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Financing Arkansas's Agricultural Producers – A Brief Primer on Proper Collateral Securitization and Alternative Financing That Every Agricultural Lender Should Know

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Agricultural lenders now face significant competition in the agricultural credit market from not only banking institutions, but also many nonbank lenders, including the Farm Credit System, United States Department of Agriculture Farm Service Agency and agricultural vendors, such as equipment manufacturers and seed companies who provide limited-purpose financing for purchases of their products. To remain competitive in the increasingly competitive agricultural lending market, lenders must be able to provide producers with financing on terms comparable to those offered by others (namely, nonbank lenders), while managing the inherent risks presented by agricultural lending.

The risks associated with financing crop production are virtually unavoidable, as credit repayment is primarily dependent on successful crop production and marketing by the producer, and is often secured by illiquid collateral serving as the secondary source of repayment. Because of a producer's inability to control the weather, commodity prices and other factors affecting crop production, even the most prudent producer, as well as its lender, can be left with little control over sufficient yields and prices necessary for repayment of a loan. Set forth below is a brief primer on proper loan collateralization and alternatives available for extending crop production financing that every agricultural lender should know when extending credit for production of agricultural commodities.

I. Properly Securing Collateral

1. Real Estate as Collateral

If a production loan will be secured by real estate, a mortgage should be executed by all persons or entities with fee simple title to the real estate and filed of record in the office of the circuit clerk of the county where the property is located. Unless the mortgage is properly executed and filed of record, the lender's interest in the real estate may not be perfect. To ensure the mortgage is executed by the proper party(s), the lender should obtain a commitment for a title insurance policy from a title company to confirm the parties executing the mortgage are the legal owners of the real estate.

The mortgage must also be properly acknowledged. Unless a mortgage or any other instrument affecting the title to real property is properly acknowledged, it may not be filed of record. *See* Ark. Code Ann. §§ 16-47-101 and 18-12-208. The Arkansas General Assembly recently enacted a statute establishing forms of acknowledgement for all mortgages and other written instruments affecting the title to real property located in Arkansas. *See* Ark. Code Ann. § 16-47-107. A lender should confirm the mortgage's acknowledgement is consistent with the statutory form, as the statute also provides that any instrument containing the form acknowledgement is deemed to be valid and sufficient for recordation. *Id.*

Additionally, the mortgage must contain a maturity date or third parties may assume the mortgage is scheduled to expire five (5) years after the date the mortgage is filed of record. *See* Ark. Code Ann. § 18-40-103. *See also Clark v. Shockley*, 205 Ark. 507, 508 (1943).

With respect to the recording location, the mortgage should be filed of record in the office of the circuit clerk of the county where the property is located. In addition to recording in the proper county, in some instances a mortgage must also be recorded in the proper county district. Arkansas has ten counties with two county seats, or districts, which are as follows:

1. Arkansas County – DeWitt and Stuttgart;
2. Carroll County – Berryville and Eureka Springs;
3. Clay County – Corning and Piggott;
4. Craighead County – Jonesboro and Lake City;
5. Franklin County – Charleston and Ozark;
6. Logan County – Paris and Booneville;
7. Mississippi County – Blytheville and Osceola;
8. Prairie County – Des Arc and DeValls Bluff;
9. Sebastian County – Fort Smith and Greenwood; and
10. Yell County – Danville and Dardanelle.

If a mortgage is given on property located in any of these ten counties, it must be recorded in the office of the circuit clerk for the county and district where the property is located. For example, if a mortgage is given on real estate located in the Southern District of Prairie County, it should be recorded in the Office of the Circuit Clerk for the Southern District of Prairie County located in DeValls Bluff.

2. Farm Equipment and Crops as Collateral

Arkansas has adopted the Uniform Commercial Code ("UCC") with only minor variations. Revised Article 9 establishes the rules for acquiring and perfecting a lien on personal property, such as farm equipment and crops. *See* Ark. Code Ann. § 4-9-101, *et seq.* If farm equipment or crops will serve as collateral securing a production loan, a lender should require the producer to execute a security agreement granting the lender an interest in the equipment/crops. The security agreement must contain an accurate description of the personal property given as collateral for the production loan.

Under current law, a financing statement covering farm equipment/crops must be filed with the Office of the Arkansas Secretary of State to perfect the lender's interest in farm equipment/crops. To ensure the lender's interest has priority over any other securing interest, the lender should obtain copies of all UCC filings filed against the producer (and, if the producer is an entity, the persons owning an interest in the entity).

3. Crop Insurance as Collateral

It is common practice for lenders to require a producer to maintain certain types and amounts of crop insurance on the crops to be produced with the loan proceeds. Crop insurance basically comes in two varieties: (i) yield-based insurance, which insures against loss of crops caused by natural disasters such as droughts, floods and hail; and (ii) revenue-based insurance, which insures against revenue losses caused by yield or commodity price shortfalls. If crop insurance will serve as collateral for a production loan, the lender should have the producer execute a document assigning the producer's rights to the insurance proceeds to the lender. Because crop insurance is federally subsidized and because of the limitations imposed by the "actively engaged" requirements under the current Farm Bill, this author suggests use of a separate document for securing the lender's interest in any crop-insurance proceeds, in addition to requiring the insurance policy to name the lender as an additional insured.

It should also be noted that, while it is permissible for lenders to require producers to carry crop insurance in connection with a production loan, federal law prohibits a lender from requiring the producer to purchase crop insurance from a specific provider. Accordingly, the loan agreement should not require the producer to purchase crop insurance from a specific insurance agent or agency.

4. Government Payments as Collateral

Although direct and counter-cyclical payments were repealed by the current Farm Bill, program payments are still made under other farm and conservation programs administered by agencies of the United States Department of Agriculture, which can serve as collateral for a production loan and help with cash flow. The primary sources of program payments are paid through the two new safety net programs administered by the Farm Service Agency ("FSA")—Agricultural Risk Coverage ("ARC") and Price Loss Coverage ("PLC")—and the Conservation Stewardship Program ("CSP") administered by the Natural Resources Conservation Service ("NRCS"). If PLC, ARC or CSP payments will serve as collateral securing a production loan, the lender should require the producer to execute the proper document assigning the producer's rights to the payments to the lender.

To properly assign PLC and ARC payments, FSA Form CCC-36 should be used and filed with the FSA office for the county where the land subject to the payments is located and with the FSA office designated as the producer's "home office" by FSA. Unlike PLC and ARC, CSP is administered by NRCS, which has its own form of assignment. Specifically, NRCS Form CPA-1236 should be used for assignments of CSP payments and filed with the NRCS office for the county where the land subject to the payments is located and with the NRCS office located in the county where the producer's designated FSA home office is located.

II. Limiting Risk through Alternative Financing

1. FSA Guaranteed Loans

Lenders may limit the risk associated with production loans by extending credit under the Guaranteed Loan Program. The Program is administered by FSA and provides a credit safety net for both producers and lenders by allowing lenders to provide financing under competitive terms and with minimal risk. Loans available under the Program include loans to purchase farmland, livestock, farm equipment, insurance and inputs (such as seed, fuel and chemicals), construct or repair buildings, improvements and other fixtures, develop farmland to promote soil and water conservation, refinance existing farm debt and cover family living expenses.

Under the Program, the loan is made directly to the producer by the lender, and FSA provides the lender with a guarantee to cover up to ninety-five percent (95%) of loss of principal and interest incurred by the lender on the loan. FSA will guarantee loans under the Program of up to $1,399,000.00 (adjusted annually based on inflation). In exchange, the lender is charged a one and a half percent (1.5%) guarantee fee, which may be passed onto the producer. Interest rates are negotiated between the lender and the producer, but may not exceed the average rate offered by the lender for non-guaranteed loans. The guaranteed portion of the loan may be sold by the lender on the secondary market. Before a lender may participate in the Program, the lender must be certified as a "qualified lender" by FSA. To learn more about the Program and how to become a qualified lender, a lender should contact the local FSA office.

2. *FSA Emergency Loans*

When shortfalls caused by natural disasters present repayment issues, rather than extending additional credit (which, in turn, entails assuming additional risk) or foreclosing a loan, a lender may work with a producer to obtain additional credit through the Emergency Loan Program. The Program is administered by FSA and offers additional financing to producers in designated areas where property damage or production losses have occurred due to a natural disaster, such as flooding or drought. The designated areas consist of those counties declared by the President or designated by the Secretary of Agriculture as primary disaster areas or quarantine areas, as well as all counties adjacent to the counties declared or designated disaster or quarantined areas.

Under the Program, FSA will loan up to $500,000.00 directly to producers to cover losses of property, equipment and income resulting from the disaster. Specifically, emergency loan funds may be used to restore or replace property or equipment essential to the producer's farming operation, pay production costs incurred during the disaster year, refinance certain debts (excluding real estate) and pay essential family living expenses and for reorganizing farming operations. Emergency loans are generally structured on a repayment plan of between one and seven years. It should also be noted that the $500,000.00 limit on emergency loan funds is in addition to funds available to producers under the Guaranteed Loan Program and other programs administered by FSA (such as PLC, ARC and the Marketing Assistance Loan Program).