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Background Information Revised March 19, 1998

USDA United States Department of Agriculture

Nonrecourse Marketing Assistance Loans and Loan Deficiency Payments

Statutory Authority

Sections 131 through 136 of the Federal Agriculture Improvement and Reform Act of 1996 (1996 Act), P.L. 104-127 (7 USC 7231-7236) require that a nonrecourse marketing assistance loan and loan deficiency payment (LDP) program be administered for the 1996 through 2002 crops of 16 commodities.

The Farm Service Agency (FSA), on behalf of the Commodity Credit Corporation (CCC), administers *nonrecourse marketing assistance loans* for wheat, corn, grain sorghum, barley, oats, soybeans, minor oilseeds (oil-type sunflowerseed, other-type sunflowerseed, flaxseed, canola, rapeseed, safflowerseed, and mustard seed), rice, upland cotton, and extra long staple (ELS) cotton. *Market loan repayment* and *loan deficiency payment* provisions apply to each of these commodities except ELS cotton.

Purpose

Loans provide eligible producers with interim financing on their eligible production and facilitate the orderly distribution of loan-eligible commodities throughout the year. Instead of selling the crop immediately at harvest, a nonrecourse loan allows a producer who grows an eligible crop to store the production, pledging the crop itself as collateral. The loan proceeds help an eligible producer to pay bills when they come due without having to sell the harvested crop at a time of year when prices tend to be lowest. Later, when market conditions may be more favorable, a producer may sell the crop and repay the loan with the proceeds of the sale.

Marketing assistance loans for each of the 16 commodities are *nonrecourse* in nature. That is, a producer has the option of *delivering* to CCC the quantity of a commodity pledged as collateral for a loan as full payment for that loan at loan maturity.

Market loan repayment provisions specify, under certain circumstances, that such loans may be repaid by a producer at less than principal plus accrued interest and other charges, with repayment of some portion of the relevant interest and principal being waived. Alternatively, the LDP provisions specify that, in lieu of securing a loan from CCC, a producer may be eligible for an LDP.

Market loan repayment and LDP provisions are intended to prevent delivery of loan collateral to CCC. In so doing, these provisions considerably reduce the Federal Government acquisition of stocks that might otherwise occur. Such stocks tend to make U.S.-produced commodities less competitive in world markets and may impose a significant taxpayer burden in the form of storage costs.

The market loan repayment and LDP provisions are discussed below.

Eligibility Requirements

There are a number of eligibility requirements for marketing assistance loans and loan deficiency payments which are related to either the producer, the commodity, or other commodity program provisions.

Beneficial Interest: A producer retains *beneficial interest* in a quantity of a commodity if all of the following remain with the producer:

- control of the commodity;
- risk of loss; and
- title to the commodity.

For loans, a producer must retain beneficial interest in the commodity from the time of harvest through the date the loan is redeemed or CCC takes title to the commodity. For LDP's, a producer must retain beneficial interest in the commodity from the time of harvest through the date the LDP is requested. Once beneficial interest in a commodity is lost, the commodity remains ineligible for a loan or an LDP even if a producer regains control, risk of loss, and title.

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For further information on beneficial interest, see the Farm Program Fact Sheet on ”Beneficial Interest Requirements for Loans and Loan Deficiency Payments, Excluding Sugar and Tobacco,“ or contact a local county FSA office.

Grade and Quality: The quantity of a commodity pledged as collateral for a nonrecourse loan must satisfy CCC’s minimum grade and quality requirements.

Contract Versus Noncontract Commodities: For the purposes of the Production Flexibility Contract program, wheat, feed grains, upland cotton, and rice are defined as *contract commodities*. Producers are eligible to receive loans and related benefits on all production of contract commodities on a farm with a Production Flexibility Contract, even if produced on noncontract acres. However, production on contract farms cannot be combined with that on noncontract farms to increase the quantity eligible for loan.

Oilseeds and ELS cotton are noncontract commodities. As such, all production of oilseeds and ELS cotton is eligible for loan, but the market loan repayment and LDP provisions do not apply to ELS cotton.

Conservation and Wetland Protection: To be eligible for commodity loans, a producer must comply with applicable conservation and wetland protection requirements.

Controlled Substances: A producer convicted under Federal or State law of planting, cultivating, growing, producing, harvesting, or storing a controlled substance is ineligible for commodity loans for that crop year and for the succeeding 4 crop years.

Foreign Persons: A foreign individual (person or entity) is eligible provided the individual satisfies FSA’s requirements for ”person” and “actively engaged“ determinations as they apply to a foreign individual.

Other: Other eligibility requirements may apply. For additional information, contact a local county FSA office.

Loan Rates

Loan rates are established annually at the national level. The national rates are based on a combination of statutory formulas and limits, and, to some extent, Secretarial discretion.

With the exception of rice, national loan rates for each marketing assistance loan commodity are adjusted to the local level (county or warehouse) to reflect spatial differences in markets, transportation costs, and other relevant factors.

Wheat: The national loan rate may not be less than 85 percent of the simple average price received by producers during the marketing years for the immediately preceding 5 crops, excluding the highest and lowest prices in those years (85-percent formula), but may not be more than $2.58 per bushel (the 1995 crop-year rate). The Secretary may reduce the wheat loan rate from the previous formula level by up to 10 percent if the estimated stocks-to-use ratio equals or exceeds 30 percent. A reduction not to exceed 5 percent may be made if the estimated stocks-to-use ratio is less than 30 percent but not less than 15 percent. No adjustment may be made if the stocks-to-use ratio is less than 15 percent.

Corn: The national loan rate is set using the same 85-percent formula, but the rate may not be more than $1.89 per bushel (the 1995 crop-year rate). The Secretary may reduce the corn loan rate from the previous formula level by up to 10 percent if the estimated stocks-to-use ratio equals or exceeds 25 percent. A reduction not to exceed 5 percent may be made if the estimated stocks-to-use ratio is less than 25 percent but not less than 12.5 percent. No adjustment may be made if the stocks-to-use ratio is less than 12.5 percent.

Other Feed Grains: The national loan rates for grain sorghum, barley, and oats are set in relation to corn, taking into consideration their respective feed values relative to corn. Because market prices are a function of relative feed values and other uses, average farm prices during the preceding 5 years relative to corn were used to determine grain sorghum, barley, and oats loan rates for the 1996

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and 1997 crops. Barring a change in procedure, relative prices will also be used to determine national rates for the 1998 through 2002 crops of these same commodities.

Rice: The national loan rate for the 1996 through 2002 crops of rice is statutorily frozen at $6.50 per hundredweight (the 1995 crop-year rate). This rate is differentiated for long, medium, and short grain rice.

Cotton: The national loan rate for upland cotton is the lower of the rate calculated from the 85-percent formula or the rate calculated from a formula based on adjusted world prices for upland cotton, but the rate may not be less than $0.50 or more than $0.5192 per pound. The ELS cotton national loan rate is set using the 85-percent formula, but the rate may not be more than $0.7965 per pound (the 1995 crop-year rate).

Oilseeds: The soybean national loan rate is based upon the 85-percent formula, but the rate may not be less than $4.92 or greater $5.26 per bushel. The national rate for each minor oilseed is based on the 85-percent formula applied to the prices of sunflowerseed, but the rate for each minor oilseed may not be less than $0.087 or more than $0.093 per pound.

Premiums and Discounts

Premiums and discounts are determined according to the grade and quality of a specific quantity of a commodity that a producer pledges as collateral for a loan. Premium and discount schedules vary considerably by commodity. On a per-unit basis, premiums are added to and discounts are subtracted from the loan rate relevant to the location where the collateral is stored at the time a loan is made. With the exception of ELS cotton, the same premiums and discounts which are applied to the loan rate of a given loan are also used in the loan repayment rate determination when a producer chooses to repay a loan.

Interest

The interest rate charged on a commodity loan is set at one percentage point above CCC's cost of borrowing from the U.S. Treasury at the time the loan is made. Once a loan is made, the rate is fixed except that the interest rate for loans outstanding on January 1 is adjusted to reflect CCC's cost of borrowing on January 1, plus one percentage point. The one-percentage-point adjustment is required by section 163 of the 1996 Act (7 USC 7283).

Accrued interest is the amount of interest that accrues while a loan is outstanding, starting with the day the loan is made. Accrued interest is calculated as (i) the applicable interest rate times (ii) the ratio of the number of days under loan (starting with the initial day and continuing through the day prior to the day a loan is repaid) to the number of days in a year (i.e., 365) times (iii) the loan principle.

Final Loan Availability Date

Loans and LDP's are available for eligible commodities from the time of harvest until the *final loan availability date*. For wheat, barley, oats, canola, rapeseed, and flaxseed, the final loan availability date is March 31 following the year in which the crop is typically harvested. For the other marketing assistance loan commodities, the final loan availability date is May 31 following the year in which the crop is typically harvested.

Loan Maturity

Statutory language requires that wheat, feed grain, rice, and oilseed loans mature on the last day of the ninth month following the month in which the loan is made; upland and ELS cotton loans mature after ten months, beginning on the first day of the month in which a loan is made. Although the statutory language on maturity for cotton loans differs from that of the other marketing assistance loan commodities, all of the commodities basically have the same length of time that loans on each may be outstanding. Note that a loan is *outstanding* if a producer has secured the loan from CCC, but has not settled the loan, either through repayment or delivery of the collateral to CCC.

The Secretary of Agriculture does not have explicit authority to extend any marketing assistance loan beyond the loan maturity date.

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A producer may repay a loan anytime after the loan is made through that loan's maturity date. The quantity of a commodity pledged as collateral for a loan may not be delivered to CCC in lieu of repayment prior to loan maturity.

ELS Cotton Loan Repayment Provisions

Market loan repayment and LDP provisions do not apply to ELS cotton. Thus, ELS cotton loans must be repaid at full principal plus accrued interest and other charges. A producer does have the option of delivering ELS cotton to CCC.

Market Loan Repayment Provisions

Market loan repayment provisions are relevant to the other 15 commodities. These provisions have several common features, but, due to statutory requirements and practical considerations, these provisions also differ in several respects among the various commodities. The common elements are discussed first.

Common: Market loan repayment provisions are *in effect* for the 1996 through 2002 crops of each of the marketing assistance loan commodities <u>except</u> ELS cotton. Market loan repayment provisions are *active* when the applicable alternative loan repayment rate, as determined by CCC, is less than the per-unit principal plus accrued interest, other charges, and, in the case of upland cotton only, per-unit storage costs, for a given outstanding loan.

A look at each of the components of the formula shows that the per-unit principal is the applicable loan rate at which CCC makes a loan to a producer. The *applicable loan rate* is the relevant crop year's base loan rate for the location where the commodity is stored, adjusted for per-unit premiums and discounts. Accrued interest, for the purposes here, is the amount of per-unit interest that has accrued through a particular day on which the repayment rate is being determined.

The *actual loan repayment rate, except in the case of upland cotton,* is the lesser of the applicable loan rate plus accrued interest, or the applicable *alternative repayment rate* that is announced by CCC. The *applicable* alternative repayment rate is the alternative repayment rate after all relevant adjustments for premiums, discounts and location have been made. The same set of premiums and discounts applied to the base loan rate for a given loan are also applied to the alternative repayment rate for that same loan.
The alternative repayment rate is determined by different methods for the commodities in question, and is announced at different times and is effective for different time intervals for the various commodities. These differences, including the variation from the general rule regarding the determination of the actual loan repayment rate for upland cotton, are discussed in the "Commodity Differences" section below.

Any portions of the interest and principal that do not have to be repaid because of the market loan repayment provisions (on a day when such provisions are active and a producer repays a loan) are *waived*. The portion of the principal, if any, that is waived when a loan is repaid is referred to as a *marketing loan gain* for the producer.

The market loan repayment provisions apply to a given nonrecourse marketing assistance loan through the maturity date of that loan. Any repayment after the loan maturity date must be made at full principal plus accrued interest.

Commodity Differences: The methods by which both base loan rates and base loan repayment rates are determined for the relevant commodities differ. Several differences are summarized in Table 1. In the case of repayments, the most notable differences regard how the alternative repayment rate is determined, and the manner in which storage costs are a factor in upland cotton loan repayments.

In general, the alternative repayment rate is equal to CCC's estimate of a competitive market price.

In the case of wheat, feed grains, and oilseeds, the alternative repayment rate is commonly known as the *posted county price (PCP)* and reflects CCC's estimate of a

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local market price for each of the relevant commodities. The actual loan repayment rate is determined as the lesser of the PCP adjusted for premiums and discounts or the applicable loan rate plus accrued interest and other charges. Because the value of wheat may vary considerably among the various classes of wheat, CCC announces separate PCP's for each of 5 classes (hard amber durum, hard red winter, soft red winter, hard red spring, and soft white).

In the case of upland cotton and rice, the alternative repayment rate is the *adjusted world price (AWP)* and reflects, as the name indicates, an estimate of world prices adjusted to the United States.

Unlike the other commodities, storage costs are a factor in the upland cotton loan repayment determination. The triggering mechanism that makes market loan repayment provisions active for a given upland cotton loan includes the accrued cost of storing upland cotton in an approved warehouse. More specifically, if the applicable AWP (that is, the upland cotton AWP adjusted by both a warehouse-location differential and premiums and discounts) is less than the per-unit *acquisition value* (represented by the sum of the applicable loan rate plus accrued interest plus per-unit storage cost), then market loan repayment provisions are active even though the applicable AWP may exceed the loan rate plus accrued interest (see examples in Table 2).

If the applicable AWP is greater than the acquisition value, the actual loan repayment rate equals the loan rate plus accrued interest. However, if the AWP is less than the acquisition value, the actual repayment rate is equal to the AWP minus the per-unit storage cost. When the latter situation arises, there is a per-unit *storage credit* on the loan repayment that is equal to the difference between the per-unit acquisition value minus the AWP, but in no case greater than the per-unit storage cost.

In certain circumstances, the alternative repayment rate for upland cotton may include a coarse count adjustment as well.

Loan Deficiency Payment Provisions

LDP provisions are *active* when the alternative repayment rate at a given location is less than the base loan rate at the same location, i.e., when the *payment rate* is greater than zero. When the provisions are active, an eligible producer may choose to receive an LDP in lieu of securing a loan if the quantity of a commodity is eligible for a nonrecourse loan. Premiums and discounts are not considered when determining the LDP rate. LDP provisions are in effect for a given loan-eligible quantity of a commodity until the *final loan availability date* for that commodity.

Storage costs and the storage credit that apply to the repayment rate calculation for upland cotton loans are not considered in the determination of the LDP rate for upland cotton.

Payment Limitations

The sum of marketing loan gains and loan deficiency payments for all crops during a crop year is limited to $75,000 per person.

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Table 1. Market Loan Repayment and LDP Provisions: Commodity Differences.

Commodity	Base Loan Rate			Alternative Repayment Rate					Final Loan Avail. Date b/
	Frequency a/	Location	Other	Frequency a/	Time	Effective	Method	Other	
Wheat	Annual c/	Vary by county	--	Daily	7am	1 day	PCP d/	Vary by class	3/31
Corn, Grain Sorghum	"	"	--	"	"	"	"	--	5/31
Barley, Oats	"	"	--	"	"	"	"	--	3/31
Soybeans	"	"	--	"	"	"	"	--	5/31
Minor Oilseeds	"	"	--	Weekly (Fri)	"	1 week	"	--	3,5/31 e/
Rice	"	Uniform across counties	Vary by kernel length f/	Weekly (Tue)	3pm (eastern time)	1 week g/	AWP h/	Vary by kernel length f/	5/31
Upland Cotton	"	Vary by warehouse location	--	Weekly (Thu)	5pm (eastern time)	1 week g/	AWP i/	Vary by warehouse location j/	5/31

a/ Frequency of announcement and frequency at which applicable rates are subject to change.
b/ The month/day shown for the final loan availability date is in the year following the year the crop was harvested.
c/ Loan rates are subject to change annually and apply to a given crop year for a commodity.
d/ The PCP (*posted county price*) method is based on a system of terminal market prices and differentials. CCC queries major terminal markets for each commodity to get market prices on a daily or weekly basis, as applicable. For each commodity, a county is assigned what have been determined to be the primary terminal markets (at most two) for that county. Differentials that reflect spatial price differences and/or transportation costs between that county and its assigned terminal markets are then used to calculate a PCP for that county, determined as the higher of the two terminal market prices after being adjusted by their respective differentials and any applicable temporary terminal market adjustments.
e/ The final loan availability dates are March 31 for flaxseed, canola, and rapeseed, and May 31 and for oil- and other-type sunflowerseed, safflowerseed, and mustard seed.
f/ Long, medium, and short grain rice.
g/ When the lower rate provisions are "active" for rice or upland cotton, the effective week excludes the 1 hour prior to the time that the next announcement is made (commonly known as the "dead hour"). That is, loan repayments at a rate less than the loan rate plus accrued interest are not accepted during the 1-hour period preceding the announcement. However, a producer with a farm-stored loan may lock in a repayment rate, such as a rate in effect prior to the "dead hour", and repay at that rate at a later time, such as during the "dead hour".
h/ The AWP (*adjusted world price*) for rice is based on a formula that uses recent rice prices in world markets.
i/ The AWP for upland cotton is derived from the average price of the world's 5 lowest-priced cottons according to a statutorily-prescribed formula.
j/ The loan repayment rate at a given warehouse location equals the loan rate plus per-unit accrued interest if the AWP (adjusted for the applicable warehouse location and premiums and discounts) exceeds the CCC acquisition value (loan rate plus the per-unit sum of accrued interest and storage costs). If the appropriately adjusted AWP is less than the acquisition value, the loan repayment rate on loans is equal to the AWP less the per-unit storage costs. The warehouse-location adjustment is calculated as the difference between the national loan rate and the base loan rate at the warehouse where the upland cotton is stored. Storage costs are not a factor in the determination of the LDP rate for upland cotton.

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Table 2. Loan Repayment and LDP Examples under Different Repayment Rate Scenarios (Per-Unit Basis).

Commodity ->	Corn				Wheat a/				Upland Cotton			
Repayment Rate Scenario ->	1	2	3	4	1	2	3	4	1	2	3	4
Item	$/Bushel				$/Bushel				$/Pound			
A. National Loan Rate	1.89	1.89	1.89	1.89	2.58	2.58	2.58	2.58	0.5192	0.5192	0.5192	0.5192
B. Warehouse Location Differential b/									0.0008	0.0008	0.0008	0.0008
C. Base County (or Warehouse) Loan Rate (A+B)	1.75	1.75	1.75	1.75	2.60	2.60	2.60	2.60	0.5200	0.5200	0.5200	0.5200
D. Premiums (+) and Discounts (-), Net	-0.06	-0.06	-0.06	-0.06	-0.08	-0.08	-0.08	-0.08	-0.0350	-0.0350	-0.0350	-0.0350
E. Applicable County (or Warehouse) Loan Rate (C+D)	1.69	1.69	1.69	1.69	2.52	2.52	2.52	2.52	0.4850	0.4850	0.4850	0.4850
F. Days Loan Outstanding Prior to Day Loan May Be Repaid	231	231	231	231	231	231	231	231	126	126	126	126
G. Accrued Interest ((F/365)*IntRate*E) c/, d/	0.07	0.07	0.07	0.07	0.10	0.10	0.10	0.10	0.0109	0.0109	0.0109	0.0109
H. Accrued Unpaid Storage per Unit b/, c/									0.0249	0.0249	0.0249	0.0249
I. Loan Rate plus Accrued Interest (E+G)	1.76	1.76	1.76	1.76	2.62	2.62	2.62	2.62	0.4959	0.4959	0.4959	0.4959
J. Loan Rate plus Acc. Interest plus Acc. Unpaid Storage (H+I) b/									0.5207	0.5207	0.5207	0.5207
K1. Terminal Market X Price e/, f/	2.50	2.25	2.20	2.15	3.75	3.35	3.40	3.30				
L1. Differential X (terminal market X to county) f/	-0.45	-0.45	-0.45	-0.45	-0.75	-0.75	-0.75	-0.75				
K2 Terminal Market Y Price e/, f/	2.60	2.17	2.10	2.05	3.50	3.10	3.05	2.95				
L2. Differential Y (terminal market Y to county) f/	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45				
M. PCP (greater of K1+L1 or K2+L2) f/, g/	2.20	1.80	1.75	1.70	3.06	2.65	2.65	2.55				
N. PCP Adjusted for Net Premiums & Discounts (M+D) f/, h/	2.14	1.74	1.69	1.64	2.98	2.57	2.57	2.47				
O. Actual Loan Repayment Rate (lesser of I or N) f/, i/	1.76	1.74	1.69	1.64	2.62	2.57	2.57	2.47				
P. Interest Waived per Unit (lesser of (greater of 0.00 or I-0) or G) f/	0	0.02	0.05	0.07	0	0.05	0.05	0.10				
Q. Marketing Loan Gain per Unit (greater of 0.00 or E-0) f/	0	0	0	0.05	0	0	0	0.05				
R. LDP Rate (greater of 0.00 or C-M) e/, f/	0	0	0	0.05	0	0	0	0.05				
S. Adjusted World Price (AWP) b/									0.5600	0.5400	0.5200	0.5100
T. AWP Adjusted by Warehouse Location Differential (S+B) b/, j/, k/									0.5608	0.5408	0.5208	0.5108
U. Applicable AWP, as Adjusted for Premiums & Discounts (T+D) b/, l/									0.5258	0.5058	0.4858	0.4758
V. Actual Loan Repayment Rate (if U less than J, then U-H; else I) b/, m/									0.5207	0.4809	0.4609	0.4509
W. Storage Credit per Unit (if U less than J, lesser of J-U or H; else 0) b/									0	0.0150	0.0249	0.0249
X. Interest Waived per Unit b/, n/									0	0	0.0101	0.0109
Y. Marketing Loan Gain per Unit (greater of 0.00 or g-l-m) b/, o/									0	0	0	0.0092
Z. LDP Rate (greater of 0.00 or C-T) b/, p/									0	0	0	0.0092

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Table 2. Loan Repayment and LDP Examples under Different Repayment Rate Scenarios (Per-Unit Basis).

a/ In practice and here, the base loan rates at the national and county levels are announced on an all-wheat basis. Premiums, discounts, terminal market prices, differentials, PCP's and repayment rates are calculated by class of wheat, both in practice and for the purposes of this example.

b/ Applies to upland cotton example only; does not apply to corn or wheat.

c/ In practice, these calculations, shown here on a per-unit basis, are based on the quantity of the commodity pledged as collateral for a loan or the quantity on which an LDP may be made.

d/ IntRate = Interest Rate. The interest rate is assumed to be 6.5 percent for the life of the loan. Accrued interest per unit is rounded to the nearest cent for the corn and wheat examples and to the nearest hundredth of a cent for the upland cotton example. In practice, rounding is done only when the repayment amount on the total quantity to be repaid has been determined.

e/ Terminal markets applicable to a given county may not apply to a neighboring county. Furthermore, the terminal markets applicable to a given county will not be the same for each commodity.

f/ Applies to corn and wheat examples only; does not apply to upland cotton.

g/ Discussed in the text as the *alternative repayment rate* as it relates to wheat, feed grains, and oilseeds.

h/ Discussed in the text as the *applicable alternative repayment rate* as it relates to wheat, feed grains, and oilseeds.

i/ Discussed in the text as the *actual loan repayment rate* as it relates to wheat, feed grains, and oilseeds.

j/ Discussed in the text as the *alternative repayment rate* as it relates to upland cotton.

k/ Coarse count adjustment is assumed to be zero in this example.

l/ Discussed in the text as the *applicable alternative repayment rate* as it relates to upland cotton.

m/ In words, if the applicable AWP is less than the applicable loan rate plus per-unit accrued interest plus per-unit unpaid storage costs, then the actual loan repayment rate is the applicable AWP less the per-unit unpaid storage costs. If the applicable AWP is greater than or equal to the sum noted, the actual loan repayment rate is the applicable loan rate plus per-unit accrued interest.

n/ If the applicable AWP is less than the applicable loan rate plus per-unit accrued interest plus per-unit unpaid storage costs, then per-unit interest waived is the lesser of (i) the per-unit accrued interest or (ii) the greater of zero or the loan rate plus per-unit accrued interest less the applicable AWP. If the applicable AWP exceeds the applicable loan rate plus per-unit accrued interest plus the per-unit unpaid storage costs, then per-unit interest waived is equal to zero.

o/ If the applicable AWP plus per-unit interest waived is less than the applicable loan rate plus per-unit accrued interest, then the marketing loan gain rate (per-unit principal waived) is equal to the applicable loan rate plus per-unit accrued interest less the sum of the applicable AWP plus the per-unit interest waived. Otherwise, the marketing loan gain rate is zero.

p/ The loan deficiency payment rate calculation does not include an adjustment for unpaid storage costs.