NORTH Dakota | Financial Institutions

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MEMORANDUM

TO: North Dakota Financial Institutions

FROM: Department of Financial Institutions

SUBJECT: Agricultural Lending During Periods of Economic Stress

DATE: February 11, 2020

During periods of economic stress, lenders may need to restructure existing operating, chattel, and real estate loans to address farm customers' diminished repayment capacities and to avoid default situations. Being proactive and addressing problems early is beneficial to all parties. As you review your options for working with distressed borrowers, prudent underwriting and administration practices remain necessary. Each borrower situation is unique and the options you utilize may vary. Although your starting point typically is to find out what the borrower can do on their end to make adjustments, there are times when the best option is to modify existing loans. Examples of modifications include the terming out of carryover operating loans, re-amortizing chattel and real estate loans over a longer time frame, rewriting credits under Federal government guarantee or participation programs, and temporary interest-only or reduced payment scenarios. There are a variety of Federal and State government programs available to assist, including programs from the United States Department of Agriculture (USDA) and Bank of North Dakota (BND), which recently announced several Ag Disaster Programs found here https://bnd.nd.gov/ag/.

Sometimes, the local, regional, or international agricultural environment results in farm producers experiencing problems due to issues out of their control. In these situations, a lender may choose to work with the producer by offering concessionary terms, such as longer amortizations or lower interest rates, to help the borrower meet debt service requirements even with diminished operating cash flows. These decisions are part of being a community bank or credit union and would not normally be subject to examiner criticism. However, appropriate risk identification and monitoring procedures still need to be in place. If underwriting standards are loosened or waived, these policy exceptions must be identified and tracked. In addition, these actions should be considered as part of the overall credit review process and when assigning the borrower's risk rating. Restructuring a credit does not automatically require a downgrade in risk ratings but should be considered as a part of the overall credit review process. Borrowers with weaker financial positions, collateral coverage, and/or cash flow projections may need to be downgraded to reflect their current condition. Management should also review the cumulative impact of distressed credits on the institution's liquidity and capital positions and overall risk profile[1].

The Department established an agricultural classification policy in 1987, which establishes that certain loans may not be classified if proper file documentation is maintained to support the loans. Examiners will continue to consistently use this policy as well as the well-established risk and classifications standards[2]. Although each loan is evaluated on a case-by-case basis, the loans will generally be treated as follows:

- Current year's operating lines are usually not classified, especially if credit file documentation suggests the operating debt can be repaid from crop sales, insurance proceeds, and government assistance payments.
- The guaranteed portions of Federal government guaranteed loans are generally not classified.
- Carryover debt is *not* automatically classified. The borrower's overall financial condition, collateral coverage, and repayment ability will also be considered. Also, carryover operating lines of credit should be segregated from current operating lines. Once all crop-related proceeds have been applied, the remaining balance should be appropriately secured by chattel and/or real estate and amortized over a reasonable time period depending upon the type of collateral and the borrower's repayment capacity.
- If the collateral margin is overwhelming, examiners *may* pass on farm real estate loans even when a borrower is experiencing negative cash flow and repayment capacities. There is no single standard to define what constitutes overwhelming collateral coverage. As always, this determination depends on the overall condition of the borrower and is determined on a case by case basis.
- In most situations, the current value of inspected and verified livestock and grain inventory will not be adversely classified. "Current" generally means no more than 90 days prior to the examination start date (180 days for breeding livestock). If the borrower is highly leveraged, operational viability is questioned, or if in an under-secured position, the crop and livestock may be classified. In these instances, it is important that the financial Institution has control over the sale proceeds.

Economic stress and difficult circumstances can have a negative impact on mental health and can affect both your borrowers and your employees. In October of 2019, the North Dakota Department of Agriculture released a statement expressing concern about producers' mental health, which can be found here https://www.nd.gov/ndda/news/resources-available-community-groups-individuals-assisting-farm-and-ranch-stress. The NDSU Extension service provides resources in understanding, identifying, and dealing with stress and mental health issues, which can be found here https://www.ag.ndsu.edu/farmranchstress. Finally, the North Dakota Department of Human Services provides resources which can be used to help identify red flags and assist you in getting your staff or your customers the help they may need. These resources can be found here https://www.behavioralhealth.nd.gov/prevention/suicide. Being vigilant of these risks and red flags can have a tremendous impact during difficult times.

[1] The FDIC issued the following Financial Institution Letter on January 28, 2020, and contains information and risk management concepts also applicable to credit unions: https://www.fdic.gov/news/news/financial/2020/fil20005a.pdf

[2] Further resources can be found here: FDIC Risk Management Manual (page 25-30) , and contains information and risk management concepts also applicable to credit unions: https://www.fdic.gov/regulations/safety/manual/section3-2.pdf.
Federal Reserve Bank Commercial Bank Examination Manual – Sections 2140 and 2142: https://www.federalreserve.gov/publications/files/cbem-2000-201905.pdf