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AGRICULTURE CREDIT

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY UNITED STATES SENATE

ONE HUNDRED SEVENTH CONGRESS

FIRST SESSION

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HEARING ON AGRICULTURAL CREDIT

WEDNESDAY, MAY 16, 2001

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met, pursuant to notice, at 10:16 a.m., in room SR–328A, Russell Senate Office Building, Hon. Richard G. Lugar, Chairman of the Committee, presiding.

Present or submitting a statement: Senators Lugar, Harkin, Conrad, and Lincoln.

STATEMENT OF HON. RICHARD G. LUGAR, A U.S. SENATOR FROM INDIANA, CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

The CHAIRMAN. The hearing will come to order.

The chair now calls on Mr. Neil Conklin, Director of the Market and Trade Economics Division of the Economic Research Service, United States Department of Agriculture; Ms. Carolyn Cooksie, Deputy Administrator for Farm Loan Programs at the Farm Service Agency of USDA; and Mr. Lawrence Dyckman, Director of Agricultural Issues at the General Accounting Office, who will be accompanied by Mr. Charles Adams.

Ms. Cooksie and gentlemen, we much appreciate your coming to the committee today to offer testimony.

Let me just say at the outset—and this will be true for each of our three panels—that the prepared testimony that you have submitted to the committee will be published in full in the record of the committee, so you will not need to ask individually for that permission; and we will ask each one of you to try to summarize your testimony in five minutes so that we can proceed rapidly through those initial summaries that you have and the questions by members of the committee who are very much interested in the credit area.

I will ask you to testify in the order that I called upon you, which would be first of all Mr. Conklin.

STATEMENT OF NEIL CONKLIN, DIRECTOR, MARKET AND TRADE ECONOMICS DIVISION, ECONOMIC RESEARCH SERVICE, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, DC

Mr. CONKLIN. Thank you very much, Mr. Chairman, members of the committee.

Thank you for this opportunity to provide an overview of the current credit conditions facing America's farmers and farm lenders.

The overall financial health of farmers and their lenders remains solid, despite low prices for major farm commodities over the last several years.

Generally favorable farm economic conditions from 1990 through 1998 contributed to this financial strength. In addition, large Federal payments to farmers have mitigated the negative effect of lower prices on farm financial conditions and have played a key role in stabilizing farm income and balance sheets.

Much of the financial viability of the farm economy continues to rest on its sound balance sheet. Throughout the 1990's and especially since 1992, asset value growth has been strong, and equity positions have generally improved. Balance sheet improvement can largely be attributed to the strength of farm real estate markets.

The recent strength in farm real estate markets suggests that farmers and lenders do not believe that farm incomes will decline precipitously in the near future.

For the majority of family farmers, off-farm income is at least as important to creditworthiness and overall financial health as farm income. The ability of small farm operators to repay debt is primarily determined by off-farm economic conditions. Even for large family farms, close to half of total household income comes from off-farm sources. Government payments not only contribute to farm income but also impact farm debt and assets. The value of most agricultural land depends largely on its expected future earnings, and a rise in available cash from Government payments or other sources can impact the overall amount and composition of debt. Government payments also help farmers to meet debt repayment obligations.

To illustrate the importance of Government payments, I would like to talk a bit about one indicator of farmers' financial health, one that we call "debt repayment capacity utilization." The term sounds a little bit intimidating, but as most of us know from our own personal experience, as we use more of our borrowing capacity as defined by our credit cards or our line on our home equity loan, our financial options become more limited.

Today, farmers are using an estimated 65 percent of their borrowing capacity. This is substantially above the low levels of the mid-1990's. If it were not for Government payments, they would be using even more of their borrowing capacity—around 80 percent.

Not all farm operators are frequent users of borrowed capital. USDA's Agricultural Resource Management Study showed that only 42 percent of all farms carried debt from 1999 into 2000. Large farms are much more likely to borrow, and their borrowing needs are greater. Over 70 percent of large farms have debt. For these larger operations, which produce two-thirds of the Nation's food and fiber, credit availability and costs are a significant issue.

The position of commercial agricultural lenders reflects the generally healthy state of farmers' finances in recent years. Lenders continue to have ample funds to lend to creditworthy borrowers, and farm debt has continued to grow. Major groups of farm lenders, including the Farm Credit System, commercial bankers, and insurance companies, as well as the Farm Service Agency, continue to enjoy historically healthy loan portfolios.

Just as Federal payments have been important to farmers, they benefit farm lenders. Federal payments increase the size and reduce the risk of cash-flows associated with farming and the ownership of farm land. By increasing and stabilizing these cash-flows, Federal payments enable lenders to offer farmers credit on more attractive terms than they would otherwise be able to.

Just as lenders profit from Federal farm payments, they may be vulnerable to decreases in payments and any ensuing fall in land values.

In conclusion, farmers and their lenders continue to benefit from strong balance sheets bolstered by high levels of Government support. Thanks largely to this support, there remains no widespread evidence of financial distress even as the sector experiences its fourth year of low prices for many farm commodities. For most small farms and even many larger farms, the non-farm economy and the current unprecedented economic expansion have become more important sources of prosperity than farm markets and Federal payments.

An important issue, however, is the divergence between low levels of market receipts and rising farm real estate values. Already, ERS estimates that on average, 25 percent of the value of U.S. farm land represents capitalized Government payments. If more than a short-term idiosyncracy, this divergence may lead to an unsustainable dependence on Federal payments which, if curtailed, could precipitate a painful period of adjustment for farmers, farm land owners, rural communities, and their lenders.

That concludes my summary, Mr. Chairman. Thank you again for the opportunity. I will be happy to answer any questions.

The CHAIRMAN. Thank you very much for that testimony.

[The prepared statement of Mr. Conklin can be found in the appendix on page 43.]

The CHAIRMAN. Let me intrude in the batting order for just a moment to recognize Senator Lincoln.

STATEMENT OF HON. BLANCHE LINCOLN, A U.S. SENATOR FROM ARKANSAS

Senator LINCOLN. Thank you, Mr. Chairman. I appreciate, and welcome to all of our witnesses here today.

I just want to say thank you for coming and testifying before the committee today on such a very important issue and also to thank the chairman and say how much I appreciate him holding this hearing on a matter of critical importance to farmers in Arkansas, especially on the state of agricultural credit.

I would also like to welcome someone who is going to testify on the second panel who is a constituent of ours. I could share many stories on the issue of agricultural credit, but I am going to let one of my constituents, Mr. Chairman, tell the tale.

Gary Canada is here today on behalf of the American Bankers Association and will testify on the second panel. I want him to know how delighted I am and how proud I am that he is here.

Gary is president of the Bank of England and has a wonderful grasp of issues facing agriculture and agricultural lenders. I rely on Gary's insight often, and I am glad that he is with us today to share his perspective on the state of agricultural credit.

Mr. Chairman, our farmers and our ag lenders need certainty, and that is probably something that we may hear echoed from many of the individuals who testify today. The agricultural economy is dismal in my home State, and many of our farmers could not even cash-flow a loan this year without the guarantee of increased emergency assistance.

Unfortunately, a press release promising assistance does not always convince the banker to grant a loan, because he is ultimately left holding the bag if Washington does not come through in the end.

Many of our Arkansas farmers were left with no choice but to sell the family farm this year. I visited with one last Saturday when I was home for an event.

Prices are dismal, and input costs are skyrocketing for our farmers, and the mood is as bad as I have ever seen it in the farming community of Arkansas. Farmers just are not optimistic about the future.

I know a little bit about farmers. I grew up with one in a seventh-generation Arkansas farm family, realizing that farmers always think it is too hot or too cold or too wet or too dry—but ultimately, they are great folks, and they depend upon us a great deal.

I am very pleased that we have many distinguished witnesses with us here today to discuss the various issues facing our ag lending community. I apologize if I do have to excuse myself for another meeting.

I want to thank all of the witnesses here and especially thank Gary Canada for coming from Arkansas and sharing with many of you all what he shares with me on a routine basis.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator Lincoln, for those thoughtful comments.

Ms. Cooksie, please proceed with your testimony.

STATEMENT OF CAROLYN B. COOKSIE, DEPUTY ADMINISTRATOR FOR FARM LOAN PROGRAMS, FARM SERVICE AGENCY, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, DC

Ms. COOKSIE. Good morning, Mr. Chairman, Senator Harkin, and members of the committee.

I am pleased to appear before you today to review the status of the FSA farm loan portfolio, discuss the impact of certain provisions of the 1996 Farm bill, and point out some issues of concern for the future.

FSA offers direct and guaranteed farm ownership and operating loans to farmers who are unable to obtain private commercial credit. The goal of FSA's farm loan program is to assist eligible individuals and families through outreach, technical assistance, and supervised credit so that they can become successful farmers and ranchers. Regardless of the type of loan, FSA's financial assistance provides a safety net for borrowers who have reasonable prospects for economic viability in agriculture.

Mr. Chairman, I would like to begin by reviewing the present status of the FSA loan portfolio. I am pleased to report that the FSA farm loan portfolio is showing its best performance in many years. All programs are performing well. Direct loan delinquency is the lowest in over 20 years at 12.3 percent; the direct loan loss rate is the lowest since 1987; and we have made progress in reducing the number of delinquent million-dollar-plus direct loan accounts from 748 at the end of fiscal year 1995 to only 180 at the end of fiscal year 2000. In addition, inventory property numbers are the lowest since 1980. The guaranteed loan portfolio is also performing well. Delinquency is at an all-time low of 1.83 percent, and dollars losses have remained low despite continuing growth of the portfolio. In fiscal year 2000, losses paid were only seven-tenths of one percent of the principal outstanding.

Mr. Chairman, this is particularly noteworthy because at the same time, the FSA loan volume has increased significantly—more than 65 percent in recent years. In fiscal year 2001, demand for FSA's farm loan assistance remains strong. The lending season is currently at its busiest and most critical time, and FSA is working hard to rapidly process the thousands of applications coming into county offices.

I believe there is no single factor, but a combination of several different factors, which lead to these achievements. First, in the 1996 Farm bill there were instituted provisions which created strong incentive for FSA borrowers to repay their loans. The 1996 Farm bill included provisions which instituted prohibitions on further FSA loan assistance to borrowers who are delinquent or who have received debt forgiveness and a one-time, $300,000 limit on debt forgiveness. These limitations have caused FSA borrowers to more carefully consider the consequences of failure to repay their FSA loans.

Provisions of the Debt Collection Improvement Act have also been beneficial. The possibility of offset of FSA program payments and Federal income tax refunds, and bars on participation in other Federal credit programs, provide additional incentives for borrowers to repay their FSA loans.

Obviously, Mr. Chairman, borrowers cannot pay if they do not have the money to make payments. The significant amount of Government farm payments over the past few years is also a major factor in portfolio performance. Also, I cannot overstate the importance of the tremendous amount of hard work by FSA field staff in implementing the numerous program changes and in working to help borrowers avoid or resolve delinquencies. FSA employees have logged many long, hard hours working to assist borrowers. This is a difficult, often frustrating task; borrowers are under stress; there are no easy solutions, and sometimes the answer is not the one the farmer would like to hear. It is also important to note, Mr. Chairman, that the increase in FSA loan volume and reduction of delinquencies has been achieved with no increase in farm loan staffing levels.

Faced with a heavy work load and limited staff, we have developed ways to decrease the paperwork burden for both staff and program customers. Both the guaranteed and direct loan programs now have abbreviated applications for loans of less than $50,000. In February 1999, we published regulations which simplified and streamlined the loan guarantee process. Within the next few months, we will publish final regulations to dramatically streamline and simplify the emergency loan program for both farmers and FSA staff.

We have also undertaken a major initiative to streamline all loan program regulations. When this project is complete, 1,200 pages of text will have been deleted, and the number of required forms reduced by almost 30 percent.

Now to the future. Any discussion of the future of agriculture must include beginning farmers, since they are the future of farming. There is keen interest in this issue and rightfully so. FSA is not able to loan all the funds the law requires to be targeted to beginning farmers. This should come as no surprise given the current state of the farm economy. When even established farmers are struggling financially, it is extremely difficult for someone with modest financial resources to get started in farming.

Mr. Chairman, as you consider a new farm bill, there are two areas from the 1996 Farm bill that should be brought to your attention. One of them imposes a lifetime ban from FSA loans for anyone who had a farm loan debt forgiven. Certainly, there must be limitations to avoid program abuses such as the revolving door situation. However, you may wish to consider whether a different approach is possible—one that will prevent the abuse targeted by the 1996 change, but allow farmers another opportunity to become successful farmers.

The second provision from the 1996 Farm bill that I mention is operating loan term limits. That is a limitation on the length of time a person may receive FSA farm operating loans. Since the agricultural economy is increasingly volatile, the committee may wish to review this provision further. It is possible that a farmer reaching the term limit under economic conditions like these today may have done everything right and still be unable to get private sector financing.

Mr. Chairman, I would like to alert the committee to a few other issues that warrant attention as the new Farm bill is developing.

One is the requirement that FSA accept an applicant's projected repayment ability as collateral for emergency loans if the available collateral is not adequate to secure the loan. The result is that FSA is making emergency loans without adequate tangible collateral. This marks a return to past policies which resulted in multi-billion-dollar losses.

Second, the issue of shared appreciation agreements is one that I am sure most of the committee members are familiar with. These agreements were entered into as a part of the process of writing down or writing off debts under the provisions of the Farm Credit Act of 1987. A significant number of these agreements are now coming due. Under the current economic conditions, many farmers may not be able to pay the amount due under their agreement. However, some farmers will not be able to keep the agreement and will face liquidation. Any additional relief from the requirements of these agreements will require legislation.

Third, there is another situation I want to bring to the committee's attention. As we help borrowers deal with financial problems, one action taken to help farmers through tough times it the deferral of a loan installment to the end of the loan. This is an action that has been taken primarily to help borrowers through weather-related cash shortfalls. As of March 31 of this year, 15,862 borrowers have these deferrals on one or more loans. Unfortunately, with the prolonged period of low prices we are experiencing, it is likely that many of these borrowers will not be able financially to cope with the remaining balance when the loans mature. Current plans are to utilize the existing loan servicing authorities in the regulations to address these situations.

However, if economic conditions do not improve, the result could be a significant number of account liquidations. It is important that the committee be aware of this situation.

In summary, Mr. Chairman, the loan programs have come a long way, but success is a journey, not a destination, and we still have a long and challenging trip ahead. We look forward to working with the committee as you wrestle with the issues that I have raised today and other complex farm lending issues as well.

This completes my statement. I will be glad to answer any questions.

The CHAIRMAN. Thank you very much, Ms. Cooksie. We appreciate that testimony.

Mr. Dyckman.

[The prepared statement of Ms. Cooksie can be found in the appendix on page 51.]

STATEMENT OF LAWRENCE J. DYCKMAN, DIRECTOR OF AGRICULTURAL ISSUES, U.S. GENERAL ACCOUNTING OFFICE, WASHINGTON, DC, ACCOMPANIED BY CHARLES ADAMS, ASSISTANT DIRECTOR

Mr. DYCKMAN. Good morning, Mr. Chairman and members of the committee.

With me is Chuck Adams, an assistant director, who has done much of our farm loan program work.

I want to thank you for this opportunity to testify on the Department's farm loan portfolio which is administered by FSA. We do have encouraging news to report, and you have heard it from Ms. Cooksie and Mr. Conklin. The condition of the farm loan portfolio has significantly improved over the last several years.

With this comes a cautionary note. While we, the General Accounting Office, have removed farm loan programs from our high-risk list, the program will still need to be continuously monitored.

I will not go into much background on the loans. We have heard that. I just want to indicate that FSA does face somewhat conflicting tasks in managing these programs. They are to provide high-risk borrowers with temporary credit so that they can stay in farming until they are able to secure commercial credit, but at the same time, they have the responsibility of ensuring that the taxpayers' investment is adequately protected.

As the chairman and members know quite well, these programs are not without significant costs to the Government. FSA's losses totaled almost half a billion dollars during fiscal year 2000, although this is far less than the $1.2 billion of losses in 1996—and if we go back to 1990, the losses exceeded $3 billion. We have made progress.

The loan portfolio has improved, although it still contains many delinquent loans. The outstanding principal owed on direct and guaranteed loans totaled more than $16 billion as of September 30, 2000. Of this amount, about $2.1 billion was owed by delinquent borrowers, and most of this, about $1.8 billion, was owed on direct loans.

This past year, we removed the farm loan programs from our high-risk list for two reasons. First, as I have indicated, the financial condition of the programs had improved since we first designated them as high-risk in 1990. Second, the actions taken by the Congress and the FSA have had a significant positive impact on the programs.

We had identified the farm loan programs as high risk because there were billions of dollars in losses stemming from loan defaults primarily made in the 1980's and because more losses were likely to occur, and they actually did occur.

The programs had evolved into a continuous source of subsidized credit for thousands of borrowers, and the problems that the program experienced, some of which were congressionally directed, contributed to financial risks. Because the Department field office officials had not been complying with existing loan and property management standards, these risks continued.

Since the mid-1990's, FSA has addressed many loan management change and problems, and the Farm bill has altered the programs' policies to reduce risk. For example, the Farm bill prohibited borrowers who were delinquent on FSA loans from obtaining additional direct farm operating loans and limited borrowers to one instance of debt forgiveness. It also required borrowers to have or agreed to obtain hazard insurance, and it limited the length of time that FSA loan assistance is available.

These and other changes improved the financial condition of the programs. For example, the amount of principal owed by borrowers who were delinquent on their direct loans and the percentage of debt owed by such borrowers declined each year, from $4.6 billion, or about 41 percent of the outstanding principal in fiscal year 1995, to $1.8 billion, or about 21 percent of the outstanding principal in fiscal year 2000. The figure on page five of my full statement graphically displays the improvements in those programs.

While we have removed the farm loan programs from our high-risk list, USDA and the Congress need to continue to monitor their performance, and we will help them. This is particularly important since more recent legislation has eased some lending restrictions that had been put in place by the Farm bill. You have heard that from the witnesses prior to myself today.

These impacts, as well as any additional changes in economic conditions that increase risk, will need close monitoring so that adjustments can be made if the integrity of the loan programs comes under pressure.

Mr. Chairman and members, this concludes my statement. I will be happy to answer any questions.

[The prepared statement of Mr. Dyckman can be found in the appendix on page 56.]

The CHAIRMAN. Thank you very much.

I appreciate the fact that each one of you has traced the history from at least 1990 with some allusion to the problems that the committee faced in the 1980's, which were horrendous. Many days have been consumed in thinking about how would any of this money ever be collected and what kind of write-offs would occur year by year in the budget. You, Mr. Dyckman, pointed out that in 1990, about $3 billion was assessed to the budget that year. It could have been much more. The question, philosophically, was how much burden could the deficit take at that stage.

We have come to a point now where about half a billion dollars is currently reflected in the budget that we just passed, which is still a lot of money, but at the same time very different, and of course, the Federal Credit System was resurrected in the process of all of this.

Now, each of you has reflected the dilemma that the committee and the Congress face as we take a look at the Farm bill. Essentially, you point out that there were fewer delinquencies, and that the balance sheet of American agriculture has been strengthened. You, Mr. Dyckman, say that you are wary about this, that you have taken agriculture out of the high-risk situation but at the same time, you are casting an eye out there, because all of you have reflected essentially large governmental payments, with cash-flow to a good number of farms, making it possible for not only the systems that you are reflecting, but country bankers generally, to be repaid.

At the same time, Ms. Cooksie, you point out that even more applicants are coming in; more farmers are availing themselves of credit. For those who are not acquainted with farming, as you pointed out to begin with, essentially, the large farmers do the most borrowing, and they are presumably sophisticated in the use of credit, but these are large sums that are involved, and they are continuing to know and gaining some profit, I suppose, from leveraging those situations, or from necessity.

Let me ask each of you as banking observers—I have reflected from my own experience, and it is generally true of American agriculture, that well-managed farms in this country over the course of time may earn four percent on invested capital. This is a figure that many farmers do not use as a part of their analysis, but as they become familiar with our analysis in the committee, they begin to think through that. Almost every other business in our society is deeply interested in return on capital.

Four percent is a very low figure in comparison to most other areas in which credit flows or investment flows in this country, and it means that that is an average for a well-managed farm situation—there are a good number of farms that are at 3, 2, one, or zero.

The problem for you issuing credit is that you are going into an industry that has at least this particular profile or outlook as opposed to one in which the possibility of higher return seems to be, if not everywhere, at least more promising.

I just wonder, given this predicament, in which essentially the Congress has almost deliberately filled in the gap of net farm income, and the reason, clearly, why farms as a whole have a higher net worth, is because this has occurred; why land values reflect this—and you suggested that 25 percent of farm payments may be capitalized into those land values. This is obviously an abnormal situation.

Finally, anecdotally—and we could argue theoretically about this—some would say that Government payments in fact encourage production and some would even say overproduction, which encourages low prices, and which brings a circular problem to this. If we were not to have the payments, however, you have testified that probably land values might come down, and payments are capitalized into that, thus making everybody who is involved in the credit business less creditworthy, or at least you would be somewhat more suspect as you took a look at the situation.

We have, at least if I am correct in my assumption, a pretty low rate of return business to begin with in all of this.

What advice do you have for us, given that analysis?

[Laughter.] Or, if you have a different analysis, please speak now or forever hold your peace, because this is an important period that we are coming into.

Mr. Conklin.

Mr. CONKLIN. Mr. Chairman, I do not think I would be as presumptuous as to give you or the committee advice about what we can do about the situation, but I do think that you have put your finger on what, as an economist, I feel is a growing longer-term challenge for the farm sector.

As I pointed out, our best analysis at ERS shows that about 25 percent of the current value of farm land—that is for farm land outside of urban areas—may reflect capitalized Government payments.

Now, to the extent—and this is one of the dilemmas of payments—to the extent that those payments get capitalized, and asset values increase over time, that actually drives down the rate of return on assets, because there is a higher asset base against which we have whatever level of market earnings farmers are obtaining.

Although we are dealing now with a set of farm programs where we are making payments on a different basis than we did prior to 1996, I think that at least the evidence to date as we look at what real estate values have done is that that change did not completely move us away from that kind of dilemma or that kind of potential trap that existed prior to 1996; it seems still to continue to exist.

The CHAIRMAN. Ms. Cooksie, do you have any analysis of this situation?

Ms. COOKSIE. No. I wish I did. What I want to say is that by definition, as you know, we are the lender of last resort, which means that if an applicant or a farmer can get commercial credit anywhere else in the world, he cannot get credit from us.

We also by definition are only supposed to make loans to small family farms, which means that we tend to deal with smaller farms, who also tend to get smaller farm payments. I can tell you from our portfolio and when we talk to our staff in the field and what I hear around the country that if it were not for these farm payments, as you said earlier, there is a huge percentage of our borrowers who would not have been able to cash-flow for the last couple of years. As we are seeing cash-flows this year, the same thing is true, that they would not be able to stay in business and have any kind of cash-flow without the farm payments.

The CHAIRMAN. Of course, that makes very astonishing, although true, your statement in the second paragraph that delinquencies are at an all-time low and your lending——

Ms. COOKSIE. Is up.

The CHAIRMAN [continuing]. You are the lender of last resort for people who are small, who have the most difficulty—and even more interesting, I suppose, is that only seven-tenths of one percent of principal outstanding resulted in losses, which is a remarkable banking figure given the group that you have described.

Now, as you point out, then, the payments are the plug in this situation, and for those who have not followed our dilemma here before, for example, the committee often takes a look at USDA's report—it is almost AGA-type—but it says that at some point, net farm income—not cash, but net farm income—has been roughly $45 billion, at least at the 1997–1998 level. If the prediction is going to fall to $41 billion, ipso facto, $4 or $5 billion is suggested as a plug. It may come in the form of a second AMTA payment or various other variations that the committee and appropriators have thought of, but we get it back up to $45 billion again, essentially. There is almost a "hold harmless" situation here. Now, that does not mean that it spreads evenly over all of American agriculture, because some are up and some are down, and this is a total aggregate. The effect of this has been to produce a net worth of all of agriculture which is higher each year, almost counter-intuitive to all the testimony coming before our committee describing chaos, bankruptcy, and difficulty.

It finally comes down to the fact that the farm program has become a careful analysis, really, of this AGA-type of what is required to keep things afloat.

Now, as you are pointing out, one effect of this, however, is growing capitalization of this in land values, so young farmers come to us and say it is getting more expensive every year to buy this land—even though things may be low price and high inputs, as Senator Lincoln was saying, why is land going up?

Well, you have described why land goes up, why the net worth of those in the business cumulatively, at least, increases. Without getting into any more analysis—the Sparks Corporation analysis of the structure of American agriculture explains a lot of this, and we will have to examine that carefully, too—namely, that about 150,000 farms, eight percent, do 72 percent of the business. This is a very concentrated group of people in production agriculture—or 15 percent more, about 87 percent of the whole group, and this is only 300,000 farms out of 2 million, which makes for an interesting dilemma for the other 1.7 million, who have a zero outcome from agriculture on a net basis; some make money, but most lose, and almost all the income comes from off-farm. As you pointed out, that plays into this, too; some of that off-farm income has been important to the growth of our whole economy, including parts of rural America.

Well, I appreciate this information. It is extremely helpful, and the details that you have will be very helpful to us.

Now I would like to recognize my colleague, Senator Harkin.

STATEMENT OF HON. TOM HARKIN, A U.S. SENATOR FROM IOWA, RANKING MEMBER, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

Senator HARKIN. Thank you very much, Mr. Chairman.

I have listened with interest to your comments and questions, and we are in a dilemma, as you have stated, Mr. Chairman. It just seems to me that if we continue on the same path, we further capitalize in land values Government programs to the point where the disparity becomes wider and wider and gets bigger and bigger all the time, and where we really do blank out the prospects for young farmers getting involved at all in agriculture, unless they inherit the land—if you inherit it, that is one thing, and I assume we are going to do something about estate taxes here very shortly in the tax bill. That is just about the only way they are going to be able to get involved.

On the other hand, if we cut it off, there could be a terrible sort of wrenching movement in all of agriculture in terms of its capital assets and the debt-to-equity ratio, and everything could come crashing down.

That somehow, it seems to me we have got to find a way out of this with—what is the term—a soft landing somehow down the pathway. Certainly, the 1996 Farm bill did not do that, our challenge in the next Farm bill is to find out how we can do that. We cannot fall off the edge of the cliff, but there has got to be some glidepath down to a softer landing on this thing so that we do not keep increasing the fact that Government payments are capitalized in land costs.

The other thing is that of late, I have become aware that many of these payments that have gone out really do in fact do the opposite of what we always talk about around here. We want to keep a family sized structure of agriculture out there, healthy rural areas, and yet many of our programs going back many years have had just the opposite effect of concentrating land. It was simplified by one farmer who said the bigger you are, the higher your payment rate, and the higher your payment rate, the bigger you are, it means you can bid up the price of land more than the smaller farmer down the road, and therefore, you just bid up the price of land and add it into your base. We have got a perverse effect on land consolidation and concentration agriculture other than what we have said we wanted to do here. That is a challenge for us in how we are going to work this out in the next Farm bill.

That is just a musing on this and sort of a further extension of what the Chairman was just talking about.

More specifically to an issue that came up in the 1980's, we were here in the 1980's when we had the Farm Credit Act of 1987 in which we restructured a lot of farmers to keep them in business. One of those you mentioned was the shared equity agreements that farmers made, and those 10 years and more are up now, and a lot of them are coming due, and farmers are now being startled by that—they either forgot about it or did not pay attention to it. You mentioned it briefly in your comments. You said that "FSA has taken extensive administrative action to mitigate the impact of these agreements. However, even with deferral of payments and development of longer-term repayment schedules, some farmers will not be able to keep the agreement and will face liquidation."

However, it seems that these farmers, according to what I heard Mr. Conklin and you say, are basically doing all right now; they are making a living. I assume that many of them probably have good off-farm income, obviously, either from a spouse and/or the actual farmer during the wintertime up in our area getting a job someplace and having additional income.

[The prepared statement of Senator Harkin can be found in the appendix on page 40.]

Senator HARKIN. Why would they face liquidation if they are doing all right? You said that even with deferral or development of longer-term repayment schedules they will face liquidation. Why would that be?

Ms. COOKSIE. Well, I am not sure that I quite agree that most farmers, particularly small farmers, are doing all right. They are on the edge. They are making it, but I am not sure that they are doing all right that they could take on this additional debt.

What we have seen in the shared appreciation agreement is something that not many people thought would happen, that the land values we have talked about have gone up, so they owe quite substantially on their shared appreciation agreements. Most of the borrowers that we have have such a debt structure out there now, they cannot take on any more additional debt, plus they do not have cash money to pay the shared appreciation agreements.

There is a problem for farmers we have seen who are not going to be able to pay. Farmers are holding on by their teeth, some of the small farmers that we deal with who are in these shared appreciation agreements, but I do not think they could take on the additional debt that it would take to pay these shared appreciation agreements.

Senator HARKIN. You are saying that, basically, they are making it, but they are not banking any money.

Ms. COOKSIE. I do not think they are banking money; we do not see banked money in our cash-flows.

Mr. DYCKMAN. If I could just add a comment, Senator, as you know, another thing to consider is whether or not these farmers are getting direct payments, and many of the small farmers do not. When we talk about the apparent prosperity in farming, a lot of that has to do with direct payments from Uncle Sam, and many of the small farmers do not receive those.

Ms. COOKSIE. Or very little.

Mr. DYCKMAN. Or very little.

Senator HARKIN. In proportion to how much a larger farmer would get.

Mr. DYCKMAN. Right. As you know, we are doing a study for you and will be issuing a report in about a month that documents the details of that.

The CHAIRMAN. Who gets what.

Senator HARKIN. Yes, who gets what and how much and what the proportion is.

Do you have any advice on these shared agreements? I would hate to force them out. If we are going to make changes that might inure to their benefit down the pike, it would be a shame to force them out. If they are there, and they are making it—you are right, they may not be banking a lot of money—but at least they are making some form of a living. I know a lot of these former farmers, and I know they are not in good shape, but it would not require much to keep them in business and keep them going.

Ms. COOKSIE. That is why I mentioned it. It is one of the things that we are going to have to look at, because there is a substantial number of farmers out there who are in that situation. We have done, as I said, everything administrative that we can do with the law. We have had them defer payments up to three years; we have changed and lowered the interest rate on the non-program loan; we have even allowed them to take out any capital improvements they have made on the property. We have done everything administratively, and something is going to have to be done with the statute if we are going to actually do something to help them out.

Senator HARKIN. It is just apparent to me that if a farmer were in those dire straights in the 1980's on the credit crunch, and they got in and restructured, as many of them did, and got into these shared equity agreements, if they are still alive and farming today, they are probably pretty good managers.

Ms. COOKSIE. Exactly. I do not want to say that shared appreciation agreements were not a good idea. Obviously, it kept them in business for an additional 10 years, because we did write down and restructure loans so they could stay in business. I do not think anybody thought land values would go up the way they have; I am not sure anybody could have foreseen the commodity prices. Those are the combinations that make it pretty unworkable for most farmers right now.

Senator HARKIN. Thank you very much.

Thanks, The Chairman.

The CHAIRMAN. Thank you very much, Senator Harkin.

We thank each of you for your expert testimony, the papers and preparation.

The CHAIRMAN. We call now upon a second panel to assist us, and that will include Mr. Jay Penick, President and CEO of Northwest Farm Credit Services; Mr. Henry Edelman, CEO of Farmer Mac; Mr. John Evans, Jr., CEO of D.L. Evans Bank; and Mr. Gary Canada, President of the Bank of England in England, Arkansas.

Gentlemen, as I mentioned to the prior panel, all of your statements will be published in the record in full, and we will ask that you summarize your thoughts in five minutes if you can do that.

I will ask you to testify in the order I introduced you, and that would be first of all, Mr. Penick.

STATEMENT OF JAY PENICK, PRESIDENT AND CHIEF EXECUTIVE OFFICER, NORTHWEST FARM CREDIT SERVICES, WASHINGTON, DC, ON BEHALF OF THE FARM CREDIT COUNCIL

Mr. PENICK. Thank you, sir.

Good morning, Mr. Chairman and members of the committee. Thank you for inviting me to testify here today and present the Farm Credit System's view of current credit conditions.

I am Jay Penick, president and CEO of Northwest Farm Credit Services. We have 44 branches and 460 employees who provide

$3.3 billion in loans to more than 14,000 producers in Washington, Oregon, Idaho, Montana, and Alaska.

I want to provide the committee with an update on Farm Credit's mission and our success in achieving it. I will provide an assessment of the rural and agricultural credit markets, and finally, I will identify legislative changes needed if Farm Credit is to continue to fulfill its role.

First, let us take a look at Northwest agriculture. Serious stress continues for many agricultural producers due to low prices and increased operating costs. Producers who started into this downturn in sound financial condition are now suffering from the ongoing difficult period. In addition to low prices, we head into 2001 with low snow pack, a dry spring, and increased energy costs.

In addition to that, 1,400 farmers in Oregon's Klamath Basin had their irrigation water cutoff and diverted to preserving water levels for the endangered suckerfish and salmon. Without irrigation water, farmers will not be able to plant, and the impact on their operations and the communities they live in will be enormous.

Farm Credit is determined to do all that we can to help our affected customers. We urge Congress to also assist these troubled producers.

Farm Credit has a specific but critical mission—to help ensure the health and well-being of American agriculture by providing a dependable and competitive source of financing. For 85 years now, Farm Credit has successfully fulfilled that mission.

Mr. Chairman, as you well know, Farm Credit is not the lender of last resort. Congress has assigned that duty to the FSA. Farm Credit uses FSA's guaranteed programs aggressively to help both young and disadvantaged as well as seasoned producers get through difficult times.

The preferred lender program in which we are an active participant has also been successful.

Mr. Chairman, we are pleased to announce numbers just received from the Farm Credit Administration on Farm Credit's service to beginning producers. During 2000, Farm Credit made almost 27,000 loans that benefit beginning farmers and ranchers. At a point of comparison, during a 7-year period between 1993 and 1999, USDA's Farm Service Agency guaranteed a total of 5,000-plus loans to beginning farmers.

When Congress addressed the law governing the Farm Credit Act in 1971, it stated Farm Credit's mission very clearly—"to encourage farmers' and ranchers' participation in the management, control, and ownership of a permanent system of credit for agriculture responsive to the credit needs of all types of agricultural producers having a basis for credit." Each association and bank has a board of directors, farmer director, to fulfill this mission.

Subchapter T structures are also used in nearly two-thirds of the farm credit associations. In the past six years, Northwest has returned over $122 million of our profits to our customers.

In summary, Farm Credit has been a success story. Congress authorized the Nation's farmers and ranchers to build a privately owned system linking the resources of Wall Street to agriculture and rural communities, and we are doing that.

Farm Credit's financial condition remains strong, but this financial strength is due in large measure to the level of Government payments to producers over the past several years.

On behalf of our customers, I want to thank this committee for its efforts to assist producers through this difficult period.

It is important to note that in the Northwest, like many other parts of the country, we have a large percentage of agriculture concentrated in commodities not traditionally supported, like potatoes, fruit, nursery, and vegetables. It is easy to see the impact of your support as we compare the balance sheets and earnings of supported commodities and the financial stress evident in nonsupported commodities. We expect that additional Government assistance will again be necessary in 2001 and beyond. We urge continuation of your recent work to assure adequate assistance.

Despite our current financial strength, Farm Credit institutions see problems in the future. Fifty-five percent of our associations expect an increase in troubled loans in the coming year. In addition, we note financial difficulties in farm-related businesses and coops, particularly input suppliers and marketing firms. We encourage the committee to closely examine this area.

U.S. agricultural credit markets have changed dramatically in the past decade. In addition to expanding the authorities of commercial banks, Congress awarded them nearly unfettered access to funding from GSEs. Commercial banks have in effect become GSEs with virtually unlimited operating authority. Meanwhile Farm Credit's authorities remain basically unchanged.

Farm Credit's charter needs updating. It has not changed materially since 1971. A few areas that might be considered are value-added agribusiness lending, increased community size and rural cooperatives, equity capital for rural businesses, and elimination of unduly burdensome and costly regulations.

In summary vigorous competition between Farm Credit, commercial banks, and other lenders is benefiting U.S. agriculture. Producers have choices, and that is critical. In short, pricing is competitive, service is better because Farm Credit ensures competition in agricultural and rural credit markets. The more intense the competition, the greater the benefit for American agriculture.

Thank you, Mr. Chairman, for allowing us to give you our views on serving agriculture.

The CHAIRMAN. Thank you very much.

Mr. Edelman.

[The prepared statement of Mr. Penick can be found in the appendix on page 64.]

STATEMENT OF HENRY D. EDELMAN, CHIEF EXECUTIVE OFFICER, FARMER MAC, WASHINGTON, DC

Mr. EDELMAN. Thank you, Mr. Chairman.

Mr. Chairman, distinguished members of the committee, my name is Henry Edelman. I am President and Chief Executive Officer of Farmer Mac.

It is an honor to appear before this committee to offer testimony on an important and timely subject—the state of the delivery system for financial credit to farmers and ranchers in the United States and Farmer Mac's role in that process.

I appear before you today on behalf of a company rapidly advancing in its congressional mission of operating an efficient secondary market for agricultural mortgages. Our recent successes and strong current condition derive from the foresight of this committee and the consequent passage of the Farm Credit System Reform Act of 1996.

Today, thousands of farmers and ranchers have more than $3.1 billion of agricultural mortgages that back securities guaranteed by Farmer Mac. We actively support mortgage lenders, large and small, in all sectors of the agricultural credit industry, with effective programs and products.

Since 1996, Farmer Mac has contributed to lender liquidity, capital adequacy, and increasingly competitive rates and loan products for farmers and ranchers seeking mortgage funds.

Over the same period, Farmer Mac increased its capital from about $12 million at the end of 1995 to over $100 million at the end of 2000, and satisfied every condition set forth by Congress in the 1996 legislation to ensure its continuing safe and sound operation.

Over the last five years, we have not only put together programs that have appealed increasingly to both agricultural lenders and the farmer borrowers they serve, but also broadened the acceptance of Farmer Mac to all sectors of the agricultural credit industry.

We believe that we have made a great deal of progress, yet we know there is much more to be done before the industry reaches the level of efficiency and financial sophistication that exists today in the residential home market.

The year 2000 was the third consecutive year that prices for core agricultural commodities were at levels that promoted Congress to provide additional income support to farmers to avert serious economic stress. Conditions likely to place continued stress on the U.S. agricultural economy persist in 2001.

Despite the low prices for agricultural commodities, the value of good farm land was stable or slightly higher in most regions of the Nation during 2000. Each commercial lending sector maintained or increased its share of the agricultural mortgage market during 2000, and agricultural lenders reported profitable performance, good loan quality—with some recent increases in delinquency and nonaccrual loans—and liquidity adequate to support lending activities during 2000.

As I noted in my opening comment, the 1996 reform legislation dealt very effectively with the statutory limitations that had constrained our development up to that time and provided the authorities Farmer Mac needed to move forward aggressively in the development of an efficient secondary market for agricultural mortgages.

The 1996 legislation enabled Farmer Mac to develop and offer to agricultural lenders mortgage credit enhancement programs that have contributed materially to lender competitiveness and mortgage availability. The relationships that we have established with those lenders, including the Farm Credit System, commercial banks, and insurance company lenders, should continue the expanding use of the Farmer Mac secondary market. That process should ultimately move lenders away from dependence on mortgage portfolio management strategies and toward greater reliance on mortgage securitization, which permits borrowers greater choice and allows lenders to reduce credit concentrations.

As has been proven in the residential sector, this process will benefit both lenders and borrowers in the agricultural sector. Farmer Mac is proud to be an intermediary in this beneficial evolution.

On a related matter, I would also like to comment on the USDA guaranteed loan programs, which were extensively revised by Congress in the 1996 Farm bill. As you know, we purchased FSA guaranteed loans in our Framer Mac II program. In most respects, we believe that the changes made in 1996 have contributed to a more streamlined and financially sound FSA guaranteed loan program. Many of the lenders we work with report that the processing of guaranteed loans has improved and that changes in loan limits and the allocation of funds have added flexibility to the programs. Nevertheless we believe that the programs could be reformed further to provide eligible borrowers with greater access to long-term fixed-rate loans at more competitive rates of interest.

The primary policy goal for agricultural credit over the next decade should be for the entire industry to achieve a level of parity with the residential mortgage market with regard to financing techniques and structures supporting highly competitive mortgage products for farmers and ranchers.

Credit legislation could be framed to support the continuing evolution of the agricultural credit industry toward these goals. This might be accomplished by reference to the Farmer Mac secondary market rates and the sale and securitization of loans that are already in the USDA. As applied to those loans, an approach of that kind would open opportunities for borrowers to have greater access to long-term fixed-rate loans and for variable interest loans to be standardized and tied to published indices.

At the same time, adequate lender profits must be preserved to ensure effective competition among lenders and provide borrowers with ready access to multiple lending sources.

Adjustments to Farmer Mac's statute with a view toward reducing or eliminating certain limitations devised some 12 years ago would also be useful. We think that this could include, for example, expanding the definition of loans eligible for the Farmer Mac secondary market to include rural development loans or rural small business loans in rural areas so far as there is no efficient secondary market for them today.

These are preliminary ideas, but we are submitting them for examination by the members and staffs of the committee. We welcome the opportunity to discuss our ideas further with you, Mr. Chairman, and thank you for having us here today.

The CHAIRMAN. Thank you very much, Mr. Edelman.

[The prepared statement of Mr. Edelman can be found in the appendix on page 72.]

The CHAIRMAN. Mr. Evans, I pointed out, but there was a din of transition between the panels, that you are from Burley, Idaho, and you are coming in on behalf of Independent Community Bankers of America in addition to your own experience at the Evans Bank.

Please proceed.

STATEMENT OF JOHN EVANS, JR., CHIEF EXECUTIVE OFFICER, D.L. EVANS BANK, BURLEY, IDAHO, ON BEHALF OF INDEPENDENT COMMUNITY BANKERS OF AMERICA

Mr. EVANS. Thank you very much, Mr. Chairman, for letting me testify this morning.

My name is John Evans, Jr. I am CEO of D.L. Evans Bank in Burley, Idaho, a small community of less than 10,000 people in the heart of potato, sugar beet, small grain, and livestock country. Our family owned bank has served our community for nearly 100 years and has survived agricultural disasters, the Great Depression, and the recent downturn in the farm economy.

I am vice-chairman of ICBA's Agricultural-Rural America Committee.

Last year, ICBA sent President Bush and the new Congress a special report entitled, "Community Banking Issues and Answers Brief: A Community Bank Agenda," which included some of the farm policy-related recommendations I will mention today.

Next week, ICBA's Agricultural-Rural America Committee will be meeting here in Washington to discuss the farm policy and related issues. A specially appointed Farm and Rural Credit Policy Task Force will also be reviewing these issues to present additional recommendations.

Mr. Chairman, unfortunately, farmers today face a triple-whammy of despairingly low prices, sharply rising energy and input costs, and an unlevel playing field in the international trade arena. Our recommendations are as follows.

First, we support the adoption of another farm aid package. Congress may need to adopt a package similar in size to last year's package. We urge ample funding flexibility be provided for the next two years so that farm aid payments can be front-loaded if necessary, especially if the new Farm bill is not adopted in a timely fashion next year.

Our second key recommendation is to pass a new farm bill that includes countercyclical income mechanisms that automatically provide farmers more assistance in years when prices fall to unacceptable levels. From a lender standpoint, we value predictability and profit in the farmers' income and cash-flow statements. We hope a new farm bill will allow farmers and lenders to plan at least 3 to 5 years in the future.

In regard to income mechanisms, we are not currently wedded to one particular approach, but the structure of the next Farm bill could include not only fixed payment mechanisms, such as AMTA payments if they are continued, but also countercyclical mechanisms. The latter would provide supplemental income payments when farm prices fall. Also, tax-deferred individual savings accounts could work with and supplement the other income mechanisms, for example, by creating a "Farmer 401(k)" or quasi-retirement program for at least part of the individual savings account.

Some goals for this type of savings account program are, No. 1, maximize farmer participation by allowing some portion of Government payments to be funnelled into accounts, and allow farmers to match a portion of the Government payments from his other income; second, include a tax deferral component that can work over long periods of time to generate significant savings; third, limit withdrawals to hardship or other specific criteria; fourth, target participation to insured financial institutions; and fifth, improve producers' finances by allowing long-term accumulation of assets to eventually free farmers from dependence on Government payments.

Our third key set of recommendations are to fully fund the USDA loan guarantee programs. A few ideas include: provide a permanent source of contingency funds to prevent disruptions in the financing of guaranteed loans; permanently eliminate the 15-year limit on eligibility; provide some flexibility to raise the loan size limit.

Our fourth recommendation is to adopt policies that help diversify rural America. Mr. Chairman, one important aspect of strengthening the farm safety net involves helping rural communities diversify their economic base. More farm families appear to be relying on off-farm income to support farming enterprises. USDA indicates that 90 percent of farm household income came from off-farm sources and averaged $60,000 last year. Yet trends indicate that counties relying largely on agriculture as a main industry lost significant population in the last decade. The recent 2000 Census revealed that while the general population grew 13 percent in the 1990's, 676 primarily rural counties lost population.

Diversifying our rural economy will help people in rural America and will help farm families have additional sources of income, thereby reducing the need to rely solely on farm programs for survival. Rural economic diversity will also keep small businesses thriving on Main Street and help sustain the rural community banks that finance them.

We offer these suggestions. First, increase deposit insurance, and index it to inflation. Deposit insurance was last increased in 1980, and its value has been eroded by one-half. A much higher level is needed to adequately ensure the retirement needs of the aging rural population and to attract new deposits, to provide more security for large financial transactions conducted by larger farms and rural businesses, and to keep money in our rural communities so that it can be recycled into new investments and new opportunities for the communities' rural residents.

Second, increase funding for USDA's Business and Industry Program. Last year, Congress increased the B and I guarantee program by 50 percent, but that was not enough. About 400 banks now use the program. There was still excess demand of $1 billion that was not funded. More funds for B and I would be a very cost-efficient way to strengthen the rural safety net and the farm economy.

Finally, we need policies to spur greater investment in telecommunication technologies in rural America to help us bridge the digital divide between our rural and urban areas.

Thank you, and I will be happy to answer any questions.

The CHAIRMAN. Thank you very much, Mr. Evans.

[The prepared statement of Mr. Evans can be found in the appendix on page 108.]

The CHAIRMAN. At this point, since the chair is the only surviving Member present on the Senate side, and a roll call vote is underway, as you can tell by the white light, I will call a short recess, vote and do my duty, and then return.

I am sorry for the interruption, but we look forward to hearing from you, Mr. Canada. You will have an opportunity to catch your breath and prepare for your testimony.

We will adjourn for just a moment.

[Recess.]

The CHAIRMAN. The hearing will resume.

Mr. Canada, you were introduced as from the Bank of England. A number of our members asked me about that, and I explained that you are from England, Arkansas.

Mr. CANADA. Yes, sir. I have had that problem more than once.

The CHAIRMAN. I suspect so. It is good to have you here, and please proceed.

STATEMENT OF GARY R. CANADA, PRESIDENT, BANK OF ENGLAND, ENGLAND, ARKANSAS, ON BEHALF OF THE AMERICAN BANKERS ASSOCIATION

Mr. CANADA. Mr. Chairman and members of the committee, I am pleased to be here on behalf of the American Bankers Association to participate in this important hearing to examine the state of credit in agriculture.

I am Gary Canada, President of the Bank of England in England, Arkansas, and I am chairman of the ABA's Agricultural and Rural Bankers Committee.

The Bank of England was chartered in 1898 and has provided credit to farmers, businesses, and others in and around England since that time. Over half of our loans are to producers. For most of my banking career, I actively farmed in the England area.

We wish to thank you, Mr. Chairman, and this committee for your prompt and effective response to the critical needs of farmers and ranchers. You helped to avert a serious and extended period of economic disruption.

At the end of 2000, banks had nearly $75 billion in loans outstanding to farmers and ranchers. For every dollar of agricultural credit outstanding, 41 cents is loaned by banks. Loan quality remains strong and losses on all farm loans have been low. However, continued low commodity prices and the uncertain nature of future Federal assistance to agriculture has heightened our concern about the continued viability of our farm and ranch customers.

From early January to early May of this year, staff of the ABA Center for Agricultural and Rural Banking conducted 19 listening sessions in 14 States. Nearly 1,000 bankers and other stakeholders participated in these sessions. In the sessions, we talked about a wide range of topics, from Federal support for agriculture to trade to FSA programs to recommendations for the 2002 Farm bill.

Of the many policy options that we discussed during our listening sessions, there was consensus about the need to create a farm policy that is consistent and allows for some level of certainty for both producers and the bankers that finance them.

The guaranteed farm loan programs offered by FSA are some of the most cost-effective tools that Congress can provide to farmers and ranchers during difficult economic times. Because these programs are such an important part of access to credit, we urge you to make funding for these loan programs a priority.

We also strongly recommend that Congress permanently repeal the 15-year term limit on guaranteed loan eligibility.

In 1992, Congress approved a low-documentation loan program for FSA guarantees. At that time, the loan limit was set at $50,000. We recommend increasing the ceiling to $150,000 on these applications.

Many USDA services still require direct farmer contact by the FSA, but guaranteed lending is not one of them. Because many program delivery problems stem from the highly localized structure that USDA maintains, FSA should consolidate guaranteed loan-making and loan servicing in specialized offices to ensure consistency of program delivery.

For the past three years, Congress has approved emergency assistance to farmers. USDA determined that the additional payments could not be assigned with an existing assignment form even if a producer had assigned to the bank payments from all programs. FSA should create a blanket assignment form for USDA benefits that would attach to all program benefits now and in the future.

Bankers are very aware of the work that this committee and others have done to improve the Federal Crop Insurance Program in recent years. We urge you to seek additional ways to make crop insurance a more effective tool for producers to manage production and price risk.

Bankers are enthusiastic about FFARRM accounts. FFARRM accounts would encourage producers to save cash when they have a surplus and would allow them to balance their cash-flow when their earnings are down. Additionally, FFARRM accounts would provide a new source of deposits to banks which would then lend these funds back to businesses and individuals in their communities.

One of the best sources of low-cost funds for beginning farmers is loans that are originated by banks using State industrial revenue bonds. “Aggie bonds” allow banks to use the bonding authority of the participating States to fund qualified beginning farmer loans. More credit could be made available by banks to more beginning farmers if aggie bonds were exempted from Federal revenue bond volume caps.

Bankers support efforts to stimulate economic development in rural America by lending to the businesses that support in some way or add value to the crops and livestock produced by farmers and ranchers.

One of the most widely used non-farm credit programs is the Business and Industry Guaranteed Loan Program. B and I guarantees allow us to make loans to retain existing businesses in our communities and to help attract new businesses.

There have been some problems with the program in the past. Prudent steps have been taken to control loan losses and address other program problems. Unfortunately, the damage has been done, and all future borrowers are being asked to pay the price through increased loan fees. We oppose increasing loan fees on B and I guarantees.

The banking industry has a substantial commitment to agricultural and to rural America. Bankers will continue to work with their customers to restructure debt, to provide credit to operate, to find ways for beginning farmers to get started, and to provide the financial services and stability that rural communities need.

The ABA looks forward to working with you as you address the challenges facing our Nation's farmers, ranchers, and rural communities.

I am happy to answer your questions.

Thank you, Senator.

[The prepared statement of Mr. Canada can be found in the appendix on page 119.]

The CHAIRMAN. Thank you very much, Mr. Canada.

Let me ask this question of you to begin with. Staff has pointed out to me that columnist Tom Mertons of Agriculture On Line Magazine recently noted that there are fewer and fewer experienced agricultural bankers who understand the business of farming in the commercial banks of this country, and his fear was that commercial banks lacking those persons or that expertise would move away from lending.

What is your observation—not necessarily from the Bank England's standpoint, but in your overall role this morning, looking at it from the standpoint of American Bankers? Is this the case, that there are fewer and fewer persons who understand agriculture?

Mr. CANADA. Yes, sir, but that does not mean they cannot learn to understand agriculture. We do have fewer and fewer agricultural lenders just like we have fewer and fewer farmers.

The CHAIRMAN. The banks are not moving away from making loans.

Mr. CANADA. In my observations, I have noticed that as far as several of the larger banks, as they buy up smaller banks in our area, agriculture is not one of their primary goals.

The CHAIRMAN. This has, of course, been a long-time quest of the committee to try to make certain that there are opportunities available, preferably competitive opportunities, so that borrowers have some options. It is a mild concern, and I simply raise it because I suspect you would be as knowledgeable as any in this overall purview.

Mr. Evans, let me pick up a point that you made, I think as your fourth recommendation, or at least an important one, about the diversifying of rural America. This is an observation that a number of witnesses have made today, that as off-farm income has increased for America's farming families, except for the eight percent that I cited earlier that the Sparks people identified, the 150,000 and so forth, a majority of income in each of the other groups comes from off the farm. In fact, they identify 100 percent for about 1.3 million, with farming coming and going in the process, but the income that keeps the bread and butter on the table really comes from off the farm. This implies some other job opportunities.

When we come to that part of the Farm bill that somehow gets into this business of rural development—which is always a very broad subject and sometimes so broad that we lose track of any comprehensive plan—what suggestions do you have for us? Who, at least in your shop or among the bankers in your dealing, has done some fundamental research? Have you worked with think tanks or universities or others to take a look at America comprehensively at what this should be ideally?

Mr. EVANS. My feeling is that farmers cannot make it just farming anymore, the margins are so tight or nonexistent. We are seeing wives going out to find full-time jobs where they had previously been helping out on the farm. The men who have worked primarily on the farm have gone out and gotten part-time jobs to supplement that income.

I cannot stress enough how tight those margins are. The input costs are increasing. In Idaho, we have a drought situation where the power company is actually paying farmers not to turn on their pumps. This is going to have a drastic impact on southern Idaho, where we bank, and it is probably going to happen all through the West and might even go further East.

The CHAIRMAN. I grant that premise, so my question is how can we go about getting a more comprehensive view of diversification to supplement these incomes.

Mr. EVANS. I do not really have an answer to that question right now, but I would be happy to——

The CHAIRMAN. If you could go back to your organization, because this is a very serious problem. You have certainly given the background very accurately, and the off-farm income situation is an acute need if people are continuing in the large majority of farms in America. This gets scattershot treatment as to what is to be done. Certain communities try to solve it on an ad hoc basis with chambers of commerce or business councils or others coming together to provide some relief. The committee is trying to take a look at all of America and the moneys that are provided for so-called agricultural development and what should be our priorities, or who ought to help us with the blueprint. We are incapable of really doing that. We can provide the legal framework or some of the moneys. If you would help us in that respect—and that would be true of any of the panel members today—if you could share that kind of expertise, it would be very helpful.

Mr. EVANS. I would be happy to.

The CHAIRMAN. Mr. Edelman, I am curious—is your secondary loan business stronger in some States than in others? How would you describe, if you were to take a look at a map of America, where you are doing business, or reasons why you are not doing business in some sectors if that is not happening?

Mr. EDELMAN. Certainly. The most competition and the most sophistication about the use of secondary markets is on the West Coast. The combination of those two has led to a large proportion of our business coming from the States basically west of the Mississippi and in fact west of the Rockies. When you look at it, those are the places where the use of Fannie Mae and Freddie Mac is most common among the smaller lending institutions, which tends to be a factor.

Another thing is the relative sophistication of the lenders and the borrowers. What you were referring to earlier today about return on investment is exactly in point here. What we see is more of a focus on return on equity among lenders and a focus on return on investment among the borrowers. The borrowers are more inclined to leverage their operations, which improves the return on investment you referred to earlier today. The use of a secondary market program tends to increase return on equity at the lending institution.

The level of competition in the Western States has fostered this partly, and also the nature of farming. Less dependence on support payments is certainly a factor in that whole process, because those are the States that are less dependent on the very sorts of payments that you have had some consternation over. That has also been a factor.

Another consideration, of course, is that the Farmer Mac concept is still relatively new in certain places, and people tend to follow the early adopters, and we have seen more progress in certain areas of the Nation than others. Perhaps the slowest process has been in the Southeastern United States, but we see that part of that also has to do with the crops and commodities grown. When you are talking about commodities and crops that are dependent, for example, on integrators and growers and the structure there, where you really are shifting the emphasis on credit upstream to an integrator, it is more difficult to securitize those loans and see them as stand-alone loans.

The CHAIRMAN. You make several interesting points. Let me follow-up in this way. In California, for example, we have had testimony from a number of farmers who are not involved, as you have suggested, in corn and wheat or cotton or rice; rather, they are in vegetables, for example. People in vegetables sometimes do well, sometimes do badly—but they have suggested, at least anecdotally, that some of these people are doing better than the four percent on invested capital, and this then leads to an interesting colloquy that we have had with some of these people as suggestions have been made that we might incorporate them in support payments of some sort, either a loan deficiency payment or a loan rate of some type or a safety net. Some of them have reacted very adversely to this, and have said “Leave us alone,” that in essence, because they don’t have all the apparatus that attends wheat and corn; as a matter of fact, they have a market that is more vital, and those who are in it do better. People are not over-encouraged to get into it, nor are they kept in it, whether they are doing well or not. As a result, in essence, they are suggesting that we ought to keep arm’s-length out of this business.

Now, you are suggesting that in addition to whatever returns might be better than this proverbial four percent, by these loan mechanisms, they can further leverage their return, which some have testified that they do. Then, farming becomes a very different proposition than what we are talking about when we take a look at the whole situation.

That is why I am intrigued that you would have much greater success in this particular sector, but I know that you are not surprised given the explanation you have given.

Mr. EDELMAN. That although it is not a perfect market, it is a more efficient market and a truer economic model when you see free enterprise operating in that way, and the participants do appreciate that.

The CHAIRMAN. Mr. Penick, mention has been made of the crisis of the 1980's in the Farm Credit System generally, and all of us who were on the committee then remember those days, and I am sure you do, too, vividly, because it was a disaster. It was predicted to be much worse than it turned out, and that was because some of the legislative suggestions that came through were sound, and the Farm Credit people really worked, and they were a smaller group than the savings and loans, for example, which were simultaneously going along a track of disaster throughout that period of time.

At the same time, it was a very frightening period for producers who were borrowers, quite apart from those who were making the loans, and the changes that occurred in Farm Credit were profound.

I wonder, because I have not heard anything in the testimony today—it is much more optimistic—that would give any hint that somehow we are missing something going on out there in the Farm Credit System. I would ask you if there is there something—or is the system essentially sound, and the elements, not only in the Northwest that you have talked about but generally in your experience, in the overall system, something on which there is no particular cause for alarm, but as you have suggested, some incremental changes, and these largely in arrangements with farmers rather than structurally with the institutions.

Mr. PENICK. When I went through the 1980's with the Farm Credit System—I did that in Ohio, Indiana, Kentucky, and Tennessee—the land values dropped out from under the foundation of the system. Tied to that were, as you know, radical changes in interest rates, which really started the process.

As we take a look at what is going on in the 1990's, we have some of the same issues with low prices and challenges from that. We do have a very favorable interest rate market, and for agricultural producers that are leveraged and those that have grown, the interest rate environment becomes a very significant part of their repayment issues.

I also believe that Congress and in total, the programs for agriculture now, are targeted more to filling in the gaps with the additional supplemental payments, and I think that that has been a benefit. In my testimony, I made the comment that there is a significant difference between the balance sheets of commodity producers who receive payments and those who do not.

Actually, what you get and what has occurred is that you really have kind of a subsistence level going on, where the Government is involved with payments in the commodities of corn, wheat, and those; where, when you take the other commodities, they really fluctuate rapidly with the market, and those producers are prepared for that—much different than they were back in the 1980's.

The system has also done a tremendous number of things internally from the standpoint of capital regulations, from the standpoint of contractual agreements and CIPA scores, things that you are aware of, that really have provided the basis for early detection of any entities within the system that are starting to show stress. Those things have really been the difference between what is going on now and what was going on them.

If the Government programs were not in place, we would have a significantly different discussion on this panel today than we are having.

The CHAIRMAN. That is apparent, but that is an interesting way of looking at it, that the payments by and large fill in gaps, and there is a sharp difference, as you note, between, at least as a group, the commodity people who are receiving the payments and those who are not, in terms of market fluctuations and perhaps returns, as we were talking about with Mr. Edelman—they are sometimes very high and leveraged and sometimes much lower, depending on shifts in the market. As you said, this may be better preparation for the fact that it will not go on like a brook; you really have to be alert to the changes in the market signals.

Mr. PENICK. They react much more quickly to the market pressures than do the other group.

The CHAIRMAN. You were saying that during the earlier period of your career, or during this crisis, you were out in the Indiana, Ohio, and Tennessee markets and so on. I remember in this committee in the late 1970's, agricultural land prices was rising rapidly. I could see that with regard to my own farm. I tracked it throughout all that period of time. Then, of course, we hit the wall of the prime rate going to 20 percent and all the long-term rates in double digits, and Paul Volcker drawing a halt to the inflation at the time, and the wheels came off. Then, the 1980's were a terrible reverse in which land values in many parts of the country, as testimony here will indicate, fell by 50 percent and in some cases by more, stripping the gears altogether, which changed the credit picture markedly for anybody making loans to see all that collateral washed out.

As we are talking about here today, we have had an incremental increase in land values in the last 3 or 4 years, even in the face of all the rest of the crises that we are discussing, which is almost counterintuitive to the rollercoaster that we saw in the late seventies and the downslide in the eighties, and the beginning of tracking in parts of the country as the nineties came, with increases, and these have been more substantial as we came through the end of the decade and remain, as you say now.

This is instructive, and hopefully, we will not have to make all the same mistakes again. This is why some institutional memory is useful, and I appreciate your supplementing it.

Well, thank you all very much for coming. We appreciate your testimony and look forward now to still a third panel.

The CHAIRMAN. The chair would like to call Mr. David Carter, President of Rocky Mountain Farmers Union, representing the National Farmers Union, from Washington, DC; Mr. Frank Brost, a rancher and Chairman of Tax and Credit Committee of the National Cattlemen's Beef Association, from Rapid City, South Dakota; and Mr. Ferd Hoefner, Washington representative of the Sustainable Agriculture Coalition, from Washington, DC

Gentlemen, we thank you for your patience and endurance, and even more importantly, your presence today. As I mentioned to the previous panels, for your testimony will be published in the record in full, and I would ask that you attempt to summarize your comments in five minutes, and we will then proceed to questioning.

Mr. Carter.

STATEMENT OF DAVID CARTER, PRESIDENT, ROCKY MOUNTAIN FARMERS UNION, ON BEHALF OF THE NATIONAL FARMERS UNION, WASHINGTON, DC

Mr. CARTER. Mr. Chairman, members of the committee, good morning, and thank you very much.

I am Dave Carter. I am President of the Rocky Mountain Farmers Union, a general agricultural organization representing independent producers in Colorado, Wyoming, and New Mexico. I am testifying this morning on behalf of the 300,000 family farmer and rancher members of the National Farmers Union.

On paper, as we have heard several folks say this morning, the appearance of the farm credit portfolios and the availability of farm credit does not look too bad. We in the Farmers Union are very concerned, though, that this is a house of cards. There is a real patent disconnect, we feel, between the performance of the portfolios and the realities of production agriculture today.

There are two factors. One has been discussed a lot this morning—underwriting the health of the ag-based financial institutions has been $69 billion worth of farm program benefits and emergency and disaster payments since 1996, and we thank you very much. It has been very helpful in stabilizing the land values.

In many areas, there is the additional impact of growth, sprawl, and nonagricultural pressures on land values which have essentially given farmers a line of credit that they will never be able to repay by growing wheat, corn, or cattle.

There has been a lot of discussion comparing now and the 1980's. In the 1980's, land values plummeted at the time commodity prices fell, and that triggered the waves of foreclosures and liquidations. Now, even though we have low commodity prices, the land values have remained stable. Farmers are not going into foreclosure bankruptcy; they are simply selling out and walking away.

We feel there are two issues at work—No. 1, the sources of credit, and No. 2, the distribution of that credit. Let me go through some of these very briefly.

First, the Farm Credit System that provides 20 percent of all farm operating debt in the United States. We are very concerned that now, more than one-third of that operating capital has gone to operations with more than $500,000 in annual sales—it is going to the larger producers.

The Farm Credit Administration proposal for a national charter purports to increase market competition, and in the short term, this could be very beneficial in that it would increase competition and lower interest rates. As we have seen happen in the airline industry and the energy industry, that is not always the long-term benefit of deregulation. What it could actually contribute to is the ongoing consolidation in agricultural financing. That is very troubling.

There was a producer in our area, for example, who related to me that he was told by his farm credit institution that unless his operating loan this year was $100,000 or more, he could not expect to talk personally with a loan officer. This is a very troubling trend.

In the commercial banking sector, we have seen a 25 percent decline in the number of commercial agricultural banks, since 1992.

The mergers and consolidations are very disturbing. In our area, we have had First National become United become Norwest and now become Wells Fargo. As was discussed earlier, as they move into these larger banks, the expertise and the background and even the interest in providing ag credit diminishes.

We have seen that there is a real concern that as the consolidations go on, there is more interest in providing a small number of loans to very large operators than a large number of loans to smaller operators.

The philosophy is being played out as the larger consolidated banks simply try to clean out their ag portfolios in many instances. We are very troubled in our region that we have heard many examples from Wells Fargo and other banks that they are simply trying to reduce the number of ag borrowers.

As this has happened, there has been an interesting and disturbing trend toward more credit being provided by suppliers and input providers. Machinery dealers, seed companies, input suppliers are willing to fill that vacuum and provide credit at a cost, with interest rates up to 17 percent in some instances by those input suppliers.

We are very concerned that in the American countryside, we are creating a modern version of the company store.

We in Farmers Union urge Congress to authorize a study and seek recommendations from a qualified outside third party on the impact and effect of concentration in the farm credit and commercial lending sectors on No. 1, the availability of farm credit and No. 2, the growing scale bias of those resources.

Then, let me talk just very briefly about USDA and FSA, and there is more detail in my written testimony. We need adequate funding for all loan programs—direct, guaranteed, emergency and disaster, non-emergency loans for socially disadvantaged and beginning farmers. The Secretary of Agriculture needs broader flexibility in transferring funds from program and program and State to State.

The Secretary also needs greater emergency short-term borrowing authority from the CCC to address temporary shortfalls.

We would also like to see USDA loan guarantee programs expanded to encourage farmers to invest in value-added enterprises, particularly in producer-owned cooperatives and I would be glad to discuss later on in the questions and answers some thoughts on diversifying agriculture.

Finally, in the area of Chapter 12, we are pleased that Congress passed legislation extending Chapter 12 effective through the end of this month, but we feel that this needs to be made a permanent part of the Bankruptcy Code. We ask that this continue to be extended until that happens.

Finally, in conclusion, let me just say that credit will never serve as a substitute for real farm income. One of the problems that we have seen, for example, with the shared appreciation program, is that the basis on which that was built in 1987 was that if commodity prices are down, land values would be down, and if commodity prices came up, the equity would go up. The problem is that with the decoupling of the farm program payments, we have had the payments go out while commodity prices have stayed down. The land values have been capitalized by program payments and we have had that disconnect. We need to make sure that our commodity prices are more relative to the land values.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you very much, Mr. Carter, for your testimony.

Mr. Brost.

[The prepared statement of Mr. Carter can be found in the appendix on page 130.]

STATEMENT OF FRANK BROST, RAPID CITY, SOUTH DAKOTA, CHAIRMAN, TAX AND CREDIT COMMITTEE, NATIONAL CATTLEMEN'S BEEF ASSOCIATION

Mr. BROST. Thank you, Mr. Chairman.

My name is Frank Brost. I am a second-generation South Dakota cattle rancher. I am also on the board of directors and a member of the Loan Committee of a very aggressive, $80 million bank in central South Dakota that does a lot of ag lending.

I am here today on behalf of the National Cattlemen's Beef Association. I thank you for the opportunity to testify.

I am chairman of the NCBA's Tax and Credit Committee, and I hope that my testimony will be able to express and represent the views of the nearly 250,000 members of our organization. I look forward to providing some insight into the importance of sound and reasonable policies regarding 1) the availability and 2) the use of credit in the United States beef industry.

Cow-calf stocker and feeder operations generate $150 billion in economic activity. The chart included in my written testimony reflects the great, wide swings in returns on the average cattle operation from a profit perspective—around $80 per head loss during the bad times to a similar amount of profit during the good times.

Like many others in agriculture, we have been successful in finetuning our production. In 1996, NCBA refocused itself on the marketing and the demand side. We are seeing successes and growing consumer demand. We feel the focus on demand is largely responsible for the recent profitability that we have enjoyed.

As margins, however, become smaller and capital needs grow, a solid financial partner becomes even more important. Sound financial partners that operate with the spirit of a partnership agreement are critical to our success and sustainability. The very segments of our industry must be capable of dealing with constant fluctuations and variations in both prices and profitability.

We have three major concerns, the first being our new producers. The average age of beef producers is nearly 60 years of age. I am among them. As a result, we must focus on young producers just starting out in the business or inheriting the family operation and continuing it. The availability of capital to make it through the high and low cycles is critical.

The industry has evolved from a labor-intensive way of life into a capital-intensive business. Management and capital have become critical ingredients. Our banks and our financial institutions need the tools and the flexibility to be that partner in helping develop young producers into profitable and sustainable operators. We have to be prepared to help that producer and that lender make the change from a producer of a commodity into a partner in the production of a product. We agree with the aggie bond concept that one of the prior speakers talked about.

The second area of concern is our existing producers. Cattle feeding has become high-tech. With lower margins and increased capital needs, there is little margin for error.

Significant environmental capital cost improvements are required. Current operating credit lines do not provide room for these new regulatory capital costs. We must find ways to finance the costs of these new regulations.

The environmental standards will also begin to apply to broad bases of cattlemen, cow-calf operators like myself, and feeder operations, many of whom lack the equity to make these kinds of long-term capital investments.

The third major area we would like to address is the area of the value-adding concept which has also been discussed previously. As stated earlier, industry-wide, we are evolving from producers of a commodity into producers and partners in the production of a product. This has brought about the banding together of producers in new business structures, in turn, cooperatives, as you have discussed.

The cattle business out of necessity needs to prepare for its place in tomorrow's marketplace. This requires more focus on marketing, more focus on operators' strategic plans and strategic objectives. To quote a Yogi-ism, "You cannot get to where you are going unless you know where you are going." All of this requires a strong, well-financed partnership between the producer and the financial partner.

In summary, I have outlined three major concerns—how we finance the next generation, how we finance existing producers into an evolving business, and how we finance value-adding components of an ever-changing business.

NCBA recommendations are, first, that beginning farmer and rancher programs should be continued and expanded to allow for higher ceilings and reductions in filing requirements for guaranteed loans. New and stronger incentives should be developed that make it easier for young and beginning farmers to get a solid footing.

This committee and those with related oversight must ensure that new and existing regulations are not hampering growth and development. Technical assistance, when needed, should be part of any and all new regulations.

The United States must remain free of foot and mouth. There has been discussion of this, and we request and urge increased funding of R and D facilities.

The emphasis on value-adding will require even more vigilance on the part of regulators. We need to ensure that technical assistance is helpful and not a hindrance. The repeal of the death tax and the creation of farm accounts will permit producers to better manage their limited resources.

Finally, the Congress in its efforts to provide a safety net should not allow one segment of the industry to benefit at the expense of others.

I appreciate the opportunity to testify, Mr. Chairman, and I will be happy to answer any questions. On a personal note, my friend, Senator Abdnor, offers his greetings to you from South Dakota.

The CHAIRMAN. Thank you for bringing the greetings of Jim Abdnor. We appreciate it.

Mr. Hoefner.

[The prepared statement of Mr. Brost can be found in the appendix on page 139.]

STATEMENT OF FERD HOEFNER, WASHINGTON REPRESENTATIVE, SUSTAINABLE AGRICULTURE COALITION, WASHINGTON, DC

Mr. HOEFNER. Thank you and good morning, and thanks for this opportunity to testify.

I am Ferd Hoefner, Washington representative of the Sustainable Agriculture Coalition. The focus of my remarks today is on the beginning farmer provisions of the credit title.

I am currently starting a second term on the USDA Advisory Committee on Beginning Farmers and Ranchers and have submitted for the record some of the correspondence between that group and the Secretary that might be of some interest.

Credit programs are the only area in which Congress has addressed beginning farmer issues directly in any substantial way, and thus, existing programs deserve careful review.

First, I would call attention to targeted Federal credit assistance for beginning farmers. Congress embarked on a reorientation of credit programs to prioritize beginning farmers in 1992 and continued this effort in the 1996 Farm bill. My written statement contains details about these targeting provisions, but the bottom line message is that the targeting provisions are working.

Targeting has resulted in a profound shift in the focus and resource allocation within FSA credit, although more so with regard to direct lending than guaranteed lending, and more so in some regions of the country than others.

One clear example of the success of targeting is the combined total of over 11,000 beginning farmer farm ownership loans of all types that have been made since these provisions went into effect in 1994.

Our recommendation for the Farm bill credit title is to retain the existing targeting features without change. The possible exception might be some modification to the guaranteed operating loan target, which is the only program which has not come close to reaching its goal.

The Beginning Farmer and Rancher Down Payment Program has been very successful and should be continued. The Down Payment Program was authorized in 1992, started in 1994, and was bolstered in the 1996 Farm bill. Under this first-time purchase program, the borrower supplies 10 percent of the purchase price, FSA 30 percent of the purchase price, or on a 10-year loan at 4 percent, and commercial lenders or the seller provides the other 60 percent. This program been very heavily used across the Midwest and more lately in other regions of the country. It has helped to create over 2,100 new farming opportunities in its seven years.

The Down Payment Program has an excellent track record. The delinquency rate at the end of 2000 was just 2.3 percent, which compares very favorably with the 12.4 percent for regular ownership loans. I would also stress that with the Down Payment Loan Program, you get three to four times the number of borrowers served when compared with regular 100 percent financed loans, which is obviously very important in times of limited funding availability.

To make the Down Payment Program more flexible and to increase its applications to other regions of the country where it is currently underutilized, we recommend that the new Farm bill establish a broader range of both the size of the down payment required from the borrower and of the length of time for the FSA loan.

At the same time, we would recommend the establishment of performance goals for each State with significant farm ownership lending.

These recommendations are consistent with the recommendations of the USDA Advisory Committee and I believe would extend the programs to all regions of the country while maximizing the number of beginning farmer loans per dollar appropriated.

Let me briefly touch on funding levels. As recent year program levels have hopefully made clear, farm bill authorization levels for direct operating and especially for direct farm ownership loans need to be increased significantly. In the current year, where appropriated dollars are significantly higher than the authorized levels, the direct farm ownership program was out of money before spring started. It currently has $25 million only because of a recent transfer from unused guaranteed operating loans.

Both the general and the beginning farmer specific transfer authorities need to be continued—they have been very important—but we should also look to increasing direct loan fund availability directly.

We believe that no single change in law would do as much to spur down payment loans and the Federal-State partnership on beginning farmers as would a change in the Tax Code and a parallel change in the credit title to allow guarantees in conjunction with aggie bond loans at the State level.

FSA provides loan guarantees for private sector loans, but under the IRS Code cannot provide guarantees for aggie bond loans facilitated by State beginning farmer programs. We strongly urge a tax change and a parallel credit title change to allow guarantees on aggie bond loans. Together, these provisions would expand the pool of participating lenders and reduce interest rates for beginning farmers.

We also note our support for Senator Grassley's bill to exempt aggie bonds from the volume cap on industrial revenue bonds.

We recommend a substantial reworking of the Interest Assist Program so that the full interest rate break is targeted to moderate-scale loans for beginning, minority, and limited-resource farmers.

Finally, we would encourage the enactment of two new programs. We believe the credit title could establish a pilot project that would test the benefits of switching funds from debt financing to equity assistance. A revenue-neutral program for qualified beginning farmers and ranchers could provide seed money to help them build equity while encouraging lower-cost approaches to farming, reducing risk, and creating incentives for saving and investment.

We would also propose the establishment of a direct participation loan program with a limited-duration Federal loan to assist beginning farmers and ranchers getting a stake in value-added agricultural coops.

I would close by saying that we have many other ideas for beginning farmers that do not relate to the credit title; sometimes, in the past too much of the beginning farmer focus has just been on credit. There are other ideas that pertain to research, rural development conservation and other titles that we would love to pursue further with the committee at a later date.

Thank you for the opportunity to testify, and I will be happy to answer questions.

[The prepared statement of Mr. Hoefner can be found in the appendix on page 145.]

The CHAIRMAN. Thank you very much, Mr. Hoefner, and I appreciate your final paragraph where you mentioned that there are other things beyond credit that are involved, and I invite each of you and your organizations to help us in each of those areas. Farmers Union has testified with regularity at our conservation hearings, and likewise our hearings on export and various other titles that we have been taking up seriatim. Your organization, Mr. Hoefner, is likewise a very valuable resource.

Mr. Brost, let me start, because you have stressed the problems for beginning farmers and therefore credit for them—more fundamentally, although this changes anecdotally from time to time as I visit Purdue University or other university agriculture departments, there are a fair number of people enrolled, and in some years even increases, but only a very small percentage of these, sometimes fewer than one in ten, are considering going into production agriculture, that is, out on the farm. The other nine-tenths plus are in agribusiness or in some background dealing with rural America. There is a lot of interest in rural America but not necessarily in being farmers.

One of the reasons, I suppose, as you know, why cattlemen have a 60-year-plus age average, and for most other sectors, it is at least high 50's, and maybe in some sectors, more than that, is because, as a matter of fact, these are the folks who are still around. The number of people coming in at entry level still remains very few.

Leaving that aside for a moment, those who do, at least that I have observe in my home State, are very aggressive and sometimes have the benefit of inheriting land, or they have other relatives who have been involved in agriculture; but bit by bit, they put together, at least in a typical Indiana situation, 2,000 or 3,000 acres. They are bits and pieces of acreage from the States or from elderly farmers who no longer want to farm or whatever. That often, these people will have 25 or 30 properties, and it is a very complex business moving the equipment around, but it gives them the opportunity to amortize the purchase of sophisticated equipment as well as their expertise over a lot more territory, and they have a lot of energy. They are young people who want to expand their operations; they are highly leveraged as a rule; I am sure they are imbibers in, if not the credit programs we are discussing today, somebody's credit program. There are not many of them. They are conspicuous because they are relatively successful, and they are young, as opposed to those who are old and who are most involved in the situation.

Is this likely to change? In other words, as you take a look at the prospects for either enhancingthe system—and you have made some excellent suggestions for ways in which we can do more than tweak the system; there are some substantial changes that can be made but the problem exists that I discussed earlier this morning of the relatively low return in this area, which means, translated for a young farmer, a middle-class income enough to put his children through college or other things that people do in our society—is this a competitive outlook for a young person? Looking at this with some realism, how many people are going to be involved, and are the programs that we have not only sufficient for them but attractive enough so that many more might be invited?

Does anybody have a "blue sky" prospect that you would like to share with us?

Mr. BROST. I would comment on that. As one of my other experiences in life, I practiced law for 25 years out in Jim Abdnor's country, where I was his attorney. What you talk about is also true in South Dakota, Senator. Young, aggressive people have to have a fire in their belly, and they have to have some financial backing of some kind, whether it is a partner, an equity partner, or whether it is an inherited partner, to get into this business—not unlike wanting to run a bank or anything else. You have to have capital because it is a capital-intensive business.

I do not see it changing, and I do not think Government can make it change. You need to be there to support financially those young people who really want to do that, with technical assistance, with good bankers providing good credit advice. The ones I saw get in trouble over my years in the law practice and my years on the bank board—my neighbors and friends and relatives in this business got in trouble because they made some bad decisions in terms of where to put that equity and how to manage their marketing and other aspects of this business.

Good advice and good sound banking counseling in a partnership mode we talked about are terribly important, but I do not see it changing.

The CHAIRMAN. Mr. Hoefner, do you have a comment?

Mr. HOEFNER. Yes, I would just add one comment. Regardless of the four percent figure, the beginning farmer conferences that have been happening around the country and the beginning farmer programs that are beginning to spring up at the State level through extension and through private organizations are getting record numbers of people to come into the programs—for whatever reasons. It behooves us to make sure that the programs that we do have and the resources that we do have are serving their needs as flexibly and as efficiently as possible. That some of the recommendations that we are making in terms of the Beginning Farmer Down Payment Program can certainly help; having a new Federal program that is focused on beginning farmer development programs could also help—there is a lot going on at the State and local level that I believe could be supported through the next Farm bill.

The CHAIRMAN. Mr. Carter, do you have any thoughts about this subject?

Mr. CARTER. Yes, very much so. We have to take a look and ask is the status quo inevitable. I was concerned when I came back from the USDA Agricultural Outlook Conference a couple of months ago that a number of folks got up, and if you did not know better, you would think that the word "low cost efficient" was one word, because they tend to use that interface.

We think that if we take a look at where we are headed right now, with fewer producers and high-volume/low-margin production—in Colorado, for example, we have 18 operations that produce 51 percent of the value of agricultural commodities in our State; it is very heavily concentrated—what does that mean for the other 28,000 operations in the State?

When we look at the marketplace, though, we see that there is the misconception that the consumer just wants to go in and buy the cheapest thing and does not care where it is produced. In reality, more than half of the consumers are bringing other values to the grocery store with them, particularly concerns about health, wellness, food safety, as has been discussed considerably this morning. If we provide more opportunities for farmers to move forward and to put the value-added attributes on their products to market to those consumers, we can get more income back to agriculture.

That is where, when we take a look at the credit that could provide new opportunities not only in diversifying the rural economy, not to bring in businesses to replace agriculture, but let us talk about some businesses to enhance the stability of agriculture. When, out of the $1 trillion, the food and fiber sector, less than 6 percent goes to the producers of the commodities, and 60 percent is going to the processing, manufacturing and retail side, it seems to me that part of the answer here is let us provide producers with the ability to capture some of that added value, and let us do it through the loan guarantee programs, the B and I, as you said, enhancing the aggie bond programs, to help producers make their equity investment into these new value-added cooperatives.

We administer a cooperative development center through our foundation—USDA has been very helpful in providing support—and we see that it is very important not only to have new businesses that producers sell their commodities to, but to have producers be owners of those businesses so they can share in the rewards and the profitability of that business.

The CHAIRMAN. Is this one of a kind? In other words, is this something that can be replicated, this extension of producers into value-added production and so forth?

Mr. CARTER. It can be—I do not want to say replicated, because each success is not something that you can take a cookie-cutter and replace it, because each one is unique—but there are lessons to be learned there, and we would see that there is a combination of resources—loans and loan guarantees, but also grant programs through USDA to help farmers do the up-front work, the feasibility studies, and the technical assistance that can be brought to bear to help us move into these new value-added markets.

I happen to also serve on the National Organic Standards Board, and when we take a look at the phenomenal growth in organic agriculture and organic market, there are some real opportunities there, but we have got to make sure that the producers get the rewards from it.

The CHAIRMAN. Yes, Mr. Brost.

Mr. BROST. Mr. Chairman, during my life, I served on the National Institute of Corrections—I was on a State corrections board—which is a marvelous governmental organization that is set up to provide technical assistance to prisons, to jails, and to community corrections. It does not have a lot of full-time employees, but it has a body of technical assistance experts that you can call upon to come in and help.

I really believe that in many of these instances as we progress into value-adding agriculture, if we had an organization with a body of those kinds of people available, where young fireball people in groups could call in to help them get their business plans to help them get their business plans and how to fund and how to market, that it might be something that would be quite beneficial.

That is a good organization that you might look at to do something from the governmental perspective.

The CHAIRMAN. Well, the idea of farmers being involved in the other aspects, as you have all pointed out the problem that six percent or so goes to producers and 60-some percent to processors, manufacturers, and what-have you, on the surface is a great idea.

The question is will farmers be willing to organize themselves and their efforts, or a portion of their time in these ways. Maybe the answer is yes of necessity, but this is going to require a lot of leadership on the part of farm organizations, people like yourselves, who try to offer some business plan or a way of doing this, and it will require support from the Federal Government to help in the financing of it. We all pray that within our lifetime, this will occur, or better still, within the next decade or so, because this kind of rescue mission, it seems to me, is necessary; otherwise, we will have a continuing dialog about the aging of the population of American agriculture, and people will stick to being corn farmers and not manufacturers or marketers or what-have-you, which will not be good enough, I am afraid, given what I see to be continuing low returns from that type of thing per se. Now, if you enhance in other ways, you get into a different story.

Well, I appreciate your heightening our imagination through your testimony. Likewise, the basic papers that you have presented are very helpful. We look forward to working with you on other aspects of the Farm bill, and any additional thoughts that you have on credit today.

Having said that, the hearing is adjourned.

[Whereupon, at 12:30 p.m., the committee was adjourned.]

APPENDIX

MAY 16, 2001

STATEMENT OF SENATOR TOM HARKIN, RANKING DEMOCRATIC MEMBER
COMMITTEE ON AGRICULTURE, NUTRITION AND FORESTRY
HEARING ON NOMINATIONS AND AGRICULTURAL CREDIT ISSUES
May 16, 2001

Thank you Mr. Chairman for convening today's important hearing on nominations to the Department of Agriculture and on the topic of agricultural credit.

USDA's role in improving our nation's nutrition is, of course, central to its mission. And its responsibilities in the marketing and regulatory area are essential to fair, properly functioning markets and protection against animal and plant diseases. So I am pleased that we have before us today the nominations of Eric Bost and William Hawks and look forward to hearing from them.

Access to credit plays a critical role in helping the U.S. farm sector meet its large capital needs and operate smoothly. In the 1997 Census of Agriculture, some 800,000 farm operators listed interest payments for either ownership or operating loans as a major production expense -- and that was a good year financially. The private banking and financial industry, the Farm Credit System and USDA all have very important roles in financing American agriculture.

Much like air traffic control and baseball umpires, the agricultural financing system draws little notice when it is working well, but a lot of attention when things go wrong. Many of us in this room remember all too well the disastrous events of the mid-1980's, when so many farmers had high indebtedness, then got into big trouble when land prices collapsed. Their banks, including institutions of the Farm Credit System, suffered along with them, and Congress was forced to step in to help. I am pleased to note that the Farm Credit System has made good on its losses of the 1980's, and today its members are in sound financial condition across the country. And since that time, further opportunities for access to capital, such as Farmer Mac, have also developed. We certainly must do what we can in the farm bill to promote a healthy farm financial sector.

An issue that very much concerns me is opportunity for young people to enter agriculture. In the area of credit, USDA offers loans to beginning farmers and ranchers with special down-payment provisions. A certain share of funds appropriated for both direct and guaranteed loans through the Farm Service Agency is set-aside for those who meet eligibility criteria as beginning farmers. In many states, however, far more applications are made for such loans than can be covered with the available money. There may be possibilities for maximizing the federal funds by combining them with state monies in certain cases.

Another essential aspect of credit is providing capital for rural businesses, including farmer-owned cooperatives and other ventures. There is a pressing need to channel additional support for borrowed and equity capital to these rural business enterprises. I continue to be strongly interested in legislation in this area, along the lines of the bill I introduced last year.

I look forward to working with the Chairman and all members of the Committee to strengthen the farm credit title, a crucial component of the farm bill we will soon be crafting.

Testimony of
Neilson Conklin
Director, Market and Trade Economics Division
Economic Research Service, United States Department of Agriculture
Before the U.S. Senate Committee on Agriculture, Nutrition, and Forestry
May 16, 2001

Good morning, my name is Neil Conklin, Director of the Market and Trade Economics Division of USDA's Economic Research Service. Thank you for this opportunity to provide an overview of the current credit conditions facing America's farmers and farm lenders. My comments this morning focus on three general areas. First, I provide an overview on the general state of the farm economy and farm sector finances. Next, I discuss, using USDA's farm typology, how different groups of farmers are faring. I then turn to the condition of the major agricultural lenders. I conclude with a short discussion of how the current situation compares with the farm financial crisis of the 1980s.

I have limited my remarks to the farm sector, farm types, and farm lenders because of the focus of previous farm bill credit titles. However, as the committee is aware, the nonfarm rural economy and nonfarm financial markets and institutions are of vital importance to farmers and their rural neighbors. ERS has an active program in these areas, and a wealth of information related to both agricultural and rural financial institutions and policy issues, including the study of rural credit conditions required in the 1996 farm bill, can be found on our website at <WWW.ERS.USDA.GOV>.

State of the Farm Economy and Farm Sector Finances

The overall financial health of farmers and their lenders remains solid, despite low prices for major farm commodities over the last several years. Generally favorable farm economic conditions from 1990 through 1998 contributed to this financial strength. In addition, large Federal payments to farmers have mitigated the negative effect of lower prices on farm financial conditions and have played a key role in stabilizing farm income and farm balance sheets, particularly with respect to farms producing program crops. Largely due to government assistance, net cash farm income (which measures cash available from sales after paying cash operating costs) and net farm income (which assesses the net value of calendar-year production) have remained near the decade average in recent years despite substantial decreases in income from market receipts. Without additional emergency farm payments in 2001, net cash farm income is forecast to decline 10 percent and net farm income is forecast to decline 9 percent, both to levels well below the 1990 to 2000 averages. However, farmer income from market sources, as distinct from government payments, is expected to increase in 2001.

Much of the financial viability of the farm economy continues to rest on its sound balance sheet. Throughout the 1990s, and especially since 1992, asset value growth has been strong and equity positions have generally improved. Since 1996, however, debt has risen more rapidly than asset values causing the farm sector debt-to-asset ratio to increase, then stabilize, at about 16 percent.

The value of farm assets at yearend 2000 totaled $1.1 trillion and farm equity was $940 billion. The value of farm assets and farm equity are both forecast to increase at a modest rate (about 1 percent) in 2001.

Balance sheet improvement can be largely attributed to the strength of farm real estate markets. The value of farm real estate has risen by more than 36 percent from 1992 through the end of 2000, while farm mortgage balances have increased about 29 percent. The added equity could help some farmers obtain additional credit.

The value of farm real estate, the largest component of farm assets, is expected to increase about 1 percent nationwide in 2001. While the ERS's farm income analysis does not assume future legislation, strength in recent farm real estate markets suggests that farmers do not believe that their incomes will decline precipitously in the near future. This confidence is apparently related to the emergency assistance Congress has provided the sector in each of the last 3 years.

Government payments not only contribute to farm income, but also impact both asset and debt components of the farm balance sheet. The value of most agricultural land depends largely on its expected future earnings, and a rise in available cash can impact the overall amount and composition of debt. Direct government payments are generally attached to the land, and accrue primarily to landowners, supporting farmland real estate values and higher mortgage loan levels in areas where they are significant. Payments also provide funds to facilitate the purchase of machinery, equipment, livestock, and other farm production assets and to cover seasonal production expenses.

Government payments help farmers meet debt repayment obligations. Farm debt repayment capacity utilization (DRCU—actual debt as a percentage of maximum debt that could be repaid from current annual income) is expected to rise in the absence of new government assistance from less than 60 percent in 2000 to almost 65 percent in 2001, its highest level since 1985. This rise suggests that some farmers will place greater reliance on available credit lines in 2001, and may have a more difficult time meeting interest and principal payments on their outstanding debt. Had farmers not received any government payments, DRCU could have reached 80 percent in both 1999 and 2000, and would remain above 79 percent in 2001.

Farm Financial Health by Farm Types

Production agriculture consists of a diverse group of farms and ranches with varying degrees of financial success, which a single aggregate performance indicator such as net farm income cannot capture. For example, an increase in sector income from one year to the next does not reveal whether this was a result of everyone's income increasing by an equal amount or just a small group of farms earning an increasing share of the sector's profits. In other words, the sector cannot be viewed as one large representative farm. The Farm Typology, recently developed by the Economic Research Service, provides a useful framework for examining the wide array of farm and farm household financial circumstances exhibited by the sector today. Importantly, the typology recognizes the increasing contribution of income from off-farm sources to the financial well being of farm operator households, especially those with limited farm sales.

When crop prices are low and aggregate farm income falls, the common expectation is that farm household income and consumption also decline leading to a lower standard of living for farm families. According to data collected through USDA's Agricultural Resource Management Study (ARMS), for the majority of farm households (62 percent) the farm business operator's primary occupation is something other than farming. Many of these part-time farm businesses produce low farm business earnings, or even losses, that contribute a relatively small amount to total household income. The farm household is insulated from financial difficulties experienced by the farm business, however, by the household's multi-vocational situation. (On 40 percent of farms both the operator and spouse work off farm, while neither work off the farm on only 21 percent of farms.) Indeed, the financial well being of these farm families is much more dependent on general economic conditions and the local economy and less dependent on commodity prices.

For the majority of family farmers, stability in off-farm income is at least as important to creditworthiness and overall financial health as stability in farm income. For small farm operators, their ability to repay debt is primarily determined by off-farm economic conditions, and not farm economic conditions or the level of federal farm support. On average, 90 percent of total farm operator household income came from off-farm sources in 1999. Even for large family farms with $250,000 to $500,000 in annual sales, almost half of total household income came from off-farm sources.

That said, the condition of the farm economy matters most to the 800,000 farm households where the primary occupation of the operator is farming. In 1999, farm households where the primary occupation of the operator was farming had an average household income of $55,000 compared with $70,000 for farm households where the primary occupation of the operator was something other than farming. As a result, these so-called farm-dependent households have, on average, a lower level of household consumption. Even at this lower standard of living, nearly one in three farm-dependent households had consumption expenditures that exceeded household income. These households had to withdraw from savings, or borrow or liquidate assets in order to accommodate income short falls.

As I have noted earlier in this testimony, farm sector income is forecast to be lower in 2001 than 2000 by about ten percent (without additional government payments). The impact of lower farm sector income falls heaviest on farming-dependent households (this includes especially the small farms in the "farming occupation/higher sales" group and the "large" and "very large" family farms). For these farm households, a modest increase in the forecast for off-farm income (3 percent) is not enough to offset the expected decline in farm income given the current projections for commodity prices and government payments in 2001. Farm earnings account for about half of household income of the "farming occupation/higher sales" small farm households. For large and very large family farms, income from farming represents 60 percent and 80 percent, respectively, of household income. However, all farm households are sensitive to the conditions in the general economy and how they may affect off-farm earnings. Under a more pessimistic outlook for off-farm income, such as a forecast unchanged from 2000, farm household income could be as much as 5 percent lower for limited resource farms and 2 percent lower for "farming occupation/low and high sales farms."

The outlook for declining farm household income has implications for the ability of some farm households to meet debt service commitments. Only 42 percent of farms reported debt outstanding at the end of 1999, indicating that debt is not a source of capital for all farms. In addition to farm debt, many households borrow money for non-farm purposes. For those who do borrow, a portion of income must be set aside for interest and principal repayment so declining household income has implications for debt repayment. Unanticipated income shortfalls can impede a farmer's ability to service debt resulting in delinquent loans. Loan defaults occur when income deficits are sizable, widespread or prolonged. The historical trends in agricultural loan delinquency rates (payment past due 30 days or more) as reported by the Federal Reserve for commercial banks suggest that loan repayment problems peaked in 1987 at 11 percent of total loan volume. Delinquency rates declined throughout most of the 1990's remaining around three percent of total loan volume for the last several years. There were only two years with an increase in commercial bank agricultural loan delinquency rates, 1996 and 1999.

Data collected in the 1999 ARMS provides for a more detailed analysis of debt repayment issues, allowing the influence of off-farm income, family living withdrawals, non-farm debt and estimated income taxes to be considered. Comparison of actual debt levels with the maximum amount of debt that can be serviced by household income suggests that 17 percent of households experienced debt repayment problems. Repayment problems varied across the farm typology, ranging from only 10 percent of retirement farm households, which borrowed primarily for non-farm purposes, to nearly one in four for large family farms. Given the expected decline in household income for farm dependent households, repayment problems may become more pronounced in 2001 for the 36 percent of farms that fall in the "farming occupation/low and high sales" and "large and very large family farms" typology groups.

Debt Concentrated on Larger Operations

Not all farm operators are frequent users of borrowed capital. USDA's Agricultural Resource Management Survey showed that only 42 percent of all farms carried debt from 1999 into 2000. But large farms are much more likely to borrow and their borrowing needs are much more substantial. Average debt burdens for large farms (those with at least $250,000 in sales) that carry debt exceeded $400,000 at the end of 1999. For these larger operations, which produce two-thirds of the Nation's food and fiber, credit availability and credit costs can be a significant issue.

As structural change in agriculture continues, assets and debt burdens are being concentrated in the hands of ever fewer farming operations. Larger farms with debt are more financially leveraged, with significantly higher debt-to-asset ratios than smaller indebted farms. But, while the debt burdens are much higher for larger farms, their ability to service debt is also higher. The term debt coverage ratio, which measures the ability to service debt from cash flow, is highest for farms with annual sales that exceed $500,000. These very large farms are profitable and are able to provide better returns on productive assets, even in the absence of federal financial support. Nonetheless, larger family operations with substantial debt are vulnerable to declines in the farm economy because of their higher debt burdens and greater reliance on farm income to service debt. Large farms rely on banks, the Farm Credit System (FCS), and life insurance companies for about three-quarters of their credit needs.

For the majority of family farmers, stability in off-farm income is at least as important to creditworthiness and overall financial health as stability in farm income. For small farm operators, their ability to repay debt is primarily determined by off-farm economic conditions, and not farm economic conditions or the level of federal farm support. On average, 88 percent of total farm operator household income in 1999 came from off-farm sources. Even for large family farms with 250,000 to $500,000 in annual sales, close to half of total household income came from off-farm sources.

While off-farm income is most important to the creditworthiness of smaller farms, federal credit lending policies are also important for the least creditworthy, especially for those small farmers with limited resources. In some regions and counties, the Farm Service Agency (FSA) is a primary lender to all small farms. A 1997 USDA study showed that 17 percent of all farm borrowers with $10,000 to $250,000 in farm sales, a group most likely to be eligible for FSA programs, had at least one FSA loan outstanding. Over 80 percent of all FSA farm lending goes to small farms.

Lender Situation and Outlook

The position of commercial agricultural lenders reflects the generally healthy state of farmers' finances in recent years. Lenders continue to have ample funds to lend to creditworthy borrowers, and farm debt has continued to grow. To date, borrowers from agricultural lenders have generally been able to withstand the low commodity prices and weather-related problems due to their previously strengthened financial positions and an increase in payments received from the Federal Government beginning in 1998. As a result, commercial farm lending institutions have been able to continue to build capital and maintain favorable credit quality levels in their loan portfolios. Commercial farm lenders have benefited from improved management, stronger loan standards, and better regulator oversight compared with the 1980s.

Major institutional lender groups (commercial banks—which supply 40 percent of total farm debt outstanding, FCS lenders—27 percent, life insurance companies—6 percent, and USDA's FSA—4 percent directly and another 4 percent through guarantees to other lenders) continue to experience historically low levels of delinquencies, foreclosures, net loan chargeoffs, and loan restructuring. Even FSA reported an improving farm loan portfolio for the 12th consecutive year and is experiencing weaker demand for loans. These aggregate farm lender indicators are expected to remain favorable barring a sustained increase in farm financial stress or a sharp decline in the general economy.

Just as Federal payments have been important to farmers, they benefit farm lenders. Federal payments to farmers both increase the size and reduce the risk of cash flows associated with farming and, therefore, the ownership of farmland. The characteristics of these cash flows, in turn, are important factors in a lender's determination of how much can be prudently loaned to a given farm business. By increasing and stabilizing farm cash flows, Federal payments enable lenders to offer farmers credit on more attractive terms than they otherwise could. This feedback mechanism may well encourage farmers to increase their use of debt and to hold more financial assets. As noted previously, much of the value of Federal payments is capitalized into farmland. ERS estimates that, on average, 25 percent of the value of U.S. farmland represents these capitalized future payments. Farmland is the primary direct and indirect collateral backing farm loans.

Just as lenders profit from Federal farm payments, they may be vulnerable to decreases in payments and any ensuing fall in land values. This vulnerability depends on such factors as (a) the importance to their overall business of loans collateralized by Federal payments or agricultural land whose value is supported by these payments, (b) the appraisal and underwriting standards they have used when making such loans, (c) overall bank financial health and quality of management, and (d) the ability of lenders to anticipate any decrease in payments.

Lenders most vulnerable to an unexpected decline in payments would be those with the highest exposure to loans whose repayment and collateralization is most dependent on them. Such lenders include those FCS lenders whose portfolios are dominated by program commodities and commercial banks with more than 10 percent of assets devoted to various types of farm loans. The 2,559 such commercial banks as of December 31, 2000 held a total of $203 billion in assets representing 3 percent of total commercial bank assets in the United States.

Lender vulnerability also depends on the standards they apply when making loans. In past agricultural recessions, agricultural lenders had adopted more aggressive appraisal and loan underwriting standards in prior years. For example, in the 1970s and early 1980s many lenders were willing to underwrite loans on the basis of collateral value or even expected collateral value (taking into account expected future appreciation in land values) with too little consideration of the cash flow from which payments were to be made. In addition, the 1970s saw a legislated shift in underwriting standards among FCS lenders from a reliance on agricultural value to market value of farmland and an increase in the maximum allowable loan-to-value ratios. The use of lax appraisal and underwriting standards is less common in recent years, with many lenders retaining vivid memories of the painful agricultural contraction of the 1980s.

Bank and FCS regulators use rating schemes that identifies weaknesses in bank financial health and management to identify vulnerable and problem banks. Although such ratings are not available to the public for individual banks and are not released in a manner that allows us to determine whether agricultural banks are more problematic than other banks, the overall level of problem banks remains very low, especially compared to previous periods of agricultural distress. In addition, the existence of both Farmer Mac and FSA's guaranteed farm loan programs affords commercial lenders tools that were not available during the 1980s to manage their exposure to the credit and interest-rate risks associated with lending to farmers.

The vulnerability of lenders to a downturn in farmland values also depends on the extent to which a downturn can be anticipated. Immediately after passage of the FAIR Act, when payments were widely expected to decline over time, banks and their regulators were well aware of the need to anticipate a fall in land values as payments declined. Therefore, banks used conservative underwriting practices. In fact, lenders often fund loans for assets with declining values such as buildings, machinery, and equipment and have sound, well-established underwriting approaches to simultaneously facilitate capital accumulation and protect themselves from undue risk exposures.

Conclusion

In general, farmers and their lenders continue to benefit from strong balance sheets bolstered by high levels of government support. Thanks largely to this support, there remains no widespread evidence of financial distress even as the sector experiences its fourth year of low prices for many farm commodities. For most small farms and even for many larger farms, the nonfarm economy and the current, unprecedented economic expansion have become more important sources of prosperity than farm markets and Federal payments. However, issues remain. Perhaps most important is the divergence between falling farm income from market receipts and rising farm real estate values. If more than a short-term idiosyncrasy, this divergence may lead to an unsustainable dependence on Federal payments, which, if curtailed, could precipitate a very painful period of adjustment for farmers, farmland owners, rural communities, and their lenders.

The agricultural situation currently facing lenders differs from that of the 1980s in that farmers entered the current period of low prices without the burden of excessive debt. In addition, interest rates and interest rate volatility have both remained relatively low. Recent declines in interest rates will benefit farm borrowers, with greater benefits accruing to farms with higher leverage and good credit ratings. The increase in farm debt in recent years has been restrained compared with the 1970s, with only a 31-percent increase during 1990-2000 compared with a 242-percent increase during 1970-80. FSA's direct farm loans outstanding as a share of total farm sector debt has dropped to 4 percent in 2000 as many financially vulnerable farmers retired or otherwise left the sector.

Farm lenders have undergone considerable restructuring and consolidation since 1980, and many have thus spread their risk over a more diversified and geographically dispersed borrower clientele. Likewise, farms have greatly consolidated in the last 20 years and farm assets are in the hands of more financially secure operators. Farm lenders also learned the risks of lending on the basis of collateral in the 1980s and have instituted better loan analysis tools based on cash flow and other criteria. Farm lender regulation is much improved over the 1970s.

I would like to close my comments by reminding the committee of some of the great policy lessons from the 1980s farm financial crisis. These lessons included (1) increased debt and interest rate subsidies are ineffective substitutes for lost income, (2) macroeconomic instability and distortions can lead to instability and painful adjustment in both commodity and land markets, and (3) lender forbearance, inadequate lender supervision, and lax regulation prolong necessary adjustments and increase their costs. These lessons have served farmers and their lenders well in recent years.

Thank you again for this opportunity. I will be happy to answer any questions.

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Statement of Carolyn B. Cooksie
Deputy Administrator for Farm Loan Programs
Farm Service Agency
United States Department of Agriculture
Before the Agriculture, Nutrition, and Forestry Committee
United States Senate
May 16, 2001

Mr. Chairman and Members of the Committee, I am pleased to appear before you today to review the status of the FSA farm loan portfolio, discuss the impact of certain provisions of the 1996 Farm Bill, and point out some issues of concern for the future.

FSA offers direct and guaranteed farm ownership and operating loans to farmers who are unable to obtain private, commercial credit. FSA borrowers range from beginning farmers and ranchers who cannot qualify for conventional loans because they have insufficient financial resources to established farmers who have suffered financial setbacks from natural disasters, or whose resources are too limited to maintain profitable farming operations. The goal of FSA's farm loan program is to assist eligible individuals and families through outreach, technical assistance, and supervised credit so that they become successful farmers and ranchers. Regardless of the type of loan, FSA's financial assistance provides a safety net for borrowers who have reasonable prospects for economic viability in agriculture.

Portfolio Status

Mr. Chairman, I would like to begin by reviewing the status of the FSA loan portfolio. I am pleased to report that the FSA farm loan portfolio is showing its best performance in many years. As of March 31, 2001, there were 95,842 borrowers owing $9.5 billion in the direct loan portfolio. In the guaranteed loan portfolio, 40,559 borrowers owe $8.3 billion. All programs are performing well-- direct loan delinquency is the lowest in over 20 years at 12.3 percent, the direct loan loss rate is the lowest since 1987; and we have made progress in reducing the number of delinquent million dollar-plus direct loan accounts, from 748 at the end of fiscal year (FY) 1995 to only 180 at the end of FY 2000. In addition, inventory property numbers are the lowest since 1980. The guaranteed loan portfolio is also performing well. Delinquency is at an all-time low of 1.83 percent, and dollar losses have remained low despite continuing growth of the portfolio. In FY 2000, losses paid were only seven-tenths of one percent of the principal outstanding.

Mr. Chairman, this is particularly noteworthy because, at the same time, FSA loan volume has increased significantly--more than 65 percent in recent years. In FY 1999 and FY 2000, FSA provided loans and loan guarantees totaling $7.5 billion to over 71,000 family farmers. Of this total, 24,000 were beginning and socially disadvantaged farmers, who received assistance totaling $1.9 billion. In FY 2001, demand for FSA's farm loan assistance remains strong. As of March 31, 2001, loans and loan guarantees totaling $1.5 billion have assisted 15,000 farmers with their credit needs. A significant portion of this loan assistance – $515 million – is being provided to 6,000 beginning and socially disadvantaged farmers. The lending season is currently at its busiest and most critical time, and FSA is working hard to rapidly process the thousands of applications coming into county offices.

Mr. Chairman, one of the best indicators of program performance comes not from internal statistics, but from the General Accounting Office (GAO). In January of this year, the GAO announced that the FSA farm loan programs were removed from that Agency's list of designated high-risk federal programs. The FSA farm loan programs, and predecessor agency Farmers Home Administration farmer programs, had been designated as high-risk by the GAO for over 10 years.

Impact of 1996 Farm Bill Provisions

I believe there is no single factor, but a combination of several different factors which led to these achievements. First, the 1996 Farm Bill instituted provisions which create strong incentives for FSA borrowers to repay their loans. Prior to these changes, there was no disincentive for borrowers to have FSA debts written off rather than to repay them. The Agriculture Credit Act of 1987 inadvertently created a "revolving door" where borrowers could repeatedly get loans, have them forgiven, and then get new loans. The 1996 Farm Bill included provisions which instituted prohibitions on further FSA loan assistance to borrowers who are delinquent or who have received debt forgiveness, and a one time, $300,000 limit on debt forgiveness. These limitations have caused FSA borrowers to more carefully consider the consequences of failure to repay their FSA loans.

Other Factors

Provisions of the Debt Collection Improvement Act have also been beneficial. The possibility of offset of FSA program payments and federal income tax refunds, and bars on participation in other federal credit programs provide additional incentives for borrowers to repay their FSA loans.

Obviously, Mr. Chairman, borrowers cannot pay if they do not have money to make payments. The significant amount of government farm payments over the past few years is also a major factor in portfolio performance. I cannot estimate the exact impact of government payments on the FSA portfolio, but clearly, under the conditions we have been experiencing in the agricultural economy, the various payment and compensation programs enacted by Congress have affected many borrowers ability to repay FSA or their other creditors. As you know, FSA only lends to those who cannot obtain credit elsewhere.

I cannot overstate the importance of the tremendous amount of hard work by FSA field staff in implementing the numerous program changes, and in working to help borrowers avoid or resolve delinquencies. FSA employees have logged many long, hard hours working to assist borrowers. This is a difficult, often frustrating task--borrowers are under stress, there are no easy solutions, and sometimes the answer is not the one the farmer wants to hear. It is also important to note, Mr. Chairman, the increase in FSA loan volume and reduction of delinquencies has been achieved with no increase in farm loan staffing levels.

Program Streamlining

Faced with a heavy work load and limited staff, we have developed ways to decrease the paperwork burden for both staff and program customers. Both the guaranteed and direct loan programs now have abbreviated applications for loans of less than $50,000. In February of 1999, we published regulations which simplified and streamlined the loan guarantee process. The new procedures are more consistent with industry standards and have resulted in faster processing, allowing lenders to give more timely service to farmers in need of a guarantee. Within the next few months, we will publish final regulations to dramatically streamline and simplify the emergency loan program for both farmers and FSA staff. We have also undertaken a major initiative to streamline all loan program regulations. When this project is complete, 1,200 pages of text will have been deleted and the number of required forms reduced by almost 30 percent. We have also joined with the other service center agencies in a common Internet web site where customers of FSA, Rural Development, and the Natural Resources Conservation Service can download and complete the forms needed to participate in many agency programs and services.

Mr. Chairman, I have devoted a considerable amount of time addressing the past and present condition of FSA farm loans and progress made. Now I would like to turn to the future.

Beginning Farmers

Any discussion of the future of agriculture must include beginning farmers since they are the future of farming. There is keen interest in this issue, and rightfully so. In 1992, the Agriculture Credit Improvement Act established special programs, and targeted specific FSA loan funding for beginning farmers. The 1996 Farm Bill continued the targeting of funds, and increased the amount of loan funds targeted to beginning farmers. As a result of these provisions, FSA has provided assistance totaling $3.5 billion to more than 45,000 beginning farmers and ranchers since 1993. While these statistics indicate the program is being used, FSA is not able to loan all the funds the law requires to be targeted to beginning farmers. This should come as no surprise given the current state of the farm economy. When even established farmers are struggling financially, it is extremely difficult for someone with modest financial resources to get started in farming. Given the large capital requirements, substantial risk and meager returns, it takes much more than a low-interest FSA loan for a beginning farmer to be successful. An advisory committee on beginning farmers and ranchers has been established in accordance with the 1992 Act, and they have provided some suggestions of new and different ways to assist beginning farmers and ranchers. Of course, many of these suggestions have a budgetary cost associated with them.

Revisit 1996 Farm Bill Provisions

Mr. Chairman, as you consider a new farm bill, there are two areas from the 1996 Farm Bill that should be brought to your attention. As I mentioned earlier in this testimony, certain provisions in that Act have reduced program abuse and resulted in improved loan repayment rates and a stronger loan portfolio. However, Mr. Chairman, there is one provision in particular that I call to your attention. As amended by the 1996 Act, section 373 of the Consolidated Farm and Rural Development Act (CONACT) imposes a lifetime ban from FSA loans for anyone who has an FSA farm loan debt forgiven. Certainly there must be limitations to avoid program abuses such as the "revolving door" situation I described earlier. However, you may wish to consider whether a different approach is possible--one that will prevent the abuse targeted by the 1996 change, but allow them another opportunity to become a successful farmer.

The second provision from the 1996 Farm Bill that I mention is operating loan term limits. A limitation on the length of time a person may receive FSA farm operating loans was imposed by the Agriculture Credit Improvement Act of 1992, and substantially amended by section 611of the 1996 Farm Bill. Implementation of this provision was subsequently suspended, through December 31, 2002, by section 255 of the Agricultural Risk Protection Act (ARPA) of 2000. The statement of managers accompanying the ARPA conference report stated that the provision was suspended until debate on it could occur as a part of development of the new farm bill. Since the agricultural economy is increasingly volatile, the committee may wish to review this provision further. It is possible that a farmer reaching the term limit under economic conditions like those today may have done everything right and still be unable to get private sector financing.

New Issues for Consideration

Mr. Chairman, I have been requested to alert the Committee to other issues that warrant attention as a new Farm Bill is developed. I appreciate the opportunity to submit these items for your consideration.

The FY 1999 Appropriations Act amended the CONACT to require that FSA accept an applicant's projected repayment ability as collateral for an Emergency Loan or EM loans, if the available collateral is not adequate to secure the loan. The result is FSA making EM loans without adequate tangible collateral. This marks a return to past policies which resulted in multi-billion dollar losses. When the GAO removed the high-risk designation from FSA Farm Loan Programs, they cited efforts by FSA and by Congress to put safeguards in place to reduce the potential for waste and abuse. The GAO also stated that "USDA and the Congress need to continue to monitor the effects of the positive actions already taken to ensure that improvements in the financial integrity of the farm loan programs continue." To make a loan where all or part of the loan collateral is the applicant's projected repayment ability re-introduces a high risk factor into the program. There is again potential for significant loan losses which will, in turn increase loan subsidy rates and program costs. Beyond the fiscal impact, one could question the benefit of this provision to farmers. It allows them to borrow beyond the point of any remaining equity they may have, so that if they aren't able to recover from the disaster, they literally walk away with nothing.

The issue of Shared-Appreciation agreements is one that I am sure some of the Committee members are familiar with. These agreements were entered into as a part of the process of writing down or writing-off then Farmers Home Administration (now FSA) debts under the provisions of the Farm Credit Act of 1987. A significant number of these agreements are now coming due. Under the current economic conditions, many farmers may not be able to pay the amount due under their agreement. FSA has taken extensive administrative action to mitigate the impact of these agreements. However, even with deferral of payments and development of longer-term repayment schedules, some farmers will not be able to keep the agreement and will face liquidation. Any additional relief from the requirements of these agreements will require legislation.

Mr. Chairman, there is another situation I want to bring to the Committee's attention. As we help borrowers deal with financial problems, especially those beyond their control, we strive to be positive and pro-active. One action taken to help farmers through tough times is the deferral of a loan installment to the end of the loan. This is an action that has been taken primarily to help borrowers through weather-related cash shortfalls; however, in 1998 and 1999, FSA also provided this option to farmers who could not pay installments due to low commodity prices. These installments were deferred to the end of the loan in the belief that the during the remaining term of the loan, the borrower would recover and be in a position to restructure, refinance, or otherwise pay the deferred installment. As of March 31 of this year, 15,862 borrowers had these deferrals on one or more loans. Unfortunately, with the prolonged period of low prices we are experiencing, it is likely that many of these borrowers will not be financially able to cope with the remaining balance when the loans mature. Current plans are to utilize the existing loan servicing authorities in the regulations to address these situations. However, if economic conditions do not improve, the result could be a significant number of account liquidations. It is important that the Committee be aware of this situation.

In summary, Mr. Chairman, we have come a long way since 1987, and even since 1996, but success is a journey, not a destination and we still have a long, challenging trip ahead. We look forward to working with the Committee as you wrestle with the issues I have raised today, and other complex farm lending issues as well. This concludes my statement. I will be glad to answer any questions.

United States General Accounting Office

GAO

Testimony

Before the Committee on the Agriculture, Nutrition, and Forestry, U. S. Senate

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FARM LOAN PROGRAMS

Improvements in the Loan Portfolio But Continued Monitoring Needed

Statement of Lawrence J. Dyckman,
Director, Natural Resources and Environment

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GAO-01-732T

Mr. Chairman and Members of the Committee:

Thank you for the opportunity to testify on the U.S. Department of Agriculture's (USDA) farm loan programs. Our testimony today is based on reports that we have issued over the past decade, the most recent of which are our January 10, 2001, report entitled *Farm Service Agency: Updated Status of the Multibillion-Dollar Farm Loan Portfolio* (GAO-RCED-01-202) and our January 2001 report entitled *Major Management Challenges and Program Risks: Department of Agriculture* (GAO-01-242). As you know, within USDA, the Farm Service Agency (FSA) is responsible for administering USDA's farm loan programs.

Our testimony today focuses on two areas covered in our reports: (1) an overview of the financial condition of FSA's farm loan portfolio as of September 30, 2000, and (2) our decision to remove the farm programs from our high-risk list. In summary:

- FSA had more than $16.6 billion in outstanding farm loans as of September 30, 2000; direct loans accounted for slightly more than half of this amount and guaranteed loans for slightly less than half. Of the $16.6 billion, about $2.1 billion was owed by borrowers who were delinquent on repaying their FSA loans. Most (87 percent) of the $2.1 billion was owed on direct farm loans. Although the total amount due on the problem loans remains high, this financial position reflects improvement in FSA's direct farm loan portfolio in recent years as well as a continuation of a relatively healthy guaranteed farm loan portfolio.

- In January 2001, we removed the farm loan programs from our high-risk list. We did so because the financial condition of the programs had improved since we first designated the programs as high-risk in 1990 and because actions taken by the Congress and USDA, many of which we recommended, have had a significant positive impact on the operation and condition of USDA's farm loan programs. Specifically, since the end of fiscal year 1995, the amount of outstanding principal owed by borrowers who were delinquent on their direct loans and the percentage of debt owed by such borrowers declined each year–from $4.6 billion, or about 41 percent of the outstanding principal, in fiscal year 1995 to $1.8 billion, or about 21 percent of the outstanding principal, in fiscal year 2000. While we have removed the farm loan programs from our high-risk list, USDA and the Congress need to continue to monitor its performance over time.

Background

FSA's farm loan programs are intended to provide temporary financial assistance for the nation's farmers and ranchers who are unable to obtain commercial credit at reasonable rates and terms. FSA provides various types of both direct and guaranteed farm loans. *Direct farm ownership loans* can be used to buy farm real estate and make capital improvements. *Guaranteed farm ownership loans* are made for the same purposes and for refinancing existing debts. Also, *direct farm operating loans* can be used to buy feed, seed, fertilizer, livestock, and farm equipment; pay family living expenses; and, subject to certain restrictions, refinance existing debts. *Guaranteed farm operating loans* are made for the same purposes but without restriction on refinancing existing debts. Additionally, direct loans include *emergency disaster loans* which are made to farmers and ranchers whose operations have been substantially damaged by adverse weather or other natural disasters.[1]

In operating the farm loan programs, FSA faces the conflicting tasks of (1) providing high-risk borrowers with temporary credit so that can stay in farming until they are able to secure commercial credit and (2) ensuring that the taxpayers' investment is protected. When a borrower does not repay his or her direct farm loans, FSA has various tools to resolve the delinquency, including (1) restructuring the loans, which may include reducing (writing down) some of the outstanding debt so that the borrower can continue in farming; (2) allowing a borrower who does not qualify for restructuring to pay an amount that is based on the value of collateral security, which is less than the outstanding debt and results in FSA's forgiving (writing off) the balance; and (3) reaching a final resolution of the debt that may or may not include a payment by the borrower, which also results in forgiving the debt. When a borrower defaults on a guaranteed loan and a commercial lender incurs a loss, FSA reimburses the lender for the guaranteed portion of the loss. FSA's losses on direct and guaranteed loans totaled about $486 million during fiscal year 2000, about 88 percent of which involved losses on direct farm loans.

FSA's Farm Loan Portfolio Has Improved but Still Contains Many Delinquent Loans

The outstanding principal owed on FSA's direct and guaranteed farm loans totaled more than $16.6 billion as of September 30, 2000. Direct loans accounted for about $8.7 billion of the total amount, and guaranteed loans accounted for almost $8 billion. Borrowers who were delinquent owed slightly more than $1.8 billion, or 20.9 percent, of the outstanding direct loan debt and about $282 million, or 3.5 percent, of the outstanding guaranteed loan debt.[2] Both the total outstanding principal owed on direct farm loans and the amount owed by borrowers who were delinquent were lower at the end of fiscal year 2000 than at the end of fiscal year 1999. Also, while the total outstanding principal owed on guaranteed farm loans was higher at the end fiscal year 2000 than at the end of fiscal year 1999, the amount owed by borrowers who were delinquent was lower. (See table 1.)

Table 1: Outstanding Principal and Amount Owed by Delinquent Borrowers, Direct and Guaranteed Farm Loans, September 30, 2000

Dollars in millions

	Outstanding principal		Owed by delinquent borrowers		Percentage owed by delinquent borrowers[a]	
Loan program	Amount	Number of borrowers	Amount	Number of borrowers	Percentage of debt	Percentage of borrowers
Direct loans	$8,659.0	96,887	$1,812.4	13,930	20.9	14.4
Guaranteed loans	7,967.1	40,679	281.9	1,863	3.5	4.6
Total[b]	**$16,626.1**	**137,566**	**$2,094.2**	**15,793**	12.6	11.5

[1]The Consolidated Farm and Rural Development Act, as amended (P.L. 87-128, Aug. 8, 1961), is the basic authority for the farm loan programs.
[2]If a borrower was delinquent on any farm loan, the principal on all farm loans held by the borrower was totaled to calculate the amount owed by the delinquent borrower.

[a] Percentages are based on whole numbers.

[b]The total number of borrowers includes some borrowers who are counted more than once because they have both direct and guaranteed loans. Also, the total amount owed by delinquent borrowers does not add because of rounding.

Note: The percent of borrowers who were delinquent on direct loans declined from 23.5 percent to 20.9 percent over fiscal year 2000, and the direct loan losses of $427 million were FSA's least in over 10 years.

Source: GAO's analysis of information in FSA's farm loan automated databases.

All types of direct and guaranteed farm loans had outstanding principal owed by delinquent borrowers at the end of fiscal year 2000, while some types accounted for much more problem debt than others. Of the direct loans, for example, natural disaster emergency loans accounted for the highest amount of principal owed by borrowers who were delinquent–about $811 million; 44.1 percent of the outstanding principal on these emergency loans was owed by delinquent borrowers.[3] Farm operating loans were second in terms of the amount of principal owed by delinquent borrowers—$569.4 million; 20 percent of the outstanding principal on these loans was owed by delinquent borrowers. Of the guaranteed loans, farm operating loans accounted for the highest amount owed by delinquent borrowers, more than $165 million; 3.8 percent of the outstanding principal on farm operating loans was owed by delinquent borrowers. Guaranteed farm ownership loans had about $115 million, or 3.2 percent of the outstanding principal owed by delinquent borrowers. (See table 2.)

Table 2: Outstanding Direct and Guaranteed Farm Loans and Portion Owed by Delinquent Borrowers as of September 30, 2000, by Loan Type

Dollars in millions

	Outstanding principal		Owed by delinquent borrowers		
Loan type	**Amount**	**Percentage of total**	**Amount**	**Percentage of total**	**Percentage owed by delinquent borrowers**
Direct loans					
Ownership	$3,482.4	40.2	$135.7	7.5	3.9
Operating	2,846.9	32.9	569.4	31.4	20.0
Natural disaster	1,838.8	21.2	810.8	44.7	44.1
Other[a]	490.9	5.7	296.5	16.4	60.4
Total	**$8,659.0**	**100.0**	**$1,812.4**	**100.0**	20.9
Guaranteed loans					
Ownership	$3,581.9	45.0	$114.9	40.8	3.2
Operating	4,380.7	55.0	165.4	58.7	3.8
Other[b]	4.5	0.1	1.5	0.5	34.2
Total	**$7,967.1**	**100.0**	**$281.9**	**100.0**	3.5

Note: percentages are based on whole numbers. Also, totals may not add because of rounding.

[a]Other direct loans are economic emergency and recreation loans, which FSA no longer makes, and soil and water loans.

[b]Other guaranteed loans are economic emergency loans, which FSA no longer guarantees.

Source: GAO's analysis of information in FSA's farm loan automated databases.

[3]Natural disaster emergency loans are inherently riskier than the other types of farm loans that FSA makes because they are made to help farmers recover from losses rather than to generate new income.

Farm Loan Programs Remain Vulnerable to Loss, but High-Risk Status Is No Longer Merited

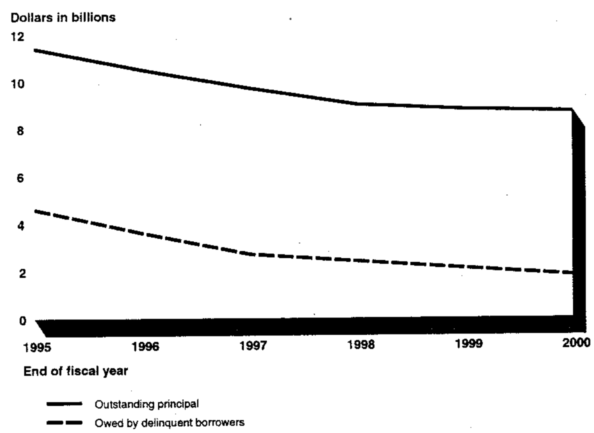
In January 2001, we removed the farm loan program from our high-risk list because (1) the financial condition of the program had improved and (2) there had been improvements in lending and servicing policies that were intended to reduce the risks associated with the farm loan programs. A decade earlier, in 1990, we had identified FSA's farm loan programs as high-risk because of significant program problems primarily with the direct loans. As we had reported in the 1980s, the farm loan programs had experienced a high rate of defaults on repayments: billions of dollars of losses had occurred and were likely to occur, and the Department had evolved into a continuous source of subsidized credit for thousands of borrowers. These problems occurred because of program policies—some of which were congressionally directed—that contributed to financial risks and because the Department's field office officials failed to comply with existing loan and property management standards. For example, the program's policies allowed borrowers who defaulted and caused losses on past farm loans to obtain new loans and allowed borrowers to obtain new direct loans for operating expenses without demonstrating their ability to pay their existing debt. Also, field offices lending officials approved loans on the basis of unrealistic estimates of production, income, and expenses and often failed to verify borrowers' existing debts.

Since the mid-1990s, USDA has addressed management problems, such as the quality controls over loan-making and servicing, and various pieces of legislation have had a significant impact on the operation of FSA's farm loan programs. Specifically, the 1996 Farm Bill made a variety of changes to the lending and servicing policies of FSA that were intended to reduce the risks associated with the farm loan programs. In particular, the 1996 Farm Bill included provisions that (1) prohibit borrowers who are delinquent on FSA direct or guaranteed farm loans from obtaining additional direct farm operating loans, (2) generally prohibit borrowers whose past defaults resulted in loan losses from obtaining new direct or guaranteed farm loans (although an exception provides that a direct or guaranteed farm operating loan for paying annual farm or ranch operating expenses may be made to a borrower whose restructuring resulted in forgiving debt), and (3) limit borrowers to one instance of debt forgiveness on direct loans.

The 1996 Farm Bill also requires borrowers to have or agree to obtain hazard insurance on the property that they acquire with farm ownership and operating loans, and requires applicants, as a condition for getting an emergency disaster loan, to have had hazard insurance on property that was damaged or destroyed. In addition, the 1996 Farm Bill provided direction for many other aspects of FSA's basic lending mission. For example, the 1996 Farm Bill limited the length of time that FSA loan assistance is available by providing that borrowers can receive direct farm ownership loans during a 10-year period that starts when they first obtain farm ownership loans and that borrowers can obtain direct farm operating loans during a total of 7 years, which may be consecutive or nonconsecutive years. The 1996 Farm Bill also enhanced the potential for direct loan borrowers to obtain conventional credit by allowing a 95-percent guarantee on loans made by commercial lenders to refinance the existing direct loans that the borrowers have, up from the previous limit of 90 percent.

We concluded that these actions have helped generate continued improvements in the portfolio in recent years. As of September 30, 2000, delinquent borrowers held more that $1.8 billion (about 21 percent) of the outstanding principal on direct loans. This compares with about $2.1 billion (23.5 percent) in September 1999, $2.4 billion (over 26 percent) in September 1998, and, $4.6 billion (about 41 percent) in September 1995. As figure 1 shows, the outstanding principal and the amounts owed by delinquent borrowers on direct farm loans have declined each year since the end of fiscal year 1995 and the enactment of the 1996 Farm Bill.

Figure 1: Outstanding Principal and Amount Owed by Borrowers Who Were Delinquent on Direct Farm Loans, End of Fiscal Years 1995 Through 2000

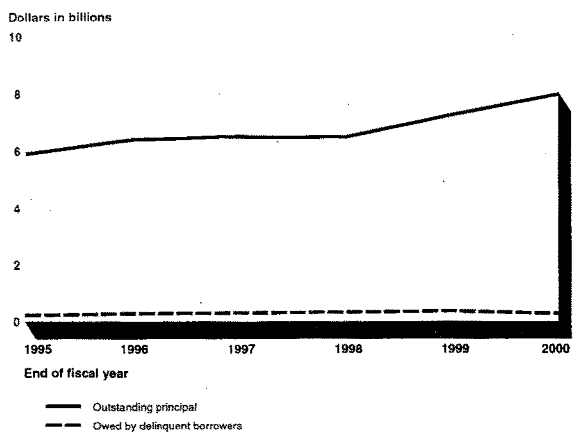


Note: The percentage of outstanding principal owed by delinquent borrowers was as follows: 40.7 percent in 1995, 34.2 percent in 1996, 28.2 percent in 1997, 26.4 percent in 1998, 23.5 percent in 1999, and 20.9 percent in 2000.

Source: GAO's analysis of information in FSA's farm loan automated databases.

In addition, as figure 2 shows, while the total outstanding principal owed on guaranteed farm loans has risen since 1995, the amount owed by borrowers who were delinquent on guaranteed farm loans has remained relatively steady.

Figure 2: Outstanding Principal and Amount Owed by Borrowers Who Were Delinquent on Guaranteed Farm Loans, End of Fiscal Years 1995 Through 2000



Note: The amount and percentage of outstanding principal owed by delinquent borrowers were as follows: \$218 million, or 3.7 percent, in 1995; \$280 million, or 4.4 percent, in 1996; \$300 million, or 4.6 percent, in 1997; \$325 million, or 5.0 percent, in 1998; \$363 million, or 5.0 percent, in 1999; and \$282 million, or 3.5 percent, in 2000.

Source: GAO's analysis of information in FSA's farm loan automated databases.

We believe that the improvements in part reflect actions that the Congress and USDA have taken to address the underlying causes of the programs' past weaknesses.

Although the programs' high-risk designation has been removed, we believe that USDA and the Congress need to continue monitoring the loan portfolio and the effects of the lending and servicing reforms, as well as any future legislation, to ensure that improvements in the financial integrity of the farm loan programs continue. This is particularly important since more recent legislation has eased some lending restrictions that had been put in place by the 1996 Farm Bill. First, Public Law 105-277 (Oct. 21, 1998) provides additional exceptions to the 1996 Farm Bill's general prohibition of new loans to borrowers who caused FSA to incur loan losses. Specifically, this act provides that a guarantee is only prohibited on a loan to a borrower who caused loan losses (1) after April 4, 1996, the date of the 1996 Farm Bill or (2) on more than three occasions on or before the date of the 1996 Farm Bill. The act continued allowing direct and guaranteed farm operating loans to restructured borrowers and also allows such loans to borrowers who are current on payments under confirmed bankruptcy reorganization plans. In addition, the act allows an emergency disaster loan to be made to a borrower who (1) caused not more than one loan loss on or before the date of the 1996 Farm Bill and (2) has not caused a loss after the date of the 1996 Farm Bill. Furthermore, the act specifies that an emergency disaster loan cannot be denied to a borrower who does not have sufficient collateral to secure the loan if the borrower can show the ability to repay the loan. Second, Public Law 106-31 (May 21, 1999) removed a loan-making provision that said that applicants for guaranteed loans needed to show that their expected income would be sufficient to repay their loans and also provide a margin to fund the replacement of capital items, such as a tractor, should that become necessary. Third, Public Law 106-224 specified that the limitation on the number of years in which borrowers can receive farm operating loans—7 years for direct loans and a total of 15 years for direct and guaranteed loans—would not be in effect from the date of enactment (June 22, 2000) and until January 2003. Fourth, under Public Law 106-387 (Oct. 28, 2000) an emergency disaster loan can be made to a poultry farmer to cover the loss of a chicken house on which the farmer did not have hazard insurance at the time of the loss if certain conditions are met. Since these provisions increase the risk of losses, their effects will need close monitoring so that adjustments can be made if the integrity of the loan programs comes under pressure.

Mr. Chairman, this concludes our formal statement. If you or other Members of the Committee have any questions, we will be pleased to respond to them.

Contact and Acknowledgment

For future contacts regarding this testimony, please contact Lawrence J. Dyckman on (202) 512-3841. Individuals making key contributions to this testimony and/or to the reports on which it was based include Charles M. Adams and Patrick J. Sweeney.

(360087)

THE FARM CREDIT COUNCIL

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Testimony of
Jay Penick
President and Chief Executive Officer
Northwest Farm Credit Services
Before the
Committee on Agriculture, Nutrition and Forestry
United States Senate
May 16, 2001

Good morning Mr. Chairman and members of the committee. Thank you for inviting me to testify here today and for allowing me to present the Farm Credit System's view on agricultural credit conditions and on credit-related proposals for the next Farm Bill.

My name is Jay Penick. I am President and Chief Executive Officer of Northwest Farm Credit Services. Northwest FCS provides loans and related services to more than 14,000 farmers, ranchers, fishermen, agribusinesses and rural homeowners in Washington, Oregon, Idaho, Montana, and Alaska. At the end of last year, we had just over $3.3 billion invested in loans in the five states we serve. We have 44 branch offices in local communities throughout our states and employ over 460 people. As a cooperative, Northwest Farm Credit is owned and governed by its customers. Our board is made up of 14 members elected by our stockholders and we rely on 160 regional farmer advisors to help us tailor our business to the needs of our customers. We have been returning value to our stockholder-customers by giving back over $122 million in the last six years through stock requirement reductions and by passing our earnings on to our customer/owners.

Today, I am appearing on behalf of the entire Farm Credit System. Farm Credit institutions provided just over 26 percent of total farm business debt used by America's farmers and ranchers in 2000. In total, Farm Credit has more than $75 billion in loans outstanding to agricultural producers, farmer-owned cooperatives, rural telecommunications and utility systems, rural homebuyers, and agriculturally related businesses. Farm Credit is the dominant lender for agricultural cooperatives and the single biggest source of financing for the GSM agricultural export loan guarantee program.

In my testimony today, I want to provide the committee with an update on Farm Credit's mission and our success in achieving it. I will provide Farm Credit's current assessment of the rural and agricultural credit markets. And finally, I will identify legislative changes that are needed if Farm Credit is to continue to fulfill the role Congress established for it.

Before I proceed with my testimony, however, I want to provide the committee with a brief update on Northwest agriculture. Economic stress continues for many Northwest agricultural producers due to low prices for some commodities and increasing operating input costs. It is important to recognize that producers who started into this downturn in sound financial condition are feeling the impact of this ongoing difficult period. As we head into the growing season, concerns continue over low snow packs, a dry spring and increased energy costs throughout the Northwest.

In addition to the area-wide drought, 1400 farmers in Southern Oregon's Klamath Basin have had their irrigation water cut-off and diverted to preserving water levels for the endangered sucker fish and salmon. Without irrigation water, these farmers will not be able to plant this year. If the situation continues, farmland prices in this area will fall dramatically. Currently, as irrigated farm land, most land in the basin is valued at $2,200 – 2,800 per acre. Without irrigation, the land is likely to be reclassified as dry land pasture valued at $150 - $250 per acre.

This income and asset value loss will cause tremendous economic hardship, not only to the farmers and those who work for them but also to the agriculture-based communities surrounding these farms and ranches. We are determined to do all we can to help our affected customers through this difficult situation. We urge Congress to assist the producers in the Klamath Basin. Through no fault of their own, many of these producers could face financial ruin.

Despite these difficulties, Northwest Farm Credit's loan portfolio as a whole remains financially sound, with troubled loans totaling only about 1.6 percent of total loans. Clearly, the strength in our portfolio over the past few years has been helped greatly by the high level of government payments to farmers. Without these payments, our portfolio would likely look quite different. A substantial portion of our portfolio is made up of non-government supported crops like potatoes, fruits, nursery products, and vegetables. It is easy to see the impact of your support as we compare the impact of prices on the supported commodities versus the non-supported commodities. Even with this high level of government payments, producers are feeling the stress of several years of continued low or record low prices.

On behalf of everyone in Farm Credit, I want to express our gratitude for the committee's efforts over the past several years to help American agricultural producers through this period of extremely low commodity prices. The additional assistance provided has meant the difference between survival and bankruptcy for many farmers. We encourage the committee to continue to provide additional support for producers during this difficult time.

Farm Credit's Mission

As America's largest cooperatively owned agricultural lender, we in Farm Credit appreciate the committee's focus on the credit needs of agriculture. We believe that Farm Credit has played a vital role in the development of American agriculture as the most productive in the world. As agriculture has changed through the years, Farm Credit has kept pace and provided the capital necessary to fuel agriculture's productivity. We continue to do so today. As we look to the future, however, additional changes are needed if farmers and ranchers are to continue to have a cooperatively owned financing alternative available for them.

The Farm Credit System was created by Congress in 1916 to provide American agriculture with the dependable and affordable source of credit it needed -- through good times and bad. For 85 years now, Farm Credit has successfully fulfilled that mission.

Farm Credit has a specific, but critical mission: to help ensure the health and well-being of American agriculture by providing a dependable and competitive source of financing to rural America. Farm Credit's constant presence in the marketplace means that farmers have a choice among lenders. The competition between Farm Credit and other lenders creates competition for farm loans and results in interest rates that are competitive with other industries and in higher service levels for farmers and rural businesses. Our focus on agriculture means farmers and ranchers and their cooperatives have a reliable source of credit.

Mr. Chairman, as you well know, Farm Credit is not the lender of last resort. Congress has assigned that duty to the USDA's Farm Service Agency. Farm Credit is not in place to address a market failure. Instead, Congress assigned Farm Credit the job of "providing sound, adequate, and constructive credit and closely related services to farmers, cooperatives and selected farm-related business" (12 U.S.C. 2001(a)). When Congress recodified the law governing the Farm Credit System in 1971, it stated Farm Credit's mission very clearly – "to encourage farmer- and rancher borrowers participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit" (12 U.S.C. 2001(b)).

By giving agricultural producers an opportunity, through Farm Credit, to own and control their lending institutions, Congress ensured that producers would always have access to credit. Farm Credit is dedicated to serving the financial needs of U.S. agricultural producers and rural communities.

Reversing the Flow of Capital -- Congress designed Farm Credit to reverse the usual flow of capital, channeling private funds from the nation's money markets to rural America. As agriculture's Government-sponsored enterprise (GSE), Farm Credit raises money on Wall Street to lend to agriculture and other rural enterprises.

Ensuring Competition for Farm Loans -- In its early years, Farm Credit, through the old Federal Land Banks, was virtually the only long-term mortgage lender to American farmers and ranchers. Over the years, others, including commercial banks and insurance companies, have come in and out of the market. As the agricultural credit markets evolved, Farm Credit served as the constant force in the market. Other lenders, when they chose to engage in agricultural lending, were forced to compete with Farm Credit. This competition provided competitive interest rates and better loan terms to farmers. Farm Credit continues in this role today, serving as the only constant and reliable source of competitive pressure in the agricultural lending markets.

Farmer Control -- In addition to fostering competition for agricultural loans, Farm Credit gives producers and their cooperatives an opportunity to own their own lender. FCS banks and associations are cooperatives, owned and governed by the farmers, ranchers, and cooperatives that borrow from them. This cooperative principle is the foundation upon which Farm Credit is built. It guarantees Farm Credit's unwavering commitment to serving agriculture and rural communities.

GSE Status -- To help fulfill its commitment to serve agriculture all across the country, Congress provides Farm Credit with the ability to access the agency debt markets. As a GSE, Farm Credit benefits from the implicit backing of the federal government. This implied support allows us to maintain a triple-A credit rating in the bond markets.

Farm Credit uses this credit rating to gather loanable funds in a cost-effective manner. In this regard, GSE status is Farm Credit's counterpart to deposit insurance, which allows commercial banks to attract depositors at a lower cost. An important difference between the two is that GSEs have *implicit* government support while federal deposit insurance is *explicitly* backed by the federal government.

Farm Credit Financial Discipline -- Farm Credit lending institutions are subject to the full regulatory and examination authority of an independent federal agency: the Farm Credit Administration. The three-member FCA board of directors is appointed by the president and confirmed by the Senate. Although Congress sets the FCA's annual budget, the agency's operating costs (approximately $38 million in 2000) are paid entirely by the lending institutions it regulates.

Like other federal financial regulators, FCA routinely examines all Farm Credit lending institutions, and has full authority to issue cease-and-desist orders, levy civil money penalties, remove officers and directors of System institutions and establish financial and operating reporting requirements.

Besides federal regulation, all Farm Credit lending institutions have additional financial safeguards:

- **Risk-Based Capital Standards** - By law, FCA requires all Farm Credit System lending institutions to maintain minimum permanent capital equity ratio at 7 percent of risk-adjusted assets. All System lenders are well above this minimum level.

- **Contractual Interbank Performance Agreement** - All FCS Banks, the Funding Corporation, and the Financial Assistance Corporation have entered into an agreement that establishes an agreed-upon standard of financial condition and performance for the banks.

- **Insurance Fund** - With passage of the Farm Credit Act of 1987, Farm Credit banks began paying into the Farm Credit System Insurance Fund. The Fund exists to insure the timely payment of principal and interest on insured obligations of System banks. On December 31, 2000, the fund totaled some $1.626 billion.

- **Joint and Several Liability** - By law, all of the banks within the Farm Credit System guarantee the payment of principal and interest on Systemwide debt issued to raise loanable funds on the money markets.

In summary, Farm Credit has been a success story. Congress authorized the nation's farmers and ranchers to build a **privately owned system** that brings the financial resources of Wall Street to agriculture and rural communities. It ensures **fair competition** in the marketplace that keeps interest rates competitive. And finally, through its cooperative principles, it ensures a continued strong **financial commitment** to all agricultural producers having a basis for credit -- in good times and bad.

Rural and Agricultural Credit Markets

Farm Credit's financial condition remains strong despite extraordinarily low commodity prices. This financial strength is due, in large measure, to the high level of government payments to producers over the last several years. However, while there has been some strengthening of commodity prices this year, input costs, particularly fuel and related items, are high and rising. Lower interest rates are alleviating some stress, but most farmers continue to experience a cost/price squeeze. Complicating this predicament, some regions of the country are experiencing very unfavorable weather. As a result of all these factors, we expect that additional government assistance to farmers will again be necessary in 2001. We urge Congress to provide this assistance.

FCS Condition

Farm Credit continues to demonstrate financial strength in virtually all performance categories. Loan volume rose to $76.031 billion in the first quarter of 2001 -- up some $800 million compared to this time last year. Net income for the first quarter rose to $390 million compared with $312 million in the first quarter of 2000. Continued strong financial performance resulted in an increase in overall capital within the System to $14.595 billion. Capital as a percentage of assets stood at 15.4 percent at March 31, 2001 compared to the regulatory minimum capital level of 7 percent required for individual FCS institutions. Farm Credit relies on this high level of capital to see it through the inevitable downturns in the agricultural economy.

Of note, Farm Credit's troubled loan volume rose in the first quarter, though it continues to stand at relatively low level. Nonperforming loans (which consist of nonaccrual loans, accruing restructured loans, and accruing loans 90 days or more past due) increased $67 million to $946 million at March 31, 2001, as compared with $879 million at December 31, 2000. These loans represented 1.24 percent and 1.17 percent of the System's loans at March 31, 2001 and December 31, 2000, respectively.

A recent survey of Farm Credit lenders provided an interesting insight to the current market conditions. Reports of higher than normal turnover of agricultural land seem to be confirmed by increases in loan volume to both new and existing customers in most Farm Credit associations. Some 61 percent of responding System associations reported loan volume increases compared to one year ago. Most of this increase is due to increased farm mortgage lending activity. Older producers are liquidating their operations as a result of depressed commodity prices while land values remain quite strong. Half of System institutions reported that land values increased in the last six months while nearly the remainder reported that values were about the same as six months ago. For 2001, 32 percent of System institutions were expecting land values to increase while 61 percent were predicting values to remain steady. Only 6 percent predicted land values would fall in 2001.

Most System institutions see clouds on the horizon. Some 55 percent report that they expect an increase in troubled loans and other non-performing assets. In addition, a number of System loan officers are noting financial difficulties in farm related businesses. While farmers and landowners continue to benefit from government assistance, many agribusiness firms are struggling. In particular, input suppliers and marketing firms are being hard hit by the continuing downturn in prices. We encourage the committee to closely examine the financial situation facing many of these businesses.

Market Structure and Competition

U.S. agricultural credit markets have changed dramatically in the past decade. Most of these changes, naturally, mirror the changes occurring in U.S. agriculture. As producers have changed their operations to adapt to the marketplace, agricultural lenders have adapted their practices and products to meet the changing financing needs of American agriculture.

Congress has played a role in this evolutionary process. As inadequacies appeared in financial markets, Congress has stepped in to fill the gaps. In just the past decade, Congress completely rewrote the nation's financial services laws. Starting in the mid-nineties, Congress allowed commercial banks to operate branches across state lines. This watershed legislation preceded a period of massive consolidation within the banking industry that resulted in the creation of the largest banks in the world. Congress, in the 1999 Gramm-Leach-Bliley legislation, completed its overhaul of depression-era banking laws, virtually demolishing the separation between banking, insurance and securities firms. As a result of this legislation, commercial banks now have virtually unlimited authority to offer products and services to meet a variety of financial needs.

In addition to expanding the authorities of commercial banks, Congress awarded them with nearly unfettered access to funding from GSEs. Prior to Gramm-Leach-Bliley, commercial banks could access the Federal Home Loan Bank System, Fannie Mae and Freddie Mac to fund loans for homebuyers. In addition, Congress had given banks GSE access for agricultural lending through Farmer Mac and the Farm Credit System.

With passage of Gramm-Leach-Bliley, however, banks were given direct GSE funding access through the Federal Home Loan Banks to support farm and rural business lending. As a result, a commercial bank today has access to GSE funding that is commensurate with the access provided to Farm Credit lending associations from Farm Credit Banks. The commercial bank, however, has been authorized by Congress to provide a far broader range of products and services.

Commercial banks, in effect, are now GSEs with virtually unlimited operating authority. Meanwhile, Farm Credit's authorities remain basically unchanged since the Congress enacted the Farm Credit Act of 1971 – some thirty years ago.

By broadly expanding the authorities of commercial banks and, at the same time, providing them access to GSE funding, Congress has reshaped the competitive landscape between commercial banks and Farm Credit.

USDA's Economic Research Service, in its February 2001 edition of "Agricultural Income & Finance," illustrated this competitive trend. Noting that, "agricultural banks remained very profitable through the middle of 2000," the ERS showed that banks substantially grew their marketshare of agricultural loans. From 1990 through 2000, ERS data reveals that Farm Credit's share of total farm business debt remained fairly stable. Farm Credit held 25.9 percent in 1990 and 26.4 percent in 2000. Meanwhile, commercial bank share of that debt grew substantially, from 34.5 percent in 1990 to 41 percent in 2000.

The result of Farm Credit's presence in the marketplace is strong competition for agricultural lending opportunities. This competition is vigorous and it benefits agriculture and rural communities.

We support full and fair competition for agricultural loans among all financial industry participants. Our commercial bank colleagues also have said they support strong competition in the market place. However, they contend that the Farm Credit System has an unfair advantage in the market. Given the vast changes in law, their broad access to GSE funds, and the continuing high profits of commercial banks, these complaints are wholly without foundation.

Even the U.S. Treasury, long a well known critic of GSEs in general and Farm Credit in particular, acknowledged in a May 2, 2001 letter to the Farm Credit Administration that, "some of the System's competitors have also gained improved access to other GSE funding." The Treasury went on to note that this "fact complicates any assessment of the competitive environment in agricultural credit markets...".

In summary, vigorous competition between Farm Credit, commercial banks and other lenders is benefiting U.S. agricultural producers. Producers have choices among lenders, financial products and related services. In short, pricing is competitive, service is better because Farm Credit ensures competition in agricultural and rural credit markets. The more intense the competition, the greater the benefit for American agriculture.

USDA Credit Programs Appear to Be Working

This committee was instrumental in adding flexibility to the lending limits for FSA guaranteed loans. We very much appreciate the flexibility allowed by the 1996 farm bill. It was a recognition of the changing financial reality of farming in many high-cost regions of the country.

As for additional changes, we encourage the committee to continue emphasis on the guaranteed loan program. We also would suggest allowing FSA the flexibility to guarantee a lease. Small farmers, particularly those just beginning their own operation, may be better off leasing land and equipment. FSA guarantees of these lease contracts would improve our ability to serve these farmers. We hope the committee will examine this issue closely as it debates the credit title of the Farm Bill.

Congress Can Help Meet Rural Credit Needs

Farm Credit is working hard to meet the changing financial needs of American agriculture. To continue to fulfill its mission going forward, however, Farm Credit needs to be equipped to meet the changing needs of agriculture and rural America.

First, Farm Credit's charter needs updating. Last changed materially in 1971, Farm Credit's lending authority is becoming outdated. Today and in the next century, producers are becoming more dependent on new and existing value-added agricultural businesses to provide markets for raw commodities. Farm Credit, agriculture's traditional lender, must be able to finance these operations. Unfortunately, we are unnecessarily restrained by an outdated charter from meeting their financing needs. Congress can and should modernize Farm Credit's charter during the next farm bill.

Second, and this might be more appropriate for a discussion of the rural development title of the Farm Bill, Farm Credit supports efforts to increase the availability of equity capital for farmer-owned cooperatives and other rural businesses. We recognize that rural America is not sharing fairly in the unprecedented prosperity of the rest of the country. There is a real need to more broadly diversify our rural economies and to generate new sources of equity capital for rural business development. We encourage the committee to consider legislation to encourage private investment in value-added agriculture enterprises, producer-owned cooperatives, and other projects that existing venture capital funds do not accommodate. These types of investments would provide off-farm income, additional markets for agricultural products, and new business opportunities in rural communities.

Finally, Mr. Chairman, we encourage the committee to urge the Farm Credit Administration to abide by the direction given to it by Congress in the Farm Credit System Reform Act of 1996. Section 212(b) of that Act states the following: "The Farm Credit Administration shall continue the comprehensive review of regulations governing the Farm Credit System to identify and eliminate, consistent with law, safety and soundness, all regulations that are unnecessary, unduly burdensome or costly, or not based on law." FCA has yet to fully implement this statutory directive. Having them do so would go a long way toward providing Farm Credit institutions the flexibility they need to continue to serve farmers, ranchers and cooperatives into the future.

Thank you Mr. Chairman for allowing us to give our views on serving agriculture. During the upcoming Farm Bill debate, we will suggest specific ways the Farm Credit Act can be updated to permit the System to continue to fulfill its mission of service to agriculture.

We look forward to working with the committee during consideration of the Farm Bill. Thank you again for the opportunity to present our views here today.

FARMERMAC

FEDERAL AGRICULTURAL MORTGAGE CORPORATION

Statement of

Henry D. Edelman, President and CEO

before the

Committee on Agriculture, Nutrition and Forestry

United States Senate

May 16, 2001

Washington, DC

Mr. Chairman, distinguished members of the Committee, my name is Henry Edelman. I am the President and Chief Executive Officer of Farmer Mac. It is an honor to appear before this Committee to offer testimony on an important and timely subject – the state of the delivery system for financial credit to farmers and ranchers in the United States and Farmer Mac's role in that process.

I am pleased to appear before you today as the CEO of a strong and vibrant company rapidly advancing in our Congressional mission of operating an efficient secondary market for agricultural mortgages. Looking back to 1995, when we appeared before Congress and requested urgently-needed changes to Farmer Mac's original charter, our recent successes and strong current condition derive from the foresight of this Committee and the consequent passage of significant reform legislation – the Farm Credit System Reform Act of 1996. We have worked hard in the intervening years to justify the confidence your members placed in Farmer Mac, as an important contributor to a stable and competitive mortgage credit delivery system for agricultural borrowers.

Today, thousands of farmers and ranchers have more than $3.1 billion of agricultural mortgages that back securities guaranteed by Farmer Mac. We are actively supporting mortgage lenders large and small, in all sectors of the agricultural credit industry, with effective programs and products. Since passage of the reform legislation in 1996, Farmer Mac has contributed to lender liquidity, capital adequacy, and increasingly competitive rates and loan products for farmers and ranchers seeking mortgage funds. By the end of 1996, Farmer Mac was able to report its first year of profitable operations since its creation in 1988; its performance has improved each and every year since, reflecting the soundness of its new operating structure. Over the same period, Farmer Mac increased its capital from about $12 million at the end of 1995 to over $100 million at the end of 2000 and satisfied every condition set forth by Congress in the 1996 legislation to ensure its continuing safe and sound operation.

Over the last five years we have not only put together programs that have appealed increasingly to both agricultural lenders and the farm borrowers they serve, but also broadened the acceptance of Farmer Mac to all sectors of the agricultural credit industry. During that period, commercial banks, Farm Credit System (FCS) institutions and insurance company lenders have become more aware of Farmer Mac and gained a better understanding of the benefits of Farmer Mac's secondary market operations and credit enhancements for agricultural mortgages. In so doing, agricultural mortgage lenders have shared with us many of the challenges they face and we have worked to help find solutions that provide them with effective access to a more competitive and stable mortgage market. At the same time, we also developed important new relationships with institutions in all sectors of the credit industry. We believe that we have made a great deal of progress since 1996, yet we know there is much more to be done before the industry reaches the level of efficiency and financial sophistication that exists today in the residential home mortgage market.

As you requested, I shall take the next few minutes to summarize the state of agricultural credit as we see it, comment on how well the 1996 Farmer Mac reform legislation has worked, and suggest policy goals and legislative changes that this Committee might wish to consider.

The State of Agricultural Mortgage Credit

2000 was the third consecutive year when prices for core agricultural commodities were at levels that prompted Congress to provide additional income support to farmers to avert serious economic stress. Conditions likely to place continued stress on the U.S. agricultural sector persist in 2001, with reports of strong and expanding production in many countries, historically low commodity prices, and weak market demand worldwide for most commodities. Despite the low prices for many agricultural commodities, cash receipts from sales during 2000 rose $7.4 billion above the 1999 level to $196.0 billion. Offsetting the increase in cash receipts was a $7.6 billion increase in cash farm expenses. Total net cash farm income, as reported by the USDA, remained relatively strong at $56.4 billion in 2000, above the 1990-2000 average of $54.8 billion and up from $54.6 billion in 1999. The higher net cash income in 2000 was attributable primarily to continuing government support payments, estimated by USDA at $22.1 billion for the year, compared to $20.6 billion in 1999 and $12.2 billion in 1998.

How did these conditions affect agricultural mortgages? As reported by USDA, farm real estate debt, the component of agricultural debt potentially eligible for the Farmer Mac secondary market, increased to $97.3 billion during 2000, up from $94.2 billion in 1999, and is projected to rise to $98.6 billion during 2001. Each commercial lending sector maintained or increased its share of the agricultural mortgage market during 2000 and agricultural lenders reported profitable performance, good loan quality (with some recent increases in delinquent and non-accrual loans), and liquidity adequate to support lending activities during 2000. In addition, the value of good farmland was stable or slightly higher in most regions of the nation during 2000.

While the facts I have referred to thus far would suggest that the state of agricultural mortgage credit looks good, this view is based on many assumptions; the numbers do not tell the whole story. First, this healthy picture is substantially due to Congressional intervention with record direct payments to the agricultural sector during the last few years. Will government payments continue in the future and what might occur if they were reduced or eliminated? Second, many lenders are experiencing increased risk concentrations with the agricultural mortgages they hold in their portfolios, due in large measure to economic stress in the agricultural sector, and they are actively seeking outlets to diversify this risk. This is accompanied by reports of rising delinquencies, which I can tell you we are also experiencing at Farmer Mac, and a slowing of the rate of growth in agricultural mortgage originations. Lastly, as risk has increased, a number of lenders have become increasingly capital constrained and have tightened underwriting requirements that make it difficult or impossible for some farmers who urgently need credit to obtain it with competitive rates and terms.

We believe that there are steps that can be taken by the lending sector to supplement the support provided by Congress and so minimize the potential for current stresses on farmers and ranchers to precipitate serious credit problems. I will comment further on these shortly.

Effectiveness of the 1996 Legislation

As I noted in my opening comment, the 1996 reform legislation dealt very effectively with the statutory limitations that had constrained Farmer Mac's development up to that time and provided the authorities Farmer Mac needed to move forward aggressively in the development of an efficient secondary market for agricultural mortgages. This legislation enabled Farmer Mac to transition into a profitable, growth-oriented corporation with strong financial support in the capital markets. It also enabled Farmer Mac to offer effective and competitive programs and mortgage products to agricultural lenders and the farmers and ranchers they serve. (Please refer to Appendices I and II to this testimony for a description of Farmer Mac's programs and the status of the Corporation's development through March 31, 2001.) We are proud to be able to report to this Committee that Farmer Mac has responded to the opportunity you provided it through the enactment of the 1996 legislative reforms: we have listened closely to agricultural credit providers and users and provided them with effective programs and products to support the mortgage credit needs of farmers and ranchers.

In addition, since 1996 Farmer Mac has focused on fortifying its financial strength through the retention of earnings and the sale of stock to investors to build its regulatory capital and stockholders' equity levels to more than $100 million by the end of the first quarter of 2001. Farmer Mac has been in compliance continuously with the regulatory capital standards Congress established for it in 1992 and has cooperated with the FCA on the development of its risk-based capital regulation, which was published recently as a final rule in the Federal Register. We are currently working with the FCA to understand fully the operation of the risk-based capital regulation. Until we have had an adequate opportunity to work through this process with the

FCA, we will not be in a position to comment on the regulation. However, we would like to reserve the right to come back to this Committee at an appropriate time to discuss the regulation if issues exist after we have completed our discussions with the FCA.

The 1996 legislation enabled Farmer Mac to develop and offer to agricultural lenders mortgage credit enhancement programs that have contributed materially to lender competitiveness and mortgage availability. Although at $3.1 billion of guarantees outstanding Farmer Mac still represents only a small fraction of the agricultural mortgage market, we have developed effective working relationships with lenders in all sectors of the industry. The relationships we have established with those lenders, including the Farm Credit System, commercial banks and insurance company lenders, should lead to expanded use of the Farmer Mac secondary market over time. The process now underway should ultimately move lenders away from dependence on mortgage portfolio management strategies, which tend to limit borrowers to less competitive, shorter-term mortgage interest rates while exposing lenders to concentrated credit risks, and toward greater reliance on mortgage securitization, which permits borrowers greater choice and allows lenders to reduce credit concentrations. As has been proven in the residential sector, this process will benefit both lenders and borrowers in the agricultural sector; Farmer Mac is proud to be the intermediary in this beneficial evolution.

On a related matter, I would also like to comment on the USDA guaranteed loan programs, which were extensively revised by Congress in the 1996 farm bill. As you know, we purchase Farm Service Agency (FSA) guaranteed loans in our Farmer Mac II program and therefore have had the opportunity to observe at first hand the operation of the revised FSA programs. In most respects, we believe that the changes made in 1996 have contributed to a more streamlined and financially sound guaranteed loan program. Many of the lenders we work with report that the administrative processing of guaranteed loans has improved greatly and that changes in loan limits and the allocation of funds have added much needed flexibility to the programs. Nevertheless, we believe that the programs could be reformed further to provide eligible borrowers with greater access to long-term fixed rate loans at more competitive rates of interest.

Policy Goals and Legislative Suggestions

The primary policy goal for agricultural credit over the next decade should be for the entire industry to achieve a level of parity with the residential mortgage market with regard to financing techniques and structures supporting highly competitive mortgage products for farmers and ranchers. By integrating in their daily operations the mortgage securitization and similar credit enhancements available through the Farmer Mac secondary market, agricultural lenders can move away from the cloistered world of portfolio lending. The financial services industry of the 21st century will be one based on the allocation of functions to those players who perform them best. As agricultural lenders increase their focus on the strategic goal of receiving riskless fee income for performing the functions of which they are the true experts – loan origination and servicing – they will be safer, sounder and better suited to the delivery of lower interest rates to farmers, ranchers and rural homeowners. We at Farmer Mac are dedicated to aiding and supporting lenders in that transition and we believe that our secondary mortgage market has reached the stage where the contribution we make is meaningful and real.

Credit legislation should be framed to support the continuing evolution of the agricultural credit industry toward the strategic goal I have mentioned. This could be accomplished by reference to the Farmer Mac secondary market rates as a benchmark for fairness and efficiency of loans directly made or guaranteed by the USDA; sale and securitization would be a logical but not compulsory consequence. As applied to those loans, such an approach would open opportunities for farm borrowers to have greater access to long-term fixed rate loans and for variable interest loans to be standardized and tied to published indices. Realistic limits on spreads above those indices could reduce credit expenses significantly for many of these borrowers, provide greater opportunities for them to remain in farming, and maintain the competitiveness of their farming operations while restricting the government's exposure to losses on those loans. At the same time, adequate lender profits must be preserved to ensure effective competition among lenders and provide borrowers with ready access to multiple lending sources. In addition, adjustments to Farmer Mac's statutory charter with a view toward reducing or eliminating certain limitations devised some twelve years ago, and toward updating Farmer Mac's business authorities consistent with the evolution of the financial markets generally and the agricultural and rural credit sectors in particular, could contribute to achieving the goal. This could include, for example, expanding the definition of loans eligible for the Farmer Mac secondary market to include rural development loans or rural small business loans, so far as there is no efficient secondary market for them today and Farmer Mac is qualified and able to expand its market to include them.

These ideas are preliminary, but are submitted for examination by the members and staffs of this Committee. We welcome the opportunity to discuss our ideas further with you, Mr. Chairman, and with the other members of the Committee at your request.

Thank you for providing us with this opportunity to address the Committee on these important issues today. I would be pleased to answer any questions at this time.

APPENDIX I

Farmer Mac – Description of Business Programs and Operations Through December 31, 2000 [1]

General

The Federal Agricultural Mortgage Corporation ("Farmer Mac" or the "Corporation") is a stockholder-owner, federally chartered instrumentality of the United States that was created in 1988 to establish a secondary market for agricultural real estate and rural housing mortgage loans ("Qualified Loans"). Farmer Mac was authorized by the Agricultural Credit Act of 1987 (12 U.S.C. §§ 2279aa et seq.), which amended the Farm Credit Act of 1971 (collectively, as amended, the "Act") to provide for the existence of a secondary market for agricultural mortgages. Farmer Mac provides liquidity to the agricultural mortgage market by: (1) purchasing newly originated Qualified Loans directly from lenders through its "cash window" and existing, or "seasoned," Qualified Loans from lenders and other third parties in negotiated transactions; (2) exchanging securities issued and guaranteed by Farmer Mac for newly originated and seasoned Qualified Loans that back those securities through its "swap" program; (3) issuing long-term standby purchase commitments for newly originated and seasoned Qualified Loans; and (4) purchasing mortgage-backed bonds secured by Qualified Loans through its "AgVantage" program. Generally, the loans involved in swap and long-term standby purchase commitment transactions are seasoned loans.

Farmer Mac conducts its business through two programs—"Farmer Mac I" and "Farmer Mac II." Under the Farmer Mac I Program, Farmer Mac purchases, or commits to purchase, Qualified Loans that are not guaranteed by any instrumentality or agency of the United States, or obligations backed by Qualified Loans. Under the Farmer Mac II Program, Farmer Mac purchases the guaranteed portions (the "Guaranteed Portions") of loans guaranteed by the United States Department of Agriculture (the "USDA") pursuant to the Consolidated Farm and Rural Development Act (7 U.S.C. §§ 1921 et seq.; the "ConAct").

Pursuant to its statutory authority, Farmer Mac guarantees timely payments of principal and interest on securities backed by Qualified Loans or Guaranteed Portions ("Farmer Mac Guaranteed Securities") and retains those securities in its portfolio or sells them in the capital markets. At December 31, 2000, outstanding Farmer Mac guarantees totaled $3.08 billion.

Farmer Mac's principal sources of revenue are: (1) fees it receives in connection with the issuance of its guarantee and commitments to purchase Qualified Loans; (2) net interest income earned on its retained portfolio of Farmer Mac Guaranteed Securities, its investments, Qualified

[1] The text of Appendix I has been excerpted, with minor editing to remove cross-reference notations, from Farmer Mac's Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 (report on Form 10K), for the fiscal year ended December 31, 2000, as filed with the Securities and Exchange Commission on March 26, 2001.

Loans and AgVantage bonds; and (3) gains on the sales of Farmer Mac Guaranteed Securities backed by Qualified Loans.

Farmer Mac funds its program operations primarily through the issuance of debt obligations of various maturities. As of December 31, 2000, Farmer Mac had outstanding $2.014 billion of Discount Notes and $955.6 million of Medium-Term Notes, net of unamortized hedging costs, discounts and premiums. During 2000, Farmer Mac continued its strategy of using debt issuances to increase its presence in the capital markets in order to improve the mortgage rates available to farmers, ranchers and rural homeowners.

Farmer Mac is an institution of the Farm Credit System (a "System Institution"), although it is not liable for any debt or obligation of any other System Institution. Likewise, neither the Farm Credit System nor any other individual System Institution is liable for any debt or obligation of Farmer Mac.

The Farm Credit Administration (the "FCA"), acting through its Office of Secondary Market Oversight ("OSMO"), has general regulatory and enforcement authority over Farmer Mac, including the authority to promulgate rules and regulations governing the activities of Farmer Mac and to apply FCA's general enforcement powers to Farmer Mac and its activities.

Farmer Mac has three classes of common stock outstanding—Class A Voting, Class B Voting and Class C Non-Voting (collectively, the "Common Stock"). The Class A and Class B Voting Common Stock are collectively referred to herein as the "Voting Common Stock."

As of December 31, 2000, Farmer Mac employed 29 persons, located primarily at its principal executive offices at 919 18th Street, N.W., Suite 200, Washington, D.C. 20006. Its telephone number is (202) 872-7700.

Farmer Mac I

Qualified Loans

Under the Farmer Mac I Program, Farmer Mac issues and guarantees securities backed by, or representing interests in, Qualified Loans. A Qualified Loan is a loan secured by a fee simple mortgage or a long-term leasehold mortgage, with status as a first lien on Agricultural Real Estate or Rural Housing (as defined below) located within the United States. A Qualified Loan must also be an obligation of: (1) a citizen or national of the United States or an alien lawfully admitted for permanent residence in the United States; or (2) a private corporation or partnership whose members, stockholders or partners holding a majority interest in the corporation or partnership are individuals described in clause (1). A Qualified Loan must also be an obligation of a person, corporation or partnership having sufficient indicia of creditworthiness to indicate a reasonable likelihood of repayment of the loan according to its terms. A Qualified Loan may be a seasoned or newly originated mortgage loan that conforms to Farmer Mac's requirements.

Qualified Loans must be secured either by Agricultural Real Estate or by Rural Housing. "Agricultural Real Estate" is defined for purposes of Farmer Mac's programs as a parcel or parcels of land, which may be improved by permanently affixed buildings or other structures, that (1) are used for the production of one or more agricultural commodities or products; and (2) consist of a minimum of five acres or are used in producing minimum annual receipts of $5,000. The maximum principal amount of a Qualified Loan secured by Agricultural Real Estate is $3.75 million (as adjusted for inflation as of October 1, 2000) for loans secured by more than 1,000 acres of land and $10.0 million for loans secured by 1,000 acres or less.

"Rural Housing" is defined by Farmer Mac as a one- to four-family, owner-occupied, moderate-priced principal residence located in a community having a population of 2,500 or fewer inhabitants, where the dwelling (excluding the land to which the dwelling is affixed) does not have a purchase price or current appraised value of more than $150,388 (as adjusted for inflation as of October 1, 2000). In addition to the dwelling itself, a Rural Housing Qualified Loan can be secured by land associated with the dwelling having an appraised value of no more than 50 percent of the total appraised value of the combined property. To date, Rural Housing Qualified Loans have not represented a significant part of Farmer Mac's business.

Purchases

Qualified Loan Purchases. Farmer Mac purchases Qualified Loans directly from approved lenders ("Sellers") for cash on a continuing basis through its "cash window." Farmer Mac also purchases portfolios of newly originated or seasoned Qualified Loans on a negotiated basis. Farmer Mac primarily purchases fixed- and adjustable-rate Qualified Loans, but may also purchase other types of Qualified Loans, including convertible mortgage loans. Qualified Loans purchased by Farmer Mac have a variety of maturities and often include balloon payments. Certain Qualified Loans also include provisions that require a yield maintenance payment in the event of prepayment (depending upon the level of interest rates at the time of prepayment). Farmer Mac seeks to develop and offer loan products that are in demand by agricultural borrowers and the lenders who serve them and that can be efficiently securitized and sold into the capital markets. Because the securitization process requires the grouping of loans into uniform pools, Farmer Mac emphasizes the importance of conformity to its program requirements, including the interest rate, amortization, maturity and payment specifications when it offers to purchase loans.

Through its "part-time farm" loan program, Farmer Mac purchases, or guarantees securities backed by, Qualified Loans made to borrowers who live on Agricultural Real Estate but generally derive a significant portion of their income from off-farm employment. To qualify as a part-time farm, the Agricultural Real Estate that secures the Qualified Loan must include a single-family, owner-occupied, detached residence that generally constitutes at least 30 percent of the total appraised value of the property. As of December 31, 2000, Farmer Mac had $109.0 million of outstanding part-time farm loans under guarantee.

During 2000, Farmer Mac purchased $442.3 million of Qualified Loans through its Farmer Mac I cash window program. During the year, the top 10 Sellers generated 89.3 percent of the Farmer Mac I cash window loan volume. This included Qualified Loans sold by Zions First National Bank ("Zions"), Farmer Mac's largest combined Class A and Class C stockholder, and Zions' "proprietary" products sold to Farmer Mac by other Sellers, which together represented 20.6 percent of Farmer Mac's total Farmer Mac I cash window volume for the year. While Zions represents a significant portion of Farmer Mac I cash window volume, Zions-related loans represented only 11.2 percent of the total Farmer Mac I Qualified Loans purchased or guaranteed during 2000.

Mortgage-Backed Bond Purchases. Under the "AgVantage" program, Farmer Mac purchases (and guarantees timely payment of principal and interest on) mortgage-backed bonds issued by Sellers who also have been certified as "AgVantage certified facilities" (each, an "AgVantage Issuer") based upon Farmer Mac's assessment of their agricultural loan underwriting and servicing capabilities, as well as their creditworthiness. AgVantage bonds, which are general obligations of the AgVantage Issuers, are secured by eligible collateral in an amount ranging from 120 percent to 150 percent of the bonds' outstanding principal amount. Eligible collateral consists of Qualified Loans having an aggregate principal balance equal to at least 100 percent of the bonds' outstanding principal amount and cash or securities issued by the U.S. Treasury or guaranteed by an agency or instrumentality of the United States. During 2000, Farmer Mac purchased 37 AgVantage bonds with maturities ranging from 2 weeks to 15 years (most of which were less than one year) from 10 AgVantage Issuers resulting in Farmer Mac guarantees of $393.9 million. As of December 31, 2000, $28.1 million principal amount of AgVantage bonds remained outstanding.

Swap Transactions and Long-Term Standby Purchase Commitments

Farmer Mac offers two alternatives to lenders who seek the benefits of Farmer Mac's guarantee without selling loans to Farmer Mac through the cash window—"swap" transactions and long-term standby purchase commitments ("LTSPCs"). In a swap transaction, Farmer Mac acquires Qualified Loans from lenders in exchange for Farmer Mac Guaranteed Securities backed by such Qualified Loans. Unlike cash window transactions, which generally involve loans with terms specified by Farmer Mac in advance, swap transactions usually are negotiated with the lender and often involve loans with payment, maturity and interest rate characteristics that differ from those of Farmer Mac's cash window purchases. Regardless of variances in loan terms from the cash window products, Qualified Loans must conform to Farmer Mac's credit standards to be eligible for swap transactions.

Farmer Mac's alternative to a swap transaction, the LTSPC, is available for a Seller seeking to obtain all of the benefits of a swap transaction (other than the replacement of loans with securities on the Seller's books) while retaining title to the Qualified Loans. An LTSPC permits a Seller to segregate a pool of loans in its portfolio and transfer to Farmer Mac the credit risk on those loans. Under an LTSPC, Farmer Mac commits to purchase any Qualified Loan in a segregated pool of loans if: (a) the Qualified Loan becomes four months delinquent; (b) the Qualified Loan meets Farmer Mac's loan purchase requirements at the time the Seller requests that Farmer Mac purchase the loan; or (c) the Seller requests that Farmer Mac purchase all of the identified Qualified Loans. In the case of a delinquent Qualified Loan, Farmer Mac will pay the

Seller a predetermined price for the loan—generally, principal plus accrued interest (the payment of the accrued interest being delayed until the delinquent Qualified Loan is liquidated); in the case of a Qualified Loan under clause (b) or (c), the price for the Qualified Loan(s) would be negotiated at the time of purchase. This structure permits the Seller to retain the segregated loans in its portfolio while reducing its credit and concentration exposures and, consequently, its regulatory capital requirements. In consideration for Farmer Mac's assumption of the credit risk on the segregated loans, the Seller pays fees to Farmer Mac based on the outstanding balance of the loans at a level approximating what would have been Farmer Mac's guarantee fee had the loans been exchanged with Farmer Mac in a swap transaction. The credit risk to Farmer Mac related to an LTSPC is the same as that of a swap or AMBS.

In 2000, the use of the LTSPC continued its development as a significant portion of the Farmer Mac I program and was the preferred alternative to swaps for non-cash transactions. As of December 31, 2000, the outstanding balance of Qualified Loans underlying Farmer Mac swap transactions was $211.6 million. Through December 31, 2000, a total of 6,194 Qualified Loans having an aggregate principal balance of $1.011 billion had been placed under LTSPCs with eight System Institutions. As of December 31, 2000, a cumulative total of 5,136 Qualified Loans with an aggregate principal balance of $862.8 million remained under LTSPCs.

Underwriting and Appraisal Standards

Farmer Mac has established Underwriting and Appraisal Standards for Qualified Loans in an effort to reduce the risk of loss from borrower defaults and to provide guidance concerning the management, administration and conduct of underwriting and appraisals to all participants in the Farmer Mac I Program. These standards were developed on the basis of industry norms for mortgage loans qualified to be sold in the secondary market and were designed to assess the creditworthiness of the borrower, as well as the value of the mortgaged property relative to the amount of the Qualified Loan. Farmer Mac requires Sellers to make representations and warranties regarding the conformity of Qualified Loans to these standards and any other requirements it may impose from time to time.

The Underwriting Standards require, among other things, that the loan-to-value ratio for any Qualified Loan (other than a part-time farm loan and a loan on an agricultural facility with a related integrator contract) not exceed 70 percent. In the case of newly originated Agricultural Real Estate Qualified Loans that are not part-time farm loans, borrowers must also meet certain credit ratios, including: (1) a pro forma (after closing the new loan) debt-to-asset ratio of 50 percent or less; (2) a pro forma cash flow debt service coverage ratio on the mortgaged property of not less than 1:1; (3) a pro forma total debt service coverage ratio, including farm and non-farm income, of not less than 1.25:1; and (4) a pro forma ratio of current assets to current liabilities of not less than 1:1. In early 1998, Farmer Mac introduced a premium loan program for loans to highly creditworthy borrowers. Under that program, Qualified Loans meeting certain more stringent Underwriting Standards than the foregoing loan-to-value and credit ratios would qualify for guarantee at a lower fee than those applicable to loans not meeting the higher standards. In 1999, Farmer Mac introduced a loan product for borrowers with high credit scores and whose security property has a low loan-to-value ratio. For these borrowers, loan processing has been simplified and documentation of the credit ratios described above is not necessary.

In the case of a seasoned loan (a loan that has been outstanding for five or more years), Farmer Mac considers sustained performance to be a reliable alternative indicator of a borrower's ability to pay the loan according to its terms. A seasoned loan generally will be deemed a Qualified Loan, eligible for purchase or inclusion in a pool of loans to be securitized, if it has been outstanding for at least five years and has a loan-to-value ratio (based on an updated estimate of value) of 60 percent or less, and there have been no payments more than 30 days past due during the previous three years and no material restructurings or modifications for credit reasons during the previous five years. Existing loans that have been outstanding for fewer than five years must comply with the Underwriting Standards for newly originated loans when the loan was originated.

In the case of Rural Housing Qualified Loans and Qualified Loans under the part-time farm program, up to 85 percent of the appraised value of the property may be financed if the amount above 80 percent is covered by private mortgage insurance. For newly originated Qualified Loans on part-time farm properties, the borrower must generate sufficient income from all sources to repay all creditors. A borrower's capacity to repay debt obligations is determined by two tests: (1) the borrower's monthly mortgage payment-to-income ratio should be 28 percent or less and (2) the borrower's monthly debt payment-to-income ratio should be 36 percent or less.

The Underwriting Standards provide that Farmer Mac may, on a loan-by-loan basis, accept loans that do not conform to one or more of the Underwriting Standards when: (1) those loans exceed one or more of the Underwriting Standards to a degree that compensates for noncompliance with one or more other Standards ("compensating strengths"); and (2) those loans are made to producers of particular agricultural commodities in a segment of agriculture in which such compensating strengths are typical of the financial condition of sound borrowers. Farmer Mac's acceptance of loans that do not conform to one or more of the Underwriting Standards is not intended to provide a basis for waiving or lessening in any way the requirement that loans be of consistently high quality in order to qualify for purchase or inclusion in a pool of loans to be securitized.

The Appraisal Standards for newly originated Qualified Loans require, among other things, that the appraisal function be performed independently of the credit decision making process and conform to the Uniform Standards of Professional Appraisal Practice promulgated by the Appraisal Standards Board. The Appraisal Standards require the appraisal function to be conducted or administered by an individual meeting certain qualification criteria and who (a) is not associated, except by the engagement for the appraisal, with the credit underwriters making the loan decision, though both the appraiser and the credit underwriter may be directly or indirectly employed by a common employer; (b) receives no financial or professional benefit of any kind relative to the report content, valuation or credit decision made or based on the appraisal product; and (c) has no present or contemplated future direct or indirect interest in the appraised property. The Appraisal Standards also require uniform reporting of reliable and accurate estimates of the market value, market rent and net property income characteristics of the mortgaged property and the relative market forces.

Sellers

A Seller may be a System Institution, bank, insurance company, business and industrial development company, savings and loan association, association of agricultural producers, agricultural cooperative, commercial finance company, trust company, credit union or other financial entity. In order to participate in the Farmer Mac I program, the Seller must meet minimum eligibility requirements, which include: (1) maintaining stockholders' equity of at least $1 million or at least $500,000 of net worth (as defined by Farmer Mac); (2) having a staff experienced in agricultural lending and servicing; and (3) maintaining a fidelity bond and either an errors and omissions, mortgage impairment or mortgagee protection policy providing coverage in an amount determined by Farmer Mac. Sellers must also provide representations and warranties to Farmer Mac regarding the qualifications of Qualified Loans sold to or guaranteed by Farmer Mac. In addition, to facilitate a wide distribution of Farmer Mac's Voting Common Stock and give program participants an ownership interest in the secondary market, Farmer Mac has established minimum Voting Common Stock ownership requirements for Sellers, subject to limited exceptions.

Servicing

Farmer Mac does not directly service Qualified Loans held in its portfolio, although it does act as "master servicer" for Qualified Loans underlying Farmer Mac Guaranteed Securities. Qualified Loans are serviced only by Farmer Mac approved servicing entities that have entered into central servicing contracts with Farmer Mac. Sellers of Qualified Loans sold into the Farmer Mac I Program have a right to retain certain servicing functions (typically direct borrower contacts) and may enter into field servicing contracts with central servicers to specify such servicing functions. Farmer Mac currently utilizes seven central servicers in its Farmer Mac I program.

Farmer Mac I Securities

Farmer Mac Guaranteed Securities are guaranteed by Farmer Mac as to timely payment of principal and interest. Farmer Mac Guaranteed Securities issued under the Farmer Mac I Program are referred to as "Farmer Mac I Securities." Farmer Mac Guaranteed Securities issued under the Farmer Mac II Program are referred to as "Farmer Mac II Securities."

By statute, public offerings of Farmer Mac Guaranteed Securities are required to be registered with the U.S. Securities and Exchange Commission (the "SEC") under the federal securities laws. Accordingly, Farmer Mac, through its subsidiary Farmer Mac Mortgage Securities Corporation, maintains a shelf registration statement with the SEC pursuant to which public offerings of such securities can occur. Farmer Mac may also issue Farmer Mac Guaranteed Securities in private, unregistered transactions. U.S. Bank Trust National Association, a national banking association based in Minneapolis, Minnesota, serves as trustee for each trust underlying registered Farmer Mac I Securities, although Farmer Mac may assume some or all of the trustee function, thereby potentially eliminating some of the cost associated with a third party trustee.

Farmer Mac I Securities are mortgage pass-through certificates issued and guaranteed by Farmer Mac that represent beneficial interests in pools of Agricultural Real Estate Qualified Loans or in obligations backed by pools of Agricultural Real Estate Qualified Loans. All Farmer Mac I Securities issued during and since 1996 have been single class or multiclass "grantor trust" pass-through certificates, which Farmer Mac calls "Agricultural Mortgage-Backed Securities" or "AMBS." These securities entitle each investor in a class of securities to receive a portion of the payments of principal and interest on the related underlying pool of Agricultural Real Estate Qualified Loans equal to the investor's proportionate interest in the pool. AMBS may back other Farmer Mac I Securities, including real estate mortgage investment conduit securities ("REMICs") and other agricultural mortgage-backed securities.

Farmer Mac I Securities are not assets of Farmer Mac, except when acquired for investment purposes, nor are Farmer Mac I Securities recorded as liabilities of Farmer Mac. Farmer Mac, however, is liable under its guarantee on the securities to make timely payments to investors of principal (including balloon payments) and interest based on the scheduled payments on the underlying Qualified Loans, even if Farmer Mac has not actually received such scheduled payments. Farmer Mac I Securities enable Farmer Mac to further its statutory purpose of increasing the liquidity of the agricultural mortgage market and create a source of guarantee fee income for Farmer Mac. Because it guarantees timely payments on Farmer Mac I Securities (without the protection afforded by the minimum 10 percent cash reserve or subordinated interest required prior to the enactment of changes to Farmer Mac's statutory charter in 1996), Farmer Mac assumes the ultimate credit risk of borrower defaults on the Qualified Loans underlying its guaranteed securities.

Farmer Mac receives guarantee fees in return for its guarantee obligations on Farmer Mac I Securities. These fees are paid as installment payments are received on the underlying Qualified Loans until those loans have been repaid or otherwise liquidated (generally as a result of default). The aggregate amount of guarantee fees received by Farmer Mac depends upon the amount of Farmer Mac I Securities outstanding and on the guarantee fee rate, which is capped by statute at 50 basis points (0.50 percent) per annum. The Farmer Mac I guarantee fee rate generally ranges from 40 to 50 basis points, depending on the credit quality of and other criteria regarding the Qualified Loans. The amount of Farmer Mac I Securities outstanding is influenced by the repayment rates on the underlying Qualified Loans and by the rate at which Farmer Mac issues new Farmer Mac I Securities. In general, when the level of interest rates declines significantly below the interest rates on loans underlying Farmer Mac I Securities, the rate of prepayments is likely to increase; conversely, when interest rates rise above the interest rates on the loans underlying Farmer Mac I Securities, the rate of prepayments is likely to decrease. In addition to changes in interest rates, the rate of principal payments on Farmer Mac I Securities is also influenced by a variety of economic, demographic and other considerations, including the obligation of borrowers under most loans underlying Farmer Mac I Securities to make a yield maintenance payment (depending upon the level of interest rates) if the borrower prepays the underlying loan. Yield maintenance payments tend to deter prepayments in a declining interest rate environment.

Transactions Under the Farmer Mac I Program

The following table summarizes through December 31, 2000 the loans purchased or guaranteed under the Farmer Mac I Program after the changes to Farmer Mac's statutory charter by the Farm Credit System Reform Act of 1996 (the "1996 Act").

	Farmer Mac I Loans Purchased or Guaranteed		
	Prior to 2000	During 2000	Total
		(in thousands)	
Post-1996 Act:			
Purchases	$ 1,124,214	$ 442,246	$ 1,566,460
Swaps	261,143	-	261,143
LTSPCs	637,685	373,202	1,010,887
Total	$ 2,023,042	$ 815,448	$ 2,838,490

In addition, as of December 31, 2000, $83.5 million of Farmer Mac I Guaranteed Securities issued prior to the 1996 Act were outstanding. These securities are supported by unguaranteed subordinate interests that represented 10 percent of the balance of the loans underlying the securities at issuance.

Funding of Guarantee Claims

The primary source of funding for the payment of claims made under Farmer Mac guarantees is the fees Farmer Mac receives for providing its guarantees. The Act requires Farmer Mac to set aside a portion of the guarantee fees it receives as a reserve against losses from its guarantee activities. Among other things, this reserve account must be exhausted before Farmer Mac may issue obligations to the Secretary of the Treasury against the $1.5 billion Farmer Mac is authorized to borrow from the Secretary of the Treasury pursuant to the Act to fulfill its guarantee obligations. This authorization is not intended to be used as a routine funding source, and has never been used.

Although total outstanding guarantees exceed the amount held in reserve and the amount it may borrow from the Treasury, Farmer Mac does not expect claims under the guarantees to exceed amounts available to satisfy those claims.

Portfolio Diversification

One of Farmer Mac's policy goals is to diversify its portfolio of Qualified Loans both geographically and by commodity.

Farmer Mac II

General

The Farmer Mac II Program was initiated in 1992 and is authorized under Sections 8.0(3) (12 U.S.C. § 2279aa(3)) and 8.0(9)(B) (12 U.S.C. § 2279aa(9)(B)) of the Act. Under those Sections: (1) Guaranteed Portions are statutorily included in the definition of loans eligible as "Qualified Loans" for Farmer Mac's secondary market programs; (2) Guaranteed Portions are exempted from the underwriting, appraisal and repayment standards that all other Qualified Loans must meet, and pools of Guaranteed Portions are exempted from any diversification and internal credit enhancement that may be required of pools of Qualified Loans that are not Guaranteed Portions; and (3) Farmer Mac is authorized to pool Guaranteed Portions and issue Farmer Mac II Securities backed by such Guaranteed Portions.

United States Department of Agriculture Guaranteed Loan Programs

USDA, acting through its various agencies, currently administers the federal rural credit programs first developed in the mid-1930s. The USDA makes direct loans and also issues guarantees on loans made and serviced by USDA-qualified loan originators (each, a "Lender") for various purposes.

Under the Farmer Mac II Program, Farmer Mac is one of several competing purchasers of Guaranteed Portions of farm ownership loans, farm operating loans, business and industry loans and other loans that are guaranteed by the Secretary of Agriculture pursuant to the ConAct (collectively, the "Guaranteed Loans"). Guaranteed Portions, which represent up to 95 percent of the principal amount of Guaranteed Loans, are fully guaranteed as to principal and interest by the USDA, which guarantee is supported by the full faith and credit of the United States.

<u>USDA Guarantees</u>. The maximum loss covered by a USDA guarantee can never exceed the lesser of: (1) 95 percent of the principal and interest indebtedness on the Guaranteed Loan, any loan subsidy due, and 95 percent of principal and interest indebtedness on secured protective advances for protection and preservation of the related mortgaged property made with USDA authorization; and (2) 95 percent of the principal advanced to or assumed by the borrower under the Guaranteed Loan and any interest due (including a loan subsidy).

Each USDA guarantee is a full faith and credit obligation of the United States and becomes enforceable if a Lender fails to repurchase the Guaranteed Portion from the owner thereof (the "Owner") within thirty (30) days after written demand from the Owner when (a) the borrower under the Guaranteed Loan (the "Borrower") is in default not less than sixty (60) days in the payment of any principal or interest due on the Guaranteed Portion, or (b) the Lender has failed to remit to the Owner the payment made by the Borrower on the Guaranteed Portion or any related loan subsidy within thirty (30) days after the Lender's receipt thereof.

If the Lender does not repurchase the Guaranteed Portion as provided above, the USDA is required to purchase the unpaid principal balance of the Guaranteed Portion together with accrued interest (including any loan subsidy) to the date of purchase, less the servicing fee, within thirty (30) days after written demand to USDA from the Owner. While the USDA guarantee will not cover the note interest to the Owner on Guaranteed Portions accruing after ninety (90) days from the date of the original demand letter of the Owner to the Lender requesting repurchase, Farmer Mac has established procedures to require prompt tendering of Guaranteed Portions.

If in the opinion of the Lender (with the concurrence of the USDA) or in the opinion of the USDA, repurchase of the Guaranteed Portion is necessary to service the related Guaranteed Loan adequately, the Owner will sell the Guaranteed Portion to the Lender or USDA for an amount equal to the unpaid principal balance and accrued interest (including any loan subsidy) on such Guaranteed Portion less the Lender's servicing fee. Federal regulations prohibit the Lender from repurchasing Guaranteed Portions for arbitrage purposes.

Lenders. All Guaranteed Loans must be originated and serviced by eligible Lenders. Under applicable regulations, all eligible Lenders must be subject to credit examination and supervision by either an agency of the United States or a state, must be in good standing with their licensing authorities and must have met any licensing, lending, loan servicing and other applicable requirements of the state in which the collateral for a Guaranteed Loan will be located. Each Lender must inform the USDA that it qualifies as an eligible Lender and which agency or authority supervises it.

Loan Servicing. The Lender on each Guaranteed Loan is required by regulation to retain the unguaranteed portion of the Guaranteed Loan (the "Unguaranteed Portion"), to service the entire underlying Guaranteed Loan, including the Guaranteed Portion, and to remain mortgagee and/or secured party of record. The Guaranteed Portion and the Unguaranteed Portion of the underlying Guaranteed Loan are to be secured by the same security with equal lien priority. The Guaranteed Portion cannot be paid later than or in any way be subordinated to the related Unguaranteed Portion.

Farmer Mac II Securities

Farmer Mac issues and guarantees the timely payment of principal and interest on Farmer Mac II Securities, which are backed by Guaranteed Portions. Farmer Mac does not guarantee the repayment of the Guaranteed Portions, only the Farmer Mac II Securities that are backed by Guaranteed Portions. In addition to issuing Farmer Mac II Securities to Lenders in swap transactions or to other investors for cash, Farmer Mac purchases Guaranteed Portions for retention in its portfolio.

Transactions Under Farmer Mac II Program

As of December 31, 2000, Farmer Mac had issued and guaranteed $794.3 million of Farmer Mac II Securities, of which $193.5 million were issued in 2000. Of the $794.3 million of Farmer Mac II Securities issued and guaranteed through December 31, 2000, $517.7 million were outstanding as of that date. Of the $517.7 million of outstanding Farmer Mac II Securities, Farmer Mac held $427.5 million in its portfolio and other investors owned $90.2 million.

Financing

Debt Issuances

Farmer Mac issues debt obligations, consisting of Discount Notes and Medium-Term Notes ("Notes"), to obtain funds for the Farmer Mac I and Farmer Mac II Programs to cover transaction costs, guarantee payments and the costs of purchasing Guaranteed Portions, Qualified Loans and securities (including Farmer Mac Guaranteed Securities). Farmer Mac also issues Notes to meet other needs associated with its business operations, including liquidity, and to increase its presence in the capital markets in order to enhance the efficiency of its debt and AMBS securities transactions and so improve the mortgage rates available to farmers, ranchers and rural homeowners. Farmer Mac's Board of Directors has authorized the issuance of up to $4.0 billion of Notes, subject to periodic review of the adequacy of that level relative to Farmer Mac's borrowing requirements. Farmer Mac invests part of the proceeds of such issuances in program assets, with the remainder invested in non-program assets in accordance with policies established by its Board of Directors. The current policies authorize Farmer Mac to invest in U.S. Treasury, agency and instrumentality obligations; repurchase agreements; commercial paper; guaranteed investment contracts; certificates of deposit; federal funds and bankers acceptances; certain securities and debt obligations of corporate issuers; asset-backed securities; and corporate money market funds.

Equity Issuances

By statute, Farmer Mac is authorized to issue Voting Common Stock, non-voting common stock and non-voting preferred stock. Voting Common Stock may be held only by banks, other financial entities, insurance companies and System Institutions that qualify as eligible participants in the Farmer Mac programs. Under the Act, no holder of Class A Voting Common Stock may directly or indirectly be a beneficial owner of more than 33 percent of the outstanding shares of Class A Voting Common Stock. There are no ownership restrictions applicable to non-voting common stock or preferred stock. To date, Farmer Mac has not issued any preferred stock. Any preferred stock issued by Farmer Mac would have priority over the Common Stock in payment of dividends and liquidation proceeds. The Class C Non-Voting Common Stock is, and any preferred stock would be, freely transferable. The holders of preferred stock would be paid in full at par value, plus all accrued dividends, before the holders of shares of Common Stock received any payment upon liquidation, dissolution or winding up of the business of Farmer Mac. To date, Farmer Mac has not paid any dividends on its Common Stock, nor does it expect to pay dividends in the near future. Farmer Mac's ability to declare and pay dividends could be restricted if it were to fail to comply with regulatory capital requirements.

Effective August 2, 1999, after obtaining the consent of the holders of its Class C Non-Voting Common Stock, Farmer Mac amended its By-Laws to eliminate the three-to-one preference with respect to dividends and liquidation proceeds which had been applicable to each share of Class C Non-Voting Common Stock relative to each share of Voting Common Stock. In conjunction with this By-Law amendment, Farmer Mac effected a three-for-one split of its Class C Non-Voting Common Stock. The two principal reasons for making these changes were to simplify the reporting of Farmer Mac's earnings per share and improve the liquidity of Farmer Mac's Class C Stock.

As of December 31, 2000, 1,030,780 shares of Class A Stock, 500,301 shares of Class B Stock and 9,620,112 shares of Class C Stock were outstanding. Farmer Mac may obtain additional capital from future issuances of common stock (both voting and non-voting) or non-voting preferred stock. Farmer Mac has no current plans to issue any additional shares of Common Stock, except pursuant to programs in which employees, members of management or the Board of Directors may be granted Class C Non-Voting Common Stock as part of their compensation arrangements.

Authority to Borrow from Treasury

The Act authorizes Farmer Mac to borrow, in extreme circumstances, up to $1.5 billion from the Secretary of the Treasury, subject to certain conditions, to enable Farmer Mac to fulfill the obligations under its guarantees.

Administrative Expenses

By statute, Farmer Mac is authorized to impose charges or fees in reasonable amounts to recover the costs of administering its activities. In that regard, Farmer Mac is authorized to require program participants to make nonrefundable capital contributions to meet the administrative expenses of Farmer Mac. Farmer Mac would issue shares of Voting Common Stock in exchange for such capital contributions. No such capital contributions have been required, and Farmer Mac has no present intention to exercise its statutory authority to require such contributions.

Farmer Mac's Borrowing Authority from the U.S. Treasury

Farmer Mac may issue obligations to the U.S. Treasury in a cumulative amount not to exceed $1.5 billion. The proceeds of such obligations may be used solely for the purpose of fulfilling Farmer Mac's guarantee obligations under the Farmer Mac I and Farmer Mac II Programs. The Act provides that the U.S. Treasury is required to purchase such obligations of Farmer Mac if Farmer Mac certifies that: (1) a portion of the guarantee fees assessed by Farmer Mac has been set aside as a reserve against losses arising out of Farmer Mac's guarantee activities in an amount determined by Farmer Mac's Board to be necessary and such reserve has been exhausted; and (2) the proceeds of such obligations are needed to fulfill Farmer Mac's guarantee obligations. Such obligations would bear interest at a rate determined by the U.S. Treasury, taking into consideration the average rate on outstanding marketable obligations of the United States as of the last day of the last calendar month ending before the date of the purchase of such obligations, and would be required to be repaid to the U.S. Treasury within a "reasonable time," which the Act does not define.

The United States government does not guarantee payments due on Farmer Mac Guaranteed Securities, funds invested in the stock or indebtedness of Farmer Mac, any dividend payments on shares of Farmer Mac stock or the profitability of Farmer Mac.

Government Regulation of Farmer Mac

General

Public offerings of Farmer Mac Guaranteed Securities must be registered with the SEC under the federal securities laws. Farmer Mac also is required to file reports with the SEC pursuant to the SEC's periodic reporting requirements.

Regulation

Office of Secondary Market Oversight

As a System Institution, Farmer Mac is subject to the regulatory authority of the FCA. The FCA, acting through OSMO, has general regulatory and enforcement authority over Farmer Mac, including the authority to promulgate rules and regulations governing the activities of Farmer Mac and to apply its general enforcement powers to Farmer Mac and its activities. The Director of OSMO, who was selected by and reports to the FCA Board, is responsible for the examination of Farmer Mac and the general supervision of the safe and sound performance by Farmer Mac of the powers and duties vested in it by the Act. The Act requires an annual examination of the financial transactions of Farmer Mac and authorizes the FCA to assess Farmer Mac for the cost of its regulatory activities, including the cost of any examination. Farmer Mac is required to file quarterly reports of condition with the FCA, as well as copies of all documents filed with the SEC under the federal securities laws.

Department of the Treasury

In connection with the passage of the 1996 Act, the Chairmen of the House and Senate Agriculture Committees requested the FCA, in a cooperative effort with the Department of the Treasury, to "monitor and review the operations and financial condition of Farmer Mac and to report in writing to the appropriate subcommittees of the House Agriculture Committee, the House Financial Services Committee and the Senate Agriculture, Nutrition and Forestry Committee at six-month intervals during the capital deferral period and beyond, if necessary." Although the "capital deferral period" expired on January 1, 1999, Farmer Mac anticipates this cooperative monitoring effort between the Treasury and the FCA will continue at least until the date, expected to be during the second quarter of 2002, that Farmer Mac is required to comply with the final risk-based capital standards adopted by the FCA.

Comptroller General/General Accounting Office

The Act requires the Comptroller General of the United States to perform an annual review of the actuarial soundness and reasonableness of the guarantee fees established by Farmer Mac.

Capital Standards

General. The Act, as amended by the 1996 Act, establishes three capital standards for Farmer Mac—minimum, critical and risk-based. The minimum and critical capital requirements are expressed as a percentage of on-balance sheet assets and a lower percentage of "off-balance sheet obligations" (primarily outstanding Farmer Mac Guaranteed Securities not owned by Farmer Mac or an affiliate). The Act does not specify the required level of risk-based capital, but directs the FCA to establish a risk-based capital test for Farmer Mac, which was published for comment on November 12, 1999. Farmer Mac submitted its timely comments on the proposed risk-based capital test on June 12, 2000. On February 22, 2001, the FCA Board approved a final risk-based capital rule for Farmer Mac. As of March 15, 2001, the final rule had not been published in the Federal Register nor made available for public review. In the event that Farmer Mac were unable to comply with existing capital requirements or higher capital requirements that may be imposed in the future, the FCA could take enforcement actions against Farmer Mac, including curtailing its business activities.

As of December 31, 2000, Farmer Mac's minimum and critical capital requirements were $96.9 million and $48.4 million, respectively, and its actual core capital level was $101.2 million, $4.3 million above the minimum requirement.

Minimum capital. Farmer Mac's minimum capital level is an amount of core capital equal to the sum of 2.75 percent of Farmer Mac's aggregate on-balance sheet assets, as calculated for regulatory purposes, plus 0.75 percent of the aggregate off-balance sheet obligations of Farmer Mac, specifically including: (1) the unpaid principal balance of outstanding Farmer Mac Guaranteed Securities; (2) instruments issued or guaranteed by Farmer Mac that are substantially equivalent to Farmer Mac Guaranteed Securities; and (3) other off-balance sheet obligations of Farmer Mac.

Critical capital. By statute, Farmer Mac's critical capital level at any time must be an amount of core capital equal to 50 percent of the total minimum capital requirement at that time.

Risk-based capital. The 1996 Act directs the FCA to establish a risk-based capital test for Farmer Mac, using stress-test parameters set forth therein. While the Act does not specify the required level of risk-based capital, that level is permitted to exceed the statutory minimum capital requirement applicable to Farmer Mac.

In November 1999, the FCA published a notice of proposed rulemaking setting forth a proposed risk-based capital test. The framework for the proposed rule is specified in Farmer Mac's statutory charter. The model underlying the proposed risk-based capital test was intended by Congress to measure the amount of capital needed for Farmer Mac to maintain adequate capital levels during a 10-year period of economic stress, based on the Corporation's credit and interest rate risk profile at the beginning of such period. Comments on the proposed rulemaking were initially due by March 13, 2000. The FCA granted an extension of the time for filing comments on the proposed rulemaking until June 12, 2000, due, in part, to a request by Farmer Mac. Farmer Mac filed its comments on the proposed rulemaking on June 12, 2000.

On February 22, 2001, the FCA Board adopted the final risk-based capital regulation for Farmer Mac. As of March 15, 2001, the final rule had not been published in the Federal Register or made available for public review. Based on preliminary information from the FCA regarding the nature of the regulation adopted by the FCA Board, and without having obtained access to the FCA's economic "stress test" model underlying the final regulation, Farmer Mac understands that it would have been in compliance with the final risk-based capital regulation as of December 31, 2000, had the regulation been in effect on that date, and that the final rule would not have required Farmer Mac to increase its capital based upon its financial position and risk profile. Based upon its review of preliminary information from the FCA, Farmer Mac understands that the overall risk-based capital requirement generated by the stress test will be a weighted average of the risk-based capital requirements of individual Qualified Loans backing securities guaranteed by Farmer Mac or held by it. Farmer Mac further understands that Qualified Loans with certain characteristics will contribute to a lower requirement (but not less than the statutory minimum capital level), while Qualified Loans with other characteristics will contribute to a higher requirement. These considerations may cause Farmer Mac to emphasize those characteristics of Qualified Loans that produce lower risk-based capital requirements as its business continues to develop, to ensure that the Corporation remains in compliance with the risk-based capital regulation.

Based on FCA's application of the final risk-based capital regulation to Farmer Mac's business as of September 30, 2000, had the regulation been in effect on that date, Farmer Mac's risk-based capital requirement would have been less than the statutory minimum capital level, in which case the statutory minimum capital level would have governed. Because the characteristics of Farmer Mac's portfolio of assets did not change significantly from September 30, 2000 to December 31, 2000, Farmer Mac's risk-based capital as of December 31, 2000 should also have been less than the statutory minimum capital level had the regulation been in effect on that date. There can be no assurance that future risk-based capital levels will always be below statutory minimum capital levels, though Farmer Mac expects that it will be able to manage its business to maintain capital levels consistent with the regulation. After Farmer Mac has had an opportunity to evaluate the final regulation fully, management may engage FCA staff in further discussions, as appropriate, to recommend revisions to the regulation.

Based on preliminary information from the FCA, the final risk-based capital regulation most likely will become effective in April or May 2001, but Farmer Mac will not be required to comply with the risk-based capital standard established under the regulation until one year after its effective date. While a risk-based capital requirement significantly above the statutory minimum capital level could have a material adverse effect on Farmer Mac, the ultimate impact of the risk-based capital test adopted by the FCA in February 2001 will have to be evaluated in light of the level of risk-based capital required relative to Farmer Mac's existing capital position, the categories of assets against which risk-based capital would have to be maintained, growth in Farmer Mac's business, Farmer Mac's ability and need to raise additional equity in the capital markets, alternative business strategies available to Farmer Mac, as well as legal and public policy considerations affecting the applicability to Farmer Mac of the risk-based capital requirement.

Enforcement levels. The Act directs the FCA to classify Farmer Mac within one of four enforcement levels for purposes of determining compliance with capital standards. Prior to the effective date of the final risk-based capital regulation for Farmer Mac, the Act provides that Farmer Mac shall be classified as within "level I" (the highest compliance level) so long as its capital equals or exceeds the then applicable minimum capital level. As of December 31, 2000, Farmer Mac was classified as within level I.

Failure to comply with the applicable minimum capital level in the Act would result in Farmer Mac being classified as within level III (below the minimum but above the critical capital level) or level IV (below the critical capital level). (Level II is not applicable prior to the effective date of the final risk-based capital regulation since it contemplates the failure to comply with the risk-based capital standard.) In the event that Farmer Mac were classified as within level III or IV, the Act requires the Director of OSMO to take a number of mandatory supervisory measures and provides the Director with discretionary authority to take various optional supervisory measures depending on the level in which Farmer Mac is classified. The mandatory measures applicable to level III include: requiring Farmer Mac to submit (and comply with) a capital restoration plan; prohibiting the payment of dividends if such payment would result in Farmer Mac being reclassified as within level IV and requiring the pre-approval of any dividend payment even if such payment would not result in reclassification as within level IV; and reclassifying Farmer Mac as within a lower level if it does not submit a capital restoration plan that is approved by the Director or the Director determines that Farmer Mac has failed to make, in good faith, reasonable efforts to comply with such a plan and fulfill the schedule for the plan approved by the Director.

If Farmer Mac were classified as within level III, then, in addition to the foregoing mandatory supervisory measures, the Director of OSMO could take any of the following discretionary supervisory measures: imposing limits on any increase in, or ordering the reduction of, any obligations of Farmer Mac, including off-balance sheet obligations; limiting or prohibiting asset growth or requiring the reduction of assets; requiring the acquisition of new capital in an amount sufficient to provide for reclassification as within a higher level; terminating, reducing or modifying any activity the Director determines creates excessive risk to Farmer Mac; or appointing a conservator or a receiver for Farmer Mac. The Act does not specify any supervisory measures, either mandatory or discretionary, to be taken by the Director in the event Farmer Mac were classified as within level IV.

The Director of OSMO has the discretionary authority to reclassify Farmer Mac to a level that is one level below its then current level (i.e., from level III to level IV) if the Director determines that Farmer Mac is engaging in any action not approved by the Director that could result in a rapid depletion of core capital or if the value of property subject to mortgages backing Farmer Mac Guaranteed Securities has decreased significantly.

Market for Farmer Mac's Common Stock and Related Matters

Farmer Mac has three classes of common stock outstanding. Class A Voting Common Stock may be held only by banks, insurance companies and other financial institutions or similar entities that are not System Institutions. Class B Voting Common Stock may be held only by System Institutions. There are no ownership restrictions on the Class C Non-Voting Common Stock.

The Class A and Class C Common Stock trade on the New York Stock Exchange (the "NYSE") under the symbols AGMA and AGM, respectively. Prior to June 18, 1999, Class A Common Stock traded on The Nasdaq SmallCap Market tier of The Nasdaq Stock Market under the symbol FAMCA, and the Class C Common Stock traded on The Nasdaq National Market tier of The Nasdaq Stock Market under the symbol FAMCK. The Class B Voting Common Stock, which has a limited market and trades infrequently, is not listed or quoted on any exchange or other medium, and Farmer Mac is unaware of any publicly available quotations or prices for that class.

The information below represents the high and low closing sale prices for the Class A and Class C Common Stock for the periods indicated as reported by the NYSE and the high and low bids for the periods indicated as reported by The Nasdaq Stock Market.

	Class A Stock		Class C Stock	
	High	Low	High	Low
	(dollars per share)			
1999				
First quarter	$ 18.50	$ 17.38	$ 18.00	$ 13.08
Second quarter	18.25	16.38	24.83	15.06
Third quarter	16.75	15.25	23.13	17.50
Fourth quarter	18.63	14.81	22.63	15.63
2000				
First quarter	16.50	15.63	20.75	15.50
Second quarter	17.13	14.75	16.13	13.31
Third quarter	17.88	16.75	18.06	13.63
Fourth quarter	18.38	16.13	23.38	17.50
2001				
First quarter (through March 9)	$ 23.25	$ 19.00	$ 27.94	$ 22.85

As of March 9, 2001, it was estimated that there were 1,506 registered owners of the Class A Voting Common Stock, 104 registered owners of the Class B Voting Common Stock and 1,441 registered owners of the Class C Non-Voting Common Stock outstanding.

Selected Financial Data

Summary of Financial Condition:	December 31, 2000	1999	1998	1997	1996
	(dollars in thousands)				
Cash and cash equivalents	$ 537,871	$ 336,282	$ 540,626	$ 177,617	$ 68,912
Investment securities	836,757	847,220	643,562	656,737	85,799
Farmer Mac guaranteed securities	1,679,993	1,306,223	552,205	442,311	419,260
Loans	30,279	38,509	168,064	47,177	12,999
Total assets	3,160,899	2,590,410	1,935,971	1,348,135	603,104
Notes and bonds payable					
Due within one year	2,201,691	1,722,061	1,473,688	856,028	259,164
Due after one year	767,492	750,337	366,122	402,803	287,128
Total liabilities	3,028,238	2,503,267	1,855,057	1,273,074	555,899
Stockholders' equity	132,661	87,143	80,914	75,061	47,205
Selected Financial Ratios:					
Return on average assets	0.36%	0.31%	0.35%	0.47%	0.14%
Return on average equity	9.50%	8.24%	7.36%	7.57%	2.64%
Average equity to assets	3.82%	3.71%	4.75%	6.27%	5.28%

Summary of Operations:	Year ended December 31, 2000	1999	1998	1997	1996
	(dollars in thousands, except per share amounts)				
Interest income	$ 195,420	$ 140,377	$ 103,561	$ 80,153	$ 37,353
Interest expense	177,722	125,419	92,992	72,992	34,623
Net interest income	17,698	14,958	10,569	7,161	2,730
Guarantee fee income	11,677	7,396	3,727	2,575	1,623
Gain on issuance of AMBS	-	-	1,400	2,362	1,070
Miscellaneous	399	220	142	253	63
Total revenue	29,774	22,574	15,838	12,351	5,486
Total expenses	13,588	11,983	9,323	7,840	5,081
Income before income taxes and extraordinary item	16,186	10,591	6,515	4,511	405
Income tax expense/(benefit)	5,749	3,670	772	(115)	12
Extraordinary gain	-	-	-	-	384
Net income	$ 10,437	$ 6,921	$ 5,743	$ 4,626	$ 777
Earnings Per Share:					
Basic earnings before extraordinary item	$ 0.94	$ 0.64	$ 0.53	$ 0.48	$ 0.07
Basic net earnings	$ 0.94	$ 0.64	$ 0.53	$ 0.48	$ 0.15
Diluted earnings before extraordinary item	$ 0.92	$ 0.62	$ 0.52	$ 0.46	$ 0.07
Diluted net earnings	$ 0.92	$ 0.62	$ 0.52	$ 0.46	$ 0.14

APPENDIX II

Farmer Mac –Press Release Reporting Financial Condition as of March 31, 2001

FARMERMAC
Financing Rural America SM

NEWS

FOR IMMEDIATE RELEASE
April 19, 2001

CONTACT
Tom Clark
202-872-7700

Farmer Mac Continues Profit Advances in 2001

Operating Earnings Per Share Up 29% for First Quarter

Washington, D.C. -- The Federal Agricultural Mortgage Corporation (Farmer Mac, NYSE: AGM and AGMA) today announced diluted operating earnings per share of $0.27 for first quarter 2001, a new record reflecting a 29 percent increase over first quarter 2000 diluted earnings per share of $0.21, and an 8 percent increase over fourth quarter 2000 diluted earnings per share of $0.25. Operating income was $3.2 million for the quarter, compared to $2.4 million for first quarter 2000 and $2.9 million for fourth quarter 2000. Operating income, revenues, return on equity and earnings per share are new operating measures that exclude the cumulative effect of the change in accounting principles recognized on January 1, 2001 under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities* ("FAS 133"), and its ongoing effects during the first quarter, in order to present measures consistent with prior presentations. Net income for first quarter 2001, including the cumulative and ongoing effects of FAS 133 during the quarter, was $2.2 million or $0.18 per share.

Farmer Mac President and Chief Executive Officer Henry D. Edelman observed, "Farmer Mac demonstrated its ability once again to deliver consistent earnings growth. At the end of the quarter, outstanding guarantee volume for all Farmer Mac programs was a record $3.2 billion, up 35 percent over the year-earlier level. During the quarter, daily volume of loan purchases in both the Farmer Mac I cash window and Farmer Mac II programs grew steadily. With regard to the latter program, we are pleased to note that Farmer Mac II set a new record, with purchases of $47 million for the first quarter."

"Furthermore, we did $98 million in Farmer Mac I purchases and guarantees, including $50 million in long-term standby commitments, and entered into agreements to provide Farmer Mac I long-term standby commitments for an additional $151 million that go into effect in the second quarter of 2001. Our flexibility to meet the changing and growing needs of agricultural lenders through these and other creative products has enhanced Farmer Mac's ability to increase its guarantee volume, and demand for these products continues to be strong in the second quarter. Although the timing and size of these transactions will vary, lender awareness of their economic and regulatory benefits is growing in the marketplace and Farmer Mac is ready to meet the needs of the lenders."

"On the whole, we believe that agricultural market conditions for 2001 will be similar to those of 2000 – low commodity prices, favorable interest rates, relatively stable land values and consistent federal agricultural support – notwithstanding the change in the U.S. executive branch. Farmer Mac will continue to manage its operations within these parameters for the benefit of the farming community and our stockholders. We are confident that lenders' increasing focus on capital efficiency, competitiveness and credit concentration issues will keep the Corporation on track to meet or exceed market analyst projections as of the date of this release for its financial performance in 2001."

Net Interest Income

Net interest income was $5.5 million for first quarter 2001, compared to $4.6 million for first quarter 2000 and $4.5 million for fourth quarter 2000. The net interest yield, exclusive of guarantee fees, was 0.66 percent for first quarter 2001, compared to 0.67 percent for first quarter 2000 and 0.60 percent for fourth quarter 2000. The increases in net interest income and net interest yield resulted from continued growth in our retained portfolio of Farmer Mac guaranteed securities (AMBS), augmented by sound financial strategies, including the ongoing rebalancing of Farmer Mac's debt obligations and investment portfolio in response to developments in the financial markets.

Other Income

Other income, which is comprised of guarantee fee income and miscellaneous income, totaled $3.6 million for first quarter 2001, compared to $2.8 million for first quarter 2000 and $3.5 million for fourth quarter 2000. Guarantee fee income, the largest component of other income, was $3.4 million for first quarter 2001, compared to $2.6 million for first quarter 2000 and $3.4 million for fourth quarter 2000. The relative increases in guarantee fees reflect an increase in the average balance of outstanding guarantees. Miscellaneous income was $166,000 for first quarter 2001, compared to $182,000 and $149,000 for first quarter 2000 and fourth quarter 2000, respectively.

Operating Expenses

During first quarter 2001, operating expenses totaled $2.6 million, compared to $2.4 million for first quarter 2000 and $2.3 million for fourth quarter 2000. Operating expenses were consistent as a percentage of operating revenues for the same quarters at 29 percent, compared to 33 percent and 28 percent, respectively, in the prior periods.

Credit

As of March 31, 2001, Farmer Mac I loans purchased or guaranteed after the enactment in 1996 of changes to Farmer Mac's statutory charter ("post-1996 Act loans") that were 90 days or more past due, in foreclosure or in bankruptcy represented 2.62 percent of the principal balance of all post-1996 Act loans, compared to 1.45 percent as of March 31, 2000 and 1.25 percent as of December 31, 2000. (Farmer Mac assumes 100 percent of the credit risk on post-1996 Act loans; pre-1996 Act loans are supported by mandatory 10 percent subordinated interests that mitigate Farmer Mac's credit exposure.) Farmer Mac anticipates fluctuations in the delinquency rate from quarter to quarter, with higher levels likely to be reported during the first and third quarters of each year due to the semiannual payment characteristics of most Farmer Mac loans. While the year-over-year increase is not insignificant, it is more reflective of liquidity issues in the agricultural sector than a decline in land values or other potentially serious drivers of loan losses.

Total direct governmental payments to the agricultural sector for 2000 are estimated by the U.S. Department of Agriculture (USDA) to have been a record $22.1 billion, resulting in farm income levels during 2000 significantly above the decade (1991-2000) average. The federal income support is not allocated equally to producers of all agricultural commodities, however, and farmers and ranchers producing agricultural commodities that receive significant federal income support should demonstrate greater liquidity than those who do not receive payments. It is expected that additional federal support will be provided to the agricultural sector in 2001, although the specific amount has not yet been determined.

As of March 31, 2001, the weighted average loan-to-value ratio for all post-1996 Act loans was 50.7 percent. Although Farmer Mac expects to recognize losses on the existing post-1996 Act delinquent loans, management believes that those losses are adequately covered by the reserve for losses, based on the value of the collateral securing the loans. Management believes that the delinquent loans have current loan-to-value ratios that adequately protect against losses at liquidation, with the exception of certain loans that are partly secured by depreciable assets that may result in Farmer Mac incurring losses upon loan liquidation. Farmer Mac recognized $321,000 in losses in first quarter 2001. Farmer Mac's provision for principal and interest losses was $1.4 million for first quarter 2001, compared to $1.3 million for first quarter 2000 and $1.3 million for fourth quarter 2000. As of March 31, 2001, Farmer Mac's reserve for losses totaled $12.4 million, or 0.49 percent of outstanding post-1996 Act loans, compared to $7.9 million (0.42 percent) as of March 31, 2000.

Provision for Income Taxes

The provision for income taxes totaled $1.6 million for first quarter 2001, compared to $1.3 million for first quarter 2000 and $1.6 million for fourth quarter 2000. Farmer Mac's effective tax rate for each quarter was 35.5 percent.

Capital

Farmer Mac's regulatory core capital totaled $104.8 million as of March 31, 2001, compared with $91.6 million as of March 31, 2000 and $101.2 million as of December 31, 2000. The capital balance as of March 31, 2001 exceeded Farmer Mac's regulatory minimum capital requirement by approximately $14.1 million.

On April 12, 2001, the Farm Credit Administration ("FCA") issued its final risk-based capital regulation for Farmer Mac. The regulation is scheduled to become effective in approximately one month, and one year after the effective date Farmer Mac will be required to meet the risk-based capital standards. As noted in our June 12, 2000 comment letter to the FCA on the proposed regulation, Farmer Mac believes that certain significant aspects of the risk-based capital regulation do not comply with the authorizing statute. The economic model incorporated in the regulation is extremely complex, and we are still analyzing its potential effects. We have requested that FCA assist us in understanding the operation of the regulation and the model; however, if unchanged, the regulation – particularly those provisions that suggest to us that the FCA went outside the authorizing statute – could lead to an increase in the capital requirement for certain newly guaranteed off-balance sheet program assets and so alter Farmer Mac's strategic plan for future growth. While we are at this time uncertain whether the regulation, as issued, would alter that strategic plan, we expect that any issues raised by the regulation will be resolved in accordance with the authorizing statute before Farmer Mac is required to meet the risk-based capital standards.

Average return on equity, excluding the effects of Statement of Financial Accounting Standards No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and FAS 133, was 12.3 percent for first quarter 2001, compared to 10.5 percent for first quarter 2000 and 11.5 percent for fourth quarter 2000.

Change in Accounting Principles

FAS 133, a revised accounting rule for determining the treatment of derivative securities, became effective as of January 1, 2001. FAS 133 requires financial derivatives to be measured and recorded at fair value. Such derivatives, which Farmer Mac uses to hedge interest rate risk, were previously accounted for as off-balance sheet items and disclosed in the financial statement footnotes.

The cumulative effect of this change in accounting principles, which accelerated recognition of certain costs associated with derivative instruments formerly amortized over the lives of those derivative instruments, was a charge of $726,000 and a negative adjustment of $8.6 million to other comprehensive income within stockholders' equity recognized on January 1,

2001. Farmer Mac projects that the charge to income will be offset over time (predominantly over the next two years) as Farmer Mac recognizes income from the assets hedged by the derivative instruments without recognizing any amortization of the related costs. Additionally, further net after tax charges against earnings under FAS 133 during first quarter 2001 totaled \$380,000, and those included as net after tax reductions to other comprehensive income were \$3.6 million. Management believes that reporting results by reference to operating income, revenues, return on equity and earnings per share provides a more accurate comparison of Farmer Mac's financial performance to previous presentations.

Forward-Looking Statements

In addition to historical information, this release includes forward-looking statements reflecting management's current expectations for Farmer Mac's future financial results, business prospects and business developments. Management's expectations for Farmer Mac's future necessarily involve assumptions, estimates, and the evaluation of risks and uncertainties. Various factors could cause actual events or results to differ materially from those expectations. Some of the important factors that could cause Farmer Mac's actual results to differ materially from management's expectations include: (1) uncertainties regarding the rate and direction of the development of the secondary market for agricultural mortgage loans; (2) uncertainties in the agricultural economy resulting from low commodity prices, weak demand for U.S. agricultural products and crop damage from natural disasters; and (3) the implementation of additional statutory or regulatory restrictions applicable to Farmer Mac, such as the imposition of regulatory risk-based capital requirements with an aggregate effect in excess of the statutory minimum and critical capital levels or restrictions on Farmer Mac's investment authority. These and other factors are discussed in Farmer Mac's Annual Report on Form 10-K for the year ended December 31, 2000, as filed with the Securities and Exchange Commission on March 26, 2001. The forward-looking statements contained herein represent management's expectations as of the date of this release. Farmer Mac undertakes no obligation to release publicly the results of any revisions to the forward-looking statements included herein to reflect events or circumstances after today, or to reflect the occurrence of unanticipated events.

Farmer Mac is a stockholder-owned instrumentality of the United States chartered by Congress to establish a secondary market for agricultural real estate and rural housing mortgage loans, and to facilitate capital market funding for U.S. Department of Agriculture guaranteed farm program and rural development loans. Farmer Mac's Class C and Class A common stocks are listed on the New York Stock Exchange under the symbols AGM and AGMA, respectively. Additional information about Farmer Mac (as well as the Form 10-K referenced above) is available on Farmer Mac's website at www.farmermac.com. An audio recording of the conference call to discuss Farmer Mac's first quarter 2001 earnings and this press release will be available on Farmer Mac's website after 2 p.m. eastern time, Friday, April 20, 2001.

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Federal Agricultural Mortgage Corporation
Consolidated Balance Sheets

	March 31, 2001	December 31, 2000	March 31, 2000
		(in thousands)	
Assets:			
Cash and cash equivalents	$ 320,437	$ 537,871	$ 344,822
Investment securities	819,957	836,757	927,673
Farmer Mac guaranteed securities	1,711,183	1,679,993	1,289,175
Loans	12,407	30,279	28,897
Financial Derivatives	593	-	-
Interest receivable	33,570	55,681	29,308
Guarantee fees receivable	3,055	5,494	2,618
Prepaid expenses and other assets	14,856	14,824	16,827
Total assets	$ 2,916,058	$ 3,160,899	$ 2,639,320
Liabilities and stockholders' equity:			
Notes payable:			
Due within one year	$ 2,024,233	$ 2,201,691	$ 1,781,310
Due after one year	715,901	767,492	745,735
Total notes payable	2,740,134	2,969,183	2,527,045
Financial Derivatives	19,610	-	-
Accrued interest payable	15,706	20,852	11,904
Accounts payable and accrued expenses	12,417	26,880	5,398
Reserve for losses	12,386	11,323	7,901
Total liabilities	2,800,253	3,028,238	2,552,248
Stockholders' equity	115,805	132,661	87,072
Total liabilities and stockholders' equity	$ 2,916,058	$ 3,160,899	$ 2,639,320

Federal Agricultural Mortgage Corporation
Consolidated Statements of Operations

	Quarter Ended		
	March 31, 2001	December 31, 2000	March 31, 2000
	(in thousands, except per share amounts)		
Interest income:			
Investments and cash equivalents	$ 21,088	$ 23,147	$ 21,958
Farmer Mac guaranteed securities	28,740	28,886	21,694
Loans	603	534	1,240
Total interest income	50,431	52,567	44,892
Interest expense	44,978	48,061	40,276
Net interest income	5,453	4,506	4,616
Gains/(Losses) on financial derivatives and trading assets	(589)		
Other income:			
Guarantee fees	3,428	3,368	2,582
Miscellaneous	166	149	182
Total other income	3,594	3,517	2,764
Total revenues	8,458	8,023	7,380
Other expenses:			
Compensation and employee benefits	1,237	1,168	1,251
Regulatory fees	223	133	150
General and administrative	1,145	966	1,007
Total operating expenses	2,605	2,267	2,408
Provision for losses	1,383	1,297	1,317
Total expenses	3,988	3,564	3,725
Income before income taxes	4,470	4,459	3,655
Income tax provision	1,588	1,586	1,297
Net Income before cumulative effect	2,882	2,873	2,358
Cumulative effect of change in accounting principles, net of tax	(726)	-	-
Net income	$ 2,156	$ 2,873	$ 2,358
Earnings per share:			
Basic earnings per share	$ 0.19	$ 0.26	$ 0.22
Diluted earnings per share	$ 0.18	$ 0.25	$ 0.21
Earnings per share excluding cumulative effect of change in accounting principles:			
Basic earnings per share	$ 0.26	$ 0.26	$ 0.22
Diluted earnings per share	$ 0.25	$ 0.25	$ 0.21
Operating Earnings per share:*			
Basic earnings per share	$ 0.28	$ 0.26	$ 0.22
Diluted earnings per share	$ 0.27	$ 0.25	$ 0.21

* operating earnings per share excludes the cumulative effect of FAS 133 and its ongoing effects during the first quarter 2001

Federal Agricultural Mortgage Corporation
Supplemental Information

The following tables set forth quarterly activity regarding: loan purchase commitments; loan purchases and loan guarantees; AMBS issuances; delinquencies; and outstanding guarantees.

Commitments to Purchase or Guarantee Farmer Mac I Loans (1)

	Long-Term Fixed Rate	5 and 7 Year Resets	ARMs	Total	Outstanding
			(in thousands)		
For the quarter ended:					
March 31, 2001	$ 40,463	$ 11,447	$ 59,494	$ 111,404	$ 18,398
December 31, 2000	159,039	2,261	70,454	231,753	13,223
September 30, 2000	288,274	126,909	40,097	455,280	10,983
June 30, 2000	45,838	2,822	32,361	81,021	8,641
March 31, 2000	10,369	16,835	32,438	59,642	10,707
December 31,1999	317,357	6,882	75,326	399,565	12,470
September 30, 1999	26,623	19,384	34,170	80,177	17,010
For the year ended:					
December 31, 2000	384,944	158,013	164,390	707,347	18,398
December 31, 1999	537,190	58,065	203,536	798,791	12,470

Purchases and Guarantees of Farmer Mac I Loans (1)

	Long-Term Fixed Rate	5 and 7 Year Resets	ARMs	Total
		(in thousands)		
For the quarter ended:				
March 31, 2001	$ 39,742	$ 4,902	$ 53,651	$ 98,295
December 31, 2000	160,706	1,176	64,344	226,226
September 30,2000	286,303	126,845	37,801	450,949
June 30, 2000	43,508	5,702	30,778	79,988
March 31, 2000	11,917	13,185	33,181	58,283
December 31, 1999	319,478	9,522	73,030	402,030
September 30, 1999	26,670	14,862	29,029	70,561
For the year ended:				
December 31, 2000	381,470	150,634	155,411	687,515
December 31, 1999	662,186	57,176	483,402	1,202,764

Federal Agricultural Mortgage Corporation
Supplemental Information (continued)

Farmer Mac I AMBS Issuances (2)

	Long-Term Fixed Rate	5 and 7 Year Resets	ARMs	Total
		(in thousands)		
For the quarter ended:				
March 31, 2001	$ 14,425	$ 4,900	$ 47,047	$ 66,372
December 31, 2000	6,777	1,176	27,824	35,777
September 30,2000	5,589	3,790	35,916	45,295
June 30, 2000	15,122	4,950	36,749	56,821
March 31, 2000	6,582	14,616	45,880	67,078
December 31, 1999	128,641	8,084	17,069	153,794
September 30, 1999	95,121	33,532	24,744	153,397
For the year ended:				
December 31, 2000	34,070	24,531	146,370	204,971
December 31, 1999	359,185	57,887	277,517	694,589

Farmer Mac I Delinquencies (3)

As of:	Post-1996 Act	Pre-1996 Act (5)	Total
March 31, 2001	2.62%	5.83%	2.72%
December 31, 2000	1.25%	6.49%	1.44%
September 30, 2000	1.80%	5.55%	1.96%
June 30, 2000	1.25%	4.12%	1.41%
March 31, 2000	1.45%	4.89%	1.65%
December 31, 1999	1.05%	3.04%	1.18%

Distribution of Post-1996 Act Delinquencies as of March 31, 2001	
By loan-to-value ratio:	
0.00% to 40.00%	13%
40.01% to 50.00%	15%
50.01% to 60.00%	31%
60.01% to 70.00%	38%
70.01% to 80.00%	3%
Total	100%

Federal Agricultural Mortgage Corporation
Supplemental Information (continued)

	Outstanding Guarantees (4)					
	Farmer Mac I					
	Post-1996 Act		Pre-1996	Farmer		Held in
	AMBS	LTSPC	Act	Mac II	Total	Portfolio (5)
			(in thousands)			
As of:						
March 31, 2001	$ 1,466,443	$ 1,083,528	$ 72,646	$ 549,003	$ 3,171,620	$ 1,648,896
December 31, 2000	1,615,914	862,804	83,513	517,703	3,079,934	1,581,905
September 30, 2000	1,621,516	707,850	92,536	491,820	2,913,722	1,571,315
June 30, 2000	1,354,623	575,143	100,414	467,352	2,497,532	1,292,359
March 31, 2000	1,310,710	551,423	107,403	387,992	2,357,528	1,268,889
December 31, 1999	1,266,522	575,097	118,214	383,266	2,343,099	1,237,623
September 30, 1999	1,118,266	367,934	130,452	377,663	1,994,315	1,190,741

(1) Includes long-term standby purchase commitments ("LTSPCs"), which obligate Farmer Mac to purchase loans in the pool at par when they become four or more months delinquent. In exchange, Farmer Mac receives an annual commitment fee on the outstanding balance of the pool over the life of the loans.
(2) Includes AMBS issued and retained by Farmer Mac. Such transactions totaled $33.9 million in first quarter 2001, $20.7 million in fourth quarter 2000, $25.0 million in third quarter 2000, $21.7 million in second quarter 2000, $46.5 million in first quarter 2000 and $50.6 million in fourth quarter 1999.
(3) Includes loans 90 days or more past due, in foreclosure or in bankruptcy.
(4) Pre-1996 Act loans back securities that are supported by unguaranteed subordinated interests representing approximately 10 percent of the balance of the loans. Farmer Mac assumes 100 percent of the credit risk on post-1996 Act loans. Farmer Mac II loans are guaranteed by the U.S. Department of Agriculture.
(5) Included in total outstanding guarantees.

ICBA
INDEPENDENT COMMUNITY
BANKERS of AMERICA

Statement Of

John Evans Jr.

On Behalf Of The

Independent Community Bankers of America

Before The

Senate Agriculture Committee

May 16, 2001

Statement of John Evans Jr.
Senate Agriculture Committee
May 16, 2001

Thank you, Chairman Lugar and other distinguished members of this committee for the opportunity to present the views of the Independent Community Bankers of America (ICBA) on the credit title of the 1996 Farm Bill and our recommendations for future farm and credit related policies.

I am John Evans, Jr. the CEO of D.L. Evans Bank located in Burley, Idaho, a small community of less than 10,000 residents in the heart of potato, sugar beet, small grain, and livestock country. Ours is a family-owned bank that has served out community for nearly 100 years. The bank has survived agricultural disasters, the Great Depression and, more recently, the downturn in the farm economy. We are a $225 million asset bank heavily involved in ag lending and in terms of our bank's services, almost everything is based on agriculture including operating lines of credit, farm real estate loans and commercial loans.

I am also serving this year as the Vice-Chairman of ICBA's Agriculture-Rural America Committee. ICBA is the ***only*** national trade association that exclusively represents the interests of community banks.

This hearing is very timely for a couple of reasons. First, obviously, is the need to rewrite the Farm Bill during the 107th Congress since the current bill expires in 2002 and there is great uncertainty about the future for many farm families. Unfortunately, farmers today face the 'triple whammy' of despairingly low prices, sharply rising energy and input costs and an unlevel playing field in the international trade arena.

The hearings are also timely because ICBA's Agriculture-Rural America committee, which consists of over twenty-five bankers from across the nation, will be meeting in a few days in Washington D.C. At that time we will be discussing in detail some of the farm policy and farm credit related issues being reviewed here today. A few years ago ICBA's Agriculture-Rural America committee sent Congress our ***"Comprehensive Proposal to Strengthen the Farm Safety Net"*** and we're pleased that several of the items we called for have either been acted upon or are about to be acted upon.

On December 15th, of last year, ICBA sent President Bush and the new Congress a special report titled ***"Community Banking's Issues & Answers Brief for the Bush Administration & the U.S. Congress,"*** to offer guidance to the incoming administration and the 107th Congress on policy issues and solutions that would help preserve and strengthen the community banking industry. A number of recommendations were made to strengthen the farm and rural economy and these are included in my testimony today. A few of our suggestions may go beyond pure farm bill policy, but we believe they are important considerations for this committee given its focus on both agriculture and rural America.

We also plan to have several bankers involved as part of a special "***Farm And Rural Credit Policy Task Force***", reviewing a number of these issues and we plan to present further details and recommendations to the congressional agriculture committees in the near future.

A Farm Aid Package

Our first recommendation today is to continue the recent series of farm aid packages to help producers offset the impact of extremely low farm prices. ICBA has supported these farm aid packages because we believe they are necessary to prevent an agricultural credit crisis that could have developed in the absence of such assistance. We recognize that ultimately farmers need to earn their income from the market to be viable, but a number of factors outside the control of farmers, including events in the broader economy and on the world stage, coalesced to drive down farm prices and dramatically reduce our farm exports. We have also recognized that many of the farm trade issues, so important to agriculture's health, will take considerable time to work out as part of the world trade negotiations.

USDA's recent supply and demand figures indicate it will be another tough year for many farmers. Farm prices for many commodities will remain low as carryover levels for most major commodities will be high. A number of experts will be discussing these projections in detail so I will simply say that even with a farm aid package this year, a number of farmers will likely leave farming. But another round of economic assistance is necessary to help stem this tide.

We were pleased that the new Budget provides roughly $80 billion to agriculture's baseline over the next decade and a minimum of $12.5 billion for the 2001 and 2002 crop years. Last March, when ICBA testified to the House Agriculture Committee on farm policy ideas, one of our recommendations was to include counter-cyclical payment mechanisms in the next farm bill to provide producers income assistance during periods of extremely low prices. We also suggested congress could establish a special fund as part of a multi-year budget that would provide increased money to agriculture in low-price years. We believe the new "reserve fund" outlined in the budget is consistent with what we recommended and is a good way to provide flexibility in the next farm bill for a counter-cyclical approach to boosting farm income in low-price years.

Predictability Is Key

I believe what everyone, including both farmers and their lenders, is trying to achieve is a greater degree of predictability so that farmers and their lenders don't have to rely on annual, ad-hoc disaster packages. That wasn't a good recipe for crop insurance and it isn't a good recipe for farm financing either. More predictability will allow lenders and their farm customers to make timely business and financing decisions and to have a better grasp – earlier – of the cash flow statements. Producers and their lenders need to have the ability to make three to five year crop projections based on the known amount of income available.

Strengthening The Farm Safety Net

Obviously, both short-term and long-term solutions are necessary on a number of fronts. For example, we must focus considerable efforts towards boosting farm exports in the long-term and enhancing trade opportunities to help raise farm prices, reduce government expenditures and ensure the long-term viability of American agriculture.

New Farm Policy Income Mechanisms – In terms of the new farm bill, ICBA believes Congress should consider legislation that provides greater income to farmers when market prices decline. The structure could include not only a fixed payment mechanism, such as the current AMTA payments, but also counter-cyclical mechanisms that would include supplemental income payments when farm prices fall, and tax-deferred, individual savings accounts that create a "Farmer 401(k)" plan.

For example, we note there is strong support for the Farm, Fish and Ranch Risk Management (FFARRM) accounts which would allow producers to defer taxes on up to 20 percent of their net income for up to five years. Perhaps the committees should consider how this or other special savings accounts could be more intricately incorporated into future farm bill safety nets rather than being stand alone accounts separate from any farm bill policy mix.

One goal of such accounts should be to ensure maximum participation and minimizing any limitations that could severely limit the number of farmers using them. Therefore, possible provisions could include allowing a portion of government payments to go into these accounts, rather than limiting them to just contributions from farmers' net income. We recommend maximizing the time limitation, for example, much longer than five years as that is too short to allow for the accumulation of assets. We believe the general goal of such accounts, especially given the recent levels of federal outlays to the farm sector, should be the accumulation of assets over a long period of time.

Therefore, another consideration would include limiting withdrawals from the accounts to hardship needs or simply minimizing the amount that could be withdrawn. This would allow a "Farmer 401K" program that would allow farmers to strengthen their long term financial position and allow them to eventually transition away from heavy government dependence. The safety and soundness of these accounts should also be assured which can best be accomplished by directing participation to insured depository institutions since these are savings accounts.

Therefore, we suggest six general goals for this type of savings account program:

- To maximize the number of family farmers able to participate by allowing for some portion of government payments to be directed into the accounts, with a "matching component" allowed by producers;
- To include a tax-deferral component *that can work over long periods of time* to allow for a more sizeable and significant increase in savings;
- To limit withdrawals based either on hardship needs or other criteria;
- To target participation to insured financial institutions – another reason to double the level of deposit insurance;
- To not be market or trade distorting;
- To improve producers finances so they're less dependent on government payments.

Mr. Chairman, in addition to the above, there will need to be additional income support provisions in the new farm bill that could be both of a fixed nature and counter-cyclical to help farmers cope with low prices. Additional questions will need to be answered including how to set a "base" period or production amount on which to determine future levels of payments. Planting flexibility should continue in the next farm bill. would be glad to work with the committee to provide our thoughts on these matters.

Increase Risk Management Tools – Mr. Chairman, we are pleased that the new crop insurance program has been substantially enhanced. Although not part of the next farm bill policy debate, I mention it here because it is an important cornerstone to a strong farm safety net. From a lender's standpoint, crop insurance is especially important because it better enables producers to repay their loans and withstand economic adversity when major weather disasters strike. The goal of enhancing the farm safety net needs to include a sound and viable crop insurance program. The program needs to be attractive enough to sustain high levels of farmer participation so Congress does not feel inclined to pass annual ad hoc disaster programs, which only further detracts from participation.

The new crop insurance reform law clearly caused more growers to buy crop insurance and at higher coverage levels. For example, Crop Revenue Coverage [CRC] participation increased by over 95,000 policies, or a 23 percent increase. Revenue Assurance [RA] increased by over 26,000 policies, or more than double 2000 sales. In addition to buying higher coverage levels, it appears that many growers switched from yield guarantees to the revenue insurance products. This sizeable increase in crop insurance participation on the hard red winter wheat crop means the hard red winter wheat crop in the 5 state region of Kansas, Oklahoma, Texas, Colorado and Nebraska will have over $1 billion in coverage for the 2001 crop. In addition, wheat producers insuring above CAT coverage levels increased from 62.0% to 70.4% of the planted acres. The HRW wheat crop is one of the few major commodities where production will be down significantly, largely due to weather conditions, and producers will have greater protection thanks to the new crop insurance program.

Similarly, we're told cotton producers opted for higher coverage levels and increased their adoption of revenue insurance. Participation in higher coverage levels of Multi-Peril Crop Insurance (MPCI-H), with coverage equal to or greater than 65 percent increased by over 13,000 policies, which represents a 21.5 percent increase in policies sold in 2001. There was 51% increase in CRC cotton policies, an increase of over 5,000 policies.

I mention these statistics to simply enforce that producers will buy crop insurance if it is perceived as a good "investment" and is sold by a private insurance network. A good crop insurance program not only helps farmers and provides more security for lenders, it will lessen the need for future government bailouts and thereby decrease government outlays.

In fact, Congress could consider making crop insurance participation mandatory for those producers receiving government payments. This would put pressure on Congress, producers and the industry to improve the program as needed to lessen the prospects of future large multi-billion dollar bailouts. You could therefore add a "crop insurance compliance" section to existing statute, similar to the "conservation compliance" requirements that exist today.

Provide Sufficient Funding and Flexibility For FSA Guarantees – Mr. Chairman, it became apparent to us with the downturn in the farm economy in the late 1990's that lower commodity prices would lead to a rapid escalation in demand for FSA loan guarantees and that more funding would be necessary. Indeed, Congress acted twice to pass supplemental appropriations bills to provide more funds for FSA loan guarantees because funding literally "dried up". Farmers were complaining to bankers because they couldn't get their production loans and bankers were being told that there was no more funding available until Congress and the President agreed to supplemental appropriations legislation, which at times becomes embroiled in non-related issues.

We believe that one of the most cost-effective programs in the government's farm safety net arsenal should be a fully funded FSA loan guarantee program. The FSA loan portfolio has witnessed improved performance with direct loan delinquency down to its lowest level in more than two decades. And, importantly from the standpoint of lenders, is the loan delinquency for guaranteed loans is at an all-time low of 1.83 percent.

It is important for Congress to keep in mind that with the guaranteed loan programs, Congress can get a sizeable "bang for the buck" because private sector lenders are providing the loan funds, not the government. However, when these programs run out of money it severely undermines their credibility and increases frustration in the countryside. This should never have to be the case. FSA guaranteed loan programs can be a useful public-private partnership and they need a sound financial footing for the long haul and made more flexible to administer.

One of our recommendations for the next farm bill is to include language in the credit title that provides a "cushion" against running out of appropriated funding. One way this could be accomplished is to provide for a back-up line of credit to the Treasury for $10-$20 million that could be tapped by the Secretary if the Chairman and Ranking Members of the House and Senate Agriculture and Appropriations committees agree that allocation of the funds are necessary. A second alternative would be to appropriate a permanent and small pool of additional funds that can be used in the event the appropriated amounts are spent. This small funding investment would provide well over $1 billion of credit to farmers in times of need.

We offer the following recommendations for FSA loan programs:

- Provide a permanent back-up or contingency funding mechanism to provide uninterrupted program operation when congressionally appropriated funds become exhausted;
- Provide the Secretary greater flexibility in transferring funds between programs especially in times of greater funding needs;
- Permanently eliminate the 15-year limit on eligibility by allowing lenders and farmers to determine when they need guaranteed loans since private sector lenders provide the loan funds under the guaranteed programs;
- Increase the loan limit, at least on a case-by-case basis, on FSA loans to better reflect the needs of modern-day agriculture. The loan limit was recently increased slightly, but many lenders complain it is still not adequate;
- Consideration of providing a greater interest rate subsidy when national interest rates increase;
- Allow FSA guarantees to be used with Aggie Bonds which will lower the effective interest rates and allow better cash flows for young, beginning and marginal farmers;
- Review criteria for participation in the Interest Assist (IA) program; and
- Continue streamlining USDA's direct and guaranteed loan paperwork and enhance computer/online access to all necessary USDA documents.

Mr. Chairman, while we're discussing guaranteed lending, I also want to recommend that Congress legislate a guaranteed lending program for on-farm storage in addition to the existing direct loan program. On farm storage needs in some areas will remain high with the rising carryover levels of major commodities and the government should not be tackling this effort alone, especially when direct loans are much more costly than guaranteed loans.

I also want to emphasize the importance of continuing to allocate funding for low interest FSA disaster loans. In my area of southern Idaho, farmers are really struggling. We estimate we'll lose 10 percent of our farmers this year. The disaster declaration last year was critical in keeping many farmers going. If not for these government loans, we would probably be losing 25% of our farmers this year. And as you know, this also hurts the main street economy in our small rural towns. We continue to face drought problems and now face sharp rises in energy costs.

Enhance Conservation Initiatives & the CRP – ICBA believes that conservation should continue to be an important cornerstone of new farm policy. In this regard we believe that more producer choice should be provided to farmers in terms of choosing the length of their Conservation Reserve Program (CRP) contracts. Producers should be allowed to choose between three-year, five-year, and seven-year contracts so that land does not have to be idled for 10-year periods, which may cause too much economic disruption.

Addressing Food Aid & World Hunger Needs – It is also important that we continue our focus on efforts to aid hungry and malnourished people in other countries in a constructive and positive way. Food aid commitments to needy foreign nations should be increased, and the functionality of these programs should be reviewed to assess ways to improve cost efficiencies.

We believe the private sector, including the World Bank and regional development banks such as the Inter-American and Asian Development Banks can help assist in developing the infrastructure necessary to allow efficient food transportation to hungry people in poor countries. Proper monitoring and oversight mechanisms also should be established to help ensure that food shipments get to the people in needy countries and are not diverted. Another example of the types of initiatives that would be of additional assistance is the George McGovern-Robert Dole International Food for Education and Child Nutrition Act introduced recently.

Improving Access to Foreign Markets – ICBA supports boosting U.S. agricultural trade so that family farmers can receive a profit from the market and be viable in the long term. The new administration and Congress should pursue several initiatives including exempting agriculture from unilateral economic trade sanctions; eliminating unfair export subsidies and trade tariffs of competitors through World Trade Organization negotiations; pursuing ongoing transparency and eventual elimination of State Trading Enterprises and passing trade negotiating authority as soon as possible. We also urge the administration's to continue aggressive efforts to ensure that international regulation of genetically modified food products are based on sound science, not politics.

In regards to passing trade negotiating authority, we are quite concerned about the consequences of losing out on trade agreements due to the lack of trade negotiating authority as mentioned in comments recently by USTR's Ambassador Zoellick.

Ambassador Zoellick indicates the U.S. is currently only party to two of the 130 free trade agreements that now exist. Given the state of American agriculture, we cannot afford to be shut out of preferential trade and investments agreements while allowing our trade competitors to reap the benefits.

Diversifying Rural America

Mr. Chairman, one important aspect of strengthening the farm safety net involves helping rural communities diversify their sources of income and their local economies. More and more farm families appear to be relying on off-farm income to support the farming enterprise. USDA statistics indicate that 90 percent of the total income of farm households comes from off-farm sources. These off-farm earnings are reported to have averaged approximately $60,000 last year, up considerably from an average of $36,000 in 1992.

Yet trends indicate that counties which have relied largely upon agriculture as the main industry lost significant population in the last decade. For example, the FDIC's first quarter 2000 Regional Outlook report on the Kansas City region highlighted these troubling trends. Only about one quarter of the 400 rural counties studied were growing. The recent 2000 census revealed that while the general population grew 13 percent in the 1990's, 676 counties, primarily rural counties, lost population. Those counties losing population are largely dependent on agriculture. This shows the importance of diversifying our rural economies which will help keep people in rural America and will help farm families have additional sources of income thereby reducing the need to rely solely on farm programs for survival in rural America. The more diversified economies in rural America appear to be the most viable for the long term.

Maintaining a stable population base in rural areas is important because many demographers say that at some point the populations of communities can fall below a critical mass, destining them for an irreversible decline because they lack the human resources needed to remain viable. The per capita cost of providing services becomes too expensive. Ultimately keeping people, leaders, workers, and citizens in rural communities is essential to keeping a healthy rural social infrastructure which is the foundation of a diverse economic base in our rural communities.

Maintaining the social infrastructure in terms of human resources is key to maintaining a viable physical infrastructure— adequate roads, schools, health care services, utilities, Main Street businesses and, yes, locally owned community banks focused on meeting local financial needs.

From the standpoint of the community banks in these rural areas, the loss of population, with its subsequent result of fewer depositors and fewer deposits, is a critical problem since fewer deposits mean fewer funds available to make loans to local businesses and citizens and therefore less investment in the physical and social infrastructure of rural communities.

We Offer the Following Suggestions to Help Diversify our Rural Communities.

Increase Deposit Insurance & Index it to Inflation -- Rural banks are losing more deposits than are being created. There are a number of factors at play, but many consequences resulting from these factors could be substantially reduced by doubling deposit insurance coverage and indexing it to inflation. American agriculture is undergoing dramatic changes resulting in fewer and larger farms as well as larger corporate and agribusiness interests. These larger farms and larger agribusinesses, especially at the local level, deal with considerably larger and larger sums of money on a routine basis. Yet, deposit insurance hasn't been raised since 1980 and its value has been eroded in half.

As we all know, millions of retirement accounts have grown well beyond $100,000. Doubling FDIC deposit insurance and indexing it to inflation will help ensure it keeps up with the savings needs of rural Americans, including farmers who will be looking to retire. In addition, the depositors of many rural banks are older and when they die, their deposits are typically inherited by their children who now live in larger cities. Thus, these funds leave our rural communities.

The result is that money which could have served as lendable funds for business investments and other loans in the community is gone. This only exacerbates the cycle—less investment and opportunity in rural communities and more population flight. New funding sources must therefore be found by the community bank to make up for this loss of depositors and deposits. Increasing the deposit insurance level and indexing it to inflation would be a quick and efficient way to immediately help infuse more funds into our rural areas and ultimately benefit rural citizens, including farm families that depend on off-farm income for survival.

Increasing funding for USDA's Business and Industry program – We were pleased that congress last year provided the USDA B&I program with a significant funding increase of 50 percent, bringing the budget to $1.5 billion for the current fiscal year. This program lends money to any rural business that provides economic opportunity to people living in districts with populations of less than 50,000 people, including gas stations, factories, and other local businesses. USDA business loans reportedly saved or created more than 29,000 jobs last year.

This is good news for banks in their efforts to help slow-growing rural markets. We are told that approximately 400 banks are currently taking part in the program and more are trying to get in. The main problem is that the B&I program is still under funded as last year almost $1 billion in guaranteed loans, for 376 projects, could not be approved due to lack of funding.

Given the statistics that show the loss of population in many agriculturally dependent counties and the need to diversify our rural economies to also strengthen our farm economy, we believe that providing more funds for the B&I program could be a very cost-efficient approach to strengthen the rural safety net and the farm economy. Remember that the lenders are the ones providing the funding, the government's expense comes only in cases of a loan default. We would also suggest that the B&I program significantly target small businesses to ensure smaller rural projects receive the same consideration for funding as larger rural projects.

Mr. Chairman, the Center for the Study of Rural America, headquartered in the Federal Reserve Bank of Kansas City, is a national rural outreach committed to illuminating the issues and challenges facing rural America. In their recent national conferences, the Center has begun exploring the need to outline a broader rural policy that goes beyond only farm policy. Diversifying our rural economies is a key challenge in the 21st Century.

An additional issue the Center has examined is the need to bring more sources of equity capital to rural America to complement the debt financing offered by private-sector lenders. We believe one way to accomplish this would be through the creation of a private-sector driven ***Rural Equity Fund*** that would have some initial start-up capital provided by the government and matched by the private sector. The fund would be able to approve equity financing for private sector rural business projects that need equity capital to complete their financing needs. Such a fund would provide new ways for rural community banks to access adequate equity capital for rural business start-ups and expansions. Additionally, we also need to find the right mix of policies that will ***spur greater investment in telecommunications technologies in rural America*** to help us bridge the "digital divide" between our rural and urban areas.

Summary

Mr. Chairman, we appreciate the Committee's efforts on behalf of American agriculture and rural America. Strengthening the farm safety net by passing a new farm bill that includes counter-cyclical income support mechanisms and greater business investment opportunities in our rural areas are essential ingredients to a viable future for many farm families. Additional longer-term solutions involving successful trade negotiations will also be very important to rural America's future. ICBA and its Agriculture-Rural America Committee looks forward to working with you Mr. Chairman and other committee members to accomplish these goals.

TESTIMONY OF

GARY CANADA

on behalf of

THE AMERICAN BANKERS ASSOCIATION

presented to the

COMMITTEE ON AGRICULTURE, NUTRITION,
AND FORESTRY

U.S. SENATE

MAY 16, 2001

Mr. Chairman and members of the Committee, I am pleased to be here on behalf of the American Bankers Association ("ABA") to participate in this important hearing to examine the current state of credit in agriculture, to discuss current farm legislation, and to discuss future federal agricultural policy that will help ensure a sound economic footing for American agriculture.

I am Gary Canada, president of the Bank of England in England, Arkansas. In addition, I am chairman of the ABA's Agricultural and Rural Bankers Committee. The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership-- which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks -- makes ABA the largest banking trade association in the country.

For those of you who are not familiar with my state, England is located about 20 miles southeast of Little Rock. The Bank of England was chartered in 1898 and has provided credit to farmers, businesses and others in and around England since that time. Today, in addition to our headquarters in England, we have banking centers in Scott and Lonoke, Arkansas.

In our area, farmers produce cotton, rice, soybeans and fish. For most of my banking career, I actively farmed in the England area. My son, who took over the farm in 1997, is the fourth generation to farm the same ground. While he is now completely in charge of the farm, I still get called when he needs extra help.

My bank has $66 million in total assets, and a total loan portfolio of $50 million. Over half of our loans are to farmers, and most of the rest of our loans are to businesses that either supply the producers in our area or are dependent upon their financial health for survival. My bank actively participates in the USDA, Farm Service Agency ("FSA") guaranteed loan program. At present, 30 farmers have loans from my bank that are guaranteed by FSA. We also participate in credit programs provided by the Small Business Administration ("SBA").

Mr. Chairman, as you begin the long and difficult process of designing a new federal farm policy, those of us who labor every day to support agriculture wish to thank you and this committee for your prompt and effective response to the critical needs of farmers and ranchers. By acting swiftly in 1998, 1999, and 2000, you helped avert what could have become a serious and extended period of economic disruption and financial ruin for many farmers and ranchers.

American agriculture continues to face an uncertain future. The banking industry shares the concerns of producers about the future economic viability of agriculture. Our industry provides the vital credit that farmers and ranchers need to be successful. At the end of 2000 banks had nearly $75 billion in loans outstanding to farmers and ranchers- - an increase of 3.3% over the previous year. In 2000, the banking industry surpassed all other lenders in loans secured by real estate and non-real estate secured loans. More farmers and ranchers borrow more money from the banking industry than from any other source. For every dollar of agricultural credit outstanding, 41 cents is loaned by the banking industry.

I lend money to farmers and ranchers in England not because I have to, and not because some regulator tells me that I must, but because agricultural lending has been good business for my bank. Further, agricultural lending has been good business for thousands of other banks in the country and that is why the banking industry has made such a significant investment in the industry. Agriculture is a capital-intensive business. Each year my customers must borrow large amounts of money to be able to plant crops, purchase livestock, buy machinery and equipment, and improve their land.

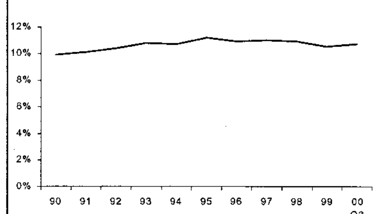
As an agricultural banker, it is my job to assess the risk in every loan and to assess the potential for repayment on every loan we make. We do our very best to examine all aspects of the deal before we make the loan. It is important that I make such a careful assessment, because it is not my money that Bank of England loans out, it belongs to the Main Street merchants, the hospital, the schools, the local restaurants and the men and women who live and work in and around England. I know that on an intellectual level you know this, but this is a reality with which I work every day.

In saying all of this, I want to tell you what my producers need most in terms of federal agricultural policy. I can sum it up in one word: certainty. If producers could present a plan to their bank at the start of each crop year that shows how their cash flow will work, banks would have a greater level of confidence about the credit that they are extending. We would be able to make more credit available in a more timely manner. The banking regulators would have a greater level of comfort in the loans that they are examining. Our farm supply businesses would be able to better project their annual performance, and that would make it easier for my bank to determine their repayment ability and on and on. As you labor to craft a new policy for agriculture, please keep this in mind and if you can just provide some certainty for my customers and the rest of agriculture, you will have accomplished much.

Despite A Difficult Agricultural Economy, Agricultural Banks Remain Strong

Despite low commodity prices for key agricultural commodities and regional weather and disease problems, widespread negative effects on banks' farm loan portfolios have not materialized. The sound state of farm banks today is the result of the strong non-farm economy, improved credit underwriting standards and high levels of government assistance in 1998,1999,and 2000 that enabled farmers to meet their debt obligations.

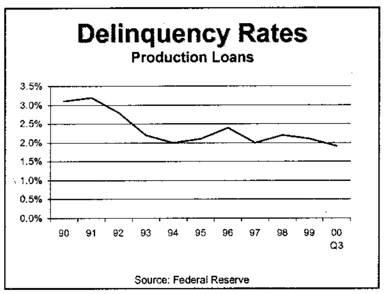
Farm Banks Average Capital Ratio

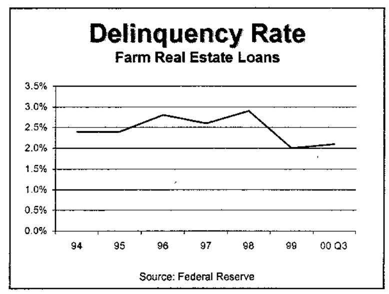


Source: Federal Reserve, Board of Governors

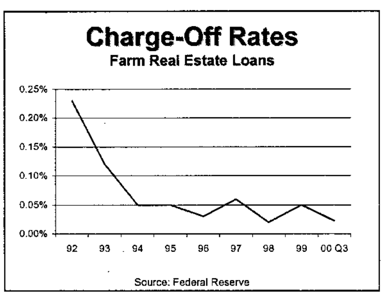
Agricultural banks tend to be better capitalized than other small banks. The average capital ratio at an agricultural bank stood at 10.7 percent as of the third quarter of 2000. As of September 2000 almost all agricultural banks met the regulatory definition of being "adequately" capitalized and more than 98 percent of all agricultural banks meet the definition of being "well" capitalized. Farm banks were able to build capital during the 1990s because they have been profitable.

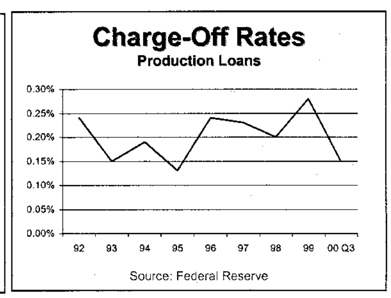
Loan quality remains strong for agricultural banks. As of September 2000, in aggregate farm banks reported $0.9 billion in farm production loans as delinquent (30 days or more past due) or 1.9 percent of the outstandings. Non-performing farm production loans (past due 90 days accruing interest and non-accruals) was 1.2 percent. Additionally, $700 million in farm real estate loans were delinquent as of the third quarter 2000. As a percent of the portfolio, delinquent farm real estate loans stood at 2.1 percent. This compares favorably to the previous year's ratio of 2.3 percent.





Further evidence of the strength of farm bank portfolios is reflected in the relatively low charge-off rates for both farm real estate and production loans. The charge-off rate for farm real estate loans stood at .02 percent – below the charge-off rate reported in 1999. For farm production loans, the charge-off rate was slightly lower than the rate reported in the last several years at .15 percent.





Despite the positives that I have reported to you about the agricultural credit portfolio and the financial performance of agricultural banks, continued low commodity prices and the uncertain nature of future federal assistance to agriculture have raised our concerns about our farm and ranch customers. I have never seen the morale of my farm customers lower. The uncertainty in agriculture has also had a negative impact on farm supply and Main Street businesses in my community and across all rural America.

ABA Center for Agricultural and Rural Banking

Our growing concern about the health of the agricultural economy and the role that our member banks play in the health of rural America led to the creation of the ABA Center for Agricultural and Rural Banking in 1999. The center is focused on the unique challenges faced by banks in rural America, and provides information, training, education, and advocacy for this unique constituency.

Farm Bill Listening Sessions Conducted in 2001

From early January to early May 2001, staff of the ABA Center for Agricultural and Rural Banking conducted 19 farm bill listening sessions in 14 states. Nearly 1,000 bankers, producers, businesspeople, state legislators, local federal officials and other stakeholders participated in the sessions held from North Dakota, south to Texas, west to Oregon and southeast to my state.

The sessions covered a wide range of topics from federal support for agriculture to trade to FSA program delivery to expectations and recommendations for the 2002 farm bill. I would like to share with you some general findings from the sessions:

- There was near unanimous agreement that the federal payments made available to producers in 1998,1999,and 2000 made the difference whether their customers had adequate cash flow. Further, participants agreed that, if economic conditions remain the same, federal support consistent with what was made available in 2000 would be needed in 2001.

- In many commodities, farmers are receiving the lowest prices they have received in 20 or 30 years. Low commodity prices are universal and nation-wide. We spent a lot of time discussing the causes and consequences of this very negative economic situation.

- Bankers have worked with their customers to continue to find ways to help them continue their operations another year. Fortunately, farming was very profitable for much of the 1990s and farmers were able to build equity. That equity reserve is what has allowed banks to continue to term out debt so that farmers can get operating credit another year. Many bankers noted that ongoing cash losses will deplete equity reserves to the point that financing options will become much more limited.

- Crops that depend heavily on export markets have been hard hit; this is especially true for cotton. Participants in the listening sessions urged our staff to communicate to you that the future of American agriculture is dependent upon policies that support free and open trade.

- One bright spot in agriculture is cattle. Prices received by producers, at all points of the production cycle have been good. Areas that we visited that have cattle production have generally been faring better than areas that are completely dependent upon crops.

- High-energy costs, increased prices for inputs, and scarce water for irrigation in the Pacific Northwest in 2001 are new, dark clouds on the horizon.

- There was a great deal of discussion about the current federal payment structure. The planting flexibility afforded by the 1996 legislation was seen as a major positive change by the participants. The dependence upon the Loan Deficiency Payments (LDP) as a price support mechanism was less universally praised. LDP is only an effective price support mechanism when a farmer has a normal to above normal yield. When drought or other factors hurt yields, the LDP is reduced and the farmer suffers a diminished cash flow. In many areas of the country, LDP payments have been large because farmers have experienced above average yields. Other areas that we visited, Texas and Kansas for example, have had extensive drought, and farmers there are faced with greatly reduced cash flows because their LDP payments were negligible. Many bankers concluded that they are uncomfortable with a price assistance program that works best only when there is an average to above average crop yield.

- Bankers and others that attended the sessions were very positive about the improvements that were made to crop insurance programs in the Agricultural Risk Protection Act of 2000. It appears that the determination of Congress to make crop insurance a credible risk management tool is beginning to pay significant dividends.

- Of all the many policy options that we discussed during our listening sessions, the need to create a farm policy that is consistent and allows for some level of certainty, for the farmer and the bankers that finance them, was a consensus conclusion at all of our sessions.

USDA, Farm Service Agency Guaranteed Loan Programs

At every listening session we discussed the USDA, Farm Service Agency. FSA distributes LDP payments, administers agricultural disaster assistance and administers the guaranteed farm loan program. At many locations the audience was very positive about the performance of the FSA. At other locations we heard about ongoing problems with FSA.

The guaranteed loan programs offered by the FSA are one of the most cost-effective and highest impact tools that Congress can provide to farmers and ranchers during difficult economic times. Because the FSA guaranteed loan programs are such an important part of access to credit, we have some very specific recommendations for you to consider in the 2002 farm bill.

In the recent past there have been shortages of guaranteed loan funding. Because you and others recognized the need, Mr. Chairman, Congress acted several times to make supplemental funding available. We thank you for responding to us and we believe that funding for the remainder of FY 2001 will be adequate.

Recommendation: We urge you to continue to make funding for the FSA guaranteed loan programs a priority. With the continued uncertainty in the agricultural economy, there must be a dependable level of funding for all FSA programs. Recent improvements to the program have established the guaranteed loan program as a credible tool for the private sector to use to deliver credit to farmers and ranchers. In order for this tool to continue to work, funding must be available.

We thank you for temporarily repealing the 15-year term limit on borrower eligibility and we strongly recommend that it be permanently repealed. For many years the banking industry has worked with USDA to successfully graduate farm borrowers from direct USDA loans to guaranteed loans and then on to non-guaranteed bank credit. However, we do not believe that Congress envisioned the kind of economic situation that we currently face when it acted to place a limit on a borrower's eligibility for guaranteed loans. Clearly, economic realities justify an immediate change.

Recommendation: Given the fact that the agricultural sector is expected to be under continued financial stress, borrower term limits should be permanently eliminated.

There continues to be widespread confusion, on the part of FSA, about what happens if a customer fails to achieve a 100% cash flow. If a farmer has a cash flow coverage of less than 100%, this means that he was unable to meet all of his operating and debt obligations, but it does not mean that the business is in eminent danger of failing. Even in the best of years, many farms may not experience 100% cash flow coverage. Many times, when cash flow is less than 100%, a business borrows money. My point is that an exclusive focus on cash flow coverage by FSA is flawed, and that this may be an artificial barrier to credit for many farmers and ranchers. When we underwrite a loan at my bank we look at other factors such as available collateral. In many cases, I might be willing to make a loan to the producer even if his cash flow is not 100% if I know about other, offsetting factors. Given the current economic situation, it seems that we should be exploring additional ways to determine the credit worthiness of a customer and not relying on a single determinant.

Recommendation: If the bank has indicated that it will approve and fund the loan, FSA should approve the guarantee, with a lower percentage of guarantee if necessary, if the cash flow coverage is less than 100%. Give banks the option of making the loan

(and taking on the additional risk) if they feel that there are other factors that offset a cash flow deficiency.

In 1992, Congress approved a low documentation loan program for FSA guarantees. The idea was to significantly streamline the paperwork on smaller loan requests to encourage banks and others to make more credit available to smaller farmers and ranchers in a more timely manner. At that time, the loan limit for low documentation loan applications was set at $50,000. Since that time farms and ranches have grown in size and the expertise of the banks that make FSA guaranteed loans has increased.

Recommendation: Increase the ceiling on low documentation FSA guaranteed loan applications to $150,000.

Today, many USDA services still require direct farmer contact by the FSA, guaranteed lending is not one of them. It is the bank that makes the direct contact with the customer, it is the bank that does the on-site inspections and appraisals, completes the loan underwriting to their and FSA standards, and it is the bank that commits the funding for the loan.

Today there are many FSA Preferred Lenders ("PLP") operating in multi-county and even multi-state regions. As a PLP, lenders can receive permission to make FSA guarantees in any state where they can demonstrate they can adequately manage and service the accounts. However, lenders must still place the individual applications in the local county office. All too often, this is where lenders encounter inconsistencies in processing and loan servicing. Inconsistencies in program administration by FSA were the main complaint that our staff heard when they conducted the listening sessions. We believe that program delivery and administration problems stem from the highly localized delivery structure that USDA maintains for the guaranteed loan program.

Recommendation: FSA should consolidate guaranteed loan making and loan servicing at state offices, or in specialized districts in very large states to ensure consistency and maximum efficiency of program delivery.

In 1998, 1999, and 2000 Congress approved additional, emergency assistance to farmers and ranchers due to low prices or weather related problems. As I noted earlier in my statement, these additional funds helped to avert a major economic crisis in agriculture. With one major exception, USDA has done an exemplary job of distributing the funds to farmers. Many farmers assign their USDA program benefits to banks for collateral. To perfect the assignment, the banker and the borrower sign an USDA assignment form and file it with the local FSA office. The form allows the farmer to indicate either specific program payments to assign or to assign all program benefits to their banker. USDA, in 1998, 1999, and 2000 determined that the additional, supplemental payments authorized by Congress could not be assigned with an existing assignment form-- even if the "all programs" box was checked on the form.

In commercial transactions, an assignment of benefits attaches to present and future receipts of the debtor. USDA, acting counter to the standards of commercial transactions, required farmers and bankers to execute and file new assignment forms each time Congress authorized a new payment program. This interpretation by USDA has created a mountain of paperwork-- to say the least.

Recommendation: FSA should create a blanket assignment form for USDA benefits that would attach to all program benefits, now and in the future, in order to stop an immense, costly, and confusing paper chase.

Creating Additional Ways for Producers to Better Manage Financial, Price, and Weather-Related Risk

During our listening sessions, bankers and others were very aware and complementary of the work that this committee and others have done to improve the Federal Crop Insurance program in recent years. We urge you to continue to seek ways to make crop insurance a more effective tool for producers to manage production and price risk.

ABA has supported incentives for producers to save money for times when their cash flows are reduced for many years. The efforts by Senator Grassley to create Fisherman, Farmers and Ranchers Risk Management ("FFARRM") accounts are to be commended. In our listening sessions, bankers have been universally enthusiastic about FFARRM accounts. FFARRM accounts will benefit rural America in several ways. Primarily they will encourage producers to save cash when they have a surplus and will allow them to balance their cash flow when their earnings are down. Secondly, FFARRM accounts could become an important source of new deposits for banks like mine, allowing my bank to make additional credit available to my customers.

Recommendation: Pass legislation that will create FFARRM accounts this year.

Finding funding for beginning farmers and ranchers has always been difficult and it is especially difficult during tough economic times. One of the best sources of lower cost debt capital for beginning farmers are loans that are originated by banks through state industrial revenue bonds. This popular program, called "Aggie bonds", allows banks to use the bonding authority of participating states to fund qualified beginning farmer loans. Approximately 15 states have aggie bond programs. Unfortunately, the states that have the program encounter funding shortages because the bonds are subject to state revenue bond caps. As a result, aggie bonds compete with other state bonding priorities and frequently do not receive top priority. More credit could be made available by banks to more beginning farmers if aggie bonds were exempted from the state bonding caps. Senator Grassley has introduced legislation that would do precisely this, and we urge you to pass this legislation this year.

Recommendation: Pass legislation this year that will exempt aggie bonds from state revenue bond caps.

Banks are the Primary Source of Economic Development Credit in Rural America

Our farm bill listening session discussions were not confined to just the challenges facing production agriculture. At many sessions we discussed rural economic development issues as well. Banks are the engines of economic activity in their community. Bankers overwhelmingly support efforts to stimulate economic development in rural America by lending to the businesses that support in some way, or add value to the crops and livestock produced by farmers and ranchers.

In many ways, the challenges facing bankers in lending to non-farm rural businesses are greater than the challenges they face in lending to production agriculture. In lending to production agriculture, there is usually a strong collateral base supporting the loan as well as a ready market for the assets of the operation should the business fail. In non- farm rural lending, the asset base of the company may be as intangible as good will, or there can be a complete lack of a market for the assets of the company. These unique challenges make it difficult for banks to provide credit to some non-farm businesses. In Washington, the ABA has worked closely with a number of farm and cooperative organizations to develop a proposal to create new sources of equity capital in rural America. We hope that new sources of equity capital can be developed to enable rural businesses access to equity capital on par with urban businesses.

Recommendation: Anything Congress can do to incent the flow of private debt and equity capital into rural America would be beneficial.

One of the most widely used federal non-farm credit programs is the USDA's Business and Industry guaranteed loan ("B&I") program. B&I guarantees allow banks like mine to make loans available to businesses that present a higher than average credit risk profile to our institutions. With the B&I guaranty we can make loans to help retain existing businesses and to help attract new businesses to our communities. There have been some problems with the program in the recent past. Some credits have failed and Rural Business-Cooperative Services, the USDA agency that administers B&I, has had some administrative problems. As a result, the agency has taken some prudent steps to control loan losses, most notably working with a federal regulator to audit some credits. We believe that this is a positive step. Unfortunately the damage has been done and now all lenders and all future borrowers are being asked to pay the price with increased subsidy costs, which limit the availability of funding, and increased loan fees.

Recommendation: We oppose increasing loan origination fees on B&I guaranteed loans. USDA has proposed increasing the fee to 3% (a 50% increase). The fee increase will have a negative impact on access to credit for many rural businesses.

Summary

I hope I have been able to convey to you the substantial commitment the banking industry has made to agriculture and rural America as well as the concerns that agricultural bankers like me has for our farm, ranch, and rural communities. I want to assure you that bankers will work with their customers to restructure debt, to provide credit for operating expenses for the coming year, to find ways for beginning farmers to get started and to provide the financial services and financial stability that rural communities need. We will continue to provide credit to those farmers and ranchers who can make the necessary and rapid adjustments to the new global environment. Even in this uncertain environment, competition for safe and sound credit opportunities is strong, and that competition among lenders benefits the producer.

Credit, however, cannot be used as a replacement for earnings and profits. One of the key lessons learned in the farm crisis of the 1980s is that agricultural businesses must be profitable in order to successfully manage their debt obligations. This was a hard-learned lesson, but a lesson never to be forgotten.

The ABA looks forward to working with you as you address the challenges facing our nation's farmers, ranchers, and rural communities. I will be happy to answer any questions that you may have at this time.

NATIONAL FARMERS UNION

STATEMENT OF

MR. DAVID CARTER

PRESIDENT
ROCKY MOUNTAIN FARMERS UNION

ON BEHALF OF THE
NATIONAL FARMERS UNION

BEFORE THE

SENATE AGRICULTURE, NUTRITION AND
FORESTRY COMMITTEE

CONCERNING

AGRICULTURAL CREDIT

MAY 16, 2001

Statement Of Mr. David Carter
President, Rocky Mountain Farmers Union

400 North Capitol Street, N.W. • Suite 790 • Washington, D.C. 20001 • Phone (202) 554-1600

On Behalf Of The National Farmers Union
Before The Senate Agriculture, Nutrition and Forestry Committee
Concerning Agricultural Credit
May 16, 2001

INTRODUCTION -

Chairman Lugar, Ranking Member Harkin, members of the Committee, I am Dave Carter, President of the Rocky Mountain Farmers Union that represents producers in Colorado, New Mexico and Wyoming. It is a pleasure to appear before this committee today to discuss credit issues as they effect the 300,000 family farmer and rancher members of the National Farmers Union and agricultural producers and rural communities in general.

The NFU believes that future economic success for farmers and ranchers is dependent upon access to an adequate amount of reasonably and competitively priced credit that is available to all producers who meet consistently applied eligibility criteria without regard to race, gender or operating scale.

BACKGROUND -

By many financial measurement tools, it would appear that U.S. agriculture is in reasonably good health and adequate credit is available from a wide range of traditional sources. However, the improved financial condition of agricultural lenders, reduced level of loan delinquencies and charge-offs and supply of credit are do in large part to a combination of factors that may not be sustainable, suggesting the financial health of agriculture is not as rosy as the data may suggest.

Since 1996, the federal government has provided about $69 billion in payments to agricultural producers through farm programs and additional economic support through a more broadly available crop insurance program that has improved participation incentives. Program payments include: Agricultural Market Transition Act (AMTA) contract payments and loan deficiency payments or marketing loan gains as well as just under $30 billion in supplemental economic assistance since 1998. Subsidized crop insurance coverage has been expanded to more crops and regions and purchase incentives have been improved through both ad hoc programs as well as permanent legislative action in addition to the revival of annual production loss disaster assistance programs.

The financial situation of U.S. producers, agricultural lenders, other agricultural sectors and many rural communities would look entirely different if producers had been forced to rely solely on the market oriented promises of the FAIR Act and had not received annual infusions of new capital through the supplemental assistance provided over the last three years.

Although the current situation is significantly different than that which existed during the farm financial crisis of the 1980's, the underlying problem is much the same. The period leading up to the 1980's crisis was characterized by significant inflation in production costs, fixed asset values and high nominal interest rates that were unable to be sustained by either the earning capacity of individual farms or alternative uses for agricultural resources. Increased debt loads were accommodated through equity financing based on inflated assets. When policies aimed at reducing the level of inflation pervasive throughout the economy were implemented, many farm families and their creditors were placed under great stress. The decline in land values resulted in a large number of family farm bankruptcies, agricultural bank failures and the near collapse of the farm credit system.

Today, farm real estate values have remained stable to actually increasing, not as a result of farm profitability, but due to government transfer payments that are more closely tied to land ownership than to the activities of farm operators. Rather than a rash of bankruptcies and foreclosures, the current situation is better characterized as a quiet departure from the sector by farmers who see little future economic promise for themselves or their families by remaining in production agriculture.

As a direct result of the late 1980's experience, both farming and agricultural lending have undergone significant restructuring and consolidation. Agricultural lending standards have been modified to incorporate better analytical tools and focus more on cash flow and repayment capacity.

The structural change in agriculture today is less abrupt in terms of foreclosures, bankruptcies, bank failures and auction sales and therefore less noticeable to the public than that which occurred in the 1980's. However, at the farm level significant adjustments are continuing.

Changes in credit practices, when combined with a generally soft farm economy in terms of the relationship of prices received by farmers to prices paid have contributed to the further consolidation of commercial farms and a noticeable shift in farm operation characteristics to the extremes. Increasingly, agriculture is characterized by a relatively small group of very large farms, i.e. with sales over $500,000 per year, and a large number, about 80% of all farm operations, that are smaller farms with annual sales less than $100,000. Many of these smaller farms are part-time operations dependent on off-farm income.

COMMERCIAL CREDIT -

Commercial agricultural credit is generally obtained from four sources: commercial banks, Farm Credit System associations (FCS), life insurance companies and supplier credit provided input suppliers, merchandisers and processors.

Banks and the FCS provide the vast majority of agricultural credit across a wide range of needs, while insurance company agricultural portfolios are almost entirely comprised of long-term real estate loans. Supplier credit ranges from intermediate or term loans generally for asset purchases to short term credit for the purchase of production inputs.

An increasing amount of credit is provided by input suppliers and processors through intermediate-term credit for asset purchases such as machinery and equipment as well as short-term operating credit based on accounts receivable for production inputs or commodity delivery contracts. This type of credit is provided not only by traditional input suppliers, but also from processor/merchandisers seeking to establish marketing arrangements, alliances or contracts with producers as well as influence the operator's production decision-making concerning the mix of inputs utilized. While this type of credit provides additional financing options for farmers, it may also reduce the producer's independence as well as reduce the longer term liquidity associated with his operation through both term loan indebtedness as well as less than competitive short term financing compared with traditional sources.

The structural and operational adjustments made by commercial banks and the FCS as a result of the 1980's experience, the more general consolidation of financial institutions in recent years and increased use of agricultural credit guarantees provided through the Farm Service Agency has resulted in greatly improved financial strength of commercial lenders and, at least the appearance that an adequate level of agricultural credit is available at least for some borrowers.

The Farm Credit System had a 19.7 percent share of all farm operator debt. However, nearly 36 percent of its lending to farm operators was to operations with over $500,000 in sales but only 10.7 and 16.9 percent respectively of its lending was to operators in the Under $100,000 and $100,000 to $250,000 sales classes where farming was the primary occupation of the operator.

The Farm Credit Administration proposal for National Chartering within the FCS may as suggested, increase market competition among lenders. In the short term this could result in reduced interest and loan fees for borrowers. However, allowing national chartering may result in a new round of system consolidations and further reductions in local control that could exacerbate the distribution of credit among all producers, and result in a greater disparity in credit availability and borrowing costs among different sized farm operations.

Similarly, the number of commercial agricultural banks declined by about 2900 banks or over 25 percent between 1992 and 1999. In 1999, commercial banks provided 43 percent to 50 percent of the credit in each USDA sales class, comparable to its 46.6 percent share of all agricultural debt. However, 21.4% of its lending portfolio to farm operators was to those with over $500,000 in sales while 15.1 percent was to operators with less than $100,000 in sales and 17.1 percent to those with $100,000 to $250,000 in agricultural sales.

Recommendations:

We are concerned that the impact of greater consolidation within the agricultural lending sector is resulting in structural changes in production agriculture that encourage and disproportionately benefit large-scale operations to the disadvantage of family farmers. The composition of the loan portfolios of agriculture's two most important sources of credit appear to indicate that increasingly large operators are gaining at the expense of smaller producers in access, costs and credit terms. We urge the Committee to authorize a study and solicit recommendations from a qualified third party to review the impact and effect of concentration and expanded financial service opportunities in the commercial and cooperative lending sectors on all scales of farming and ranching operations, related agricultural sectors and rural communities.

FARM SERVICE AGENCY CREDIT PROGRAMS (FSA) -

USDA's Farm Service Agency is responsible for administering the direct and guaranteed loan programs for farm ownership and operating credit and direct emergency disaster loans. Portions of the non-emergency loan funds are reserved for socially disadvantage family farmers and beginning farmers.

Under the guaranteed loan program, USDA guarantees a private lender repayment of the interest and 90 percent of the loan principal. Qualifying borrowers may be eligible for interest rate assistance where FSA pays for a 4-percentage point reduction in the borrower's interest rate. USDA has also implemented a preferred lender program that allows qualified lenders to expedite the process of providing guaranteed loans to eligible borrowers. Direct loans are made and serviced by USDA with interest rates based on the cost of borrowing from the U.S. Treasury.

The quality of the government's agricultural credit portfolio has improved significantly in terms of the relative number and value of loan delinquencies for both the direct and guaranteed loan programs due in large part to supplemental payments to producers over the past three years.

For fiscal year 2001, FSA lending authority is $4 billion comprised of $3 billion included in the FY 2001 appropriations legislation and $1 billion in unused funds carried over from the prior year. This compares to $5.6 billion authorized in FY 2000 of which $3.7 billion was utilized in that year's programs. The 2001 appropriations legislation provided authority for FSA to address funding shortfalls in specific programs by allowing it to transfer funds between the farm ownership and operating loan programs.

In addition, the 2001 program levels indicate a continuation of the trend toward greater reliance on the guaranteed loan program for both farm ownership and operating credit as the direct loan program level is reduced about 30 percent from the prior year.

Since the passage of the Agricultural Credit Act of 1987, farm credit legislation has attempted to determine the proper role for USDA as a "lender of last resort". Credit initiatives, including the credit title of the 1996 farm bill, have increasingly tightened the requirements concerning loan delinquencies and write-downs as well as program eligibility requirements. Like many legislative actions, these efforts tended to reflect the improved outlook for agriculture based on the conditions existing at the time of passage.

Recommendations:

The National Farmers Union believes that all producers who meet the eligibility requirements for FSA loan programs should be assured access to credit in a timely fashion. We recommend that the Secretary of Agriculture be given even broader flexibility in transferring funds from program to program and state to state in order to ensure the timely availability of credit to producers. In addition, we urged the Committee to consider providing the Secretary emergency short-term borrowing authority from the Commodity Credit Corporation to address any temporary short-falls in appropriated funds that may occur in the programs.

In order to expedite the application, review and approval process, we request the Committee review on a regular basis USDA efforts to: 1) Expand the preferred lender program. 2) Ensure adequate personnel levels and training for credit specialists in local FSA offices. 3) Develop new, simplified application procedures, such as electronic decision trees, to ensure comparability in the qualification and application process. 4) Explore the need and desirability of providing a centralized, potentially electronic review, oversight and appeal process. 5) Review the conditions that encourage and/or require graduation from FSA lending programs to commercial credit, including the consistency of their application in all regions of the country.

Given the on-going economic problems faced by farmers and ranchers due to generally low commodity prices and weather-related production losses, the potential for an increase in the level of delinquent payments and need for loan restructuring and/or write-downs could increase. We believe the limitations concerning eligibility for FSA direct and guaranteed loan programs should be reviewed as they apply to producers who have availed themselves of previous loan reductions programs.

Anecdotally, we have also received many comments this spring from producers who were having difficulty obtaining operating credit due to their inability to make timely payments of prior loan obligations because of the uncertainty of payments under various federal disaster programs. It appears that either the Secretary's authority to mitigate these problems is not being fully utilized, or additional authority is required.

In addition, many shared appreciation agreements that were signed during the last agricultural credit crisis are maturing at a time when the ability of many to fulfill those obligations is diminished although farm asset values have been stable or increasing. There is also confusion concerning capital investment in assets after a shared appreciation agreement was executed and any producer liability for the asset appreciation due to those improvements. We support utilizing production value as a basis for shared appreciation and forgiveness of any appreciation resulting from conservation easements. The asset appreciation impact of any post agreement investment should also be deducted from the current value of the assets subject to shared appreciation, including those that matured prior to August 18, 2000. Also, FSA should be required to notify and offer the special financing of recapture repayments contained in the fiscal 2001 agricultural appropriations act to all producers subject to shared appreciation agreements.

Specific levels of FSA credit funding have been allocated and reserved for beginning farmers since 1994 to encourage new entrants into production agriculture. The direct supervised credit program programs have been successful, and should be expanded through an increase in budget authority of $100 million and a $1 billion increase in program level. Additionally, new, cost-effective innovations should be explored and implemented on a pilot program basis to further encourage the intergenerational transfer of farming operations.

While credit is one important component of such an objective, we believe additional options should be explored utilizing USDA's credit guarantee authority through programs such as "aggie bonds" and private sales contract guarantees for farm purchase transactions by beginning farmers.

Integration of FSA farm loans and grants to states in a "Farm Link" program could create a cost-effective opportunity for beginning farmers by providing assistance to both them and retiring producers. The expanded grant portion of this program would cost an estimated $25 million per year.

In addition, a grant-in-lieu-of-credit program, limited to outlays similar to those associated with the cost of interest rate buy-downs could be effective in providing beginning farmers with the equity necessary to enter agriculture without the high leverage factor associated with credit programs.

Success in agriculture, particularly for beginning farmers, socially disadvantaged farmers and other smaller producers, is increasingly tied to market access and the ability to enhance the value of their commodities through processing and merchandising. Unfortunately, many of the producers who most need the ability to share in value added businesses, including farmer-owned cooperatives, are unable to generate the capital required for participation. We support expanding the FSA loan guarantee program to include loans to finance producer ownership of value added enterprises, and encourage the Committee to explore additional means to provide initial capital for the creation of new value-added cooperatives, including direct investments by agricultural lending institutions.

BANKRUPTCY CODE: CHAPTER 12 -

Chapter 12 of the U.S. Bankruptcy Code provides farmers and ranchers important alternative debt restructuring options. These provisions can be utilized in lieu of forced liquidation or more onerous restructuring requirements that may reduce the likelihood of success in resolving existing indebtedness issues, allowing the farm or ranch operation to continue in operation.

Congress recently approved and sent to the President legislation that would extend Chapter 12 of the U.S. bankruptcy code for 11 months retroactive to its expiration date last June. The extension will thus expire on May 31, 2001. Provisions to make Chapter 12 a permanent part of the code are included in the broader bankruptcy reform legislation awaiting a conference between the House and Senate.

Recommendation:

We urge Congress, at a minimum, to approve in a timely manner an additional of Chapter 12 extension through June 30, 2002 or until such time as the provisions are made a permanent part of the code.

CONCLUSION -

Mr. Chairman, the National Farmers Union recognizes the importance of credit as a risk management element in an unstable economic environment for producers and agriculturally dependent rural communities. We believe the public/private partnership in agricultural credit that has evolved among commercial banks, cooperative lending associations and the Department of Agriculture provides a generally positive model to ensure the availability and access to credit for responsible producers. However, we also believe Congress, USDA and the private sector can do more to ensure that access to those programs is equitable and that new innovations combining the strengths of the public and private sectors are explored to further enhance the success of family farmers and ranchers.

Additionally, we do not believe expanded or enhanced credit programs, by themselves or in conjunction with other risk management programs such as crop insurance, can replace the need for a strengthened economic safety net for producers or the desirability of ensuring greater market competition within other agricultural sectors.

Thank you for the opportunity to present our views at this important hearing. We look forward to working with the Committee as it develops the credit and other titles to the next farm bill.

Mr. Chairman, I will be pleased to respond to any questions you or your colleagues may have.

May 1997

Biography of
DAVE CARTER
President, Rocky Mountain Farmers Union

Elected president of the Rocky Mountain Farmers Union in November 1993, Dave Carter represents farm and ranch families in Colorado, New Mexico and Wyoming.

As president, Carter is working to advance the organization's legislative, cooperative and educational priorities. He is currently working with members throughout the three states on new, producer-controlled marketing initiatives. He was instrumental in establishing the Rocky Mountain Farmers Union Cooperative Development Center, which has helped foster projects such as a certified kosher meat processing co-op and a value-added wheat project.

Carter also serves as treasurer of the National Farmers Union, which represents more than one-quarter of a million farmers and ranch families. Carter served as a full-time national officer for the National Farmers Union from 1987 until his election as RMFU president.

During his employment with the national organization, he worked directly with state Farmers Union organizations in 23 states. He also monitored trends in corporate agriculture for the Farmers Union. His 1991 text, " Who Owns America?", is utilized by the Farmers Union to introduce high school students to the dangers posed to family-sized farms by increasing corporate concentration in agriculture.

Before 1987, Carter worked for nine years as director of communications for the Rocky Mountain Farmers Union. In addition to coordinating the group's public relations, he conducted issues research and coordinated the Farmers Union's legislative activities at the Colorado Capitol. Carter directed the successful campaign to pass strong agricultural debt restructuring legislation in Colorado in 1986.

Prior to joining the Rocky Mountain Farmers Union staff, he worked on daily and weekly newspapers in Colorado. He obtained his bachelors degree with honors from the University of Northern Colorado in 1976. He was recognized as one of six "honored alumni" from that institution in 1996.

Carter serves on the board of directors of the National Farmers Union Insurance Companies, the executive committee of the National Farmers Union, the board of directors of the Mountain View Harvest Cooperative, and the board of the Colorado Rural Rehabilitation Corporation.

He enjoys flying, hiking, skiing, woodworking and photography. He and his wife, Sue, have two children, Joanna, 14, and Jeffrey, 10. He is active in the Episcopal Church of the Holy Comforter in Broomfield, Colorado.

NATIONAL CATTLEMEN'S BEEF ASSOCIATION

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Statement by the

NATIONAL CATTLEMEN'S BEEF ASSOCIATION

On

Agriculture Credit

Submitted to the

Senate Agriculture, Nutrition, and Forestry Committee

The Honorable Richard G. Lugar, Chairman

by

Mr. Frank Brost
Rapid City, South Dakota
NCBA Tax & Credit Committee Chair

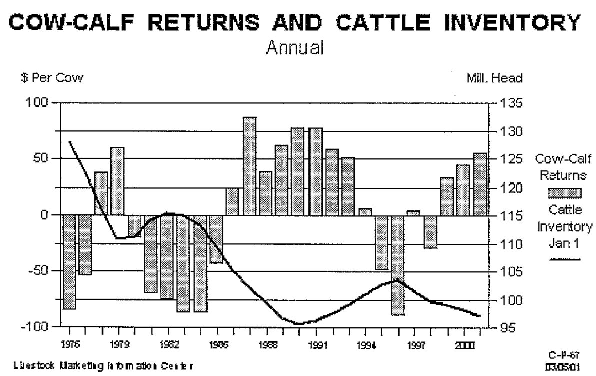
May 16, 2001

Mr. Chairman and Distinguished Members of the Committee:

Introduction

My name is Frank Brost; I am here today on behalf of the National Cattlemen's Beef Association (NCBA), which is the trade association of America's cattle farmers and ranchers, and the marketing organization for the largest segment of the nation's food and fiber industry. I thank you for the opportunity to testify today. As Chairman of NCBA's Tax and Credit Committee I hope that my testimony represents the views of nearly 250,000 members of NCBA and our affiliates nationwide. Furthermore, I look forward to providing some insight into the importance of sound and reasonable policies regarding the availability and use of credit in the US beef industry.

The agricultural GDP annually generates over $150 billion in local and national economic activity. Considering that a typical family feeding facility (5000 head) may utilize more than $4 million dollars in feed, fuel, equipment, labor and interest on operating expense[I] from the local community it is imperative to local economies that we take the appropriate steps to ensure that these operations are sustained. When you add the high level of economic activity from the public monies generated, such as fuel taxes, property taxes, excise taxes, income taxes and related revenues, one must consider every opportunity to create growth and sustainability in the cattle industry to benefit citizens at every level.



Cow calf, stocker and feeder operations across this country are the origins of much of this economic activity. The chart above shows the wide swings in return on investment that most operations will endure. While the number of cattle in the United States have generally been on a decline since the industry reached its highest points in the mid 70's, total production is reaching some of the highest levels in history.

Improvements in genetics, increased feed efficiency, and improved management in every sector have all contributed to this dramatic increase in production per unit. Many of these factors have come as a direct result of the industry's internal adjustments in lean times. Today's family ranch must remain competitive with annual returns so minimal that our dependency on the accumulation of equity and the security of outstanding liens is of utmost priority to the cattlemen of this country.

Economic conditions in the industry have improved in the past several years. However, during the mid-1990's our industry experienced some of the most devastating losses in our history, in large part due to inflated commodity prices and our own over supply. Many cattle producers had to make dramatic adjustments to sustain their operations. Local economies, especially in areas dominated by cattle based agriculture systems were equally shocked by the lack of profitability.

Producers that were able to survive these dramatic downturns generally had several things in common. Good weather, acceptable debt to asset ratio's and strong partners to provide much needed cash flow and operating capital.

Sound financial partners that operate with a spirit of "partnership" are critical to our success and sustainability. The various segments of our industry must be capable of dealing with constant fluctuations and variances in both price and profitability. Stocker or grazing operations and feeder and fed cattle prices exhibit the same types of fluctuation as those shown in the cow-calf chart.

The Next Generation

According to industry and private estimates the average age of a beef producer in the United States is rapidly approaching 60 years, modestly higher than the 54 year old [II]average of all of agriculture. We value that experience, and the wisdom that comes with an older constituency. We also realize that ours is a physically demanding industry that is rapidly changing in its technical expertise—we must better prepare the next and future generations to take control of the worlds safest and most wholesome food supply.

For young producers just starting out or inheriting a family operation, their success is largely dependent on the amount of capital available to them to make it through the high and low price cycles that dominate our industry. When prices are high, nearly everyone can survive. When prices are low, only those surrounded by lenders that understand and advisors that are willing to think creatively are likely to make it back to higher ground.

Our young cattlemen need special assistance that many of today's banking and financial institutions are net yet prepared to meet. Traditional agriculture lending institutions, both public and private, have long met most of the challenges. Young/beginning Farmer & Rancher programs at the federal level and a number of creative state based solutions have helped, but we should not rest. We should ensure that lenders and institutions are capable of the flexibility needed to finance our producers whom are just starting in the business.

Studies show that a lack of startup capital is the primary concern for both lenders and young farmers and ranchers. Lack of equity and the known level of return on investment keep many successful partnerships from developing. Our industry is capital intensive and true success is often a generation of equity building away from the first meeting between a banker and a cattleman.

Tools that help young producers begin operating without undue risk to the capital provider must be continued. NCBA supports efforts to better serve these new entrants to our industry and hope that at every opportunity we can vigorously seek out ways to ensure the highest potential for success possible. These efforts associated with finance are only part of the picture. Relieving the producer and lender from undue regulations are additionally important. Educational efforts directed at the producer, and lender, are important in understanding the opportunities and concerns. Accurate economic forecast and a climate that is conducive to opening new and profitable markets are also essential ingredients in creating successful "next generation" cattle operations in the United States.

Existing Producers

Regardless of the size, location, or type of cattle operation, a number of changes have taken place in recent years that changes the relationship between producers and their credit/capital provider. Today's rancher may very well be depending on as many as a dozen different sources of products, management and services, all of which more likely than not involve a financial relationship.

Today's feedlot manager is a combination of commodity analyst, feed mill operator, cattle buyer, marketing specialist and animal health professional. Each one of these new responsibilities is important to every owner of cattle. Each also creates a need for the appropriate amount of risk management and capital to ensure that services are not delayed and that maximum production and profit is achieved.

Cow-calf and stocker operators are likewise dependent upon the same successful management of risk and available capital to ensure profit and sustainability. Existing operations of every type are increasingly finding themselves facing new and expensive regulatory pressure that in many cases alters the best use of available funds. This week the House of Representatives is holding hearings to assess the cost of proposed regulations to existing and new animal feeding operations.

The Environmental Protection Agency and the United States Department of Agriculture have requested comments from producers on the potential impacts of these new regulations on the livestock industry. In public meetings across the country, hundreds of family farm livestock producers spoke out against the initial "Strategy on Animal Feeding Operations" and were amazed at what seemed to be the underestimate of the cost of these new potential regulations. NCBA and its member affiliates continue to prepare comments for the proposed rules and hope that realistic, sustainable and science based measures will be the basis for final rules that ranchers and feeders will have to comply.

Members of this Committee should be aware that the industry has no surplus of capital to implement dramatic changes in environmental regulation. The cost of implementing new regulations must come from within the current system, which is just now experiencing some reasonable return to management following several years of devastating losses. Existing operations will be forced to pass on cost where possible, seek assistance, utilize current equity (which will weaken their ability to sustain themselves through adverse market conditions), or they will have to cease their operation.

In every case, new regulatory pressure could be equal to adverse weather and market conditions, when determining significant threats to existing operations and in turn may limit the ability of lenders to meet the needs of longstanding customers and clients within the industry. It is NCBA's hope that this Committee will take a keen interest in the result of any new or proposed regulations when developing the next farm bill.

Value Added Producers (Creative New Solutions)

In the past several years a number of producers have banned together in cooperative fashion to add value to the production of their farms. Several of these new marketing arrangements have met great success while others have not. In the coming years it is likely that an increase in the amount of funding for producer owned value added production systems will continue.

The greatest successes have come when combinations of producer, private venture capital, and federal assistance have been a part of the process. It is our hope that our investments in new products and marketing will help these producer-owned groups to achieve success. Both private and publicly supported lenders will need to assist in the development of these new programs if success is likely to occur.

Summary/Recommendations

The policy of the NCBA is well established regarding the role of the federal government in agriculture credit. While a number of concerns are likely to be addressed here today, there are primarily three areas that we believe are essential.

1. Investments in the future

   Beginning farmer and rancher programs should be continued and expanded to allow for higher ceilings and reductions in filing requirements for guaranteed loans. New and stronger incentives should be developed that make it easier for young/beginning farmers and ranchers to get a solid footing in a sustainable agriculture enterprise.

2. Reasonable regulations and effective infrastructure

   This Committee and those with related oversight must ensure that new and existing regulations are not hampering the growth and development of agriculture operations without undue cause. Science based regulations and technical/compliance assistance when needed should be a part of any and all regulations impacting livestock operations in the United States.

   If a foreign animal disease were reported in the United States it would cause widespread disruption in the marketplace and potentially tremendous losses of livestock leading to a credit crisis. Therefore increased investments in sections of USDA that protect the United States from foreign animal diseases must be made at once. The US has remained free of diseases like Foot and Mouth Disease and BSE because of a number of firewalls put in place over the past 100 years. It is apparent that those safeguards work, however, without the appropriate levels of support these firewalls will become increasingly stressed. Increased funding of research and development facilities and renewed emphasis on retaining the staff and resources needed to respond to any threats.

We also support the Administration's effort to clarify the indemnity program in the event that a foreign animal disease was discovered in the United States.

3. Creative solutions to long-term concerns

Continued emphasis on value added production will require even more vigilance on the part of regulators and Congress to ensure that any "assistance" provided is helpful and conducive to producers, and that we maintain a competitive and equitable marketplace for all segments of the industry.

The repeal of the Death Tax, inclusion of Farm Fish and Ranch Risk Management (FFARRM) accounts, and reductions in Capital Gains rates will help every producer to better manage their resources in a manner that is conducive to business.

The Congress in their efforts to provide a safety net should not allow one segment of the industry to benefit at the expense of others. The cattle industry has long rejected the concept of direct payments to producers and we understand that not all of our friends in the agriculture community agree with that position. We believe in a market-based, supply demand approach to addressing the needs of agriculture.

Mr. Chairman, again I thank you for the opportunity to testify today and I will be happy to answer any questions that you might have.

[I] 2000 Idaho Livestock Costs and Returns Estimate, Calf to Slaughter ; Concentrate Ration, Robert L. Smathers, Neil R. Rimbey, Dan D. Hinman and C.Wilson Gray/ University of Idaho College of Agriculture Cooperative Extension Service.

[II] Average Age of Farm Operators: 1997, USDA/National Agriculture Statistics Service Census of Agriculture

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Statement of

Ferd Hoefner

on behalf of the

Sustainable Agriculture Coalition

to the

U.S. Senate Committee on Agriculture,

Nutrition, and Forestry

Credit Title Hearing

May 16, 2001

Good morning and thank you for the opportunity to testify. I am Ferd Hoefner, Washington Representative for the Sustainable Agriculture Coalition, a group comprised of farm, rural, and conservation organizations dedicated to policy and program reforms in support of a more sustainable food and agricultural system. The Coalition, an arm of the Midwest Sustainable Agriculture Working Group and a member of the National Campaign for Sustainable Agriculture, has a long record of involvement with credit issues in general and to programs for beginning farmers and ranchers in particular. In addition to representing the Coalition, I was also involved in the development of credit reform and beginning farmer credit provisions of the 1990 farm bill and 1992 credit act on behalf of the Center for Rural Affairs, one of the Coalition's member organizations. Currently, I am starting a second term on the USDA Advisory Committee on Beginning Farmers and Ranchers. My remarks this morning will review existing beginning farmer credit provisions with recommendations for revisions and additions.

We are concerned as are many others with the falling farmer "replacement" rate and the aging of American agriculture. It bears notice that for several decades now farm entry rates have fallen faster than the rate of farm closures. The overall decline in farm numbers over this period has been primarily due to declines in the new entry rate. Yet, the future of a dispersed, individually owned and operated family farm system of agriculture depends on the ability of new farmers to enter agriculture. We believe concerted effort is required to keep this system alive by, among other steps, a new federal program emphasis on new farmer entry.

The barriers that hinder a new generation from entering agriculture are significant and include:

- insufficient farm exit and farm entry strategies
- inability to acquire initial capital investment
- policy biases favoring current over future landowners
- high rental rates and land prices due to heightened competition from established farmers or developers, heightened by regressive federal farm program payment distribution patterns
- difficulty in identifying viable farm entry opportunities
- lack of community support, and
- inadequate financial, managerial, production, and marketing assistance.

In the early 1990s, Congress responded to some of these concerns by enacting major changes to federal farm credit programs. A substantial portion of federal credit assistance was targeted to beginning farmers. A new down payment loan program was started to assist beginning farmers make their first land purchase. A new federal-state partnership was initiated to team federal assistance with state "aggie bond" and other new farmer assistance programs. Land acquired by the federal government through farm foreclosures was targeted for resale to beginning farmers. Supervised credit, periodic loan assessment, and enhanced effort to graduate borrowers to commercial credit were re-highlighted following the turbulent 1980s. Finally, a new borrower training program was initiated to increase financial management skills and review production options, including sustainable agriculture strategies.

We recognize that credit policy is only one piece of what needs to be a multifaceted approach to beginning farmer policy, and will address briefly other aspects we feel are appropriate for the upcoming farm bill at the close of this testimony. However, credit programs are the only area in which Congress has addressed beginning farmer issues directly in any substantial way, and hence the existing programs deserve careful review. A description of the major provisions, progress made in implementation, and issues for the future follow.

- ***Targeting federal credit assistance to beginning farmers.***

Description: Currently, 70% of direct farm ownership loan funds and 35% of direct operating loan funds are reserved for qualified beginning farmers and ranchers until the last month (September) of each fiscal year, while 25% of guaranteed farm ownership loan funds and 40% of guaranteed farm operating loan funds are reserved for beginning farmers for the first half (October-March) of each fiscal year. In addition, 60% of the 70% direct farm ownership reservation is targeted for beginning farmer down payment loans for the first half of the fiscal year. The targeting features were first introduced in the 1992 credit act and were revised in the 1996 farm bill.

Results in Brief: Targeting has resulted in a profound shift of focus and resource allocation within FSA credit. Targeting has very definitely worked as intended, though more so with direct than guaranteed loans and more so in some regions of the country than others. Progress has been steady after a slow start, and now a very substantial share of total direct and guaranteed current borrowers are beginning farmers. In recent years, the direct FO and OL lending targets have been met or nearly met, while the guaranteed loan goals and the down payment sub-target have lagged. The guaranteed farm operating loan program is the single program with only very limited progress to date and is still quite far from achieving the goal set by Congress. In 2000, the GOL program finished at less than 25% of the target. Nonetheless, while a far greater percentage of direct loans flow to beginning farmers, given the much larger guaranteed loan program levels, a significant guaranteed loan volume serves beginning farmers.

The track record for each program from 1994 through 2000 on the beginning farmers and ranchers targets is summarized in attachment A.

Since 1994, there have been over 6,000 direct farm ownership loans (regular, non-down payment) made to beginning farmers, nearly 800 beginning farmer participation loans (in which FSA and banks or other lenders partner in a loan), over 2,100 direct beginning farmer down payment loans, nearly 1,000 guaranteed farm ownership loans made with down payment loans, and nearly 2,000 guaranteed farm ownership loans to beginning farmers without connection to down payment loans.

Attachment B provides a state-by-state list of regular direct beginning farmer FO loans (non-down payment) from 1994 to the present and Attachment C is a state-by-state list of guaranteed FO loans not made in conjunction with down payment loans from 1994 through early 2000.

Issues: The direct loan targets have worked as intended and should be maintained. Some progress has been made on the guaranteed loan side, but the effectiveness of targeting of guarantees rests primarily with participating lenders' lending policies. Less than 10 percent of guaranteed farm operating loans, by far the largest federal loan program, are currently being made to beginning farmers.

- ***New Down Payment Loan Program***

Description: A new down payment loan program, first implemented in 1994, assists beginning farmers make their first land purchase. Under this partnership-style loan, the farmer supplies 10% of the purchase price, USDA lends equal to 30% of the purchase price for 10 years at 4% interest, and commercial lenders, state programs, or sellers provide the remaining 60%. At the end of the 10 years, the bank or other lender refinances the entire loan. For the same level of appropriated funds, the down payment loan program allows USDA to serve three to four times as many borrowers as compared to traditional 100% financing. The commercial lender portion of the down payment loan may be guaranteed at 95% rather than the usual 90%. A down payment loan recipient is also eligible for a 95% guarantee on an operating loan.

Results in Brief: The program has been used very heavily across the midwest and in a few other states and has helped to create over 2,100 farming opportunities in 7 years through 2000. The top 20 states in down payment loan volume have been, in order, Illinois, Kansas, Iowa, Nebraska, Missouri, Wisconsin, Oklahoma, Minnesota, Michigan, North Dakota, South Dakota, Ohio, Indiana, Montana, New York, Arkansas, Colorado, Idaho, California, Texas. The top 5 states (IL, KS, IA, NE, MO) account for 58% of the total loans. Not surprisingly, 15 of the top 20 states are part of (or soon will join) the Federal-State Beginning Farmer and Rancher Partnership effort (see below) and have existing beginning farmer credit programs at the state level.

Attachment D lists the number of down payment loans from 1994 - 2000 by state. Attachment E shows the state distribution of guaranteed FO loans made in conjunction with down payment loans.

To date the down payment loan program has had an excellent track record on performance. The delinquency rate has never been greater than 3 percent (2.3% at the end of FY 2000). This compares quite favorably to regular direct farm ownership loans (12.4% at the end of 2000) and much higher rates for emergency loans.

Issues: The down payment program is not for everyone, and there remains a need for regular direct FO loans. However, with a limited pool of farm ownership loan funds available each year, 3 to 4 times more beginning farmers can be served using down payment loans rather than traditional loans. Moreover, the government competes with itself by offering both down payment partnership loans, which require 10% from the borrower and a willing private lender, and 40 year, 100% financing through regular farm ownership loans. It is easier for loan officers to do traditional loans then to do partnerships, and USDA has never established effective performance goals for state and local offices with respect to down payment loans. On the other hand, the down payment program requirements could be made more flexible to attract further interest.

- ***Federal-State Partnership***

Description: A new federal-state partnership was initiated to better coordinate federal assistance with "aggie bond" and other state new farmer assistance programs. Aggie bond programs use federal tax exempt financing to make lower interest loans available to beginning farmers. There are now 16 states with aggie bond programs and additional states with other types of beginning farmer credit programs.

Results in Brief: Sixteen states currently have partnership agreements with USDA, and two more are expected in the near future. The USDA Advisory Committee encouraged former Secretary Glickman to actively promote this partnership, and subsequently a letter to Governors was sent from the Secretary's office. As a result, several additional MOUs are expected soon.

Attachment F lists the states with current Memoranda of Understanding and the dates they were signed.

Issues: Close to 15% of down payment loans have been made in conjunction with state programs, a number that would climb much higher if guaranteed loans were permitted in conjunction with aggie bonds. No single change in law would likely do as much to spur down payment loans, the partnership, and beginning farmer lending in general as changing the tax code and credit law to allow guaranteed loans in conjunction with aggie bonds (see below).

- ***Resale of Inventory Properties***

Description: Certain land acquired by the federal government through farm foreclosures was targeted for resale to beginning farmers. Under this 1990 provision as revised in 1996, land is reserved for beginning farmers for a very short period of time prior to sale to the general public. If credit sale or direct ownership loan funds are not available at the time a qualified beginning farmer is prepared to buy the property, the land may be leased to the beginning farmer for up to 18 months while new funds become available.

Results in Brief: Under this provision, over 500 farms (approximately 150,000 acres worth $55 million) have been sold to beginning farmers, out of a total of nearly 10,000 inventory properties sold. The two biggest years for both inventory sales in general and for beginning farmer inventory sales were 1993 and 1994. However, inventory acquisitions and sales, including sales to beginning farmers, have continued each year, though at much lower rates. Through 1999, 8 properties had been leased to beginning farmers.

Attachment G is a list by year and by state of inventory sales to beginning farmers and ranchers.

Issues: In some cases, inventory property is too marginal or in other ways is inappropriate for beginning farmers. However, many parcels are excellent beginning farmer opportunities, especially if subdivided or combined to appropriate sizes. A major problem since implementation of the 1996 farm bill credit title is the very restricted statutory time frame for acting on the beginning farmer preference. The window of opportunity for making these sales under current law lasts often for only a couple of weeks and often not at the time of year that farm sales might generally be contemplated. Many states and counties report that there is not enough time for adequate publicity or settlement.

- ***Loan Assessment***

A re-emphasis on supervised credit and a specific periodic loan assessment requirement was included in the 1990 farm bill. Implementation of loan assessment was delayed, but has been in effect since 1996. The number and quality of assessments vary throughout the country. An automated, web-based loan or farm assessment system was pilot tested in several states earlier this year and the new automated system for the loan assessment program is scheduled to be fully operational in 2002.

- ***Borrower Training***

Description: The objectives of federal farm credit have always included providing the management assistance necessary to conduct a successful operation, but a lack of funding and trained staff made it difficult to fulfill this obligation. A new borrower training program was initiated by the 1990 farm bill to increase farm and financial management skills. Courses include goal setting, record keeping, cash flow planning, and production options. In 1994, Congress adopted legislation to encourage FSA to incorporate information on sustainable agriculture and integrated farming systems into the training curricula as well. Originally, borrower training requirements applied to both direct and guaranteed loans, but Congress later changed the law to drop guaranteed loan recipients from the program, even in cases where the guaranteed loan was to a beginning farmer.

Results in Brief: USDA contracts with State or private providers to deliver the program. Currently, there are 181 vendors of whom 42% are community colleges, 17% are Cooperative Extension, 22% are colleges and universities other than Extension or community colleges, and 19% are private vendors. Many evaluations of the training programs have been very positive. In focus groups, many participants reported excellent training experiences, especially with respect to financial management. However, a few particular vendors have been poorly ranked, some large states have too few sites to allow for convenient access to classes, the cost and length of the training varies considerably (from $0-$600 and from 15-75 hours), and waivers are too frequent and inconsistently applied from state to state. In the past three years, 51% of all borrowers received waivers, including 41% of beginning farmers.

Issues: Some states are making waivers almost routine, and there is little national guidance on situations in which waivers are appropriate. More could be done to promote the programs consistently ranked as excellent as models for other states and vendors to follow. The USDA Advisory Committee on Beginning Farmers and Ranchers has recommended that FSA undertake a comprehensive review of the borrower training program and take steps to improve it (see Advisory Committee correspondence at the end of the Attachments). An issue for Congress to consider is whether to re-link borrower training to guaranteed ownership loans made to beginning farmers.

- ***Transfer Authority***

Description: Current law provides some general flexibility for FSA to transfer funds between loan authorities and includes a specific authority to transfer unused guaranteed farm operating loan funds on August 1st of each year to the beginning farmer down payment program and on September 1st of each year to regular beginning farmer ownership loans.

***Results in Brief*.** This transfer authority has proven to be very important. Congress regularly appropriates more money to guaranteed farm operating loans than demand would dictate, while direct farm ownership funds are always in short supply. From 1997-2000, 141 down payment loans for over $6 million resulted from August 1st transfers, representing from between 8-34% of the total down payment obligations in those years. In the same years, 760 regular beginning farmer FOs resulted from the September 1st transfers, with over $87 million obligated, representing from between 18-71% of total obligations. In the current fiscal year, the general transfer authority has allowed FSA to transfer guaranteed OL funds to direct FO for an additional $25 million in critically needed loan funds. *Attachment H summarizes the beginning farmer transfer activity over the past four years.*

Issues: Both the general and the specific transfer authorities have been used well to help adjust program dollar availability to demand. They should be continued. At the same time, higher authorization and appropriations funding levels for direct farm ownership loans would also help ease the shortage and reduce the need for transfers.

Recommendations

The Coalition urges the Committee to consider the following revisions and additions to the beginning farmer credit provisions.

1. Targeting of Loan Funds - The beginning farmer targets and reservation periods should be retained from the 1996 farm bill. It may be appropriate to modestly revise the target rate for guaranteed operating loans, but otherwise the numbers and dates should be continued in the current form.

2. Program Funding - As recent year's program levels have hopefully made clear, the farm bill authorization levels for direct operating and especially direct farm ownership loans need to be increased significantly. In the current fiscal year, even with appropriated dollars significantly higher than the authorized level, the direct farm ownership program was out of money by spring and currently has $25 million more available only due to the transfer of unused funds from the guaranteed operating loan program. The transfer authorities should be retained, but direct loan funding levels should be increased directly as well.

3. *Beginning Farmer and Rancher Down Payment Loan Program* - To make the down payment program more flexible and to increase its application in regions of the country where it is currently underutilized, the program should be amended to allow the borrower to choose to put down between 5 and 15% of the purchase price (rather than the existing flat 10%) and for the government loan (30% of purchase price) to be extended for either 10 or 15 years (compared to current single 10 year option). We also recommend a one percent reduction in the interest rate.

At the same time, we recommend the establishment of performance goals for each state with significant direct farm ownership lending history. The performance goals should gradually increase the percentage of total farm ownership loan funds used as down payment loans, at least until the statutory target of approximately 40% is reached. In our view, these performance goals should Include a self-enforcement mechanism so that if the goal is not met, the state loses an equal share of its funding. Those funds would then be transferred to states exceeding their goals. This provision will maximize the number of beginning farmer loans made per dollar appropriated.

4. Inventory Land Sales - The existing beginning farmer preference on inventory land sales is often unactionable. The statutory time lines for inventory land sales should be lengthened so that land is available for sale to beginning farmers for no less than one complete normal land sale season. A directive should also be added to emphasize the importance of maximizing beginning farmer and rancher opportunities by splitting or joining inventory parcels to appropriate sizes. The 18 month lease/purchase option should be retained to guard against funds being unavailable at the time an inventory sale is ready to be made.

5. Borrower Training - The borrower training requirement should be restored to beginning farmer guaranteed borrowers. The law should also be amended to spell out limited circumstances in which waivers are permissible. If it has not already done so by the time the farm bill is written, the Department should be directed to undertake a comprehensive review of the borrower training program with specific emphasis on concerns related to waivers, access, cost, and number of vendors/sites, and to make recommendations for model programs.

6. *Loan Guarantees for Aggie Bond Loans* - FSA provides loan guarantees for private sector loans, but under the current IRS code cannot guarantee federally tax-exempt first time farmer (aggie bond) loans facilitated by state beginning farmer programs. At the same time, farm bill loan targets for guaranteed loans to beginning farmers have not been reached. Reducing the cost of borrowing to beginning farmers is essential if they are to compete for land with established, expanding farms.
In conjunction with a badly needed tax law change to allow guaranteed farm loans to be used with aggie bonds, the farm bill should specifically authorize such a purpose for all guaranteed loans, including the 95% guarantee on beginning farmer down payment loans. Together, these new provisions in the tax bill and the farm bill would expand the pool of participating lenders and reduce interest rates for beginning farmers.

In addition to amending tax law to allow federal guarantees on first-time farmer loans, we also strongly support legislation to exempt aggie bonds from the volume cap on industrial revenue bonds. Some states cannot meet the demand for aggie bonds because they do not have a sufficient overall bond cap to undertake large industrial and multi-family housing bonds and still have room for small, individual beginning farmer bonds (which average just $125,000 per bond). Exempting aggie bonds from the cap and removing the need to compete against large-scale, investor owned bonds would greatly enhance beginning farmer opportunities in states with this problem.

7. Guarantees for Land Contracts - The credit title should be amended to specifically authorize loan guarantees for contract land sales from private land sellers to qualified beginning farmers and ranchers. Provision should be made for a bank or other commercial lending institution to serve as the escrow agent on a fee for service basis. This addition to the credit title would provide a boost for the growing national movement to link retiring farmers with beginning farmers in planned farm transitions.

8. Interest Assisted Guaranteed Loans - As with guaranteed operating loans in general, Interest assisted guaranteed loans have not come close to achieving the beginning farmer target rate of 40%. The bulk of "Interest assist" funds have also been used by just a small handful of states. The interest assist program should be amended to limit the current maximum 4% interest rate break to beginning farmer and SDA loans of up to $100,000, with a 2% break for all loans of any type up to $300,000. This would spur additional beginning farmer lending and focus public program costs on targeted populations.

The program should also be amended to provide flexibility with respect to beginning farmer and rancher and SDA interest assisted loans to allow positive cash flows. Finally, it would be helpful to provide an option for multiyear interest assistance for beginning farmers and ranchers and SDA customers, not to exceed 5 years. This would eliminate extra paperwork and help re-enforce the emphasis on targeted borrowers.

9. Beginning Farmer and Rancher Equity Assistance - Credit programs obviously focus on debt financing. Instead of loans, equity assistance in the form of grants could be an effective strategy for providing beginning farmers with seed money to begin to build equity. Equity assistance might have the added benefit of fostering lower cost approaches to farming, reducing risk, and creating incentives for saving and investment. On a pilot basis, at least, the new farm bill should authorize a program to offer beginning farmers and ranchers equity-enhancing start-up grants in annual payments for five years in amounts not to exceed the total cost to the government of average FSA beginning farmer operating loans for a similar duration. Qualified beginning farmers and ranchers opting to participate in the grant program would have to meet FSA eligibility criteria, submit a suitable farm plan, provide a partial cash match from another source, and be willing to forgo eligibility for FSA operating loans at the same time. The program would be roughly revenue neutral.

10. Value-Added Farm Coops Loans - One final new authority we would propose is the establishment of a direct participation loan program to provide a low interest, limited duration federal loan, in combination with private financing, to assist beginning farmers and ranchers gain a stake in value-added agricultural coops. In addition, we would suggest a set-aside of a portion of interest-assisted guaranteed loans (with re-pooling after 6 months) for beginning farmers and ranchers to use to enter value-added agricultural cooperatives.

Concluding Remarks

Many of the new beginning farmer credit efforts of the past decade have born fruit and have increased new farming opportunities. However, access to credit is only one of many issues facing potential beginning farmers. In some instances, debt financing has in fact been overemphasized. Even when used appropriately, borrowing needs to be in the context of a broader set of services. Among the broader programs that have sprouted up around the country - often generated by non-governmental organizations - are apprenticeship and mentoring programs, land link efforts to match retiring and young farmers, education on new farm transition models, whole farm planning, and a variety of training programs. While beginning farmer training and outreach programs, through cooperative extension and/or non-governmental organizations, exist to a limited degree in 16 states, they are greatly underfunded compared to the need. In our view, these state, local, and regional programs need to be encouraged.

Consistent with the recommendations of the USDA National Commission on Small Farms, we support a farm bill initiative to establish a ***Beginning Farmer/Rancher Development Program*** to support new and established local and regional training and technical assistance initiatives that foster new farming opportunities, including but not limited to mentoring and apprenticeship programs, curricula development, resource and referral services, "land link" assistance, education and outreach on farm exit strategies and innovative farm transfer models, entrepreneurship and business training, financial management, whole farm resource planning, and risk management education.

In recognition of the importance of the beginning farmer issue to the future of American agriculture, the program should receive mandatory funding through the Commodity Credit Corporation, with annual amounts starting at $20 million and increasing to $40 million over 5 years. The program would be administered by CSREES on a competitive basis, with matching requirements, and emphasize collaborative state-based and regional networks that include Extension, community-based, non-governmental organizations, relevant USDA and state agencies, and other appropriate partners. A national administrative council would include representatives from CSREES, NRCS, RBCS, RMA, FSA, the National Farm Transition Network, National Council of State Agricultural Finance Programs, National Association of State Agricultural Loan Programs, and other organizations and coalitions with expertise in operating beginning farmer programs.

In addition to the development program, we would also favor incorporation of beginning farmer concerns in other sections of the farm bill. For instance, we would support provisions in the:

• ***research title*** to promote to research, development, and dissemination of farm transfer, finance, development, management, production, and marketing models and strategies that foster new farming opportunities through emphasis on innovative farm transfer tools, low capital investment approaches, optimal use of skilled labor and management, high value production and marketing methods, and other similar means of getting successful independent family farms started;

• ***risk management title*** to incorporate beginning farmer premium discounts and to include within Risk Management Education a specific focus on beginning farmer risk management strategies, including non-credit financing models, conservation, marketing, and diversification strategies, and community-based re-lending;

• ***conservation title*** to provide authority within conservation incentive programs for up-front, lump sum payments to qualified beginning farmers in return for full term contracts for conservation practice installation and environmentally-sound management and to incorporate within the Farmland Protection Program a preference for state and local programs that integrate concern for future farmers, not just saving farmland and open space; and

• ***rural development title*** to amend rural business and coop development programs to include and give priority to beginning farmer projects and projects that incorporate substantial participation by beginning farmers, and to require value-added agricultural coops receiving federal financial assistance to reserve at least 10% of membership in the coop for qualified beginning farmers and ranchers.

We would strongly encourage the Committee to hold a hearing to focus on the full range of beginning farmer issues and the related structure of agriculture concerns prior to work on the next farm bill. As a majority of land changes hands over the coming decade, it would serve the nation well to give serious attention to the ways in which policy can help or hinder a new generation of family farmers. Thank you for the opportunity to testify, and I would be happy to try to answer any questions.

A

FARM LOAN PROGRAMS
BEGINNING FARMER (BF) LOANS/OBLIGATIONS
FISCAL YEAR 1994 - 2000

	Percentage of Total Loans that were BF Loans				Percentage of Total Obligations that were BF Obligations			
Fiscal Year (FY)	Direct OL	Guaranteed OL	Direct FO	Guaranteed FO	Direct OL	Guaranteed OL	Direct FO	Guaranteed FO
FY - 1994	14	07	58	12	16	06	44	10
FY - 1995	24	12	73	17	26	09	68	14
FY - 1996	22	11	71	16	24	08	67	13
FY - 1997	28	14	89	20	31	12	88	18
FY - 1998	31	17	80	24	35	14	79	21
FY - 1999	31	13	67	19	33	11	66	16
FY - 2000	34	12	62	19	37	09	62	18

B

Non-Downpayment FO Loans to Beginning Farmers to Purchase Real Estate Since 1994

STATE	Total	Regular	Limited Resource	Participation	With State Agency Assistance
ALABAMA	82	72	5	5	0
ALASKA	12	7	5	0	0
ARIZONA	5	5	0	0	0
ARKANSAS	460	354	47	55	4
CALIFORNIA	91	65	25	0	1
COLORADO	135	87	10	36	2
CONNECTICUT	16	16	0	0	0
DELAWARE	14	14	0	0	0
FLORIDA	78	65	10	3	0
GEORGIA	120	111	9	0	0
HAWAII	6	3	3	0	0
IDAHO	73	53	17	2	1
ILLINOIS	336	202	49	69	16
INDIANA	196	105	39	49	3
IOWA	341	160	44	123	14
KANSAS	343	214	93	33	3
KENTUCKY	270	181	77	9	3
LOUISIANA	72	62	10	0	0
MAINE	25	19	6	0	0
MARYLAND	32	30	2	0	0
MASSACHUSETTS	52	27	25	0	0
MICHIGAN	225	147	49	25	4
MINNESOTA	302	130	143	29	0
MISSISSIPPI	38	30	8	0	0
MISSOURI	356	230	70	29	27
MONTANA	203	110	79	14	0
NEBRASKA	422	227	103	86	6
NEVADA	15	9	2	4	0
NEW HAMPSHIRE	10	2	8	0	0
NEW JERSEY	22	16	5	0	1
NEW MEXICO	46	43	2	0	1
NEW YORK	161	100	59	0	2
NORTH CAROLINA	132	116	14	0	2
NORTH DAKOTA	201	113	58	12	18
OHIO	135	86	23	26	0
OKLAHOMA	510	321	115	66	8
OREGON	61	48	7	6	0
PENNSYLVANIA	132	38	92	2	0
PUERTO RICO	130	26	103	0	1
RHODE ISLAND	14	6	6	2	0
SOUTH CAROLINA	38	23	10	4	1
SOUTH DAKOTA	335	217	91	26	1
TENNESSEE	152	110	34	6	2

TEXAS	188	154	32	1	1
UTAH	90	45	15	16	14
VERMONT	44	26	17	0	1
VIRGIN ISLANDS	1	1	0	0	0
VIRGINIA	72	57	14	1	0
WASHINGTON	94	86	4	4	0
WEST VIRGINIA	148	77	71	0	0
WISCONSIN	312	184	78	45	5
WYOMING	32	19	10	3	0
Total	7380	4649	1798	791	142

C

	Guaranteed FO Loans to Beginning Farmers for Purchase of Real Estate (No DPL)					
	No State Assistance					With State Assistance
	Total	FCS	BANKS	OTHER	LOANSIZ	Total
ALABAMA	33	24	9	0	221,437	
ARKANSAS	187	59	128	0	221,415	
CALIFORNIA	28	5	19	4	180,002	
COLORADO	43	6	37	0	165,842	
CONNECTICUT	8	5	3	0	167,156	
DELAWARE	10	3	7	0	224,010	
FLORIDA	38	17	21	0	145,410	
GEORGIA	64	18	41	5	217,019	
IDAHO	7	3	4	0	147,784	
ILLINOIS	64	10	52	2	127,111	1
INDIANA	28	0	28	0	123,897	
IOWA	50	0	50	0	116,907	3
KANSAS	40	5	35	0	87,654	1
KENTUCKY	75	5	70	0	156,515	
LOUISIANA	46	5	41	0	157,891	
MAINE	5	1	4	0	113,200	
MARYLAND	11	11	0	0	134,545	
MASSACHUSETTS	14	8	5	1	163,857	
MICHIGAN	40	23	17	0	144,283	2
MINNESOTA	31	6	24	1	104,056	
MISSISSIPPI	16	2	11	3	174,139	
MISSOURI	87	15	72	0	111,274	12
MONTANA	39	0	37	2	153,764	
NEBRASKA	61	1	60	0	115,082	1
NEVADA	2	2	0	0	193,000	
NEW HAMPSHIRE	1	1	0	0	38,250	
NEW JERSEY	5	4	1	0	156,800	
NEW MEXICO	23	1	22	0	169,920	
NEW YORK	54	20	33	1	135,376	
NORTH CAROLINA	53	18	22	13	171,455	2
NORTH DAKOTA	35	10	24	1	137,798	4
OHIO	20	0	18	2	151,259	
OKLAHOMA	110	11	99	0	121,336	4
OREGON	13	2	11	0	153,815	
PENNSYLVANIA	20	6	14	0	128,504	
PUERTO RICO	9	3	5	1	155,054	
RHODE ISLAND	3	2	1	0	172,333	
SOUTH CAROLINA	8	2	6	0	171,702	
SOUTH DAKOTA	76	3	70	3	92,801	1
TENNESSEE	29	1	28	0	138,033	
TEXAS	52	8	43	1	171,807	
UTAH	4	1	3	0	145,000	
VERMONT	17	3	6	8	130,503	
VIRGINIA	20	11	9	0	181,100	
WASHINGTON	38	3	33	2	186,805	
WEST VIRGINIA	39	9	30	0	86,461	
WISCONSIN	88	7	80	1	141,799	3
WYOMING	7	0	7	0	201,029	
TOTAL	1,751	360	1,341	51	151,353	

D

Downpayment Loans Since 1994

State	Total	Source	of Other	Financing
		Guarantee FO	***State Agency***	***Other***
ALABAMA	17	12	1	4
ALASKA	0	0	0	0
ARIZONA	0	0	0	0
ARKANSAS	30	24	0	6
CALIFORNIA	23	20	0	3
COLORADO	29	11	5	13
CONNECTICUT	3	3	0	0
DELAWARE	0	0	0	0
FLORIDA	6	6	0	0
GEORGIA	5	4	0	1
HAWAII	0	0	0	0
IDAHO	25	12	1	12
ILLINOIS	315	92	68	155
INDIANA	40	21	0	18
IOWA	251	34	80	135
KANSAS	270	104	14	152
KENTUCKY	8	4	1	3
LOUISIANA	1	0	0	1
MAINE	4	0	0	4
MARYLAND	3	1	0	2
MASSACHUSETTS	0	0	0	0
MICHIGAN	75	54	1	20
MINNESOTA	78	39	6	33
MISSISSIPPI	0	0	0	0
MISSOURI	200	97	31	72
MONTANA	40	25	2	13
NEBRASKA	222	87	25	110
NEVADA	0	0	0	0
NEW HAMPSHIRE	0	0	0	0
NEW JERSEY	2	2	0	0
NEW MEXICO	5	2	0	3
NEW YORK	32	18	1	13
NORTH CAROLINA	2	2	0	0
NORTH DAKOTA	68	12	39	17
OHIO	45	27	0	18
OKLAHOMA	97	49	8	40
OREGON	10	2	0	8
PENNSYLVANIA	8	2	0	6
PUERTO RICO	2	0	1	1
RHODE ISLAND	0	0	0	0
SOUTH CAROLINA	2	0	0	2

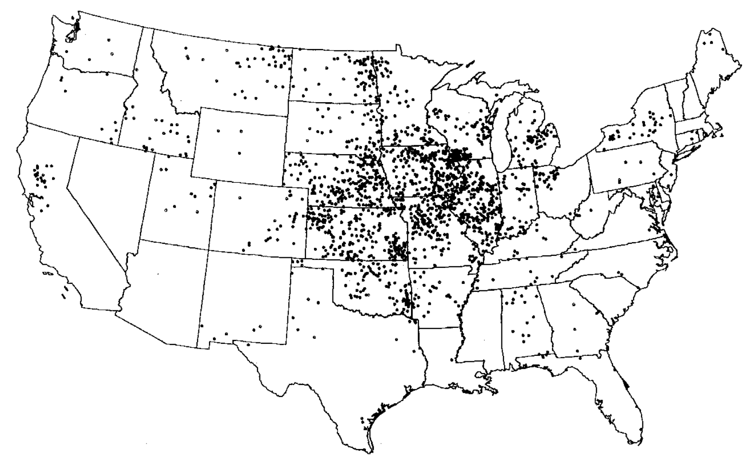
SOUTH DAKOTA	66	28	3	35
TENNESSEE	16	9	0	7
TEXAS	18	6	1	11
UTAH	13	1	2	10
VERMONT	0	0	0	0
VIRGIN ISLANDS	0	0	0	0
VIRGINIA	3	2	0	1
WASHINGTON	5	2	0	3
WEST VIRGINIA	5	2	0	3
WISCONSIN	120	53	4	63
WYOMING	3	1	0	2
	2167	870	294	1000

€

	Guaranteed FO Loans Made With Downpayment Loans				
	Total	FCS	Banks	Other	Loan Size
ALABAMA	12	11	1	0	72,892
ARKANSAS	23	7	16	0	93,114
CALIFORNIA	18	12	6	0	95,679
COLORADO	11	7	4	0	81,959
CONNECTICUT	3	3	0	0	95,325
FLORIDA	6	1	5	0	44,950
GEORGIA	4	1	3	0	76,920
IDAHO	12	3	9	0	96,182
ILLINOIS	81	41	38	2	79,674
INDIANA	20	0	20	0	71,628
IOWA	31	2	29	0	42,845
KANSAS	91	32	59	0	50,569
KENTUCKY	3	2	1	0	85,767
MARYLAND	1	0	0	1	71,500
MICHIGAN	51	35	16	0	74,987
MINNESOTA	39	14	24	1	65,169
MISSOURI	89	35	54	0	52,689
MONTANA	25	0	25	0	66,677
NEBRASKA	85	1	83	1	82,234
NEW JERSEY	2	0	2	0	69,000
NEW MEXICO	2	0	2	0	120,000
NEW YORK	17	3	14	0	48,887
NORTH CAROLINA	2	0	0	2	118,500
NORTH DAKOTA	12	10	1	1	70,101
OHIO	17	5	12	0	69,615
OKLAHOMA	47	14	33	0	47,723
OREGON	2	1	1	0	120,350
PENNSYLVANIA	2	0	2	0	40,500
SOUTH DAKOTA	26	0	26	0	57,559
TENNESSEE	8	0	8	0	58,313
TEXAS	6	0	6	0	64,643
UTAH	1	0	1	0	77,000
VIRGINIA	2	2	0	0	47,250
WASHINGTON	2	0	2	0	156,150
WEST VIRGINIA	1	1	0	0	36,000
WISCONSIN	50	17	33	0	79,082
WYOMING	1	0	1	0	132,000
TOTAL	805	260	537	8	67,710

Downpayment Loan Activity Has Been Centered in Heartland

Downpayment Loans Originated Since FY 1994

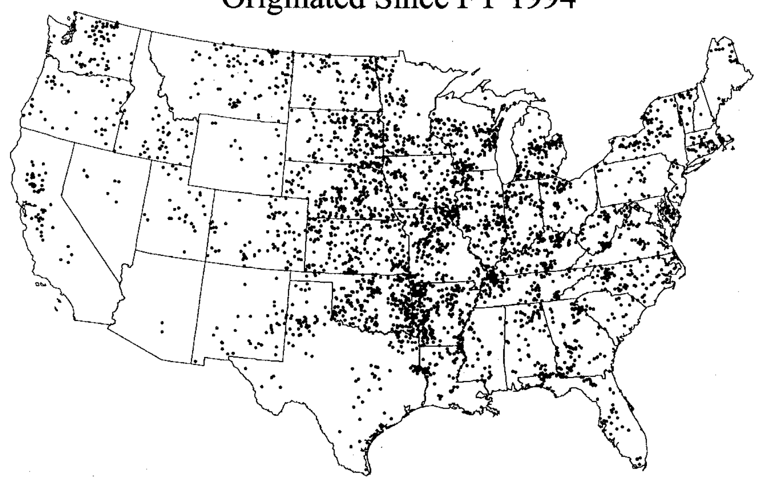


Downpayment loans
1 Dot = 1 loan

Source : Kansas City OBFN Database,
March 10, 2000

Non-Downpayment FO Loans to Beginning Farmers

Originated Since FY 1994



Regular FO Loans to Beginning Farmers to Purchase Real Estate

. **1 Dot = 1** loan

Source : Kansas City OBFN Database, March 10, 2000

F.

FEDERAL/STATE BEGINNING FARMER PARTNERSHIPS

USDA has entered into Memorandums of Understanding with State Beginning Farmer Programs in the following States:

STATES	DATES
Missouri	February 5, 1993
Iowa	August 13, 1993
Nebraska	September 30, 1993
North Dakota	November 19, 1993
Colorado	November 23, 1993
Arkansas	January 18, 1994
North Carolina	February 9, 1994
Illinois	March 8, 1994
Minnesota	March 10, 1994
Oklahoma	August 18, 1994
Wisconsin	September 12, 1994
Alabama	November 2, 1994
Hawaii	March 6, 1995
South Dakota	March 13, 1996
Kansas	January 6, 1997
Pennsylvania	June 4, 1998
Idaho	expected soon
Indiana	expected soon

G

FILE: FLPLS(ACQBFACB)
DATE: 03/08/00

(1 OF 3)

FSA - FARM LOAN PRGMS - NATIONAL SUMMARY
CONACT PROPERTIES *SOLD* TO BEGINNING FARMERS AFTER APRIL 1, 1996
REQUESTED FOR THE BEGINNING FARMER ADVISORY COMMITTEE
AS OF 03/07/00

STATE	SLD CNT FY90	SLD CNT FY91	SLD CNT FY92	SLD CNT FY93	SLD CNT FY94	SLD CNT FY95	SLD CNT FY96	SLD CNT FY97	SLD CNT FY98	SLD CNT FY99	SLD CNT FY00	TOTAL SOLD CNT
-----	----	----	----	----	----	----	----	----	----	----	----	-----
ALABAMA	0	0	0	1	0	0	0	0	0	0	0	1
ARKANSAS	2	0	1	4	1	0	1	3	0	0	0	12
CALIFORNIA	0	0	0	1	1	1	0	2	1	0	0	6
COLORADO	3	3	1	12	4	2	2	0	4	0	0	31
FLORIDA	1	1	0	0	0	0	0	0	0	1	0	3
GEORGIA	3	0	1	4	3	0	0	0	0	0	0	11
HAWAII	0	0	0	1	0	0	0	0	0	0	0	1
IDAHO	2	3	0	3	5	3	1	1	0	0	1	19
ILLINOIS	1	0	1	3	1	0	0	1	0	1	0	8
INDIANA	1	0	0	0	1	0	0	1	0	0	0	3
IOWA	2	0	0	9	7	1	12	4	1	0	0	36
KANSAS	8	1	2	8	1	4	0	2	0	0	0	26
KENTUCKY	1	0	3	0	0	0	0	0	0	0	0	4
LOUISIANA	7	0	1	1	0	0	0	1	0	0	0	10
MAINE	0	0	0	0	0	1	0	0	0	0	0	1
MARYLAND	0	1	0	0	0	0	0	0	0	0	0	1
MASSACHUSETTS	0	0	0	1	0	0	0	0	0	0	0	1
MICHIGAN	1	0	1	0	0	0	0	1	1	0	0	4
MINNESOTA	0	0	0	11	5	2	0	3	5	2	0	28
MISSISSIPPI	5	0	0	3	1	1	0	1	1	0	0	12
MISSOURI	5	1	0	5	11	3	1	1	1	1	0	29
MONTANA	1	0	0	4	4	0	0	1	2	1	0	13
NEBRASKA	1	0	1	6	12	3	0	2	2	1	1	29
NEW MEXICO	0	0	0	3	1	0	0	0	3	0	0	7
NEW YORK	3	4	2	0	2	1	1	1	0	0	0	14
NORTH CAROLINA	3	0	0	8	4	1	1	0	1	0	0	18
NORTH DAKOTA	4	1	1	5	7	2	2	4	5	0	1	32
OHIO	0	0	0	0	0	1	0	0	0	0	0	1
OKLAHOMA	2	0	2	4	2	1	0	5	3	0	2	21
OREGON	2	0	0	1	1	0	1	1	0	0	0	6
PENNSYLVANIA	1	0	0	2	0	0	0	2	0	0	0	5
PUERTO RICO	2	0	1	2	1	0	0	0	0	0	0	6
SOUTH CAROLINA	0	0	0	0	0	0	0	6	3	3	0	12
SOUTH DAKOTA	1	2	1	12	15	5	2	4	6	0	0	48
TENNESSEE	1	2	1	0	0	0	0	0	0	0	0	4
TEXAS	1	1	0	2	3	1	0	1	1	1	0	11
UTAH	0	1	0	0	0	0	0	0	0	0	0	1
WASHINGTON	0	1	3	7	3	1	0	1	0	0	0	16
WEST VIRGINIA	0	0	0	3	0	0	0	0	0	0	0	3
WISCONSIN	9	2	0	1	6	0	0	0	0	0	0	18
WYOMING	0	0	1	7	0	0	0	0	3	0	0	11
TOTAL	73	24	24	134	102	34	24	49	43	11	5	523

SOURCE: FSA - KCMO FOCUS *ACQD* DATA BASE.

[FY00 Final = 15] [Total 90-00 = 533]

H

FARM SERVICE AGENCY
FARM LOANS

Funds Transferred from the Guaranteed Operating - unsubsidized loan program to the Direct Farm Ownership beginning farmer program

FY 1997

As a result of the transfer of funds on August 1, 1997, to the down payment program, and the transfer of funds on September 1, 1997, for beginning farmer loans, the following loans were made:

	# Loans	% of FY Total	$ Obligated	% of FY Total
down payment loans	98	28%	4,319,000	34%
beginning farmers	386	69%	42,642,000	71%

FY 1998

As a result of the transfer of funds on August 1, 1998, to the down payment program, and the transfer of funds on September 1, 1998, for beginning farmer loans, the following loans were made:

	# Loans	% of FY Total	$ Obligated	% of FY Total
down payment loans	22	8%	954,000	8%
beginning farmers	172	34%	19,641,000	36%

FY 1999

Due to the shortfall of funds in the guaranteed operating - unsubsidized loan program in FY 1999, a transfer was not consummated.

FY 2000

As a result of the transfer of funds on August 1, 2000, to the down payment program, and the transfer of funds on September 1, 2000, for beginning farmer loans, the following loans were made:

	# Loans	% of FY Total	$ Obligated	% of FY Total
down payment loans	21	15%	878,000	14%
beginning farmers	202	18%	25,227,000	18%

DOCUMENTS SUBMITTED FOR THE RECORD

May 16, 2001

Max Baucus

Statement of Senator Max Baucus
Committee on Agriculture, Nutrition, and Forestry
Hearing to Review the Credit Title of the Farm Bill
May 16, 2001

Mr. Chairman, thank you for holding today's hearing to consider the nominations of Mr. Bost for Under Secretary of Food, Nutrition, and Consumer Services and Mr. Hawks for Under Secretary of Marketing and Regulatory Programs. I welcome both of you and look forward to hearing from you.

The impact of the services provided by USDA through the Food, Nutrition, and Consumer Services are crucial to improving the nutritional levels of Americans by providing children and needy families better access to a healthful diet. The Marketing and Regulatory Programs are essential in protecting against plant and animal diseases as well as ensuring fair and functioning markets.

I am pleased that Chairman Lugar is holding a hearing to review the Credit Title of the Farm Bill. Access to and availability of credit is critical to farmers and ranchers, in particular beginning farmers and ranchers. Credit provides funding for land and equipment purchases as well as everyday operations. Credit also acts as a contingency fund in difficult times.

Access and availability to credit has stabilized our rural communities by providing not only the necessary capital for agriculture but also small businesses which create jobs for the local economy. Rural communities rely heavily upon sufficient sources of credit in order to survive.

As we look towards revising the Farm Bill, we must ensure that our farmers and ranchers have access to stable and dependable credit. I look forward to the testimony of our distinguished guests and I welcome them here today. I am also eager to work with my colleagues on these issues as they are of great importance to the state of Montana.

NEWS FROM

ICBA
INDEPENDENT COMMUNITY
BANKERS *of* AMERICA

For further information contact:
Mark Scanlan, ICBA director of agricultural finance, at (202) 659-8111.

For Immediate Release #01-30

ICBA Proposes Farm and Rural Policy Agenda

Washington, D.C. (May 16, 2001)—The Independent Community Bankers of America today, in testimony before the Senate Agriculture Committee, urged Congress to adopt a broad set of policies to rejuvenate the farm economy and rural America. "Unfortunately, farmers today face the triple whammy of despairingly low prices, sharply rising energy and input costs and an unlevel playing field in the international trade arena," stated John Evans Jr., CEO of D.L. Evans Bank in Burley, Idaho, and vice chairman of ICBA's Agriculture-Rural America Committee.

Evans urged action on four policy fronts: 1) Pass a fourth consecutive farm-aid package; 2) Pass a new farm bill that includes flexible budgeting, counter-cyclical income mechanisms and 'Farmer 401(k)' individual savings plans; 3) Provide full funding for USDA-guaranteed loan programs; and 4) Adopt new policies to attract capital and business opportunities to rural America.

Evans asked for ample funding flexibility for farm-aid packages to cover the next two years, saying "funds may need to be front loaded to address immediate needs before a new farm bill is passed." He also suggested a new farm bill needs a counter-cyclical payment program. He stated farm payments should work together with new 'Farmer 401(k)' plans or similar savings accounts so producers can build long-term assets and transition from reliance on government payments. Moreover, Evans suggested that "maximizing farmer participation was essential" for any new savings account options and could be accomplished by "allowing a portion of new government payments to be funneled into the accounts which producers could partially match from other income".

Evans said 90 percent of farmers' total household income was from off-farm sources and communities relying largely on agriculture were losing population. He said solutions were to increase federal deposit insurance and index it to inflation to allow more local funds to recycle in rural communities and provide new investment opportunities; to significantly increase funding and options for USDA guaranteed loan programs; to establish a private-sector rural equity fund to help local lenders fund business start-ups and expansions; and to adopt policies to attract broadband and telecommunications technologies into rural America.

ICBA is the primary voice for the nation's community banks, representing 5,000 institutions at nearly 17,000 locations nationwide. Community banks are independently owned and operated and are characterized by attention to customer service, lower fees and small business, agricultural and consumer lending. ICBA's members hold more than $486 billion in insured deposits, $592 billion in assets and more than $355 billion in loans for consumers, small businesses and farms. They employ nearly 239,000 citizens in the communities they serve. For more information, visit www.icba.org.

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DELAWARE STATE UNIVERSITY

OFFICE OF THE DEAN
SCHOOL OF GRADUATE STUDIES, RESEARCH AND CONTINUING EDUCATION

May 31, 2000

The Honorable Dan Glickman
Secretary of Agriculture
Washington, D.C. 20250

Dear Secretary Glickman:

The Department of Agriculture's (USDA) Advisory Committee on Beginning Farmers and Ranchers (Committee) held its second meeting in Kansas City, Missouri, April 11-12, 2000. As always, we enjoy working with you to enhance and improve the environment for beginning farmers and ranchers. We continue to look forward to working with you and other USDA officials.

Following is a list of items and recommendations, with a brief discussion of their importance to beginning farmers and ranchers:

(1) Adequate funding provided for FSA loans. The Committee recommends to the Secretary that funding for all FSA loan programs be increased in the FY 2001 budget, based on FY 2000 funding and expected loan demand. It is imperative that Congress take action to cover the needs of farmers and ranchers in FY 2001.

(2) USDA should champion changes in the law concerning State "Aggie Bond" programs in the pending tax legislation. The Committee thanks the Secretary for stating his agreement that Aggie Bonds should be placed on equal footing with other federal programs that are exempt from the tax law prohibiting guarantees. The Committee also requests the Secretary's support of H.R. 1810 and S. 1038 which would exempt Aggie Bonds from state volume caps on Industrial Revenue Bonds.

(3) USDA should conduct a comprehensive assessment of Farm Service Agency (FSA) beginning farmer and rancher programs. The Committee urges the Secretary to initiate a meeting between the National Agricultural Statistics Service (NASS) and the Beginning Farmers and Ranchers Assessment Sub-committee together with appropriate delegates from the USDA Advisory Committee on Small Farms, the Economic Research Service, and the FSA Economic and Policy division, to discuss priority questions that might be added to the annual NASS survey in order to improve the knowledge base on beginning farmers, farm entry, small farms and

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related structure of agricultural issues. This discussion should include, but not limited to, the possibility of questions related to the number of years of experience of the operator(s), the presence and status of junior operators on the farm, the methods of farm acquisition, and the nature of farm transfer or succession plans.

The Committee recommends that the Secretary include beginning farmer and rancher issues in future research and extension competitive grant program requests for proposals using as appropriate some of the questions raised in the NASS survey.

The Committee, also, recommends that the Secretary allocate discretionary funds to a university, a firm, or non-Government organization, which would be used to conduct research on FSA loan programs to beginning farmers and ranchers.

(4) USDA should become more involved in promoting Federal/State beginning farmer and rancher partnerships. The Committee wishes to commend the Secretary for sending a letter to 34 Governors whose states do not currently have an MOU with USDA. However, the Committee recommends that the Secretary encourage USDA to provide technical assistance to states without beginning farmer and rancher programs, and work with the Committee to develop future legislative proposals to make the federal/state partnership more attractive to states.

(5) USDA should assure that adequate, trained staff is available in FY 2000 in FSA offices where heavy demand for loans is expected. The Committee recommends that the Secretary encourage cross-training of FSA employees at the county level, hire additional qualified loan officers, and be prepared to replace personnel in the future, as almost 30% of farm loan employees nationwide are eligible for retirement in the next 2 years.

(6) USDA should continue to support full funding ($10 million) of the Small Farmer Outreach, Training and Technical Assistance (Section 2501) Program. The Committee commends the Secretary for his efforts and support of the 2501 Program, and solicits his support for full funding by endorsing recommendation number 7.3 of the National Commission on Small Farms report requesting $20 million for the 2501 Program in FY 2002. This is extremely important in order to maintain small farm operations nationwide.

The Committee also recommends that the Secretary encourage USDA to provide the necessary support, technical assistance, guidance, etc., to create sources for alternative financing where credit needs exist and to remove impediments in the Farm Credit Administration (FCA) which prevent financing for under-served groups.

(7) Term Limits. The Committee recommends the Secretary develop a legislative proposal to increase the term limits for direct operating loans from 7 to 10 years and to eliminate disaster years from the calculation of the 10-year and 15-year limits for direct and guaranteed loans, respectively. This is important in order to encourage young people to become involved in farming and ranching.

(8) Interest Assistance (IA). The Committee urges the Secretary to take the appropriate steps to: utilize IA in states where it is not currently being used; make beginning farmers a higher priority with regard to IA; and establish IA for 5 years to beginning farmers without requiring an annual review.

(9) Borrow Training. The Committee recommends that FSA undertake a comprehensive review of the borrower training programs with specific emphasis on concerns in the area of waivers, cost, and number of vendors available, while using the most successful programs as models for national programs guidance, and also looking at ways to partner with RMA's risk management education program and other agencies to devise innovative improvements to the program.

(10) Down-Payment Program. The Committee recommends that the Secretary consider a legislative proposal to lengthen the repayment period for the FSA finance portion of loans made under the Down-Payment Program.

(11) Crop Insurance. The Committee recommends that the Secretary support legislation to provide higher subsidy rates on crop insurance coverage to beginning farmers and ranchers, and to increase their actual production history to 110% of the county average so that they can obtain operating loans.

(12) Training for Young Beginning Farmers and Ranchers. The Committee recommends that USDA design and encourage model programs to train high school students in farm operation and management in cooperation with Future Farmers of America (FFA), 4-H, Risk Management Education, and other programs.

I would be pleased to answer any questions you may have or to meet with you to discuss these recommendations in further detail. The Committee also made considerable progress on a wide variety of additional recommendations which we hope to forward to you sometime in the future. It is the Committee's desire to be able to meet again in October 2000. On behalf of the Committee, thank you for your consideration of our recommendations and your support of our efforts to assist beginning farmers and ranchers. Attached is a list of names of the USDA National Advisory Committee.

If I can provide you with additional information, please feel free to contact me at the following numbers: (302) 857-6800 or (302) 857-6801 (work) (302) 857-6804 (fax).

Sincerely,

Hazell Reed, Ph.D.
Chair, USDA Advisory Committee on
Beginning Farmers and Ranchers

HR/

cc: Members, National Advisory Committee
on Beginning Farmers and Ranchers

Attachment:

USDA

United States Department of Agriculture

Office of the Secretary
Washington, D.C. 20250

FEB - 1 2000

Dr. Hazell Reed, Chair
USDA Advisory Committee on
Beginning Farmers and Ranchers
Delaware State University
1200 North Dupont Highway
Dover, Delaware 19901-2277

Dear Dr. Reed:

Thank you for your letter of September 9, 1999, in which you submitted recommendations on behalf of the Advisory Committee on Beginning Farmers and Ranchers (Committee). I am sincerely grateful for the work of the Committee and congratulate you for being elected Chair. I apologize for the delay in responding to your letter.

I was eager to review your recommendations and am glad to have the opportunity to share my thoughts with you. I will address each of your recommendations in turn.

(1) Adequate funding must be provided for Farm Service Agency (FSA) loans.

Under the Agriculture, Rural Development, Food and Drug Administration, and Related Agencies Appropriations Act, 2000, FSA has the authority to provide a total of $3 billion in loans to family-size farmers. Congress also recently approved an additional $2.6 billion in supplemental funding for FSA loan programs. Our projections indicate that funding for both the direct and guaranteed loan programs should be sufficient to meet the demand for credit in fiscal year (FY) 2000.

(2) USDA should champion changes in the law concerning State "Aggie Bonds" programs in the pending tax legislation.

I commend you in your effort to create additional opportunities for young family farmers and ranchers by increasing the availability of reduced interest rate financing. As you note, proposed changes in the Federal tax law could expand the availability of affordable financing. Unfortunately, the use of loan guarantees in conjunction with Federally tax-exempt securities amounts to a double subsidy, which is contrary to Federal credit policy. I am aware that other Federal agencies offer programs that are exempt from this policy, and I agree that consideration should be given to placing Aggie Bonds on an equal footing. The Department of Agriculture (USDA) will discuss the issue with the Office of Management and Budget in the coming months, and I will keep you apprised of any developments.

(3) USDA should conduct a comprehensive assessment of FSA's beginning farmer and rancher programs.

I appreciate your interest in evaluating the beginning farmer programs. I want to work with the Committee to determine if these programs are effectively achieving their mission, and USDA will provide staff resources, when possible, from various USDA agencies to assist in this effort.

(4) USDA should become more involved in promoting Federal/State beginning farmer and rancher partnerships.

I agree that USDA needs to do more to encourage State participation in our program of coordinated financial assistance for beginning farmers and ranchers. The farming opportunities already created by the 16 Federal/State partnerships are a good start, but USDA can do more. I will send a letter to Governors of the remaining 34 States informing them of the availability of partnerships and encouraging them to sign memorandums of understanding with FSA (if the States have beginning farmer programs) to create more opportunities for beginning operators.

(5) USDA should assure that adequate trained staff is available in FY 2000 in FSA offices where heavy demand for loans is expected.

In FY 2000, FSA will hire approximately 100 additional employees to help process and service direct and guaranteed loan applications, with plans to hire additional employees in future years. Before obtaining their loan approval authority, new FSA loan officers are required to complete an extensive training program involving courses in credit and financial analysis and general program operations. Employees must also complete a series of docket reviews, tests, and other evaluations before they are allowed to approve loans. I believe this training program enables us to offer our farm loan customers an experienced team of loan officers capable of making informed credit decisions as well as providing sound advice and guidance to borrowers.

(6) USDA should continue to support full funding ($10 million) of the Small Farmer Outreach, Training and Technical Assistance (section 2501) program.

The President's budget for FY 2000 included $10 million in funding of the section 2501 program. Unfortunately, Congress appropriated only $3 million for the program in FY 2000. On January 7, 2000, I did, however, transfer $5.2 million from the Fund for Rural America to the section 2501 program for FY 2000. You may rest assured that I will continue to support full funding of the section 2501 program in the future.

Again, thank you for the hard work and careful thought you and the other Committee members put into formulating these recommendations. Although a number of challenges lie ahead, I am confident that with the Committee's help USDA can make significant progress in improving our programs for new farm operators, as well as encouraging more people to enter the industry. I look forward to working with the Committee to this end.

Sincerely,

Dan Glickman

DAN GLICKMAN
Secretary