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Shared Appreciation Agreements on USDA Farm Loans

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Summary

Shared appreciation agreements are agreements between the U.S. Department of Agriculture and borrowers who are unable to repay their debts. The agreements allow borrowers to have their debts "forgiven" temporarily and allow USDA to "share" in any appreciation of the property at the end of the term. Disputes have arisen about the original intent of Congress, with some borrowers suing in court to stop the U.S. Department of Agriculture from collecting payments. Recent regulatory changes have attempted to aid farmers in fulfilling their agreements. The new farm bill contains a provision to allow borrowers to restructure the amounts due.

What are Shared Appreciation Agreements?

When a borrower experiences difficulty in repaying a loan made by the U.S. Department of Agriculture's (**USDA**) Farm Service Agency (**FSA**[1]), USDA may restructure the loan and give priority to principal and interest write-off or set-aside. Thus, USDA can "forgive" portions of loans to farmers who can not make full repayment. In return for the forgiven portion of the loan, a borrower may be required to enter into a shared appreciation arrangement (**SAA**), which would allow USDA to share in the appreciation of the borrower's real estate property backing the loan. Appreciation is considered the gain in value between the time entered into an SAA and the time of repayment.[2]

The amount of the farm's equity in which USDA potentially can share is 75% of the appreciation in the case of agreements that last four years or less and 50% of the appreciation for agreements that last longer than four years. Repayment is required

[1] The Farm Service Agency previously was known as the Farmers Home Administration (**FmHA**).

[2] An exemption of certain capital improvements was granted in a regulation published on August 18, 2000. See "**Regulatory Changes**" below.

sooner if the property is conveyed (sold) —with the exception of transferring title to the spouse upon the death of a borrower— or if the operator ceases farming. In the event that a borrower's property value does not rise, no money is due. The maximum amount that can be recovered by FSA cannot exceed the amount written off. Prior to August 18, 2000, SAAs had a maturity period of 10 years. In a regulatory change on August 18, 2000, new SAAs would have a maturity period of five years (See "**Regulatory Changes**" below.).

Appreciation of the property's value is determined by appraisals. If an appraisal is obtained by FSA in order to determine the recapture amount prior to the expiration of the SAA, the borrower may appeal the appraised value and request an independent appraisal. At the end of the 10-year agreement, the borrower selects an appraiser from a list of FSA approved appraisers. If the borrower is unable to pay the recapture amount or obtain financing to do so, the recapture amount can be established as a loan and be repaid over a period of up to 25 years at a special, low interest rate. If payment cannot be made or a new note taken, the account is considered delinquent and processed for liquidation.

Authorizing Legislation and Intent of Congress

SAAs were instituted as part of the Agricultural Credit Act of 1987 (P. L. 100-233; H.R. 3030, January 6, 1988), which amended the Consolidated Farm and Rural Development Act ("**Con Act**," P.L. 87-128, August 8, 1961). (The Con Act is the authorizing statute for USDA farm loans.) The specific language of the Con Act (Sec. 353(e)) that deals with SAAs states:

"SHARED APPRECIATION ARRANGEMENTS.–

(1) IN GENERAL. –As a condition of restructuring a loan in accordance with this section, the borrower of the loan may be required to enter into a shared appreciation arrangement that requires the repayment of amounts written off or set aside.

(2) TERMS. –Shared appreciation agreements shall have a term not to exceed 10 years, and shall provide for recapture based on the difference between the appraised values of the real security property at the time of restructuring and at the time of recapture.

(3) PERCENTAGE OF RECAPTURE. –The amount of the appreciation to be recaptured by the Secretary shall be 75 percent of the appreciation in the value of such real security property if the recapture occurs within 4 years of the restructuring, and 50 percent if the recapture occurs during the remainder of the term of the agreement.

(4) TIME OF RECAPTURE. –Recapture shall take place at the end of the term of the agreement, or sooner–

(A) on the conveyance of the real security property;
(B) on the repayment of the loans; or
(C) if the borrower ceases farming operations."

The SAA provision was contained in the Senate version of the bill (S. 1665, Sec. 613(e)), but not in the House version (H.R. 3030). During conference, the provision was adopted into the enacted law (P.L. 100-233). Questions have arisen about the intent of Congress in authorizing SAAs, with some SAA participants believing no repayment would be required if the borrower remained in farming for 10 years. Senate Report 100-230 to accompany S. 1665 would appear to conflict with this view. It states that:

> "It is the Committee's intent that the Secretary shall administer the shared appreciation provisions so as to maximize the potential recovery of debt which has been written-off or set aside." [page 46-47]

and that:

> "As a condition of restructuring a loan, the borrower of the loan may be required to enter into a shared appreciation arrangement with FmHA that requires the repayment of amounts written off.
>
> Shared appreciation agreements shall have a term not to exceed 20-years, and shall provide for recapture based on the difference between the appraised values of the security property, which shall be real property, at the time of restructuring and at the time of recapture." [page 125]

According to the language in S. Rpt. 100-230 and language in the Con Act, Sec. 353(e), it appears that the Congress intended SAAs as a way to keep farmers on their farms, while at the same time allowing recovery of loan write-downs by the FSA. This was reinforced during Senate floor debate (*Congressional Record* Pages 33612-4, December 2, 1987) when Senators clarified that SAAs did require repayment, with the total repayment not to exceed the amount originally written-off.

Current Situation

Many borrowers are faced with a situation where the appreciation on the land has been substantial while they do not have funds to repay the amounts due. Some reports indicate that farmers are telling FSA that even though their land has appreciated enough to cover the forgiven portion of the loan, they still do not have the cash to pay because of depressed prices for many agricultural commodities. Thus, a significant percentage of the borrowers with SAAs coming to maturity during the years 1999 and 2000 were not able to repay the recapture amounts, according to USDA. In response, FSA issued a rule on April 23, 1999, allowing affected farmers to receive an extension on the repayment deadline. (See "**Regulatory Changes**" below.) Otherwise, some farmers would have been required either to use the appreciated land as collateral for a commercial loan or sell enough land to reimburse FSA.

In June 2001, 109 farmers in 16 states filed suit in the U.S. District Court in Bismarck, ND, challenging USDA's efforts to require payment under SAAs (Stahl et al. vs Veneman). The dispute arose from some borrowers' belief they had to repay the write-down amount only if they sold their farm or ceased farming within 10 years, while those who kept their property would owe nothing. Among their arguments in court documents were claims that: (1) The portion of debt written-off that was attributed to principal, was

reported to IRS as income due to discharge of federal indebtedness that was no longer collectable; and, (2) They were told by FSA employees that the SAA would go away after 10 years if they did not sell the land or cease farming. On August 22, 2001, a federal judge refused to order USDA to halt its collection on disputed loans while the lawsuit was pending. On May 20, 2002, the judge granted the government's motion to dismiss and the case was dismissed. The plaintiffs expect to appeal to the Eight Circuit Court.

Regulatory Changes

***Federal Register*, April 23, 1999 (Vol. 64, No. 78, Pages 19863-5).** Interim rule that allowed borrowers with SAAs ending in 1999 and 2000, who had not yet paid their obligation under the SAA or made arrangements to pay and could not pay the amount owed, to have all or part of their obligation suspended for one year. A suspension may be renewed twice (for a total suspension of up to three years). At each renewal, the borrower will receive a suspension limited to the portion of the recapture amount FSA determines, based on a Farm and Home Plan, that the borrower still is unable to repay at the time of the renewal request. The amount of the recapture payment subject to a suspension will accrue interest at a rate equal to the applicable federal borrowing interest rate, as determined by the FSA Administrator.

If a borrower wants to refinance the amount owed under an SAA, that must be requested within 30 days of receiving the notice requesting repayment. If the real estate is conveyed (sold), with the exception of transferring title to the spouse upon death of a borrower, during the suspension period, the recapture amount plus any applicable interest will become due immediately and payable under the notice procedures explained in the notice to the borrowers.

***Federal Register*, August 18, 2000 (Vol. 65, No. 161, Pages 50401-5).** Final rule that made the following changes:

1. Allow the value of some capital improvements made during the term of the SAA to be deducted from recapture. The value contributed by a dwelling, barn, grain storage bin, or silo, constructed during the term of the SAA, will be deducted from the final appraisal (i.e., when the SAA matures). If new construction is a replacement for, or an addition to, a structure, only the difference in value added will be deducted.

2. Change the maturity period of future SAAs from 10 years to 5 years. This change will reduce the burden of FSA in monitoring SAAs and allow the farmer to plan for the future without a contingent liability in the distant future.

3. Reduce the interest rate on shared appreciation loans (**SA loans**) to the Farm Program Homestead Protection rate. SA loans are approved when the borrower cannot pay the SAA. Previously, SA loans could be amortized for up to 25 years at non-program rates (10.25% as of March 1, 2000). Under this final rule, the rate is reduced to the Homestead Protection rate (6.75% as of March 1, 2000), which is below market and near the Federal borrowing rate.

According to FSA, these changes gave borrowers an opportunity to repay a portion of the debt that was written off, while still ensuring the government promptly recaptures some appreciation of the collateral.

Legislation

FY2001 Agricultural Appropriations (P.L. 106-387; Sec. 818). Changed the amortization rate on all future SA loans to the Homestead Protection rate less 1%. Additionally, the amortization rate on all SA loans in existence as of October 28, 2000, was similarly reduced. Regulatory changes published in the *Federal Register* on February 21, 2002, and effective March 25.

Farm Bill. Two separate provisions dealing with SAAs were included in the House and Senate passed farm bills (H.R. 2646 and S. 1731), but were dropped in conference in favor of different measure. (See below.)

House Farm Bill. Sec. 522 of H.R. 2646 would have provided a temporary suspension of foreclosure for borrowers who failed to make payments required under SAAs. Specifically, Sec. 522 would have prohibited USDA from foreclosing or requiring payments under SAAs until after December 31, 2002.

Senate Farm Bill. Sec. 531 of S. 1731 would have allowed SAA borrowers the option to grant USDA an agricultural use protection and conservation easement on the property subject to the SAA. The easement would have been for 25 years and would have required that the property "continue to be used or conserved for agricultural and conservation uses." Sec. 531 also would have allowed the easements for SAA borrowers who already had reamortized the recapture amount under an earlier agreement with USDA.

Farm Security and Rural Investment Act of 2002 ("Farm Bill," P.L. 107-171; Sec. 5314). Allows the Secretary to modify a recapture loan on which a payment has become delinquent if the default is due to circumstances beyond the borrower's control and the borrower has acted in good faith. Reamortized loans may not exceed 25 years and may not reduce outstanding principal or unpaid interest.