattle operation she would like to start. Thus, this farmer has a demonstrated intent to progress toward ranching as her primary business and vocation.

Result: This young, beginning farmer could be treated as a full-time YBS farmer. The association may need to rely more heavily on the applicant's education and farming experience to make this loan. However, this loan would likely be consistent with a sound and constructive YBS program.

3. Young farmer with welding shop seeks $200,000

Facts: A young farmer rents 100 acres of farmland, owns his equipment, and owns a welding shop in a rural area. His gross cash farm income is $50,000, and his gross income from the welding shop is $75,000. He requests a $200,000 loan to refinance the high-cost, long-term debt he incurred when he purchased the welding shop. He would like to expand his agricultural production acreage, but first he needs to increase his cash flow by refinancing this high-cost debt.

Analysis: This farmer has demonstrated his intention to make farming his primary business and vocation. The income from the welding shop is critical to the farm's growth and success; therefore, this loan contributes to the young farmer's ability to remain in agricultural production.

Result: This young farmer could be treated as a full-time YBS farmer, and the loan would likely be consistent with a sound and constructive YBS program.

4. Small farmer with wheat and cattle operation seeks $300,000 to purchase spouse's dental practice

Facts: A small farmer operates a wheat and cattle operation. He rents all his land and equipment from his father and intends to take over and grow the operation as owner once his father retires. His spouse is a licensed dentist. They apply for $300,000 to purchase the local rural dental office. The income from this nonfarm business is needed for the farmer to continue and grow his operation.

Analysis: This farmer has a demonstrated intent to progress toward farming as his primary business and vocation. Financing this business enterprise helps the YBS farmer diversify and grow his operation; it also helps the local rural area by providing local dental care.

Result: This small farmer could be treated as a full-time farmer, and the loan would likely be consistent with a sound and constructive YBS program.

5. Beginning farmer seeks $2 million to purchase farmland

Facts: An applicant requests a $2 million loan from an association to purchase agricultural land. The association classifies him as a "beginning" farmer since he has less than 10 years of agricultural experience and this is his first purchase of agricultural land. While the property has the capacity to produce agricultural products, the farmer does not currently intend to engage in agricultural production. However, he does have sufficient ability to repay the loan with income generated by his nonagricultural business.

Analysis: Although likely eligible for this loan as a bona fide farmer due to his purchase of agricultural land, the facts suggest that this farmer has not demonstrated an intent to progress toward agricultural production as his primary business and vocation.

Result: While the association likely could make this loan and offer YBS credit enhancements, this beginning farmer should not be treated as a full-time farmer.

6. Small fruit and vegetable farmer seeks $65,000

Facts: A small farmer requests $65,000 to purchase a 1.5-acre rural plot near a large metropolitan area and $1,000 in operating funds for inputs and equipment to grow fruits and vegetables. The applicant is an immigrant to the United States who works in construction and sells produce at farmers' markets on the weekends. He would like to grow his small farm business by purchasing small plots of land as he can afford them, with the intention of moving out of construction except as needed to supplement his farm income. Produce sales currently bring in a modest annual income of approximately $5,000.

Analysis: This farmer represents a growing trend in agriculture in which immigrants run small, specialized agricultural operations. Although the farmer is currently working in construction, he has demonstrated a serious commitment to making farming his primary business and vocation.

Result: This small farmer could be treated as a full-time farmer, and the loan would likely be consistent with a sound and constructive YBS program.

7. Young, beginning farmer seeks $150,000 to start a vineyard

Facts: A young, beginning farmer who has a small general law practice in a rural town requests a $150,000 term loan to start a vineyard in her community on the property owned by her parents — property that she will one day inherit. The income from her small practice annually nets $45,000. She also requests a $30,000 term loan to improve the law practice. The applicant, who has had a serious interest in grape varieties, wines, vineyards, and wine regions for several years, intends to spend a portion of each day running the day-to-day operation. As her wine business grows, she intends to devote less and less time to the legal practice. Her business plan, submitted with the loan application, describes how she intends to implement her vision of developing a successful and prestigious label that will offer a variety of red and white wines.

Analysis: Although she is currently practicing law, this applicant has demonstrated the intention to make farming her primary business and vocation. The income from her law practice is critical to her entrance into the winemaking business, so providing financing for both her legal and agricultural needs will help her sustain and grow her winemaking operation.

Result: This young, beginning farmer could be treated as a full-time farmer, and these loans would likely be consistent with a sound and constructive YBS program.

For more information

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