

Executive Summary

July 2015

Term limits, which impose a statutory maximum on the number of years a farmer may receive a Farm Service Agency (FSA) direct operating loan (DOL), do not appear to have had a major impact on FSA borrowers in the past two decades. A vibrant farm economy, together with ample credit availability, has combined to enable farmers to be more reliant on commercial credit sources and less reliant on FSA. Some groups, however, are more likely to be adversely affected by term limits. Given current farm income expectations, crop farms using 1-year DOLs, mid-size family farms, and those in more economically depressed regions appeared to be more vulnerable to term limits.

FSA may obligate DOL funds to an eligible farmer in 6 calendar years before the term limit is reached. The years need not be consecutive, and multiple loans received during a year count only against 1 year of eligibility. The enforcement of term limits is waived for beginning farmers through their 10th year of farming. Waivers for 2 years are also provided, on a case-by-case basis, provided borrowers continue to meet all other eligibility criteria. Youth loans and microloans to beginning farmers and veterans are exempt and do not count against the limitation. Key findings include, as follows:

Less than 1 Percent of DOL Borrowers Reach Term Limits Each Year—On average, about 400 borrowers reach term limits each year, representing less than 1 percent of all borrowers with outstanding DOL indebtedness. Since legislation mandating term limits was passed in 1992, the total number of borrowers who had reached term limits through December 31, 2014, was 5,639. Most borrowers have received DOL loan funds in only 1 or 2 years, likely reflecting the strength of the farm economy and the ample availability of commercial credit at reasonable rates and terms.

Changing Farm Economic Conditions Likely to Influence DOL Demand—Given projections for a weaker farm economy, the number of farmers reaching term limits is likely to increase in upcoming years. Expectations for tighter farm profit margins and lower farmland values will likely cause lenders to exercise more discretion, which would reduce credit availability and raise the demand for DOLs. Meanwhile, working capital constraints could lead farmers to rely more heavily on credit to finance annual production expenditures. These factors, when taken together, could reduce existing DOL borrowers' ability to improve their financial status and graduate to private lending.

Relative to Other Direct Borrowers, Farms Reaching Term Limits Are Not Necessarily Less Financially Sound—Borrowers reaching term limits through 2012 were less solvent than other direct borrowers, but that has not been true in more recent years. Also, there has been little discernable difference in profitability and debt coverage capacity between term-limited and other direct borrowers. Farms reaching term limits have tended to be larger in terms of annual sales than the average DOL borrower and are located in the Northeast, Lake States, or Northern Plains. There is no indication that borrowers either were forced into liquidation or reduced their scale of operation subsequent to reaching term limits.

Most Term-Limited Borrowers Would Have Difficulty Obtaining Commercial Credit— Most DOL borrowers who reached term limits since 2005 do not appear to be sufficiently creditworthy to meet commercial lender underwriting standards. It is estimated that fewer than 15 percent of term-limited borrowers would likely meet commercial underwriting criteria as defined by an FSA classification of commercial. While some term-limited borrowers could qualify for FSA guarantees, such an outcome is unlikely for most term-limited borrowers, given their marginal creditworthiness

Term Limits Are More Likely to Affect Crop Producers—Term limits are calculated based on the years in which loan funds are received rather than years over which the borrower maintains an outstanding balance. Consequently, crop farmers—who often rely on annual loans to cover expenses necessary to plant a crop—would more likely be adversely affected by term limits than livestock producers, who more commonly use intermediate-term OLs with 7-year terms. Crop producers represented 36 percent of all DOL borrowers since 2005, but crop producers also represented 50 percent of those who have reached term limits. Among this group, grain, oilseed, and fiber producers represented one-fourth of all borrowers and 45 percent of those reaching term limits.

Most Term-Limited Borrowers Remain Active FSA Credit Customers—Farm borrowers who reach their term limit can still maintain an outstanding DOL balance and participate in other FSA credit programs. Most term-limited borrowers maintain a loan balance for several years with over half of those reaching term limits since enactment in 1992 still being active borrowers at year-end 2014. On average, only 15 percent of term-limited borrowers have managed to completely pay off their outstanding direct indebtedness each year. Over 8 percent received a direct farm ownership or emergency loan after reaching the term limit, and over 15 percent received an FSA-guaranteed loan. Seventeen percent had loans that were later restructured. Eight percent of term-limited borrowers had liquidated their operations and resolved the remaining FSA debt through debt settlement. Of those remaining, over 90 percent still had an active interest in a farm or ranch as indicated by their eligibility to vote in elections for the 2015 FSA county committee.

Term Limits Have Limited Impacts on Targeted Groups—Over three-fourths of all DOL obligations are targeted to beginning or socially disadvantaged (SDA) farmers. Nearly 75 percent of term-limited borrowers used their 6 years of eligibility as beginning farmers. Because beginning farmers receive a term-limit waiver, they may continue to receive DOLs, provided they are still deemed to be beginning farmers. And, non-beginning SDA farmers have represented only 10 percent of term-limited borrowers

Introduction

Term limits impose a statutory limit on the number of years that a farm borrower may receive loan funds through programs administered by the U.S. Department of Agriculture (USDA). Direct operating loans (DOLs) were established under Section 311(c)(2) of the Consolidated Farm and Rural Development Act (ConAct) for qualified farmers. Term limits of 6 years were initially enacted for both direct and guaranteed farm ownership (FO) and OL programs by the Agricultural Credit Improvement Act of 1992.¹ Term limits have never applied to emergency loan (EM) borrowers. Subsequent legislation exempted direct FO and all guaranteed loan programs from any term-limit provisions. Microloans made to veterans and beginning farmers are also exempt from term limits. Also, the limitation does not apply if the borrower's farm is subject to the jurisdiction of an Indian tribe. Waivers are granted in some circumstances, enabling FSA to obligate DOL loans to borrowers for 7 or more years. Waivers are granted to qualified beginning farmers through their 10th year of farming. Non-beginning farmers may receive a 2-year waiver, provided the operation is viable, the borrower has or will complete financial training, and commercial credit is unavailable.

By limiting the number of years a farmer may receive loan funds, term limits ensure FSA's role as a temporary credit source. Term limits also encourage creditworthy borrowers to pursue commercial credit in an effort to preserve years of direct loan eligibility for use in case of a financial setback. As greater numbers of farm borrowers reach their term limits, there is an increasing concern about possible adverse impacts: Are there creditworthy, but term-limited, borrowers who will confront less reasonable rates and credit terms, or who may be forced into partial liquidation? Are there regions and/or production types where a notable share of term-limited borrowers may have an adverse impact? Do term limits adversely affect the Government's ability to serve as a safety net to agricultural credit markets?

Borrowers are expected to transition, or graduate, to private sources of credit over time (Section 345 of the ConAct; 7 CFR 765.101). Farmers considered viable for commercial credit may be required to refinance their direct loans with a commercial lender.² Eligibility to receive additional direct loans requires borrowers to develop a feasible plan, which is defined as a business plan projecting a positive margin after debt service and a positive overall cash flow. Borrowers unable to develop a feasible plan are ineligible for any new direct loans.

Section 5104 of the Agricultural Act of 2014 amended Section 311 of the ConAct to require an annual report on term limits for direct operating loans (see Appendix 1). This study estimates the number and location of current and past direct borrowers who have reached term limits, and their structural, demographic, and financial characteristics. Economic impacts on farm borrowers who have thus far reached term limits are also examined, as well as impacts on future

¹ The ConAct states that an applicant is eligible for a direct operating loan if they received a DOL in 6 or fewer years. The regulations (7 CFR 764.252) state that an applicant is not eligible if they have closed a DOL in 7 or more years. In effect, a borrower has 6 full years of eligibility. Upon receipt of a loan at any time during the 7th year, they become ineligible for any further assistance. This report uses the terminology of 6 full years of eligibility in defining the duration of the term limit.

² The process for evaluating a borrowers potential for graduation to commercial credit is described in Section 4 of 4-FLP Direct Loan Servicing (<http://fsaintranet.sc.egov.usda.gov/dps/services/downloadhandler.ashx?fileid=17989>).

borrowers. The study also addresses how expected farm economic conditions may affect the future demand and role of FSA direct loan programs.

Status of Direct OL Program

FSA administers direct and guaranteed loan programs through 2,117 service centers. Guaranteed loans are made and serviced by commercial lenders, but are guaranteed by USDA. Supplying only 2.3 percent of overall farm debt in 2014, direct loans do not represent a major source of credit to agriculture (Figure 1). However, this understates their role as a safety net, as reflected in higher market shares during the farm financial crisis of the 1980s when FSA's share peaked at 24.3 percent.

Also, aggregate market shares can under-represent the importance of FSA credit to targeted groups and economically depressed regions. In many areas of the Northeast, Appalachia, Southeast, and Mountain West, over 20 percent of indebted farmers have turned to FSA for credit since 2011 (Figure 2). FSA credit also tends to be important among targeted groups, such as SDAs and beginning farmers. From 1994 through 2014, the share of DOL funds going to these targeted groups increased from 25 to 75 percent. In many southern states, a majority of indebted racial minority family farms have received an FSA loan in the past 5 years.

As aggregate FSA market share has declined from peaks reached during the 1980s, defaults and loan write-offs have likewise declined, reflecting the strength of the farm economy and changes in Federal credit policies and procedures. Since the mid-1990s, the share of DOL borrowers who were 30 days or more in default has declined from over 25 percent to 12.3 percent in 2014 (Figure 3). Likewise, the share of DOL borrowers receiving write-offs on any direct loan has fallen from nearly 5 percent to less than 1.5 percent.

Despite declining aggregate market share, FSA credit programs continue to play an important role in farm credit markets. Since 2008, both the amount of dollars lent and number of borrowers receiving DOLs have increased. In real terms, the amount of DOL obligations in fiscal year 2014 was the highest since 1989 (Figure 4). While mostly due to greater loan size limitations and the increasing capital needs among farm businesses, this may also reflect increasing risk in the farm sector, as well as increased marketing efforts and eased eligibility criteria. Also, FSA is seldom the sole credit provider and works closely with commercial lenders in providing joint financing to family farm operations.

DOLs have tended to be more heavily used by livestock producers, who comprised over 60 percent of new borrowers since 2005, rather than crop producers (Figure 5). Among production specialties, beef farms represent the largest share, comprising 46 percent of all borrowers, followed by corn-soybean and dairy operations, at 12 percent each.

Farm Economic Outlook

In sharp contrast to the record farm incomes and increasing farmland values that benefited farmers through 2012, the current outlook is less optimistic. Net farm income in 2015 is expected to decline for the third consecutive year, falling 43 percent from the record level achieved in 2012 ([USDA, ERS, 2015 Farm Sector Income Forecast](#)). Despite recent reductions in farm income, the financial health of the farm sector remained strong through 2014. Farmers'

median household income—including non-farm income—remains at historic highs and above that of non-farm households ([USDA ERS, 2015 Farm Sector Income Forecast](#)). Through 2014, farmland values remained strong, thereby embellishing farmers' balance sheets. From 2009 through 2014, USDA reported farm real estate gains exceeding 20 percent in 20 States (including the largest agricultural producing regions) ([USDA NASS](#)). Aggregate debt-asset ratios remain at historic lows, while U.S. farm equity is at record highs.

In the first quarter of 2015, loan repayment rates slowed significantly, with lenders' expectations for loan repayments at 10-year lows ([Federal Reserve Bank of Kansas City, Ag Credit Survey](#)). Likewise, requests for renewals and extensions of agricultural loans increased dramatically in the first quarter of 2015. In the Kansas City Federal Reserve district, lender expectations indicate that demand for non-real estate farm loans in 2015 will be the highest since 1980. Even so, past-due loans at Farm Credit System and commercial banks declined to 7-year lows in 2014 (Federal Reserve Bank of Kansas City, [Agricultural Finance Databook](#); Federal [Farm Credit Banks Funding Corporation](#)). There is no immediate indication that worsening credit conditions are causing lenders to curtail lending, but lenders are expressing increasing concern regarding farm incomes and future repayment ability. Through the first quarter of 2015, bankers were still indicating they were positioned to meet credit demand but were anticipating higher defaults and more renewals and extensions than in the past year (Federal Reserve Bank of [Kansas City Agricultural Credit Survey](#), Federal Reserve Bank of [Chicago Agletter](#), and Federal Reserve Bank of [St. Louis Agricultural Finance Monitor](#)).

With corn and soybean prices at 5-year lows, crop farms experienced sharply lower incomes in 2014 and are expected to continue to face tight profit margins in 2015, thereby draining available working capital. Dairy farms experienced relatively high incomes in 2014, but increased production and growing worldwide competition for dairy products have resulted in a 34-percent decline in milk prices since 2014. Income prospects for livestock and poultry producers remain strong, but higher costs for non-feed items, especially purchased livestock, will likely result in a greater need for working capital. All of these factors point to an increased aggregate demand for operating credit.

Even though farmers' balance sheets indicate sufficient equity to fund increased working capital requirements, 80 percent of this equity is in real estate. Historically, farm businesses have used credit to access the equity in real estate to cover unexpected shortfalls. Lenders' ability to meet this demand will likely be influenced by land values. Since the first quarter of 2014, lender surveys conducted by the Federal Reserve Banks of Kansas City, St. Louis, and Chicago have all reflected steady to decreasing farmland values. In corn-soybean producing regions, bankers reported declining land values through the first quarter of 2015. Tight margins and lower land values may cause lenders to exercise more discretion in dispensing credit in upcoming years, thereby reducing future credit availability.

Farm Business Financial Conditions

Increasing farm asset values until recently, combined with high farm incomes experienced through 2012, have provided farms with a high degree of financial resilience. Farm income per farm business in 2013 was \$98,976, generating a return on assets of 3.4 percent (USDA, Agricultural Resource Management Survey (ARMS)). The share of farms considered financially vulnerable, defined as those with a debt-asset ratio greater than 40 percent and having a negative

farm income, was 2.8 percent at the end of 2013. Solvency was also high, with debt-asset ratios at 10.6 percent and average net worth of \$992,782. This net worth provides a strong cushion against losses. Among farms experiencing a loss in 2013, 90 percent could have withstood these losses for 5 or more years before equity was depleted.

Regardless of their solvency, most farms are constrained by working capital due to the mismatch in timing of income and expenses. In 2013, farm businesses had working capital sufficient to meet only half of their farm expenses (USDA, ARMS). Also, outstanding farm debt has become more concentrated among fewer farms that tend to be more financially stressed. While only 2.8 percent of farms were financially vulnerable, these farms held 15 percent of total farm debt (USDA, ARMS). Even though the average debt-asset ratio for all farms has declined, the average debt-asset ratio for indebted farms remains relatively high. At the end of 2013, the average debt-asset ratio for indebted farms was 28.6 percent, compared to 10.6 percent for all farms (USDA, ARMS).

Aggregate statistics also ignore the complex nature of many intergenerational farms. Over one-fourth of all farm businesses have a beginning farmer present as either a primary, secondary, or tertiary operator. These young/beginning farmers may face significant capital constraints, despite the financial resilience of the overall farm business. For example, farm assets (and resultant net worth) may be controlled by parents or grandparents, or ownership shares may be diluted among numerous heirs.

Despite the overall strong financial resiliency of U.S. farm businesses, several factors—including asset illiquidity, working capital constraints, concentration of debt among more financially stressed farms, and the financing of intergenerational transfers—suggest farm businesses will be increasingly reliant on lender-supplied credit. Increased credit demand, combined with greater discretion by lenders, will likely increase the demand for DOLs. Likewise, these same factors will likely reduce farmers' ability to improve their financial status and graduate to private lenders. Consequently, the number of farmers reaching term limits is likely to increase.

Impacts of Term Limits on FSA Loan Portfolios

Since the implementation of term limits, 5,639 borrowers had hit the term limit as of December 31, 2014.³ On average, about 400 borrowers reach term limits each year, comprising less than 1 percent of all DOL borrowers (Figure 6). Most of the farmers who reach term limits remain active in FSA programs. Even though they are unable to utilize DOLs, term-limited borrowers may still use other FSA credit programs and maintain outstanding direct loan balances. Of the 5,639 borrowers who have hit term limits, 2,931 had an outstanding direct loan balance at year-end 2014 (Table 1). This includes borrowers with an outstanding direct farm ownership (FO), emergency (EM), and/or DOL loan. About 6 percent of the 5,639 term-limited borrowers had received an FO or EM loan after reaching the OL term limit. Another 15 percent received FSA guaranteed loans. Over 15 percent of term-limited borrowers benefited from primary loan servicing.⁴ About 8 percent of term-limited borrowers appeared to have exited farming as

³ The number of borrowers reaching term limits is based on the total number of years DOL funds were received as of December 31, 2014. Beginning farmers who started farming after 2004 were excluded from the total of 5,639 term-limited borrowers.

⁴ Direct program borrowers who are 90 or more days in default and financially distressed are eligible to receive primary loan servicing under 7 CFR 766.101. Under this provision, an eligible borrower is eligible to receive loan

indicated by debt settlements. Reflecting the high level of targeting, 75 percent of those reaching term limits were beginning farmers in the last year in which they received a DOL.⁵ Over 90 percent of term-limited borrowers still had an interest in a farm or ranch as indicated by eligibility to vote in the elections for the 2015 FSA county committee (COC).⁶

While there are some term-limited borrowers in all states, their presence tends to be regionally concentrated (Figure 7). In fact, about half were in 25 congressional districts (see Appendix 3). The distribution of term-limited borrowers largely reflects historical DOL usage, which has been greatest in the Northern Plains, Lake States, and western Corn Belt. Nearly a third of borrowers reaching term limits have been in the Northern Plains and Corn Belt (Table 2). Borrowers in the upper Midwest and Northeast are relatively more likely to be close to reaching term limits than borrowers in other regions. For example, Northeast borrowers represent only 6.9 percent of all DOL borrowers, but over 10 percent of borrowers with 2 or fewer years of remaining eligibility (Table 2).

In 2014, half of all borrowers reaching their term-limits were beef or dairy farms (Figure 8), reflecting the importance of DOLs to these operator types. For example, since 2012, dairy's share of borrowers reaching their term-limits has been 1.5 to 2 times their share in the total DOL portfolio. Livestock producers typically use DOLs with 7-year terms to cover intermediate expenditures such as purchases of breeding stock. Crop farmers, in contrast, often require annual loans to cover operating expenses. Producers of grain, oilseeds, and fiber only represented one-fourth of all DOL borrowers, but 45 percent of those reaching term limits since 2005.

Since 1993, more than two-thirds of farms have utilized FSA DOLs for 2 or fewer years (Table 3). Nearly 45 percent of DOL recipients since 1993 have not borrowed from FSA since before 2005. Of all 97,447 borrowers who received DOL loans since 1993, less than 5 percent had reached term limits by the end of 2014. Some borrowers had used over 6 full years of eligibility, reflecting exceptions granted to beginning farmers and to microloan borrowers, and the issuance of waivers.⁷

Characteristics of Borrowers Who Have Reached Term Limits

Most DOL borrowers who reached term limits since 2005 do not appear to be sufficiently creditworthy to meet commercial lender underwriting standards. Only 15 percent of term-limited borrowers had an FSA score indicating a potential for graduation to commercial lending. In addition, term-limited borrowers have been more highly indebted than other FSA borrowers. FSA's Farm Business Plan data indicate that the average debt-asset ratios for term-limited

consolidation, rescheduling, re-amortization, interest rate reduction, deferral, write-down, or any combination of these actions. A borrower qualifying for primary loan servicing is entitled to receive these restructuring provisions on all outstanding direct FO, OL, and EM loans.

⁵ Term limits do not apply to youth loans or DOL microloans made to beginning farmers and/or veterans. While term limits apply to all other regular DOLs, beginning farmers receive a waiver on their enforcement. Thus, beginning farmers may continue to receive a DOL past the 6-year limit as long as they continue to meet the eligibility criteria for beginning farmers.

⁶ Eligible voters in FSA county committee elections include individuals of legal voting age who have an interest in a farming operation that participates or cooperates in any FSA program.

⁷ A borrower may receive a one-time waiver of term limits for up to 2 years provided the borrower has completed borrower financial training and has a *feasible plan*. The borrower must also be unable to obtain credit from a commercial lender.

borrowers exceeded 50 percent, and a third had debt-asset ratios exceeding 70 percent. The aggregate debt-asset ratio for all U.S. farms was 11 percent.⁸ Farm Business Plan data also indicate that less than a third had positive working capital at the time they reached their term limits.

It was not readily apparent in recent years, however, that term-limited borrowers were any less creditworthy than all other direct borrowers. While the debt-asset ratio for term-limited borrowers was noticeably greater from 2005 to 2010, the difference in solvency had diminished in succeeding years (Table 4). By 2014, the debt-to-asset ratio of term-limited borrowers was actually lower than that for other FSA borrowers. Also, the overall FSA score, which reflects debt coverage and liquidity in addition to solvency, indicated that term-limited borrowers since 2007 were, overall, more financially sound than all other borrowers (Table 5).⁹ Likewise, profitability—as reflected in return on assets—has been greater for term-limited borrowers, while debt coverage capacity has been comparable to all other direct borrowers.

Term-limited borrowers tend to operate larger farms with larger dollar amounts of total assets and production. Since 2011, term-limited borrowers have averaged about \$300,000 in gross revenue compared to under \$200,000 for all direct borrowers (Table 5). This suggests that farm size may be a key determinant of whether a farm is more likely to rely on FSA as a regular credit source. A farm that meets FSA farm eligibility criteria and averages \$300,000 in gross revenue would likely be considered a mid-size family farm. While these mid-size family farms may be more profitable than the average FSA direct borrower, they also require more labor and management, leaving less time for off-farm income. This is reflected in a lower average non-farm income for term-limited borrowers relative to all other borrowers since 2006 (Table 5). Non-farm expenses also tended to be higher, resulting in the household putting an additional drain on farm working capital.

Despite these obstacles, there is no indication that those who reached term limits were forced to downsize their operations. Among those who remained in FSA's portfolio for up to 6 years after reaching term limits, there was little change in their annual sales, after adjusting for commodity price changes (Table 6). Among dairies, herd size did not change for those borrowers who reached term limits. Also, the average FSA score for term-limited borrowers remaining in FSA's portfolio after reaching term limits did not indicate any notable change in financial condition. For term-limited borrowers remaining in the portfolio for 6 years after reaching the term limit, the average FSA score only increased slightly, from 2.2 to 2.3.

⁸ The Farm Business Plan is a Web-based application used by FSA to assist borrowers with obtaining loans and improving their farming business. A completed Farm Business Plan provides the business's financial condition, operating plans, and financial summaries.

⁹ The FSA score is a borrower account classification used to determine borrowers' eligibility for graduation. The score is completed using the most current balance sheet and income/expense statements available. It is a weighted index of the current ratio, debt-asset ratio, return on assets, and term debt coverage ratio. The score can range from 1 to 4, with 1 being most creditworthy and 4 being the least creditworthy (see paragraph 252 of FSA Handbook 1-FLP).

Characteristics of Active Borrowers by Remaining Years of DOL Eligibility

Active borrowers, defined as those with outstanding FSA direct loan indebtedness, are by definition the most vulnerable to term limits. For example, 4,081 active borrowers (2,529 + 1,552)—about 9 percent of current OL borrowers—had either reached term limits or had only 1 more year remaining (Table 7). Over one-fourth are located in just 4 States: Kentucky, Nebraska, Texas, and Iowa. Regions that are most dependent on FSA direct programs, such as New England, the Mountain States, and West Virginia, do not represent a large share of all term-limited borrowers. But, term-limited borrowers in these States may represent a large share of direct borrowers. For example, 18 percent of all DOL borrowers in Maine have 1 or no years of eligibility remaining.

As a group, SDAs are slightly less represented among active term-limited borrowers. Racial minorities comprised 11 percent of all DOL borrowers, but only 8.2 percent of current DOL borrowers with 1 or fewer years of eligibility (Table 8). Hispanics represented 4.6 percent of all borrowers, but only 2.5 percent of all borrowers with 1 or fewer years of eligibility. Women represented 17.1 percent of all borrowers, but only 6.1 percent of those with 1 or fewer years of eligibility remaining.

Many active borrowers facing term limits have credit shortfalls that could hamper their ability to obtain commercial credit. Default rates were greater than average for those borrowers with less than 1 year of DOL eligibility remaining. The default rate for active borrowers with less than 1 year of eligibility was 15.9 percent compared to 13.6 percent for all active DOL borrowers (Table 9—see “Amount Delinquent” section). Over 16 percent of active borrowers with less than 1 year of eligibility remaining had FSA scores less than 2 (standard), which would suggest the presence of a credit shortcoming restricting their ability to obtain loans through a commercial lender (Table 9—see “FSA Classification Score” section).

Borrowers with greater amounts of DOL indebtedness are more likely to reach term limits. While borrowers with less than \$100,000 in outstanding DOL loans represent 60 percent of all borrowers, they are less than one-third of borrowers who have either reached or will reach term limits the next year they receive a DOL (Table 9—see “Total Indebtedness” section). In contrast, borrowers with over \$100,000 in indebtedness represented two-thirds of borrowers either reaching or near term limits. This outcome is consistent with historical trends, which indicate that mid-size family farm operations are more likely to reach term limits.

Given current farm income expectations, a large share of the 4,081 active borrowers with 1 or fewer years of eligibility remaining will likely be adversely impacted by term limits. FSA classification scores would suggest that 15 percent could obtain credit on their own merits. While some could qualify for FSA guarantees, such an outcome is unlikely for those borrowers with FSA classifications of acceptable or marginal, which represent half of those facing term limits.

Recommendations

While term limits do not currently appear to be having any notable impacts on the DOL portfolio, there are concerns for future years. Expectations for lower farm incomes and a greater probability of falling land values are likely to result in greater dependence on DOLs as a credit

source. In turn, the number of borrowers affected by term limits is likely to increase. Given that term-limited borrowers have historically not met commercial lenders' credit standards, any borrowers reaching their term limits will likely be adversely impacted. Thus, it would be prudent to continue to monitor the number and characteristics of DOL borrowers by years of eligibility used.

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Table 1. Number of Direct OL Borrowers Reaching Term Limits		
Item	With Outstanding Direct Loans (12/31/14) ¹	No Outstanding Direct Loans (12/31/14)
	--- Number of Borrowers ---	
Reaching DOL Term Limit	2,931	2,708
With Outstanding DOL Balance	2,529	0
Received FSA Loans After Term Limit Reached: ²		
Direct FO	243	51
Direct EM	151	86
FSA Guaranteed	448	550
Received 51-S After Term Limit Reached	620	367
Loan Write-Off After Term Limit Reached		
Direct Debt Settlement	38	300
Guaranteed Loss Claim Paid	13	45
Targeted Group ³		
Beginning Farmer ⁴	2,206	1,875
Racial-Ethnic Minority	214	175
Woman	144	115
SDA	344	265
Veteran	161	247
In Service Center Information Management System (SCIMS) as eligible voters ⁵	2,707	2,134
¹ Includes all outstanding direct loans (FO, OL, and EM). ² Exclusive of waivers and exemptions for beginning farmers. ³ Groups are not mutually exclusive. A beginning farmer may also be a racial-ethnic minority, woman, or veteran. ⁴ Qualified beginning farmer at time of last direct OL obligation. ⁵ Not all direct borrowers may be eligible voters resulting in the number of eligible voters being less than number of borrowers. A legal entity may be a borrower, but only the individual members would be listed as eligible COC voters.		
Sources: FSA's OBFN, OM3R, DSTH, GLS and R540 data files; and USDA SCIMS.		

Table 2. Distribution of Borrowers by Current Years of Eligibility and USDA Production Region.¹

USDA Production Region ²	Borrowers receiving DOLs since 1993, by years of DOL eligibility remaining		Borrowers with outstanding DOLs by years of DOL eligibility remaining		All borrowers
	0 Years	1-2 Years	0 Years	1-2 Years	
	-- Percent --				
Northeast	11.2	10.4	9.5	11.3	6.9
Lake States	11.3	14.6	11.4	13.6	10.8
Corn Belt	13.6	9.0	11.9	11.3	15.6
Northern Plains	17.5	12.6	17.6	16.1	14.2
Appalachia	13.1	15.6	16.8	13.7	12.5
Southeast	5.0	6.5	6.6	6.1	6.7
Delta	5.9	6.1	6.1	5.7	7.2
Southern Plains	11.0	10.5	9.9	9.7	12.1
Mountain	6.5	8.0	4.4	5.6	5.8
Pacific	4.8	5.6	4.3	4.7	3.5
AK+HI+Territories	0.1	1.1	1.5	2.2	4.7

¹Columns add to 100%.

²See [USDA ERS Farm Production Regions](#).

Source: FSA OBFN Data Files.

Table 3. Total borrowers Receiving Direct OLs Since 1993, by Years of Eligibility Used.

Years of Eligibility Used	Year of Last Direct OL Obligation					Total Borrowers
	2014	2011-2013	2008-2010	2005-2007	Before 2005	
1	5,325	8,822	6,825	4,210	23,961	49,143
2	2,471	3,959	2,818	1,870	8,911	20,029
3	1,707	2,215	1,425	1,053	4,220	10,620
4	1,153	1,340	891	651	2,425	6,460
5	800	772	578	475	1,530	4,155
6 or more	970	1,260	1,227	980	2,603	7,040
Total	12,426	18,368	13,764	9,239	43,650	97,447
(6*) Term limited ¹	617	1,070	1,192	962	1,798	5,639

¹Borrowers using all years of eligibility after adjusting for beginning farmers and the April 4, 1996 transition rule (Section 311(c) of the ConAct), which gave borrowers using 4 or more years of eligibility before 4/4/96 an additional 3 years of direct OL eligibility.

Source: FSA OBFN Database.

Table 4. Balance Sheet Characteristics for FSA Direct Borrowers for Last Business Plan Created During the Calendar Year.

Year Term Limit Reached	Borrowers Reaching Term Limits ¹				All Other Borrowers			
	Total Assets \$	Total Debt \$	Net Worth \$	Debt- Asset %	Total Assets \$	Total Debt \$	Net Worth \$	Debt- Asset %
2005	423,881	259,933	163,948	61.3	460,420	220,223	240,197	47.8
2006	480,715	285,449	195,266	59.4	492,981	235,621	257,361	47.8
2007	552,205	319,440	232,765	57.8	559,738	262,335	297,402	46.9
2008	588,413	332,340	256,073	56.5	595,060	280,999	314,061	47.2
2009	699,420	384,463	314,957	55.0	636,211	313,890	322,321	49.3
2010	684,917	393,098	291,819	57.4	671,172	335,929	335,243	50.1
2011	771,469	396,326	375,144	51.4	690,729	342,152	348,576	49.5
2012	808,704	434,469	374,234	53.7	702,354	348,380	353,974	49.6
2013	689,910	372,871	317,039	54.0	642,027	320,609	321,418	49.9
2014	825,318	388,893	436,426	47.1	595,893	303,076	292,817	50.9

¹For Calendar year in which term limit was reached.

Source: FSA's Farm Business Plan.

Table 5. Selected Income Statement Characteristics for FSA Direct Borrowers for Last Business Plan Created During the Calendar Year.

Year Term Limits	Gross Revenue	Net Income	Non- farm Income	Non-farm Expenses	Score ¹	ROA ²	TDCR ³
Borrowers Reaching Term Limits							
2005	210,296	50,427	23,391	28,713	2.3	5.2	1.6
2006	223,779	48,909	24,317	29,250	2.3	5.9	1.4
2007	227,127	50,916	29,698	32,028	2.2	2.7	1.4
2008	262,605	64,151	26,612	33,740	2.1	4.4	1.6
2009	295,043	60,072	27,903	34,713	2.2	4.6	1.4
2010	285,128	59,564	32,199	33,586	2.2	4.7	1.4
2011	297,512	64,642	30,786	35,227	2.1	5.5	1.5
2012	345,408	74,613	30,979	37,565	2.1	5.0	1.5
2013	300,063	62,043	30,472	36,179	2.2	4.2	1.4
2014	341,879	58,449	39,237	37,000	2.1	4.0	1.4
All Other Borrowers							
2005	153,946	32,650	23,529	22,599	2.2	3.1	1.3
2006	168,393	37,917	26,045	23,944	2.3	3.7	1.4
2007	168,614	32,578	29,953	26,583	2.3	3.3	1.3
2008	171,244	34,157	34,033	27,936	2.4	3.0	1.4
2009	222,227	37,205	35,576	29,298	2.4	3.5	1.3
2010	210,139	37,780	36,350	30,047	2.4	3.4	1.4
2011	185,743	33,479	36,981	30,107	2.3	3.3	1.4
2012	168,765	31,475	40,466	30,772	2.3	3.0	1.5
2013	130,955	26,182	40,427	30,940	2.3	3.3	1.6
2014	199,557	56,606	44,769	37,406	2.3	3.6	1.4
¹ FSA score is a borrower account classification used to determine a borrower's eligibility for graduation. The score may range from 1 to 4 with 1 representing the most creditworthy and 4 being the least creditworthy. ² Return on assets. ³ Term debt coverage ratio (includes non-farm income).							
Source: FSA's Farm Business Plan.							

Table 6. Gross Revenue, FSA Score, and Debt-Asset Ratio, by Years After Reaching Term Limit			
Years after Term Limit	Gross Revenue ¹	FSA Score ²	Debt-Asset Ratio
0	304,625	2.2	0.61
1	320,728	2.2	0.54
2	318,888	2.3	0.52
3	315,498	2.3	0.52
4	317,939	2.5	0.52
5	319,704	2.3	0.51
6	325,694	2.3	0.49
¹ Adjusted for inflation using NASS prices received index. ² FSA borrower account classification score (see Table 4, note 1).			
Source: FSA's Farm Business Plan.			

Table 7. Counts of Active Direct Operating Loan Borrowers by State or Territory and Years of Remaining Eligibility as of December 31, 2014.¹

State/Territory	Years of Remaining Eligibility							Total
	0	1	2	3	4	5	>5	
ALABAMA	17	5	18	26	46	135	996	1,243
ALASKA	2	1	3	3	5	14	21	49
ARIZONA	3	2	6	11	26	48	160	256
ARKANSAS	79	35	67	128	172	242	737	1,460
CALIFORNIA	39	19	41	59	69	133	442	802
COLORADO	28	15	29	34	51	92	239	488
CONNECTICUT	4	1	1	4	4	8	28	50
DELAWARE	0	0	0	0	0	2	12	14
FLORIDA	6	11	17	28	51	88	365	566
GEORGIA	79	37	59	75	106	180	699	1,235
HAWAII	7	6	9	12	17	41	152	244
IDAHO	33	21	36	39	64	103	379	675
ILLINOIS	45	15	23	41	46	97	323	590
INDIANA	12	10	8	15	10	28	118	201
IOWA	147	81	145	177	229	295	846	1,920
KANSAS	88	62	60	90	164	240	714	1,418
KENTUCKY	209	88	125	196	275	447	1,711	3,051
LOUISIANA	48	29	40	63	76	163	692	1,111
MAINE	29	17	18	17	27	39	119	266
MARYLAND	0	2	3	9	5	22	72	113
MASSACHUSETTS	19	9	19	28	41	57	140	313
MICHIGAN	73	57	72	81	130	188	404	1,005
MINNESOTA	95	73	97	131	194	230	641	1,461
MISSISSIPPI	45	16	32	59	99	197	1,235	1,683
MISSOURI	37	28	45	51	78	168	679	1,086
MONTANA	21	9	15	42	58	93	268	506
NEBRASKA	171	86	137	137	190	287	802	1,810
NEVADA	1	2	3	4	10	26	92	138
NEW HAMPSHIRE	4	12	6	14	19	37	94	186
NEW JERSEY	9	4	7	13	20	28	64	145
NEW MEXICO	17	12	14	12	39	45	187	326
NEW YORK	63	61	63	93	121	185	433	1,019
NORTH CAROLINA	82	33	37	50	90	141	384	817
NORTH DAKOTA	65	52	57	68	113	141	334	830
OHIO	11	10	13	19	35	56	334	478
OKLAHOMA	83	66	82	156	257	492	1,913	3,049
OREGON	37	22	29	57	62	91	191	489
PENNSYLVANIA	115	74	95	142	209	276	581	1,492
PUERTO RICO	0	4	7	29	59	187	525	811
RHODE ISLAND	1	3	7	5	6	7	28	57
SOUTH CAROLINA	70	37	50	79	118	161	307	822
SOUTH DAKOTA	70	47	71	111	175	248	819	1,541
TENNESSEE	50	36	59	90	132	235	732	1,334
TEXAS	173	92	121	170	224	404	1,815	2,999
UTAH	44	49	53	75	101	175	653	1,150

Table 7. Counts of Active Direct Operating Loan Borrowers by State or Territory and Years of Remaining Eligibility as of December 31, 2014 (continued)

State/Territory	Years of Remaining Eligibility							Total
	0	1	2	3	4	5	>5	
VERMONT	25	26	22	41	66	78	131	389
VIRGIN ISLANDS	0	0	0	1	0	3	6	10
VIRGINIA	33	24	39	45	91	144	440	816
WASHINGTON	39	25	35	46	47	87	225	504
WEST VIRGINIA	78	41	54	77	131	182	492	1,055
WESTERN PACIFIC (WP)	0	0	0	0	3	6	20	29
WISCONSIN	119	80	138	233	381	521	1,114	2,586
WYOMING	4	5	5	12	16	16	69	127
TOTAL	2,529	1,552	2,192	3,198	4,758	7,609	24,977	5,516

¹Youth Loans and Microloans to beginning farmers and veterans are exempt from DOL term limits.

Table 8. Counts of Active Direct Operating Loan Borrowers by (a) Race, (b) Ethnicity, and (c) Gender, and by Years of Remaining Eligibility as of December 31, 2014.^{1 2}

Race/Ethnicity/Gender	Years of Remaining Eligibility							Total
	0	1	2	3	4	5	> 5	
(a) Race								
American Indian/Alaskan Native	63	48	81	117	209	385	1,542	2,445
Asian	15	7	13	20	27	53	197	332
Black	138	59	67	104	153	305	1,131	1,957
Hawaiian/Pacific Islander	1	3	1	5	13	31	100	154
Unknown	1	0	2	8	11	37	108	167
White	2,311	1,435	2,028	2,944	4,345	6,798	21,899	41,760
Total	2,529	1,552	2,192	3,198	4,758	7,609	24,977	46,815
(b) Ethnicity								
Hispanic	62	41	65	90	165	369	1361	2153
Not Hispanic	2,450	1,500	2,110	3,087	4,559	7,196	23,498	44,400
Unknown	17	11	17	21	34	44	118	262
Total	2,529	1,552	2,192	3,198	4,758	7,609	24,977	46,815
(c) Gender								
Female	134	98	132	249	407	818	5,724	7,562
Female Organization	13	5	12	15	37	89	294	465
Male	2,241	1,337	1,879	2,695	3,906	6,034	17,276	35,368
Male Organization	71	62	94	144	241	428	1,095	2,135
Other Organization	68	50	74	91	166	238	577	1,264
Unknown	2	0	1	4	1	2	11	21
Total	2,529	1,552	2,192	3,198	4,758	7,609	24,977	46,815

¹Each active DOL borrower is counted once under each of the three categories—race, ethnicity, and gender. Hence, the totals for each combination of race-ethnicity-gender and years of remaining eligibility are equivalent.

²Youth Loans and Microloans to beginning farmers and veterans are exempt from DOL term limits.

Table 9. Counts of Active Direct Operating Loan Borrowers by (a) FSA Credit-Risk Classification Score, (b) Total Indebtedness, and (c) Amount Delinquent, and by Years of Remaining Eligibility as of December 31, 2014.^{1 2}

Financial Categorization	Years of Remaining Eligibility							Total
	0	1	2	3	4	5	> 5	
(a) FSA Classification Score								
1 Commercial	416	249	359	437	655	1,124	2,659	5,899
2 Standard	781	456	621	945	1,407	2,243	5,250	11,703
3 Acceptable	744	466	696	1,018	1,562	2,514	13,485	20,485
4 Marginal	518	318	439	664	976	1,498	3,067	7,480
5 Not Classified	67	63	77	134	156	227	489	1,213
Unknown	3	0	0	0	2	3	27	35
Total	2,529	1,552	2,192	3,198	4,758	7,609	24,977	46,815
(b) Total Indebtedness								
< \$50,000	493	272	447	745	1,226	2,460	16,865	22,508
\$50,000 - \$99,999	411	237	360	530	791	1,392	2,216	5,937
\$100,000 - \$249,999	931	584	742	1,103	1,625	2,360	3,890	11,235
\$250,000 - \$499,999	608	381	556	711	1,004	1,263	1,838	6,361
\$500,000 - \$999,999	84	76	84	105	110	126	154	739
\$1,000,000 or more	2	2	3	4	2	8	14	35
Total	2,529	1,552	2,192	3,198	4,758	7,609	24,977	46,815
(c) Amount Delinquent³								
Current	2,136	1,297	1,845	2,668	3,956	6,389	22,176	40,467
< \$50,000	257	160	215	306	523	828	2,308	4,597
\$50,000 - \$99,999	64	31	57	85	126	169	210	742
\$100,000 - \$249,999	54	49	51	101	114	165	201	735
\$250,000 - \$499,999	15	10	19	28	30	41	54	197
\$500,000 - \$999,999	2	5	3	7	9	15	26	67
\$1,000,000 or more	1	0	2	3	0	2	2	10
Total	2,529	1,552	2,192	3,198	4,758	7,609	24,977	46,815

¹Each active DOL borrower is counted once under each of the three financial categories. Hence, the totals for each combination of financial category and years of remaining eligibility are equivalent.

²Youth Loans and Microloans to beginning farmers and veterans are exempt from DOL term limits.

³At least \$1 of outstanding DOL funds that are 30 days or more delinquent.

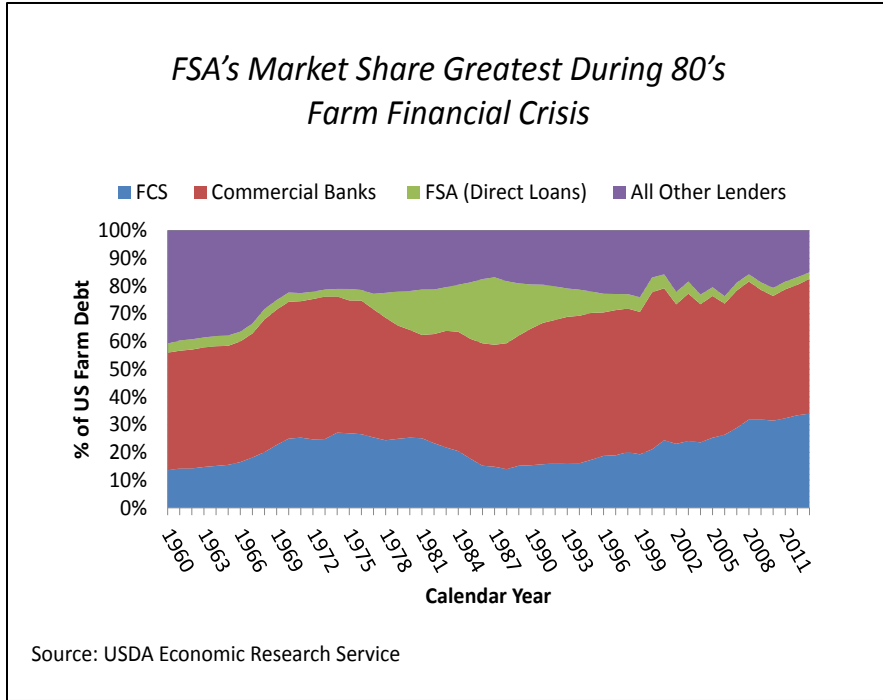


Figure 1. U.S. Farm Debt Market Shares, 1960-2014.

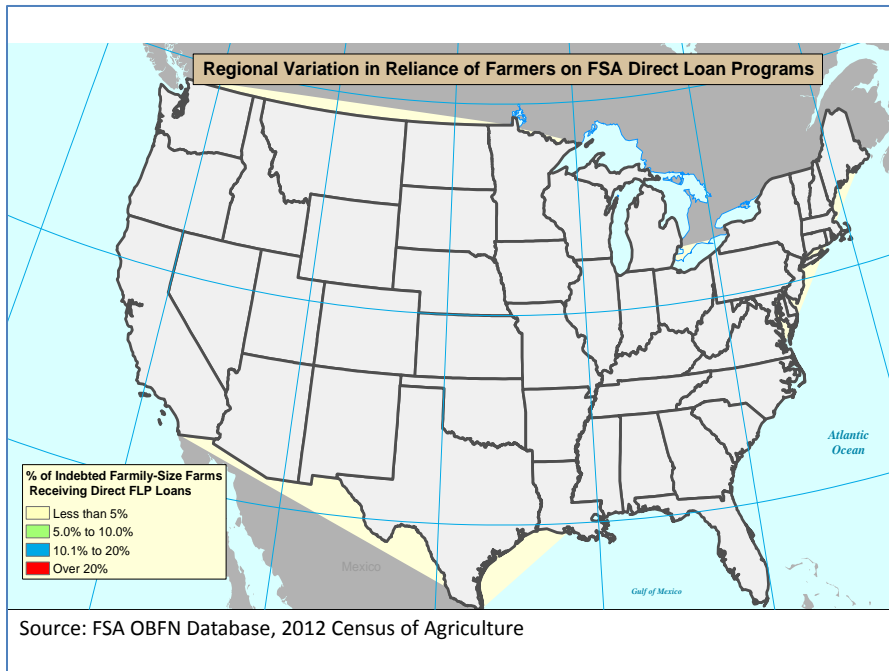


Figure 2. Share of Indebted Farmers Receiving an FSA Direct OL Loan since FY2011.

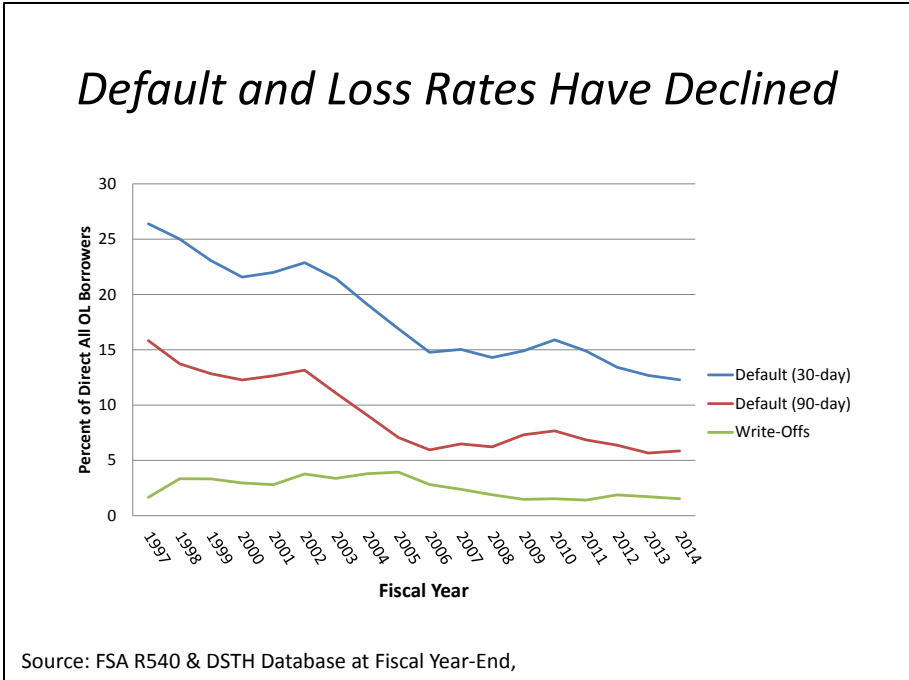


Figure 3. Percent of Direct OL Borrowers in Default or Receiving a Debt Settlement, FY1997-FY2014.

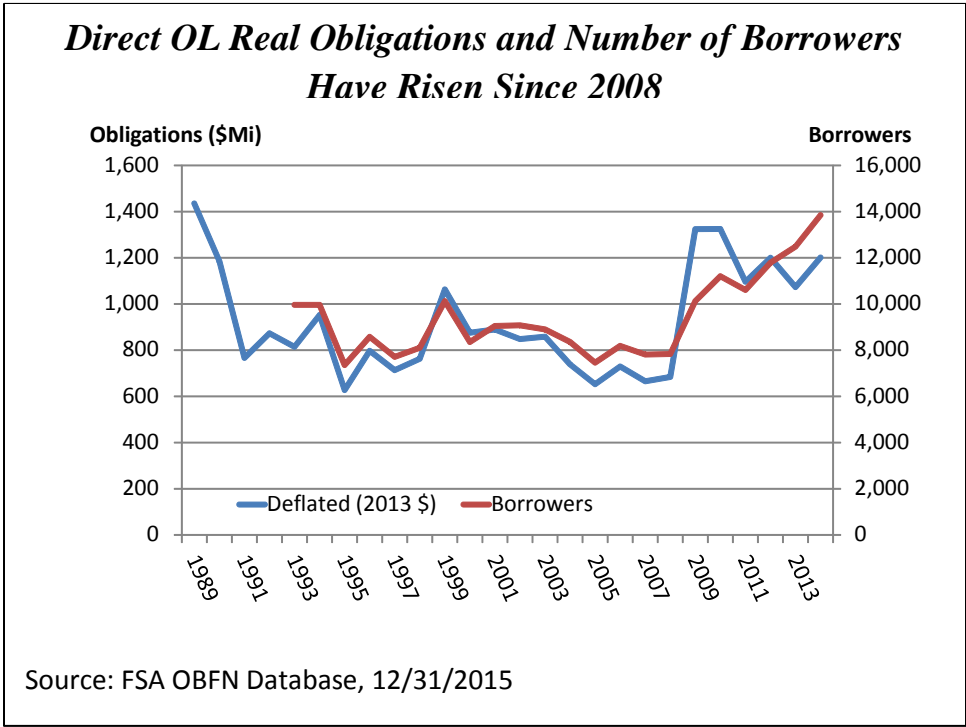
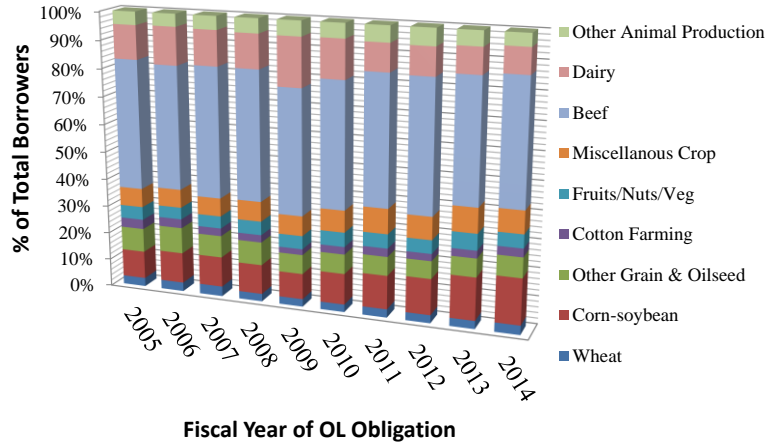


Figure 4. Direct OL Obligations and Borrowers, by Fiscal Year through 2014.

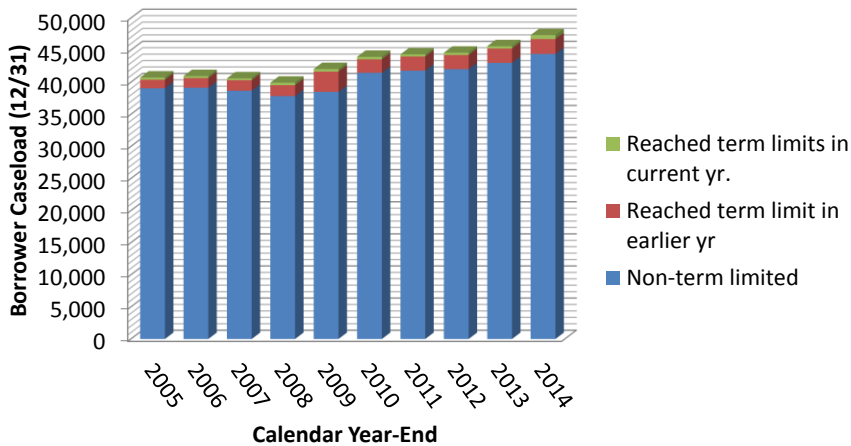
New Direct OL Borrowers by Fiscal Year and Farm Type



Source: FSA OBFN Database & Farm Business Plan

Figure 5. Distribution of Farm Borrowers Receiving Direct OL Loans by Fiscal Year and Farm Type.

About 400 Direct OL Borrowers Reach Term Limits Each Year



Sources: USDA FSA R540 calendar year-end and OBFN databases (12/31/2014)

Figure 6. Direct OL Borrowers Reaching Term Limits by Calendar Year.

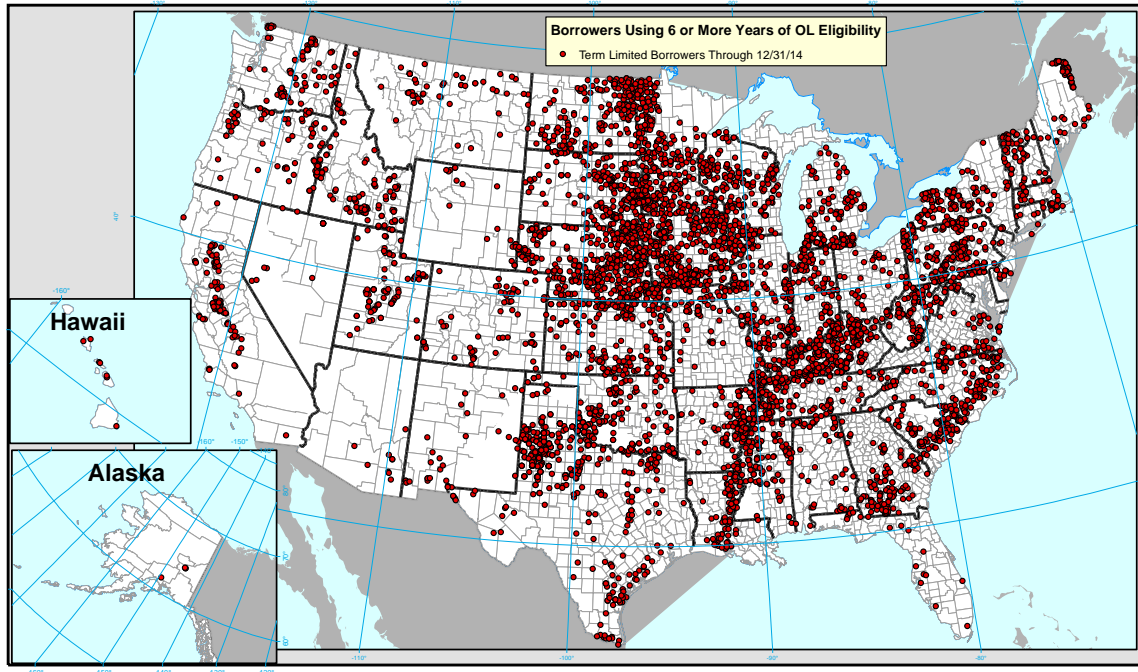


Figure 7. Geographic Location of All Borrowers Reaching Term Limits.

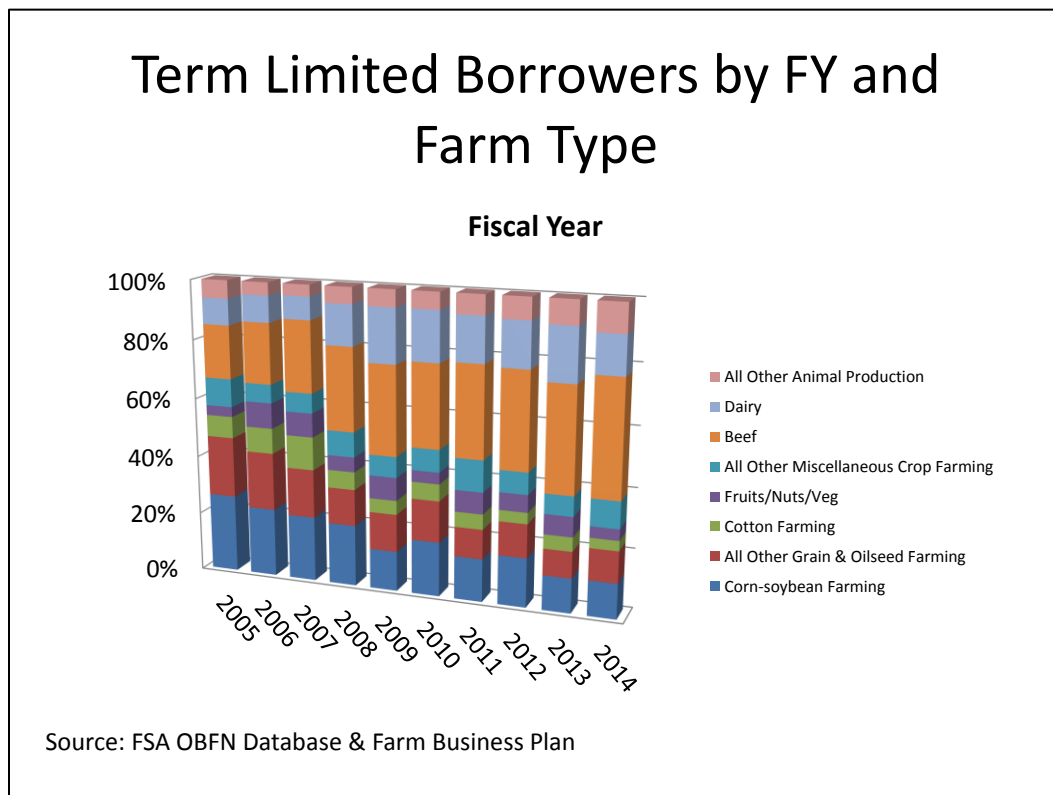


Figure 8. Distribution of Term-Limited Borrowers by Fiscal Year and Farm Type.

Appendix 1. Text of Legislation from Section 5104 of the Agricultural Act of 2014.

5) ANNUAL REPORT ON TERM LIMITS ON DIRECT OPERATING LOANS.—

(A) IN GENERAL.—The Secretary shall prepare a report annually that describes—

- (i) the status of the direct operating loan program of the Department of Agriculture; and
- (ii) the impact of term limits on direct loan borrowers.

(B) DEMOGRAPHIC INFORMATION.—

(i) IN GENERAL.—The report shall provide a demographic breakdown, on a State-by-State basis, of—

- (I) all direct loan borrowers; and
- (II) borrowers that have reached the eligibility limit for direct lending programs during the previous calendar year.

(ii) DEMOGRAPHIC INFORMATION.—The available demographic information shall include, to the maximum extent practicable, a description of race or ethnicity, gender, age, type of farm or ranch, financial classification, number of years of indebtedness, veteran status, and other similar information, as determined by the Secretary.

(C) ADDITIONAL CONTENT.—In addition to information described in subparagraph (B), the report shall provide—

- (i) a demographic analysis of the borrowers impacted by term limits;
- (ii) information on the conditions impacting the direct lending portfolio of the Department of Agriculture, including impacts by region and agriculture sector, and credit availability within those regions and sectors;
- information on the status of borrower operations impacted by term limits; and
- (iv) recommendations, if appropriate, to address any identifiable unmet credit needs.

(D) SUBMISSION.—The Secretary shall—

- (i) annually submit to the Committee on Agriculture of the House of Representatives and the Committee on Agriculture, Nutrition, and Forestry of the Senate a copy of the report; and
 - (ii) make the report available to the public, including posting the report on the website of the Department of Agriculture.
-

Appendix 2. Past Mandated Studies of FSA Credit Programs

Over the past 20 years, the U.S. Congress and the Office of Management and Budget (OMB) authorized several reports to increase understanding of the role of USDA credit programs. Section 650 of the Federal Agriculture Improvement and Reform Act of 1996 (1996 Farm Bill) required USDA to provide a report to Congress assessing the demand for and availability of credit in rural areas for agriculture, housing, and rural development ([USDA, 1997](#)). The report concluded that the system of commercial banks, Farm Credit System, other private lenders, and USDA functioned well in meeting the overall demand for credit in rural regions. Section 5301 of the Farm Security and Rural Investment Act of 2002 (2002 Farm Bill) required USDA to provide an evaluation of direct and guaranteed loan programs. The study was driven by concern over the higher cost of direct relative to guaranteed lending and the possibility that cost savings could be realized by shifting lending resources from the direct to the guaranteed program ([USDA FSA, 2006](#)). The analysis undertaken by USDA concluded that direct and guaranteed lending programs serve unique groups of borrowers and it would be difficult to serve the more economically disadvantaged direct borrowers solely through a guaranteed program. As part of the fiscal year 2005 budget, OMB requested an independent performance-focused review of the effectiveness of FSA direct farm loan programs. This analysis showed that direct programs primarily serve family-size farming operations, of which a majority tended to be only temporary borrowers ([Nwoha, J., et al.](#)).

Appendix 3. Twenty-five Congressional Districts with Largest Numbers of Borrowers Reaching DOL Term Limits

	Member, 114th Congress	State	District	Party	Number of Term Limited Borrowers (12/31/14) ¹
1	Smith, Adrian	Nebraska	3	R	345
2	Peterson, Collin C.	Minnesota	7	D	233
3	Noem, Kristi	South Dakota	0	R	217
4	Neugebauer, Randy	Texas	19	R	172
5	Cramer, Kevin	North Dakota	0	R	172
6	King, Steve	Iowa	4	R	121
7	Crawford, Rick	Arkansas	1	R	111
8	Lucas, Frank	Oklahoma	3	R	108
9	Graves, Sam	Missouri	6	R	106
10	Whitfield, Ed	Kentucky	1	R	100
11	Huelskamp, Tim	Kansas	1	R	95
12	Thornberry, Mac	Texas	13	R	91
13	Guthrie, S. Brett	Kentucky	2	R	89
14	Blum, Rod	Iowa	1	R	85
15	Loeb sack, David	Iowa	2	D	81
16	Fortenberry, Jeff	Nebraska	1	R	73
17	Simpson, Mike	Idaho	2	R	72
18	Young, David	Iowa	3	R	69
19	Duffy, Sean P.	Wisconsin	7	R	68
20	Massie, Thomas	Kentucky	4	R	67
21	Poliquin, Bruce	Maine	2	R	66
22	Barr, Andy	Kentucky	6	R	63
23	Conaway, K. Michael	Texas	11	R	62
24	Smith, Jason	Missouri	8	R	60
25	Walz, Timothy J.	Minnesota	1	D	59

¹Total number of current and former direct borrowers reaching term limits through 2014.