

**Featured Professionals**

Mark W. Vyvyan

**Related Services**

Real Estate &amp; Construction

## Potential Pitfalls for Agricultural Lenders

**Legal Update**

03.01.2021

Most lenders are familiar with creating and perfecting security interests in personal property. However, when lending to farmers, there are a few additional issues.

Agricultural products are generally considered personal property — not part of the real estate upon which they are grown — and are therefore subject to the provisions of Article 9 of the Uniform Commercial Code (UCC). Under the UCC, a security agreement is necessary to create a security interest in personal property. With only a few exceptions, a secured party must file a UCC financing statement to perfect the priority of its security interests against competing claims.

When crops are the collateral, a secured lender should be careful to use language in the security agreement sufficient to create a security interest in both crops growing at the time of the security agreement and future crops. A security agreement should make clear it covers “crops growing or to be grown” as opposed to a security agreement that only references “all growing crops.” Courts have found the latter description insufficient to cover future crops.

Loans to crop-sharing farmers can also result in a secured lender ending up with less collateral than it had bargained for. Because a borrower can grant a security interest only in collateral to which it has rights, secured lenders should be careful to determine whether the borrower has entered into a crop-sharing arrangement. If the borrower/farmer is growing crops under a cash lease, the borrower/farmer will have rights in all of those crops and can therefore subject those crops to a valid security interest. If, however, the borrower/farmer is farming under a crop-share lease which grants its landlord ownership of part of the crop, the borrower/farmer will only be able to grant a valid security interest in the portion of the crops to which the farmer is entitled.

A lender should also be careful to ensure that its security interest in crops is not defeated by a sale to a third-party buyer. Farmers, particularly those who have become cash-strapped, may attempt to sell their farm products without corresponding payment to their lender, despite the fact the lender may have a perfected security interest in those farm products. The Food Security Act of 1985 overrides the general rule under the UCC that a buyer of crop collateral would take subject to a lender's perfected security interest. Under the Food Security Act, buyers of farm products purchase free of a perfected security interest unless the buyer receives either:

1. an appropriate written notice directly from the secured lender within one year prior to the sale; or
2. a properly-filed notice from the Secretary of State of the applicable state, *but only if that state has adopted a central filing system* approved by the federal government.

At present, 19 states have central filing systems approved under the Food Security Act. Those states include Minnesota and North Dakota, but do not include other states in the Upper Midwest like Wisconsin or Iowa.

For states that require direct notice from a secured lender to preserve the lender's security interest in the event of a sale, secured lenders need to send a crop purchaser a written notice listing:

1. the secured creditor's name and address;
2. the debtor's name and address;
3. the debtor's social security number or taxpayer identification number;
4. a description of the farm products covered by the security interest, including the amount, crop year, and location of the products; and
5. any payment obligations that are conditions for the release of the security interest.

Because lenders often do not know potential purchasers for their farm products collateral, the terms of the security agreement should require the borrower/farmer to notify the lender of any potential purchasers.

For states with an approved central filing system, the secured creditor must file an Effective Financing Statement (EFS) in order to protect its priority. The EFS is a separate document from a typical UCC financing statement. An effective EFS must contain the same information as required in the written notice under the direct notice exception. However, an EFS need not include crop year or payment obligation information.

Lenders who wish to take agricultural products as collateral need to be aware of additional steps that must be carefully taken.