Lawmakers join opposition to SBA poultry lending plan

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Opposition continues to mount to a Small Business Administration proposal critics fear would significantly reduce the flow of government-backed loans to poultry farmers.

The SBA, as of Tuesday, had received nearly 200 comment letters from poultry producers, farm appraisers and lenders, all decrying a plan to amend affiliation standards in a way that opponents claim would render the vast majority of chicken farmers ineligible for financing through the agency's 7(a) loan program.

But the SBA's bigger challenge could be the growing number of lawmakers who are upset with the proposal.

Arkansas Sens. John Boozman and Tom Cotton, as well as Mississippi Sens. Cindy Hyde-Smith and Roger Wicker, submitted comment letters last month opposing the rule change. On Tuesday, 34 members of the House of Representatives also raised objections.

Divisive plan

Here are key components of a controversial SBA proposal to alter the agency's 7(a) loan program:

- **Companies with contractual ties could be deemed affiliates and disqualified from 7(a)**
- **Borrowers with liquid assets above certain levels must invest more to receive loans**
- **Application fees charged by lenders and third-party agents to be capped**
- **Lenders' ability to lend to employee-owned firms to be curtailed**

Source: SBA

"We are deeply concerned that this proposed rule would drive rural American out of SBA's loan programs," the congressional group wrote in their letter. Instead of acting as subsidiaries of larger chicken companies, most producers "operate diversified farming operations with poultry growing representing only one income stream."

The ranks of opposing lawmakers will likely grow before comment period ends on Dec. 18. Rep. Blaine Luetkemeyer, R-Mo., is among those who have expressed concern about the affiliation standard.

"The recently proposed SBA rule is a one-size-fits-all, knee-jerk reaction that harms small poultry farmers and could have a detrimental effect on other agricultural industries," Luetkemeyer said in an email to American Banker. "SBA must ensure proper oversight of the 7(a) program while supporting American farmers and I hope they will reconsider this broad proposal."

Under the proposed affiliation standard, if a small business shares "identical or substantially identical business or economic interests" with a bigger customer, or is "economically dependent through contractual or other relationships," the SBA would deem that small business to be an affiliate, making it too large for 7(a) financing.

The agency in 2016 removed a provision similar to the current proposal, limiting affiliation to instances where firms were controlled by close relatives.

In March, the agency's Office of the Inspector General issued a report that pointed to its growing portfolio of poultry loans to back a claim that the control big chicken companies exert over small producers through operating contracts amounted to affiliation, especially since most producers sold all of their birds to one large chicken company.

As part of the proposed rule, the SBA would deem a borrower that derives more than 85% of its revenue from another business over a three-year period as economically dependent on the other business and, therefore, affiliated with it.

Finally, the SBA can deem a business to be affiliated with a larger client based on the "totality of the circumstances" surrounding the relationship, "even though no single factor is sufficient to constitute affiliation."

In the text of its proposed rule, the agency singled out poultry as an industry likely to impacted the most, noting that "the agreement between a poultry farmer and a large poultry producer ... may be critical to the determination of whether the farmer is an independent small business."

Even so, many comment letters have raised fears of a ripple effect that could hit other sectors that operate under similar business models. Most dairy farmers, for example, sell all their milk to a single source, said Richard Baier, president and CEO of the Nebraska Bankers Association.

"These producers would be ineligible for SBA guaranteed loans because they derive more than 85% of their revenues from a single source," Baier wrote in his comment letter. "Our country has seen a massive consolidation in the food processing, marketing and distribution industries over the past 50-75 years. As a result, producers have limited options for the marketing and sale of their products."

Nebraska farmers could be particularly hard-hit by the proposed change. The retailer Costco is building a major chicken processing plant near Lincoln, Neb., that is expected to supply rotisserie chickens to nearly half its stores. Costco is relying on local farmers to supply it, Baier said, and several have already moved to expand their operations.

The SBA has said it plans to wait until the comment period closes before responding to the mounting pile of comment letters. In a Tuesday email to American Banker, Dianna Seaborn, director of the SBA's Office of Financial Assistance, pledged that the agency would carefully consider all comments, as well as expert opinion and other relevant data.

"SBA must then decide whether the proposed solution will accomplish the goals or solve the problems identified in the proposed rule," Seaborn wrote. The SBA will also have to consider whether there are any "alternative solutions."

Exclusion from 7(a) would be potentially devastating for poultry producers, said Ron Graham, a veteran appraiser specializing in poultry farm appraisals who spent 26 years as a lender in the Farm Credit System. According to Graham, no other agency or organization can match the terms that 7(a) offers.

The SBA can guarantee loans as large as $5 million under 7(a). In contrast, the Department of Agriculture's Farm Service Agency caps its guarantees at $300,000 for operating loans and $500,000 for land purchases.

Most poultry producers need at least $2 million — and frequently more — to set up their operations, Graham said.

"It's just a matter of economies of scale," Graham added. "We've seen a lot more loans for $2 million to $5 million in the past five years than we ever saw before. … For most of my career, a $1 million poultry loan was a really big deal. Now, it's just average."

The SBA has not provided updated statistics on the size of its poultry lending portfolio, but according to the agency's inspector general office, it totaled $534 million in fiscal-year 2016. In its 2018 fiscal year, which ended Sept. 30, the SBA made $65 million in poultry loans in Arkansas, said Chris Hegi, CEO of the $1 billion-asset First Financial Bank in El Dorado, Ark.

Hegi and First Financial are part of a group of community banks that have filed comment letters arguing against the proposal.

That number will likely grow. A spokeswoman for Live Oak Bancshares in Wilmington, N.C., said the $3.4 billion-asset company — the nation's biggest 7(a) lender — would likely file a comment letter.

"I feel it's likely we'll comment, particularly on the affiliation portion," said Dawn Thompson, Live Oak's senior government affairs manager. "We're going through the entire proposed rule now. … I think there's a lot of concern this rule would hurt agricultural lending."

The proposed affiliation standard is part of a package of rule changes the SBA is proposing. The agency also plans to limit its participants' ability to lend to employee-owned firms, cap application fees and require borrowers with liquid assets above a certain level to invest more to receive 7(a) financing.

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