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FARM CREDIT MEDIATION IN SOUTH DAKOTA: WHAT CAN PRODUCERS EXPECT?



by

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A farm credit mediation bill was adopted during the 1988 South Dakota legislative session at the the request of Gov. George Mickelson. This bill guarantees certain agricultural borrowers and lenders the opportunity to mediate an agreement before foreclosure proceedings can be initiated. Similar legislation has been adopted in other states such as Iowa and Minnesota. Experience in these states indicates that several benefits may be realized by mediation. This act will be effective from May 30, 1988 until at least December 31, 1990.

This newsletter explains what the mediation process is, who is eligible, and what results participants can expect from mediation.

WHAT IS MEDIATION?

Farm credit mediation is simpler to describe than to actually accomplish. Mediation brings the debtor and creditor together with a neutral third party, the mediator, to discuss the financial situation and alternative solutions to the problem. The object of mediation is to work out an agreement that resolves financial problems that benefit all parties.

The South Dakota Mediation Board will oversee the mediation process in South Dakota, under authorization from the South Dakota Department of Agriculture. This board will consist of seven members, at least two from the agricultural community

and two from the financial community. Board members will be appointed by the governor. Initially, the board will establish training and certification requirements for mediators. The board will also establish fees to be charged to participants. All fees must be shared equally between the borrower and creditor(s). All requests for mediation must be filed with the board.

Either the borrower or creditor(s) may file a request for mediation. Individuals, corporations, trusts, or cooperatives who receive more than 60 percent of gross income from farming and have borrowed more than \$50,000 for farming from any one creditor are eligible for mediation. Any creditor with agricultural loans over \$50,000 to an individual borrower is also covered by the mediation act.

Mediation processes are generally described as being mandatory (or voluntary) and/or binding (or non-binding). The South Dakota Mediation Act establishes a mediation process for South Dakota that is mandatory before foreclosure proceedings can be initiated against any borrowers exceeding the \$50,000 limit. The process is also non-binding, in that the parties involved in the mediation process are not required to reach an agreement, nor are they obligated to honor any alternatives discussed during the process.

Because the mediation act will restrict creditors' actions until they obtain a mediation release, it is expected that most requests for mediation will come from creditors. The mediation release formally removes the restriction imposed by the mediation act.

Creditors still may take actions other than mediation to collect a delinquent loan. These may include informal negotiations and debt writedowns. The creditor can avoid the process if the borrower waives his right to mediation or a court rules there is sufficient danger of the borrower destroying or moving pro-

perty used as collateral to secure the original loan.

The mediation board must notify the borrower that a request has been made for mediation within three business days after the request is filed. The board will also issue a meeting notice setting the time and place for the initial meeting with the mediator. Initial mediation sessions must be held within 21 days of the date the notice is mailed. The mediation process is limited to 42 days, unless it is extended by mutual agreement. If no meeting is held, and no agreement or extension is signed within 42 days, the board will assume the borrower has waived his right to mediation.

Borrowers have specific rights and obligations under the mediation act. Provisions of the program require the board to offer borrowers assistance to prepare for the mediation sessions. This assistance may consist of analyzing the business and personal financial situation, referring the borrower to groups or programs dealing with the agricultural economic crisis, or helping the borrower develop reasonable goals and expectations for the mediation process. Evaluation of the financial viability of the current farming operation will also be done to prepare for the mediation session.

The South Dakota Department of Agriculture and the South Dakota Cooperative Extension System are finalizing plans to allow mediation participants to take advantage of extension expertise in financial management. The S.D. Department of Agriculture will train people specifically for the role of mediator. The Cooperative Extension Service staff will not be mediators, but will assist in the mediation process and reorganization plans. The Cooperative Extension Service has demonstrated success in this role with their financial management program (see SDSU Economics Dept. Staff Paper No. 87-5, Planning for Tomorrow - Today, Project Report - 1987).

The borrower and spouse are required to attend the mediation session and to provide all requested information to the board to retain their right to mediation. Creditors must attend at least one mediation session before a mediation release can be obtained.

If the borrower requests mediation, the board will evaluate the request and may direct a mediator to meet with the parties. However, when the borrower initiates the mediation process, attendance at the mediation sessions is not mandatory for either party and failure to attend the meeting does not affect the borrower's or creditor(s)' rights to mediation.

All financial information revealed at mediation sessions will be held in confidence. Agreements resulting from mediation will be put into writing by the mediator and signed by the borrower and creditor(s). Once the agreement is signed, it releases the creditor's restrictions of the mediation act.

WHAT FACTORS CONTRIBUTE TO SUCCESSFUL MEDIATION?

A broad definition for successful mediation is that, through mediation, a solution satisfactory to both parties was reached. This solution may not be the best for either party, but for both parties is preferable to the most likely alternative. Achieving a mutually beneficial resolution will not always be easy, and almost never painless.

Adequate preparation for the mediation session by both the borrowers and lenders is one of the most important ingredients for reaching a mediated agreement. Farmers must fully analyze their financial position and establish reasonable goals for their operation. After the goals have been established, the farmer and advisor should determine what concessions they are willing to make to reach these goals. The farmer must realize that all of his goals cannot be attained at once and that short-term and long-term goals are often in conflict. For example, to save part of the operation it may be necessary to give up part of the operation by deeding land to the creditor. Almost all farmers whose financial troubles have led them to mediation will change their operation and/or lifestyle in some fashion.

Several options exist for farmers when negotiating an agreement. For less severe cases, farmers may only have to obtain some off-farm income, change their combinations of enterprises, or reschedule

loan payments. Other borrowers may have to surrender personal or agricultural property or some of their farmland to reach an agreement. There will be some who will need to combine all of these aspects.

The financial analysis may indicate the only workable solution to a farm credit problem is voluntary liquidation, foreclosure, or bankruptcy. This is not necessarily a bad situation because the operator may then have time prior to liquidation to organize his operation in order to preserve some equity if the problem is not too severe. Early financial analysis is the key to this solution.

Creditors will have options to offer during mediation. Because of the expense involved in foreclosure or bankruptcy proceedings, the creditor may be better off forgiving some of the debt, lowering the interest rate, or rescheduling loan payments. Whether or not any of these options is adopted is determined by the willingness of both parties to work toward a suitable agreement. However these options do not come without a cost. This cost is paid by someone -- generally other borrowers of the bank. The farmer will also have a closer scrutiny for credit worthiness analysis.

One strategy that has been used successfully in other states is deeding the land over to the creditor with the stipulation that the farmer has the right to rent or buy back the land.

To summarize, the key ingredients to successful mediation are: adequate preparation, realistic goals, and cooperation between parties.

EXPECTED RESULTS FROM MEDIATION

The most important benefit farmers can obtain through mediation is to continue farming, but doing so with a goal-directed management plan. However, it is not always possible to save all or even part of the farm. If the farmer is able to stay on the farm, he may be able to manage it more effectively because of mediation. The financial analysis required to prepare for mediation increases knowledge of the farm's financial condition, what enterprises are profitable, and

good management practices. A major source of stress and tension will be removed if the process leads to a resolution of the financial problems.

If the farmer is not able to continue farming, a mediated agreement may allow for a more dignified exit from farming. If the financial analysis and mediation begin in time, the farmer may also leave with some equity.

Creditors can also benefit from mediation, primarily through more financially beneficial resolutions to default situations. An agreement that eliminates the necessity of going to court will save court costs, legal fees, and the cost of disposing of acquired property. When a mediated settlement helps prevent foreclosure or repossession, the creditor is able to maintain a much better reputation within the community.

Both parties will benefit from an atmosphere of decreased tension and increased communication during and after the mediation process.

LONG TERM EFFECTS OF MEDIATION

It is too early to tell how durable the positive effects of the mediation process will be. Farm operations that are maintained in the short run may eventually dissolve. If the results of mediation in other states are any indication, the process may allow quite a few farms to continue operating in the short run. Given this, it is not unreasonable to assume that at least a small proportion will be able to permanently restore their operations. Because of South Dakota's dependence on agriculture, preserving these operations may pay significant dividends to the state in the long run.

CONCLUSION

In better economic times for South Dakota's agricultural economy, mediation may become an unnecessary and/or expensive inconvenience. However, because of the tremendous financial and social pressures caused by recent agricultural troubles, mediation appears capable of playing a valuable role in resolving these issues. Similar efforts in neighboring agricul-

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tural states have demonstrated that the mediation process can result in negotiated settlements that benefit both lender and borrower.

Borrowers should take full advantage of the right to obtain the services of a financial consultant through the mediation program. Farmers and creditors going through the mediation process in Minnesota said these services contributed greatly to the success of the process.

The FINPACK program was specifically cited by mediation participants in Minnesota as a source of very useful information in the mediation process.

FINPACK is a computerized financial management program that compares and analyzes different production options for producers. The same program is in use by South Dakota Cooperative Extension Service and is available to all producers, not just those going through mediation. The program was designed to enable top agricultural managers to maintain the competitive edge of their operations, but the concepts have been found to work equally well for financially stressed operations.

Thorough preparation for mediation and a willingness to work together toward a solution are essential if this process is going to work effectively and provide maximum benefits.