# REVIEW THE AVAILABILITY OF CREDIT IN RURAL AMERICA

## HEARING

BEFORE THE

SUBCOMMITTEE ON CONSERVATION, CREDIT, ENERGY, AND RESEARCH

OF THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

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# CONTENTS



## WITNESSES



## SUBMITTED MATERIAL

# HEARING TO REVIEW THE AVAILABILITY OF CREDIT IN RURAL AMERICA

**TUESDAY, MARCH 27, 2007**

HOUSE OF REPRESENTATIVES,
COMMITTEE ON AGRICULTURE,
SUBCOMMITTEE ON CONSERVATION, CREDIT,
ENERGY, AND RESEARCH,
*Washington, DC.*

The Subcommittee met, pursuant to call, at 10 a.m., in room 1302 of the Longworth House Office Building, Hon. Tim Holden (Chairman of the Subcommittee) presiding.

Members present: Representatives Holden, Herseth, Costa, Ellsworth, Space, Walz, Salazar, Boyda, Gillibrand, Peterson (ex officio), Lucas, Rogers, Fortenberry, Schmidt, Moran, Graves, Bonner, Musgrave, and Goodlatte (ex officio).

Staff present: Nona Darrell, Scott Kuschmider, Rob Larew, John Riley, Sharon Rusnak, Anne Simmons, Debbie Smith, Kristin Sosanie, Kevin Kramp, Josh Maxwell, and Jamie Weyer.

## STATEMENT OF HON. TIM HOLDEN, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF PENNSYLVANIA

Mr. HOLDEN. This hearing on the Subcommittee on Conservation, Credit, Energy and Research to review the availability of credit in rural America will come to order. I would like to welcome our witnesses and guests to today's hearing. I hope this hearing will provide a good perspective on how we can best help our agriculture producers and rural residents obtain credit and create opportunity for development. Farmers have opportunity for credit from several sectors. The Department of Agriculture's Farm Service Agency issues direct loans and offers guarantees on loans made by commercial lenders.

But FSA is only a lender of the last resort for those who cannot obtain credit from the traditional market. The Farm Credit System like commercial banks make loans to credit worthy farmers and it is not a lender of last resort. The Farm Credit System was created to provide a permanent, reliable source of credit to U.S. agriculture. Back in the early part of the last century credit was often unavailable or unaffordable in rural areas. Many lenders avoid such loans because agriculture was such a high risk.

So Congress created the Farm Credit System which is authorized by statute to lend to farmers, ranchers, and harvesters of aquatic products. Loans may be also made to finance the processing and marketing activities of these borrowers for home ownership in rural areas, certain farm or ranch-related businesses, and agricultural aquatic and public utility cooperatives. Commercial banks also lend to agricultural producers and businesses, as well as rural homeowners. Other sources of credit for agriculture include life insurance companies, individuals, merchants, and dealers.

Together, commercial banks, life insurance companies, and individuals and others provide 63 percent of the total farm debt without federal support or federal mandate. Both the Farm Credit System and commercial banks also work collaboratively with each other and with farm and commodity groups, agri businesses, rural businesses, and civic leaders in search of financial solutions to a wide range of service and product needs.

This hearing today will review the availability of credit in rural America. I hope we can answer the questions. Are we doing enough to assist beginning and young farmers and ranchers who obtain credit, and are our agricultural needs being met across America. I will ask members to submit opening comments with three exceptions, and only one of them is here right now, so I would ask the ranking member, Mr. Lucas from Oklahoma, for his opening statement.

[The information appears at the conclusion of the hearing.]

## STATEMENT OF HON. FRANK D. LUCAS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF OKLAHOMA

Mr. LUCAS. Thank you, Mr. Chairman. For once in my life, I am proud to be an exception under that scenario, and thank you for having this hearing today which gives the members of this subcommittee an opportunity to learn more about the availability of credit to producers. Providing credit to American's farmers and ranchers is a necessary and serious undertaking for many lenders in the United States. Today's hearing is going to provide a venue where we can discuss the various sources of credit available to producers through the Farm Service Agency, Farm Credit System and commercial banks.

Both the Farm Credit System and commercial banks have done an outstanding job of servicing their community's credit needs. It is Congress' job to insure that credit needs are met in a manner that provides fair and equitable competition. Congress has spent a great deal of time the last few years modernizing America's finance laws. We just enable rural America to keep pace with the rest of the world. According to the Congressional Research Service, commercial banks lend the largest portion of the farm sector's total debt at 37 percent. The Farm Credit System currently holds 30 percent of the farm sector's total debt while the Farm Service Agency provides three percent of the debt through direct loans and guarantees and another four percent of the market. These numbers reflect a healthy balance among our lending institutions.

There are several policy issues for us to consider as we discuss the next farm bill. Should we increase the $200,000 limit per farmer on FSA direct farm ownership and operating loans? What should the term limits be for producers to receive FSA direct and guaranteed operating loans? And should the Farm Credit Act of 1971 be updated? There are many questions that will be asked today but none more important than discussing if producers have access to the credit they need. Access to credit is critical to all businesses and agriculture is no different.

Today's witnesses will provide us with insight as to the current status and the availability of credit to producers, and we must determine if any changes are needed regarding the current law. I look forward to today's hearing and its testimony. And I thank you, Mr. Chairman, for his hearing opportunity.

[The information appears at the conclusion of the hearing.]

Mr. HOLDEN. I thank the ranking member. And we would like to welcome our first panel to the table, Associate Administrator Glen L. Keppy from the Farm Service Agency, accompanied by Deputy Administrator Carolyn Cooksie; Administrator Nancy Pellett, Chairman of the Board and CEO of the Farm Credit Administration, and she is accompanied by Mr. Charlie Rawls, General Counsel for Farm Credit. Administrator Keppy, we will begin with you, please.

**STATEMENT OF GLEN L. KEPPY, ASSOCIATE ADMINSTRATOR, FARM SERVICE AGENCY, USDA, ACCOMPANIED BY CAROLYN COOKSIE, DEPUTY ADMINISTRATOR, FARM SERVICE AGENCY, USDA**

Mr. KEPPY. Mr. Chairman, members of the committee, thank you for the opportunity to review the current status of the Farm Loan Program or better known as FLP at the Department of Agriculture. It is an honor for me to be here today with my good friend, Nancy Pellett, and later on Carolyn Cooksie and I will be happy to answer questions. Before I accepted this position a little less than a year ago, today I was getting ready to plant corn and was taking care of my livestock back in Iowa.

FLP is a success story. We make direct and guaranteed farm ownership and operating loans to family-size farmers and ranchers who cannot otherwise obtain commercial credit from a bank, Farm Credit System, or other lenders. Our current portfolio includes $6.2 billion in direct loans and $9.2 billion in guaranteed loans. The quality of our portfolio has improved significantly. Here are just a few of the highlights. Losses, our direct loan program have dropped 2.9 percent. That is the lowest level since 1986. Losses in our guaranteed loan program are less than ½ of one percent, and that is the lowest since 1985.

Delinquency rate for direct loans are 8.1 percent and 1.4 percent for guaranteed loans, again the lowest in more than 10 years. Last year we graduated 2,824 borrowers out of FSA and into commercial credit. The direct loan case load to beginning and SDA farmers has more than quadrupled from 1995 to 2006. The guaranteed loan case load has more than doubled from 1997 to 2006. FSA continues to help minority farmers in proportion greater than the demographic percentage of the total farming population, and we remain committed to small farms in America.

Research at the University of Arkansas studied FSA direct loan originations during fiscal year 2000 through 2003 found that 92 percent of direct loans originated went to small farmers with less than 250,000 in gross sales. They also determined that 78 percent of FSA direct loans originating between 1994 and 1996 have already been paid off. Our rear view mirror is filled with success stories, but our attention is clearly focused on some of the challenging curves up ahead. Term limits in the present statute place quality restrictions for direct operating loan borrowers. That means that 7,000 borrowers have one year left of eligibility and 11,000 borrowers have two years left.

The Federal work force is getting older. As many as 26 percent of our current FSA loan officers will be eligible to retire within the next three years. The 2007 Farm Bill proposals relate to credit seeking to help beginning and socially disadvantaged farmers overcome some of the increased financial hurdles that they face in becoming established operators. We propose to increase direct loan funding targets to better focus direct funding and its special features on beginning and SDA farmers, modify the existing down payment loan program to better fit the current needs of beginning and SDA farmers, and increase the direct loan limits that have been unchanged for over 20 years to improve our ability to meet the increased capital requirements beginning and SDA farmers face in today's agriculture.

Through modernization, a steadfast focus on farmers, and meeting farm loan program objectives, each enhanced by the hard work and dedication of FSA employees, we have made great strides in performance improvements. Using our farm business plan FSA borrowers are now processed through a real time, web-based system. Our commitment to FLP streamlining has reduced direct and guaranteed loan application processing time by almost 30 percent, and we have developed the Farm Loan Risk Assessment Program, which provides risk base oversight that areas of potential concern within our portfolio can easily be identified.

Thanks to having a rural delivery system coupled with the dedication and hard work of our existing team of experienced loan officers, FSA is well positioned to continue high quality delivery of existing programs and new initiatives to American farmers. We look forward to working with this committee so that together we might strengthen the livelihoods of farm families while ever improving the viability of rural America. As I said, Carolyn and I will be happy to answer questions at the end of the panel.

[The prepared statement of Mr. Keppy appears at the conclusion of the hearing.]

Mr. HOLDEN. Thank you, Mr. Keppy. Administrator Pellett.

**STATEMENT OF NANCY C. PELLETT, CHAIRMAN OF THE BOARD AND CEO, FARM CREDIT ADMINISTRATION, ACCOMPANIED BY CHARLIE RAWLS, GENERAL COUNSEL, FARM CREDIT ADMINISTRATION**

Ms. PELLETT. Chairman Holden, Ranking Member Lucas, and members of the subcommittee, I am Nancy Pellett, Chairman and CEO of the Farm Credit Administration. I would ask that the committee include my full written statement for the record. And I too am pleased to be on this panel this morning with my good friend, Glen Keppy. Also joining me today is my fellow board member, Lee Strom from Illinois. Dallas Tonsager from South Dakota is ill this morning and could not be here. But I must tell you that I am very fortunate to have the opportunity to work with these two very thoughtful, dedicated individuals who love agriculture and rural

America. Also, at the table with me this morning is Charles Rawls, our General Counsel.

The FCA is an independent arm's length safety and soundness regulator established by Congress to oversee the Farm Credit System. Specifically, we are responsible for approving regulations and examining the institutions of the Farm Credit System. The system is a cooperative structured government-sponsored enterprise that Congress established to improve the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit, and closely related services to them, their cooperatives and to selected farm businesses.

We also regulate and examine Farmer Mac, who provides a secondary market operation for agriculture mortgage loans. Mr. Chairman, as you well know, the health of rural America is so crucial to the future of agriculture and our country. If we are going to continue to encourage young people and new entrants to get involved in agriculture rural America must be able to offer the basic infrastructure and amenities that will entice them to return to these rural areas. We believe the system has a congressional mandate to assist in providing credit and capital for these important projects and must play a meaningful role going forward in strengthening rural America.

Directly linked to this is the importance of serving young, beginning, and small farmers. The system continues to increase its service to these important groups, and FCA will continue to closely examine the system's service to ensure that these important groups are served in a constructive, safe and sound manner. One of the ways we have encouraged system institutions to continue their service to rural communities has been to use the broad investment authority provided in the Farm Credit Act. FCA issued guidance in January of 2005 that gave system institutions a provisional opportunity to make mission-related investments through pilot programs supporting investments in rural America.

The pilot programs are intended to strengthen the system's mission to provide for an adequate and flexible flow of funds to agriculture and rural communities across the country. Further, the pilot investment programs are intended to provide Farm Credit System institutions greater flexibility to partner with government agencies and other rural lenders in fulfilling their mission objectives. Through these programs the agency is looking to gain a better understanding of the diverse financing needs of agriculture in rural communities, and how Farm Credit System institution investments can help increase the availability and efficiency of funds to these markets.

While we believe these programs are important for agriculture and for rural America, I do want to make it clear that FCA is very aware that safety and soundness must come first. With each of these pilot programs we place appropriate conditions on them to limit risk exposures and we can revise our approval any time safety and soundness comes into question. Mr. Chairman, first and foremost, I want to reiterate that the Farm Credit Administration is a safety and soundness regulator of the Farm Credit System. Most of our time and certainly the majority of our resources are dedicated to examination. Similar to the office of the Comptroller of the currency and other banking regulators, we do have the regulatory enforcement and supervisory tools that we need to carry out our responsibilities.

In fact, because of the experience of the '80s, we do have the additional powers that some regulatory agencies lack. We also have responsibility to monitor and address how well the system is carrying out its mission as established by Congress. Overall, we believe that the system does do a very good job of using the authorities provided under the Farm Credit Act to meet the needs of farmers and ranchers and other authorized borrowers across the country. For example, with new emphasis on renewable fuels, specifically ethanol, various system institutions have responded by providing financing for this emerging market. Just a few weeks ago in this subcommittee you heard from the system regarding its commitment to funding renewable fuel projects.

Now as the regulator FCA is supportive of these important projects while continuing to ensure the system's safety and soundness. There are though, two areas where we think the subcommittee should consider changes in law to clarify the ability of system institutions to meet the needs of agricultural producers in rural communities. These suggested changes are clarifications of the statute and are explained more fully in my written statement and we would be pleased to have further discussions on them with you and your staff. In addition, the Farm Credit System Insurance Corporation will also be suggesting one technical change to the Farm Credit Act, and has outlined that in a separate letter to the subcommittee.

In closing, I would report to you that the quality of loan assets, risk bearing capacity, stable earnings, and capital levels collectively reflect a healthy Farm Credit System. Additionally, capital levels continue to be strong especially when compared with the system's risk profile. As we continue to see major changes in the lending landscape including higher energy and input costs the FCA is committed to maintaining our excellence in examination and being the strong arm's length regulator that Congress intended. We will also continue to craft thoughtful and sound regulations that will ultimately benefit the all important end users whom we must always keep in the forefront of our mind, farmers and ranchers of rural America. Mr. Chairman, thank you for allowing me to testify today. This concludes my statement, and I would be happy to answer any questions that you may have.

[The statement of Ms. Pellett appears at the conclusion of the hearing.]

Mr. HOLDEN. I thank the witnesses for their testimony. The Chair will remind members that they will be recognized for questions in order of seniority if they were at the beginning of the hearing, and after that based on the time of their arrival with the two exceptions of the Chairman and the Ranking Member of the Full Committee. Mr. Keppy, what did you say the default rate was for your agency on the loans?

Mr. KEPPY. 8.1.

Mr. HOLDEN. 8.1. Any idea how that compares to other government agencies such as SBA or rural development USDA business and industry guaranteed loans?

Ms. COOKSIE. I think we compare very well. I think we are lower than some of them and higher than some. I think we need to keep in mind the farmer that we deal with is a limited resource borrower that some of the other people that we would compare ourselves with don't deal with as farmers. So I think for the farmer, the limited resource farmer that we deal with, the default rate and the loss rate is pretty good.

Mr. HOLDEN. Also, Mr. Keppy, we hear an awful lot about shortages in your agency and other government agencies. I am just curious, do you have the resources and the staff to serve the needs of farmers?

Mr. KEPPY. I feel very good about the staff. I just came from a farm loan chief's meeting and we have——

Mr. HOLDEN. Excuse me, Mr. Keppy. Your mic is either not on or you need to move a little closer, sir.

Mr. KEPPY. I just came from a farm loan chief meeting yesterday, and we have a staff that is very dedicated and working with our web-based business plan to be very proactive working with borrowers and trying to catch problems and catch existing situations before it gets out of hand. As far as funding, we are making do with the funding that has been allocated to our programs but with the changing agriculture and with the enthusiasm around ethanol and other things there is going to be a much higher input cost and more money is going to be needed. The farm bill addresses some of them issues but there is always a need, and I think that very easily and effectively the borrowers that Carolyn works with could see some benefit from increased funding.

Mr. HOLDEN. Any idea of the number of applicants you have to decline services to, percentage?

Ms. COOKSIE. Are you talking about the ones we decline because they just don't qualify or because we don't have money?

Mr. HOLDEN. Both.

Ms. COOKSIE. We have probably a 32 percent rejection rate because——

Mr. HOLDEN. 32?

Ms. COOKSIE. Yes, because they don't qualify. We have two categories basically that we carry over every year applications from year to year. That is usually the direct operating which is the farmer in the field, and the direct farm ownership, which is the real estate loans. And we also carry over some applications from year to year that are unfunded from one year to the next year, and the guaranteed OL interest assistance, the operating loan interest assistance, which is the program we buy down the interest rate. So we do have some carry over from year to year because we don't have funding in those areas.

Mr. HOLDEN. Thank you. Ms. Pellett, and we had this conversation when we met a few weeks ago, there are people who say that the Farm Credit System goes beyond its authority making loans to commercial activities at a hospital that we talked about as well, how is it that they are able to make that type of loan and where does the authority come from?

Ms. PELLETT. Mr. Chairman, the authority to do these types of things comes from the investment authority given in the Farm Credit Act. We did have this conversation, and I in no way feel that the system is going beyond their mission. The investment authority given to the Farm Credit System by the Farm Credit Act is again very broad powers, and I am delighted to be able to talk about some of this. As I mentioned in my testimony, a flow of funds to rural communities is imperative to keeping agriculture healthy and to getting new entrants into farming. If my sons or my daughters are going to come back to farming, they have got to have in their local communities the amenities that their college friends have in the urban areas.

The investments in rural America project that we gave guidelines for in January of 2005 outlines some pilot programs that the system has taken advantage of, and the investment authority that they used to give financing to purchase bonds for this hospital in a rural area of Minnesota is a prime example. But it is merely a move of getting a flow of funds into these rural communities that is so necessary for agriculture and to get these entrants, new entrants, into agriculture and farming.

Mr. HOLDEN. Thank you. I see my time has expired. I might have a few questions if we have a second round. The ranking member, Mr. Lucas.

Mr. LUCAS. Thank you, Mr. Chairman. I think it is worth noting, Chairman Pellett, as we sit there and discuss this today, that 20 years ago your institution, and for that matter all financial institutions that serve rural America was coming out of a very tough five year stretch, a stretch that put a great strain on everyone that changed the landscape of rural America and most surely the financial institutions that serve it. Now looking at not only Mr. Keppy's statistics about how current his customers are, so to speak, but looking at the profit numbers in your testimony it looks to me like it is fair to say that rural America right now under the present farm bill under the present set of circumstances whether set aside in a few areas seems to be generally prosperous. Is it a fair statement to say that the people you are administrating are making record profits at the present time?

Ms. PELLETT. And they are because agriculture is so very profitable today. We learned some very valuable, valuable lessons during that time 20 years ago. Farmers learned lessons. The Farm Credit System learned lessons. Congress did, and the Farm Credit Administration learned some valuable lessons. As a result of these times, Congress gave the Farm Credit Administration the powers that it needed to regulate and to produce a safe and sound Farm Credit System and this Farm Credit System is very safe and sound today.

Mr. LUCAS. Which leads me to my next question. Do you believe you have the specific authorities because agriculture depending on world weather conditions and world market conditions can be very cyclical just like the cow-calf business is and has been for 200 years. Do you believe you have, as we work our way into this new farm bill, the necessary authorities to provide the responsibilities you have?

Ms. PELLETT. We as an agency do have the necessary authorities that we need to regulate and ensure that the Farm Credit System remains safe and sound. Now as far as the Farm Credit Act, the Farm Credit Act has not had a major overhaul for some 35 years. As you well know, Congressman, the scope, the landscape of agriculture has changed dramatically, and so maybe it is time to take an explorative, thoughtful look at the Farm Credit Act to ensure that the Farm Credit System does meet the needs of agriculture as it looks today.

Mr. LUCAS. Mr. Keppy, I am fixing to go out and do my 20 town meeting road trip over the next two weeks, not quite the accomplishment of Mr. Moran but an accomplishment nonetheless. When you talk about expanding the ownership or the loan limits and those kind of things, I expect I will get the response back from some of my constituents does that risk meaning that we will have fewer resources for more producers if we allow ourselves to invest more through your agency than particular producers. How do I respond to that?

Mr. KEPPY. I think that that is going to be the way that it may happen but I guess we are looking at the fact that because of the change in agriculture the loan limits do have to rise and that is with the limited resources that is probably one of the dilemmas that we will have to face. Carolyn, would you like to add to that?

Ms. COOKSIE. Well, I think that is right. Loan limits haven't changed the Con Act, which is where this is housed. It is 1978. We all know that farming has changed tremendously, prices have changed tremendously, so I think it is true that if the appropriation does not go up we are going to be making larger loans to fewer farmers, but I think we have to balance that by the need because there are many farmers out there now that we can't reach because of the loan limit so we had to do a balancing act. And I think the fact that the Secretary's proposal is saying 500,000 and any combination under that for operating and farm ownership is probably the best place we can be at this point.

Mr. KEPPY. Because every borrower's needs are different. Some may want to put it in farm ownership. Others need a higher operating line so they can use that 500,000; however in which one of the programs they can benefit the most out of so I think that is very positive to have that flexibility.

Mr. LUCAS. Thank you, Mr. Chairman.

Mr. HOLDEN. Thank the ranking member. Mr. Walz.

Mr. WALZ. Thank you, Mr. Chairman, and thank you all for taking the time to come today. I come from that southern Minnesota district where that hospital is being built in St. James and toured that facility, and I can tell you that critical access hospital is absolutely part of the rural landscape, and understanding farm credit from a perspective of all the infrastructure that goes into rural development from the schools to the highways to the hospitals is critical so this is a very timely and important topic for this subcommittee, and it is one that I hear an awful lot about. So I had just a couple of questions on this. Mr. Keppy, you mentioned something I found pretty interesting. You said your loan rate to minority or some socially disadvantaged may be—possible borrowers is fairly high I heard you say and that you are doing pretty well with that. I guess my first question is how are you making yourselves accessible to that population? How are you getting out and marketing that? How are these people getting access to this credit to allow them to get on the land?

Mr. KEPPY. Well, we clearly are concentrating on beginning farmers at SDA and we have an outreach program and an education program to try to enhance their ability to know about the programs and to help them proceed and be successful borrowers and move them up the ladder, if you will, to ultimately being able to get commercial credit from some other segment.

Mr. WALZ. The next thing I would say is that the Ranking Member I thought had a very insightful question, and I get the same question also as if we are concentrating some of these loans into small approvals. How are we going to expand it or what is going to be the nature of this with the limits that are on there. It is the one that comes up often. And I also get a lot of talk from bankers. They say they have got the access and they have got plenty of money and they want to get it out to them too. My question would be, and maybe to any of you on this, your response to some of those criticisms that there is plenty of credit out there, there is plenty of other resources, and that your coming in is an unfair advantage to try and give that. How do you respond to that because from my perspective is, what I want is, is I want the market to provide the most access to credit and capital possible for people out there, whatever that—if that mechanism is more lenders, great, if it is more on the side of the bankers. Whatever it is, I want to try and get a grasp of it. How would you explain that from your perspective?

Mr. KEPPY. The Chairman laid out our guidelines very well. We are the lender of last resort. If a producer comes in and can get a loan at some commercial facility that is where he or she should get the loan. If they are denied and are not able to do it then FSA steps to the plate and provides the loan that they need so that they can progress, and it is a goal of all of our people in the field is to get the people moved up, get the producers moved up to where they can be a commercial loan, whether it be a commercial bank or Farm Credit System.

Mr. WALZ. Did I hear that right, Ms. Cooksie? You said 32 percent are turned away also?

Ms. COOKSIE. The rejection rate, the yearly rejection rate of applications that are either withdrawn or rejected for some reason.

Mr. WALZ. Where do those people go?

Ms. COOKSIE. Good question because we are the lender of last resort, and usually nine times out of ten it is based on their cash flow or their credit.

Mr. WALZ. And the last question before I finish up and yield back my time, Mr. Chairman, I am not sure if you can quite answer this. Could you sum up where you think the current Administration is at on the ability to expand Farm Credit's ability to lend? Where would you think our current Administration is at on that?

Mr. KEPPY. The Administration is very proactive in beginning farmers and SDA. I think everybody in this room realizes the age of farmers today is my age or older, and we are not going to be in it that much longer and we need our sons and daughters and people to get involved, and so it is an immediate need that we address that, and I think in the proposal that the Administration laid in the center of the table for discussion provides that.

Mr. WALZ. I yield back my time. Thank you, Mr. Chairman.

Mr. HOLDEN. Thank you. The Chair recognizes the Ranking Member of the Full Committee, Mr. Goodlatte.

Mr. GOODLATTE. Thank you, Mr. Chairman. Thank you for holding this hearing. Ms. Pellett, Mr. Keppy, everyone, welcome. We are very pleased to be talking about this issue. I know last year a little later in the year you and the other members of the Administration board and a number of others, in fact, some members of this subcommittee, were in Stanton, Virginia, when we resigned the original farm credit legislation that was adopted during Woodrow Wilson's administration, he being a native of Stanton, Virginia. And I was pleased to hear you say that after 35 years it is time for the Farm Credit Act to be given a serious review. I agree with that. I know that the lender owned institutions have their proposal, the Horizons proposal, and we will certainly give very careful consideration to that to make sure that the Farm Credit System is modern and up to date and in touch with modern agriculture.

I would like to ask you about another issue, however, this morning, and that is I would like to hear more about the recent processing and marketing proposed rule, and can you tell the committee more about how the need for this rule came to be and explain how this fits in with this structure of the law?

Ms. PELLETT. Thank you, and I would be pleased to. This is a proposed marketing and processing regulation. It is a proposed regulation. The comment period has ended and our staff is now going through the many comment letters that have come in regard to this proposed regulation. It is an effort, it is a revision of a previous regulation, and it is an effort to respond to farmers and ranchers who are trying to bridge that gap between them as producers and the end user out here, the consumer. And there is a revision of a previous regulation as far as some of the structure that is involved here but just like all of agriculture has changed so has this structure of some of these endeavors by producers to get closer to that end consumer, and it is value added, a means of financing value added businesses which is given to the Farm Credit System by the statute that authority. Mr. Rawls, if you have anything that you would like to add to that.

Mr. RAWLS. I think the only point since the question was raised about legal authority, this does come from Section 111 of the Act, which provides authority for system institutions to make loans to farmers basically for processing and marketing operations that are directly related to their operations. And what the agency is exploring in its rulemaking is that concept of directly related and so as the Chairman said we traditionally had a rule that said 50 percent ownership was the test for financing, processing, and marketing operations. What we are doing through this proposal is looking at other ways maybe to think about directly related and that would be farmers control the board of an operation, maybe farmers control management or otherwise have a contractual relationship such that they are in charge, and we think that that might fairly meet that test.

And there are two other elements to this. We said, well, maybe if farmers own 25 percent of the entity or control 25 percent of owning stock and they need a 20 percent through put so you are getting a very significant measure of farmer involvement. And then the last test is one where we are trying to capture what is happening where we see farmers creating different sorts of entities, for example, for their children also involved in those operations, and it would be an integration test.

Mr. GOODLATTE. Thank you, Mr. Rawls. I want to get to one question to Mr. Keppy as well. What is the profile of the traditional borrower of the loan guarantee program, and how can we focus on getting these borrowers on track to qualify for available commercial credit?

Mr. KEPPY. The traditional borrower is one as I just said earlier that has been denied the opportunity to get money from either commercial or Farm Credit. They are borrowers that we work with with our field staff to try to improve their efficiencies and their capabilities, their beginning and SDA farmers, and we are trying to move them up the ladder so that they can enter the commercial and Farm Credit. The profile is that there are small family farms, husband and wives family working together trying to make ends meet. There are a lot of challenges facing agriculture. There is a lot of opportunity and it is FSA's goal to try to help the producers move on their ability to borrow the money.

Mr. GOODLATTE. Thank you. Thank you, Mr. Chairman. I do have an opening statement I would like to submit for the record.

Mr. HOLDEN. The Chair thanks the ranking members and recognizes the gentle woman from South Dakota, Ms. Herseth.

[The information appears at the conclusion of the hearing.]

Ms. HERSETH. Thank you, Chairman Holden, and thank you all for being here today. I would like to start, Mr. Keppy, with this focus on young and beginning farmers, and you describe in your testimony the Administration's proposal as it relates to opportunities for new farmers for land purchases by reducing the interest rates and reducing the minimum producer contribution from 10 percent of the property purchase price to five percent, and this is all a good step in the right direction, but could you describe again or further what the Administration is proposing, if anything, to assist younger producers with credit on the operating side?

Mr. KEPPY. Well, as we talked about already the limits are going to go up to 500,000 and give the operator the choice of using the money for operating loans if that is what they need or to use the money for beginning—for the farm loan ownership side of the equation.

Ms. HERSETH. And do you have any concerns that—if that is the primary focus of helping them on the operating side, do you have concerns that what young farmers are paying in cash rents will simply be subsumed by the increase in the borrowing authority or the limits, excuse me?

Mr. KEPPY. The agency is very concerned about many facets of the changing agriculture and the FSA changes that we are seeing. We are going to try to stay ahead of them. It is a goal that we can help—our goal is to make sure that we are helping them producers get into mainstream lending procedure and ultimately graduate from FSA programs.

Ms. HERSETH. Also, as a follow-up to Mr. Walz's question with regard to how FSA is going to make itself available to minority or socially disadvantaged farmers, I do want to raise with you a concern on the record today about the proposed FSA office closings. In the State of South Dakota most of the offices that are being proposed for closure are actually in counties where, well, it is Indian country, these counties, and if we are going to be helping Native American farmers and ranchers, many of whom are younger, I do want to raise with you the concern I have about these proposals and the accessibility of these individuals to access FSA programs.

And so can you perhaps separate from the proposal of the office closings, have you had any specific discussions within the agency about outreach and making programs more accessible to Native American farmers and ranchers?

Mr. KEPPY. It is the goal of the field staff that is working for FSA, that is absolutely their goal is to make sure that we make accessible all the programs that we have to all of the people that are out there and SDA is women and minorities and it is a goal that we make sure the programs go to them.

Ms. HERSETH. And I appreciate that goal but have there been any specific recommendations that have been submitted to you or that you have folks you are working with that have generated specifically in working with tribal members whether it is disaster assistance, programs that are offered, specific programs authorized for tribal members within the farm bill?

Mr. KEPPY. I am not prepared at this moment but the Administration has been talking. I know there has been dialogue to that effect. Carolyn, have you got anything specific?

Ms. COOKSIE. No, but let me just say that as part of the outreach effort for all the states for socially disadvantaged beginning farmers we gave all our states and our loan officers goals for SDA and beginning farmers that they have to reach, so we attached those to their annual performance plans. So I feel confident in saying that when a state director in your state put his plan together he would have had to have addressed the issue of how all of those under served areas are going to be served in the plan. We could do some follow-up for you on that. I think that would probably be better.

Ms. HERSETH. I would appreciate that very much. Thank you. And my time is also up, and I may have more questions if there is another round. But, Ms. Pellett, thank you for being here, and I don't know if this is clarification from Mr. Walz's questions but if I have a second round I will come back to you, but I did want to ask one further question. Administrator Keppy, does the Administration have a position on expanding the lending authority with the Farm Credit System in particular? I know that in the proposals of the Administration for young farmers and beginning farmers as you have described anything that we can do to expand the lending opportunities but specifically on expanding lending authority for the Farm Credit System. Does the Administration have a position?

Mr. KEPPY. I am not aware of a position but I will look into that further and respond to you later.

Ms. HERSETH. Thank you. Thank you, Mr. Chairman. I do hope there will be opportunity for a second round.

Mr. HOLDEN. There will be. The Chair thanks the gentle woman and recognizes the gentleman from Kansas, Mr. Moran.

Mr. MORAN. Mr. Chairman, thank you very much. Let me although I thought I would avoid this topic of office closures since

Ms. Herseth raised the topic I would add my concern about access being eliminated in regard to a series of county consolidation and office closures going on across the country but especially in my home state, and I would appreciate you conveying our concern, in fact, my opposition to the plan to the folks at FSA. Let me direct—I think most of my questions will come for the second panel but let me direct to Madam Chairman the issue of the scope of lending of Farm Credit. How has that scope, how has permissible lending changed over the history of the Farm Credit System? Is Farm Credit now able to make loans that they were not originally able to make? Have they become legislatively, congressionally or administratively permissible or have there been expansions of definitions that have allowed the scope of lending to be increased?

Ms. PELLETT. Congressman, the Farm Credit Administration carries out the will of Congress in its regulation of the Farm Credit System. And as I mentioned earlier and as my testimony mentioned several times agriculture has changed so drastically. The Farm Credit Administration in its regulations albeit that it follows the statute has tried to ensure that the Farm Credit System meets the needs of the farmers and ranchers of today. And so I would say that probably the regulations have become a little more flexible although following the statute to a tee.

Mr. MORAN. I would not expect you to suggest that you didn't follow the statute but I was curious as to what kind of loan could be made today that was impermissible under previous rules. What would be an example that would be understandable?

Ms. PELLETT. Let me think for a minute, and I would call upon my general counsel also.

Mr. RAWLS. I think the short answer is a yes. Historically the act has been augmented to provide broader authorities.

Mr. MORAN. The act has been as in Congress' act?

Mr. RAWLS. Yes. Now that has not occurred to a great extent in recent years. As the Chairman mentioned the last major rewrite was 1971, but there have been amendments. We have ended up with an act that is a little creaky because of various amendments and the changing structure of the system that came out of the '80s but essentially there is fairly broad authority there to lend to agriculture, and then you look at one which deals with real estate loans, Title Two, production or shorter term credit, Title Three is broad loans to cooperatives and infrastructure, telecommunications and wastewater and so on, broad participation authority to work with commercial banks, to actually get into the larger agri business type loans with the commercial banks through participation or similar entity loans. So there is a lot there to work with but over time those have been—the act has been augmented.

Mr. MORAN. While Ms. Pellett thinks of examples of a loan that can be made today that could not have been made in the past. Let me take my question in a slightly different direction. What is the underlying legislative history or purpose of the Farm Credit Act in regard to the suggestion that Farm Credit is a lender of last resort or is to make loans to those who are not otherwise commercially creditworthy? Is that part of the history, is that part of the law, and is that part of the atmosphere at Farm Credit?

Mr. RAWLS. No, that is not part of the history. The Farm Credit System was established as you know as a cooperative system of farmers who got together and wanted charters to establish their own lending institutions. And the lender of last resort, as I think was discussed earlier, is an aspect of the USDA program but has never been an element of the Farm Credit System. Farm Credit System is by and large a GSE but it essentially operates as a private lending institution.

Mr. MORAN. And, therefore, the purpose of Farm Credit is to fill what nitch or gap that was not being met by other lenders?

Mr. RAWLS. Reading back in the history there was a gap basically with farmers getting credit, access to credit, got certainly all types of loans at the time the system first came into being.

Ms. PELLETT. Congressman, and the Farm Credit System is charged by Congress to be there during good times and bad, and that is where the Farm Credit System has been throughout time. And now when it is in this very—agriculture is in this very healthy state there are lots of lenders out there but as Congressman Lucas mentioned should this become cyclical as we know it does the Farm Credit System will be there at all times. The Farm Credit System, I would also like to say, sets maybe the standard for competitive rates and by that not just their borrowers can take advantage of a competitive rate set by the Farm Credit System but all farmers benefit from this competitive rate.

And so I would say, and I would hope you might agree, competition is always good, and that is where the Farm Credit System has been throughout time also.

Mr. MORAN. My time has expired. If there is a second round, I would like to follow up with a couple of thoughts and I would appreciate some examples of what has happened over time as far as lending ability. Thank you. Thank you, Mr. Chairman.

Mr. HOLDEN. The Chair thanks the gentleman and recognizes the gentleman from Colorado, Mr. Salazar.

Mr. SALAZAR. Well, thank you, Mr. Chairman. Mr. Keppy, you talked a little bit about term limits. Could you expand on that a little bit, and then also do you track people after they leave your system and they go into the private sector as to what the success rate is? Could you talk about that a little bit?

Mr. KEPPY. Term limits were set up in the original statute to have FSA work with the borrower for a certain number of years and seven is the number that is in the book today, and it was the intent that they graduate to the next avenue of getting money either through Farm Credit or commercial banks. And, yes, it is a challenge. There are some individuals that after the seven year period are not ready to graduate, and it is a cold fact but those producers are going to have a challenge getting monies if they need to to expand their farming operation.

Mr. SALAZAR. Do you kick them out of the system automatically at the seven year period or are there certain requirements that you can allow them to stay in longer?

Mr. KEPPY. I would like Carolyn to answer that.

Ms. COOKSIE. There are actually two limits. One of them is for the direct program as Mr. Keppy said, which is seven years. After they get—they have used a loan for seven years then they have to go to another creditor somewhere else. The other one is for the guarantee program, which is 15 years, which is a combination of direct and guaranteed for 15. The guaranteed is now till September 2007. Term limits for direct loans are not, and so we do have a lot of farmers that are going to hit that wall and we don't have any other avenue for them.

Once they hit that year limit there is no other avenue in the COT Act to move them or help them after that. They have to find credit elsewhere or they have to go out of business so it is a concern.

Mr. SALAZAR. So is this something that Congress should change or do you think that this is something that you can change within your system?

Ms. COOKSIE. Well, the problem with changing it within the system is that there are so many variables of farming that you are doing fine and you feel like next year you are going to be able to go to commercial credit, then you have a bad weather year and your cash flow goes down to nothing or energy prices go up as they have been, and so your cash flow becomes a problem. So for us to be able to deal with it in house is a problem for us because I don't know that we can actually do that in a realistic way.

Mr. SALAZAR. Ms. Pellett, thank you very much for being here as well, and you mentioned a couple of things. First of all, you said that agriculture was doing great, and I can agree with you, I guess, somewhat, but as you know fuel prices have gone up by 113 percent and fertilizer prices have gone up by some 60, 70 percent, so the bottom line isn't as rosy as most Americans would like. You mentioned two things. You mentioned that you would like to see two changes in proposed law. Could you expand on that a little bit?

Ms. PELLETT. The changes that we are suggesting are merely clarification of the existing, several existing USDA programs. One is the rural business investment corporations originally designed to promote economic development and create wealth and job opportunities. The Farm Credit System was mentioned specifically in this, and as when the regs were written the non-leveraged corporations were not included, and we would just like some clarification there. We think it would be another way to bring a flow of funds into rural America, and the Farm Credit System would like to be a part of that.

The second one is a technical change in loan to value requirements with guaranteed loans just to make it consistent with USDA requirements, loan to asset requirements, so those two minor changes but both of them clarifications.

Mr. SALAZAR. I do appreciate that. Thank you, Mr. Chairman, I yield back.

Mr. HOLDEN. The Chair thanks the gentleman and recognizes the gentlewoman from Colorado, Ms. Musgrave.

Ms. MUSGRAVE. Thank you very much, Mr. Chairman. I would be remiss if I did not add my concerns about office closures, proposed office closures, along with Ms. Herseth and Mr. Moran. You know, service is in the title there, and we want service and we want accessibility. I really have a two part question. Consolidation is really an issue to me. Farm Credit Service is rapidly consolidating and now has more than 20 institutions that are larger than one billion. So there is an image there that it is farmer owned and farmer controlled. And I am really wondering about whether or not that will be the case as I assume this trend will continue, and I would like to know if that is your opinion whether or not this consolidation will continue.

And really you have to look at the average agricultural bank there that is 84.5 million in assets to really see the comparison. In February of this year Farm Credit System issued a memorandum talking about non-mission activities that were taking place, and this kind of goes along with Mr. Moran's question also. And some of the non-mission activities could be commercial real estate development. The reference is also made to speculation, and I would really like to know why this warning was issued and what are the specific non-mission activities that are occurring. Could I have some explanation about that, please?

Ms. PELLETT. Non-mission activities are by far the exception rather than the rule, and when these are brought to our attention or our examiners find them during their process of examination our staff, our agency, takes prompt action to correct.

Ms. MUSGRAVE. Could you tell me what some of those would be, a non-mission activity?

Ms. PELLETT. A non-mission activity was one that you mentioned, and that is development. These might be agricultural areas that are going to be used for development. There is a fine line here as we define those areas, so development is not part of the mission of the Farm Credit System. Moderate housing, however, is.

Ms. MUSGRAVE. Could you address that consolidation issue, please?

Ms. PELLETT. Please help me and explain a little bit further, please. Excuse me.

Ms. MUSGRAVE. Well, the rapid consolidation of the Farm Credit System now contains more than 20 institutions that are larger than one billion, and then when you think about what we think of farmer owned and farmer controlled, do you think that this has any bearing on who is really going to be controlling?

Ms. PELLETT. No. The Farm Credit System is a very strong cooperative system and the borrowers are the owners. We have within the past year passed a governance regulation that firmly puts control of that association in the hands of the board of directors.

Ms. MUSGRAVE. Could you elaborate on that?

Ms. PELLETT. Yes. Yes. The board of directors have the firm control of that association. There are audit committees. There are internal auditing regulations. There are outside directors. Somebody on the board has to be a financial expert and these are just some things that are included in that governance regulation. But it has become somewhat of a model for other regulators. As far as consolidation in the Farm Credit System, it kind of follows the trend of agriculture. We in agriculture, I am a producer, we are trying to cut overhead. As Congressman Salazar said our input costs are going up. We are cutting overhead and doing our best to do that. The Farm Credit System has tried to do the same thing, and one of the means by which they have done that is through consolidation.

Ms. MUSGRAVE. So you do expect the consolidation to continue though. That is the trend that we are following now.

Ms. PELLETT. It was a very rapid trend before I came on this board but it has slowed down tremendously since I came on the board, and I have been here about four and a half years.

Ms. MUSGRAVE. Thank you very much. Thank you, Mr. Chairman.

Mr. HOLDEN. The Chair thanks the gentle woman and recognizes the gentle woman from Kansas, Ms. Boyda.

Ms. BOYDA. Thank you so much, Chairman Holden. Let me just start by saying thank you for being here today. This is obviously an important issue to my district, and let me just start by saying when I do get to speak with—spoke with some Farm Bureau people on Saturday morning in Allen County, Kansas, and my opening remarks was, okay, I heard, I get it. I can barely have a conversation without hearing about the FSA. And it is two things that I am hearing. One, you are closing them down, you are consolidating. It is just the wrong direction. It is very, very troublesome. But just the lack of technology means that now somebody has got to drive a couple of counties over to be told that things aren't operating, and the next day they are going to have to drive back because the computer systems only work in the afternoon sometimes, and then come back a third day when things aren't working well. So maybe other have been more polite, and I am just going to say there is outrage in my district about this closing and certainly ask what we can do in Congress' role and seeing if we can reverse that trend. So my guess is we will be having further conversation about that. Thank you very much.

I am concerned with the Farm Credit that it is going beyond its original boundaries and am concerned that its original intent was to be there when other lending sources weren't available. Let me just ask a couple of questions and I will follow up maybe on what my colleague from Kansas also asked. The hospital that was built in Congressman and Representative Walz's district, would that have been built with these Farm Credit funds 30, 40 years ago?

Ms. PELLETT. Probably not because this was an investment by Farm Credit institutions. The Farm Credit System has not used the very broad authorities that the Farm Credit Act gives them in this investment area until quite recently.

Ms. BOYDA. Were there no other funds available? Was it checked? I mean was Farm Credit the last resort, were there other commercial or bonds or other mechanisms that were aggressively used to fund that hospital?

Ms. PELLETT. There have been although the project was stymied until the Farm Credit System came in and purchased those bonds to make the building of that hospital possible. USDA has come in with a guarantee at this point as well.

Ms. BOYDA. I understand. Let me just ask another question. You were speaking about something where you were also making loans from Value Added. What were the two words that you used to describe that? I will ask later. It doesn't matter. It was part of——

Ms. PELLETT. Processing and marketing.

Ms. BOYDA. Yes, thank you very much. PM, let us call it. I would just like to add there my concern and as you make your regulations having 50 percent ownership makes sense. Having a certain number of input from the local farmers that are there makes sense. Having people on boards, having titles, that is awfully easy to accomplish without actually having that very clear binding relationship, so I would certainly ask that you keep those relationships very strong. Keep the ties as you are offering any credit to people who are getting into the Value Added areas. I certainly would not support saying if somebody is just on a board or if they hold some titles in a corporation that that is reason for allowing that credit to go through. So I will yield back my time again. Thank you.

Mr. HOLDEN. The Chair thanks the gentle woman and recognizes the gentleman from Michigan, Mr. Walberg. The gentleman passes. Mr. Rogers.

Mr. ROGERS. Thank you, Mr. Chairman. I want to follow up on this questioning about the credit availability. I have heard conflicting things from Mr. Keppy and the counsel, Mr. Rawls, about this being a credit source of last resort. Mr. Keppy said it was his understanding that originally the intent was for Farm Credit availability to be a credit source of last resort for farmers. Was that not your statement?

Mr. KEPPY. Well, FSA's obligation is——

Mr. ROGERS. As far as Farm Credit is not meant to be a credit source of last resort.

Mr. KEPPY. Thats right.

Mr. ROGERS. So if the community bankers, which I think are going to be on the next panel, say that they can provide this credit to farmers you believe that the competition of your entity should be there to compete for that business, and, if so, why?

Ms. PELLETT. Yes, sir, I do believe that the competition should be there, and it is probably as relevant today as it was 90 years ago when the Farm Credit System originated as Congressman Goodlatte commented on earlier. Competition is always good but the thing also is that the Farm Credit System is mandated by Congress to be there during good times and during bad times, and the commercial bankers don't have that mandate.

Mr. ROGERS. Let me ask, do you have any specific recommendations for this committee as to what, if any, changes you think should be made to the parameters within which Farm Credit can be made available?

Ms. PELLETT. I don't know as I am prepared to comment on that today. I do want to offer the assistance, technical assistance, of our staff as you go around evaluating and exploring the Farm Credit Act and the farm bill. I offer our staff for any assistance that they could offer to you.

Mr. ROGERS. How about you, Mr. Rawls?

Mr. RAWLS. I am with the Chairman.

Mr. ROGERS. I was hoping you would peel off. I was afraid you wouldn't but I was hoping you would peel off. Thank you, Mr. Chairman. That is all I have got.

Mr. HOLDEN. The gentleman from Indiana, Mr. Ellsworth.

Mr. ELLSWORTH. Thank you, Mr. Chairman. Thank you all for coming. I guess we are all kind of beating the same horse here. I hate to call it a dead horse. I guess I am sitting here wondering why we are going—if this was a lender of last resort then why are we having two panels here today because I am just going to go out on a limb and say that the next panel coming here will say that they are being unfairly treated because of these increases, so it is the lender of last resort. Why will the ICBA come in in the next 15 or 20 minutes and tell us this is not a good idea?

Ms. COOKSIE. I would be very surprised if they did for farm loan programs because we are certainly not in competition with any bank or Farm Credit. They are our lending partners in our guarantee program. But since we are the lenders of last resort, that means that people come to us for loans when they can't get commercial loans from banks or Farm Credit. So I don't believe that farm loan programs are in any way in competition with the banks or Farm Credit at all.

Mr. ELLSWORTH. Anybody else? The next question would be can you explain to me, I have been here 3 months now and why the— I think this is like a lot of federal programs. They start off with really good intentions and then through amendments and add-ons sometimes get muddled up. I find that more and more. The reasoning behind going from a 2,500 making on population community to 50,000 as opposed to just doing an occupation. It says farm right there in the Farm Credit Administration. It doesn't say town or city. Can you explain that to me for a newcomer why population matters? Why wouldn't it just be if you are a farmer apply for this and you qualify?

Ms. PELLETT. Congressman, this is part of the Act that probably does need some investigation and exploration. Our mandate is rural housing loans, and as we look at the landscape—I am from Iowa, I am from Atlantic Iowa, population around 7,000, 7,500. My town is purely rural, and yet the Farm Credit System cannot make loans, rural housing loans, in that town. And so just as agriculture has changed maybe the 2,500 population limit some place in between is where it should settle but I am frustrated that the Farm Credit System cannot make loans in some of these county seat towns that are more than 2,500 population scattered across the United States.

Mr. ELLSWORTH. Are you pretty confident that has never occurred, and I don't know, that a loan has been made in a community that say has 7,000, 10,000, 20,000, are you confident that that has never been done?

Ms. PELLETT. I cannot say for absolute certainly, no, sir, but according to the statute that is the limitation, the 2,500 population.

Mr. ELLSWORTH. Thank you very much. Mr. Chairman, I don't have anything further.

Mr. HOLDEN. The Chair thanks the gentleman and recognizes the gentleman from Missouri, Mr. Graves.

Mr. GRAVES. Thank you, Mr. Chairman. I was actually very interested in what Mr. Moran what had to say, so I would like to yield my time to the gentleman from Kansas.

Mr. MORAN. I thank the gentleman for yielding although I want to head down a different track. There was something that my colleague from Kansas indicated, and I would appreciate, Mr. Keppy or Ms. Cooksie, to speak about this issue of computers. My impression is that we are on the verge of a collapse at USDA in regards to the ability for our farmers and ranchers to access certainly the

FSA programs. I would be interested in knowing your perspective in regard to the lending aspect at FSA. Just within the last week a report from a farmer that he went to his local FSA office. They could not access the computer, over capacity.

All the computers in the FSA office were closed down so that he could have a chance for the computer to work for him. I just think that Ms. Boyda raised a topic that this committee, the House Agriculture Committee, needs to pursue a lot of time—needs to spend a lot of time on but more importantly USDA from the Secretary down needs to grasp an issue that has been around USDA for a long time seemingly not getting any better and my guess is, my prediction is, something catastrophic is around the corner. Am I missing something? Would you like to reassure me that things are just fine?

Mr. KEPPY. I have been in here for less than a year, and one of my biggest frustrations coming in to here was the fact to get my hands around the fact that the IT problems that exist. I had thought that the U.S. government and the county and state offices surely had some of the best technology available, and it was frustrating for me to find out that that is not the case. And it is frustrating for farmers when they come in to their office and have to wait for maybe their particular time zone to get time on the computer. There are challenges in that area. Dialogue had been taking place since last fall between our department and the Administration and the Hill, and we are very appreciative of that.

I think that there are some solutions, there are some corrective activities that are going to take place. You are right, it is close to maybe being a disaster but I think that we started soon enough on the problem that—and maybe I should rephrase, not soon enough but we are addressing the issue now. I hope that we can resolve it. Also, within FSA we are looking at ways to make a signature authority and other things that take place in the office a little bit less complex but still meet the obligations that FSA has.

As far as farm loans they are affected somewhat by the computer challenges but farm loan was very proactive and came up with the web-based business plan that the field staff is using, and they are not experiencing the degree of problems that FSA has in the rest of the areas, and I would like Carolyn to further comment.

Mr. MORAN. Let me make sure I understand what you just said, and that is that it is the same computer you would access. It wouldn't matter when you went to your county office what computer you were on but it is a different program and that program is more effective, more likely to work than the other side of FSA?

Ms. COOKSIE. Absolutely. A few years ago, as you know, the farm loan portion of FSA came over from the Farmers Home Administration. When we came over in '95, we had an outdated computer system so we had to start thinking about in farm loan programs how we are going to modernize more quickly than probably the rest of the agency did so we bought servers that are just for our systems and FLP. As Mr. Keppy said a few years ago, a couple years ago we bought some web-based systems off the shelf that we could use that is not dependent on the servers that FSA has, so we have not had some of the concerns that the rest of the agency has had.

Mr. MORAN. In the loan application process is the information that FSA, the farm program side of FSA, is it required in the loan process that do you need the information from FSA in order to evaluate a loan application?

Ms. COOKSIE. I don't need the information from farm programs part of FSA to evaluate an application for farm loan programs.

Mr. MORAN. So their computer problems do not affect your computer?

Ms. COOKSIE. There are only two times where we really have a problem. We have two common data bases that we interact with. One of them is called the SKIMS data base which is where you put the borrower information in and the other is the EOFF which is where you get indication to get into the system. When that is down for FSA then the farm loan program experiences problems. When it is not, which is not been the biggest problem then the farm loan program is pretty much up and running.

Mr. MORAN. I thank the Chairman. I especially thank the gentleman from Missouri for yielding his time.

Mr. HOLDEN. Thank the gentleman, and recognize the gentle woman from New York, Ms. Gillibrand.

Ms. GILLIBRAND. Thank you, Mr. Chairman. I just spent part of my weekend talking to farmers in Washington County in my upstate New York district, and the biggest concern they have as dairy farmers is just staying in business. And one woman described to me what it is like to be a farmer today and how the high cost of fuel, the high cost of feed, the low prices of milk have really put her farm in a very difficult position, and she said that the farmers don't want to answer their phones because it is creditors calling over and over again, and they have no ability to pay. And for the dairy industry it is even a bit more dire because they typically will have good times and bad times and when the milk prices are high they are able to pay everybody back and everything gets back on a level playing field.

But what has happened is because these low milk prices, high gas prices, and high feed costs have continued for so long they don't think they will be able to rebound, so my biggest concern is that we will have no dairy farms in upstate New York or in the northeast if we don't change our current policies. So in the testimony I was particularly looking at Mr. Keppy's testimony. You talk about delinquency rates and foreclosures, and you give a very rosy picture, and you say that for delinquency rates they are down to 8.1 percent in '06 from 23.8 percent in '95, and you say the decrease was facilitated by expanded authority since 1996 to offset federal payments, salaries, and income tax refunds to delinquent buyers. I would like to comment on what percentage of these do you think are dairy farms, and are they overwhelmingly being hit whereas other farms may be doing well. And, second, what are other recommendations you can make to us as legislators about how we can help our farmers receive the credit they need, have the kind of flexibility they need to be able to sustain their farms and stay in business.

Mr. KEPPY. The percentage question, Carolyn, I will give to you.

Ms. COOKSIE. I don't have data with me on the 8.1 percent, which one of those are dairy farmers. We do have that in our data base. That could be a follow-up question we could get back with you. I would be happy to do that. You know, any delinquency rate and any foreclosure rate no matter how high it was years ago and low it is now that still represents somebody out there in trouble. And one of the dilemmas that we have in the loan program is trying to figure out how we help them pass the authorities that we have. We only have certain authorities.

Now I do have to say in farm loan programs we have a little bit different thing because we do have the authority that some other lenders don't have. When a borrower gets in trouble if they are going to get in financial trouble they probably want to get in financial trouble with us because we have something called the servicing actions that is mandated by law that we have to offer everybody who is 90 days delinquent to try to get them out of the situation there. We try to re-amortize. We try to restructure. We have a myriad of servicing actions that we try to work with them that a lot of other lenders just don't have. And so we try all of those but at the end of the day whether it is a dairy farmer or a tobacco farmer or whatever, there are some people who are just not going to make it, and we don't have any authority not to collect the loan back at some point.

Ms. GILLIBRAND. Is that something you can look to us as Congress to begin to have a discussion about, is there anything that you need from the regulatory perspective that would allow for more flexibility for farmers, particularly those who are in industries that are in a difficult climate. And also we experienced some severe flooding in my district. We had extraordinary flooding in Delaware County in particular this past summer, and it really hurt our farms. And having another loan payment was not something they were able to take on, so I would really like you as our panelist and as leaders in our farming industry to begin to think creatively about what help we can give you to allow our farmers to sustain their business because I am very concerned that we are at a tipping point, and we need to make some serious decisions and make some effective and hopeful recommendations about how to move forward.

Mr. KEPPY. As you know, we are very proud of the progress that FSA has made on making loans, but we are in a new era of today and there are new challenges that none of us really have a handle on in many different areas. You refer to dairy and we have done a lot of work in the dairy side. I have learned more about dairy the last short year than I ever knew before, but there are some challenges ahead and we need to continue to have the dialogue, and I think together we can come up with programs that can be beneficial as we move into these new challenges.

High prices are great but along with high prices come higher input so the bottom line is just uncertain as of today, but you bring up some good concerns.

Ms. GILLIBRAND. I welcome your activism. Thank you. Thank you, Mr. Chairman.

Mr. HOLDEN. Thank the gentlewoman. I want to thank our witnesses for their testimony today and for their indulgence. Several members have indicated they want to follow up on questions so thank you for your indulgence on that. And I want to remind all members any questions can be submitted for the record and answered. Ms. Boyda, I believe had a question, Mr. Keppy, that we will submit to you for a response specifically to Kansas. I really don't have a question, but I would be remiss if I didn't follow up and say that the Pennsylvania farmers are not thrilled about closing of offices either. So I am not trying to pile on but we need to chat, Mr. Keppy, and I recognize——

Mr. KEPPY. The points that have been—excuse me for interrupting but the points that have been made on that particular issue are well taken. We are in a very open process. We are in dialogue and we need input that you have provided and what the state people are going to provide. It is an effort to try to make sure that we are as efficient as can be. It is definitely from bottom up and we just need to continue to have dialogue so that we make sure that we are being proactive to the American taxpayers and have an efficient a program as possible. But we need a lot more dialogue and I appreciate the comments that I heard today.

Mr. HOLDEN. We understand, and we will be talking to your people in all of our states but you are sitting in the seat so we just wanted to let you know. I recognize the ranking member, Mr. Lucas.

Mr. LUCAS. Thank you, Mr. Chairman. And really just to speak more for some observations about what we have heard and what we are going through in this process. I think it is worth noting that I think for three of us in this room this will be our third farm bill, so a lot of us, we are together adjusting to the new world and working our way through it. But, Mr. Keppy, I just offer you an observation and being an ag economist by training at Oklahoma State and having been a farmer in that '79, '87 period so when it was so horrible, so horrible for everybody out across the country, I just note that your agency is designed and targeted to help challenged farmers, to help beginning farmers, but you can't be, and I speak now to my colleagues as much as to you, but you can't be a permanent source of credit forever.

At some point our friends with the special challenges or from a beginning mode have to move on to regular sources of credit. You cannot be their source of credit for 30 some years or 40 years or 50 years. That is why those limitations are in the bill. If it is not viable then the assets need to be provided to other challenged farmers or other beginning farmers. You just cannot be the permanent source of credit. It is not good for the system. And, Ms. Pellett, time and time again we have heard comments about maybe you are part of the system of last resort for credit. That is clearly not why Farm Credit was created. It was created in 1916 to provide more sources of credit to create more competition, to bring down the markets, to give farmers and ranchers a variety of opportunities to finance their operations, and it has been successful.

And the competition that your entity has created with the commercial banking industry has driven them to more profitable, more aggressive—I say profitable, more advantageous products for consumers out there, and this is good but we all need to remember that when more credit is available chasing a fixed amount of assets, be it land or whatever the inputs are, we drive up prices so as we make credit more available and more effective it chases those assets and up goes the price of land whether it is the beginning farmer or the established farmer or anyone else.

I have tried in the '96 Farm Bill and the 2002 Farm Bill to suggest to my colleagues that we look at the whole picture, the whole entire picture. Should we be allowing people to move a loss off their form F tax return over against the regular income? Does that encourage assets that are part-time farm, aren't farm related to wind up competing with people trying to be farmers on a day-to-day basis? We need to look at the whole picture. I just say this. When you look at where agriculture is in this country, when I was a freshman at Oklahoma State or a sophomore that fall of '79 the tractorcades were going on, and a number of our witnesses here remember the tractorcades up and down this town. It was a reflection of how tough the economy was back home that '79 to '87 period.

We have had almost 20 amazing years under farm bills written by both Republicans and Democrats alike. Let us bear in mind the good place we begin from as we write this new farm bill. Let us help all of you help our constituents out there, but let us be realistic about this. We can't save everybody. We can't fix everybody's problem but we can create an environment where everyone can compete effectively and in a realistic fashion, then rural America will prosper. I apologize, Mr. Chairman, for the tirade but I have lived through the tough times. These aren't the tough times. We need to build off of the good times we are in right now. Thank you, sir.

Mr. HOLDEN. The Chair thanks the ranking member. Ms. Herseth.

Ms. HERSETH. Thank you, Mr. Chairman. I appreciate the comments of our ranking member given his experience, and I think he has highlighted and kind of brought us into focus particularly with some of what is being proposed for the Farm Credit System and an expansion of the lending authority. I do want to come back to that real quickly, but, first, Ms. Pellett, since the Rabobank experience where Rabobank tried to buy the Farm Credit Association that served Nebraska and South Dakota, Iowa, Wyoming. Have you had any other institutions wanting to leave the system?

Ms. PELLETT. No, ma'am, there have not been.

Ms. HERSETH. And were some of the governance provisions that were recently passed in part a response to the Rabobank experience?

Ms. PELLETT. Possibly, but they were underway far before that experience.

Ms. HERSETH. And finally you had mentioned a little bit earlier an area where you think deserves further investigation within the Horizons project that has been proposed as it relates to home mortgage lending for communities less than 50,000. Given that another proposed change in the lending authority is to enable the Farm Credit Council to lend to entities that are primarily engaged in processing farm production or furnishing goods and services to farmers, I know that this has been explored a bit in other questions, as the Farm Credit regulator will such an increase in authorities cause you any concern whatsoever? Do you feel that you have fully investigated the impact given what we have seen with other government sponsored entities and the need for the regulator to be in a firm position to manage anticipated growth in the lending authorities that you have the tools available to you?

Ms. PELLETT. We have not, Congresswoman, investigated any of their proposals in great depth. In fact, today is the first time that they have really been made public. But our attempt at processing and marketing has been the proposed regulation that has been talked about, and as we go about reading the comments and coming to a final rule that is our attempt under the present statute of bringing processing and marketing regulations up to date. It is not an attempt, however, to expand the authorities of the Farm Credit System in this area but it merely brings it more in focus with the intentions of farmers and ranchers today to get closer to that consumer.

Ms. HERSETH. I appreciate your explanation. I think that that is an important point to make with regard to updating a system of regulations that keep track with how farming and ranching have evolved particularly with producers desire to get a percentage of that processing dollar. So thank you very much and thank you, Mr. Chairman.

Mr. HOLDEN. Thank you. Does anyone else have a follow-up question that they wish to ask? I recognize the Chairman of the Full Committee.

Mr. PETERSON. Thank you, Mr. Chairman, and I just want to thank you and the ranking member for your leadership and the other members in this hearing today and the other work that you are doing. And I am little tied up today so I apologize for the brief appearance, but we know that things are in able hands and we appreciate the work that you are doing.

Mr. HOLDEN. Thank the Chairman. The Chair wishes to thank our witnesses today. Thank you. The second panel will convene momentarily. We welcome the second panel to the table. Mr. Frank Pinto, President of the Pennsylvania Association of Community Bankers, on behalf of Independent Community Bankers of America and America's Community Bankers from Harrisburg, Pennsylvania. The Ranking Member would like to introduce the second panelist.

Mr. LUCAS. Yes, sir, Mr. Chairman. Thank you for that opportunity. I would like to welcome Jeff Greenlee to the hearing today. Jeff grew up on a peanut, cattle, and wheat farm in Oklahoma. Jeff is a fellow agricultural economics graduate from Oklahoma State University. He currently serves as President of the NBanc in Altus, Oklahoma where he has worked since 1994, and he has been in the banking industry for over 20 years. Thank you, Mr. Chairman.

Mr. HOLDEN. We would also like to welcome Mr. Doug Stark, President of the Farm Credit Services of America from Omaha, Nebraska; Mr. Armin Apple, Director of Agribank, McCordsville, Indiana; Mr. John Zippert, Federation of Southern Cooperatives, and Chairman of Rural Coalition, Epes, Alabama; Ms. Karen Stetler, Director of LSP Farm Beginnings, on behalf of Land Stewardship Project, Lewiston, Minnesota. The Chair would like to ask our witnesses to keep their comments or summation to five minutes and submit their full testimony for the record. Mr. Pinto, you can begin if you are ready, sir.

**STATEMENT OF FRANK PINTO, PRESIDENT, PENNSYLVANIA ASSOCIATION OF COMMUNITY BANKERS, ON BEHALF OF INDEPENDENT COMMUNITY BANKERS OF AMERICA AND AMERICA'S COMMUNITY BANKERS, HARRISBURG, PA**

Mr. PINTO. Good morning, Chairman Holden, Ranking Member Lucas, and members of the subcommittee. Thank you for the invitation to testify. I am Frank Pinto. I am the President of the Pennsylvania Association of Community Bankers. I am also representing the America's Community Bankers and the Independent Community Bankers of America. As Chairman Holden noted in his opening remarks, the commercial banking industry is the largest single sector provider of agricultural credit supplying nearly 40 percent, and we are really proud of this. Since this is a hearing on availability of credit in rural America, I think we took two approaches. The Independent Community Bankers of America did a survey that was just concluded this past February with over 1,000 bankers.

In a survey of the Pennsylvania community bankers last week, we asked the question is there a lack of credit available in your market place. In both surveys 100 percent of the bankers responded no. Two-thirds had five or more competitors in the market place. Respondents overwhelmingly report that agri businesses have ample credit. So our two surveys then the findings are clear. In our eyes there is no lack of credit in rural America. There is no lack of competition. Numerous private sector lenders serve rural markets and agri businesses have ample credit available. Our surveys are reinforced if you look back in history at previous findings and the United States Treasury Department statements.

A 1996 USDA study of almost 4,000 non-metro and metro manufacturing firms revealed that credit was equally available. In contrast to numerous findings the system has been pushing for well over a decade for expanded powers. Both the Clinton and Bush treasuries have warned against expanding Farm Credit powers because FSC is highly subsidized and could displace private sector competition. For example, in 2000 the Treasury stated FSC lenders are not just another competitor. The government is giving them significant competitive advantages. These proposals are not new. Back in 1995 the Farm Credit asked to lend to agri businesses, expand their mortgage finances, and remove borrower stock and borrower rights requirements. Congress did not act.

Again this year the Farm Credit seeks to lend the non-farmer owned and non-farmer controlled corporations engaged in virtually any activities that either directly or indirectly benefit farmers. The language appears to allow FSC to lend to any mainstream businesses. This benefits FSC, not rural America. The result would significantly weaken the vibrant network of private sector lenders essential to a competitive rural market. Community banking would be weakened, implicit burden on government taxpayers expanded, public benefits would not be targeted to any verifiably underserved group. The FSC also seeks authority to provide mortgage products in cities of 50,000. There is no lack of mortgage credit.

USDA indicates homeownership percentages are higher in nonmetro areas than in metro areas. FSC can offer mortgages in the suburbs of Washington, D.C., New York City, and Los Angeles.

Farm Credit desires to offer home equity loans which can be used for any purposes including any non-farm purpose. System income for mortgage and real estate lending is tax exempt offering significant advantages over the private sector. Another proposal removing borrowed stock requirements appears to allow FSC to engage in broad commercial and consuming lending. In our eyes there is no need for new powers.

FSC, as you heard earlier, has experienced unprecedented growth with loan volume growing over 16 percent, the highest growth rate since 1981. FSC achieved this growth under current authority. At this rate the FSC assets will multiply 10 times within a decade and a half. FSC's return on assets is over 1.5 percent. By contrast rural banks are always less than one percent. New authority as advocated would not be used to make new loans. FSC would shift existing loans from community banks and on to the Farm Credit books. State and local governments could lose taxes making it harder to sustain adequate services and infrastructure. Adding less than 100 FSC lenders in the rural business markets does not enhance competition when there are already 6,000 community banks serving towns of 20,000 or less.

Farm Credit is unique. It is the only GSE retail competitor, and that is important for you guys and gals to understand. Introducing a highly subsidized lender into the market undermines robust private sector competition leading to fewer credit choices. FSC's proposals will allow a dramatic shift away from farmers and into non-farm lending. In regard to the regulator this year's FSC plans to propose broad new scope and eligibility regulations allowing FSC to finance non-Farm Credit needs. We have numerous concerns here. We believe that the FCA should be required to testify annually to Congress providing assurances that no ineligible lending activities are current.

In conclusion, rural America is awash in credit. The FCA is not supervising sufficiently to prevent ineligible lending. Farm Credit should not be allowed to shift their focus away from real farms and from agricultural credit needs. If FCS achieves their agenda there will be no incentive for the system to engage in loan participations with community banks. Congress should not pursue legislation that could displace countless community banks from the market. I ask that a letter of opposition to the system's Horizons proposal from over 50 state banking associations be included in the record, and of course we look forward to questions. Thank you, Mr. Chairman.

[The statement of Mr. Pinto appears at the conclusion of the hearing.]

Mr. HOLDEN. All testimony and all letters will be entered into the record. Mr. Greenlee.

**STATEMENT OF JEFF GREENLEE, PRESIDENT, NBANC, ON BEHALF OF AMERICAN BANKERS ASSOCIATION**

Mr. GREENLEE. Thank you, Mr. Chairman, and members of the committee. I am pleased to be here today representing the American Bankers Association to discuss the availability of credit in rural America. My name is Jeff Greenlee. I am President of NBC Bank, Altus, Oklahoma. We are a community bank chartered in Tulsa, Oklahoma with banks located in Tulsa, Altus, Enid, and

Kingfisher. I am pleased to report to you that the banking industry operates nearly 22,000 banking offices in rural and small town America. The services our industry provides guarantees that rural Americans have the same access to financial products and services that urban Americans enjoy. In agricultural production and agricultural real estate finance the banking industry had $106.9 billion loaned to American farmers and ranchers at the end of 2006.

Nearly 40 cents of every dollar borrowed by producers comes from the banking industry. I am pleased to report to you that the agriculture loan portfolio is performing very well. The choices producers have to finance their operations have never been greater. Congress deserves much of this credit for what we have achieved in financing rural America by providing a safety net that supports agriculture. Congress strengthens the ability to farmers and ranchers to obtain credit that they need. Ninety years ago the Congress created the Farm Credit System, a government backed retail lender. It enjoys considerable tax advantages and relies on taxpayers to loan the FCS the credit rating so it can borrow lendable funds in the government sponsored bond market.

For over a year the Farm Credit System has publicized the Horizons Project. FCS has touted how it assembled all of the stakeholders in rural America to solicit opinions what the FCS should do next. I wish to point out that no representative from the Farm Credit System ever consulted with the American Bankers Association or to my knowledge any banker in the country. The Horizons Project is about expanding the system, not a fresh vision for rural America. It would set the FCS on a path that would take them further away from financing agriculture producers. Today the FCS is a large, fast growing institution with a concentration of credit to large borrowers.

In fact, almost ¼ of all FCS loans are to borrowers who have borrowed more than $5 million. The recommendations of the Horizons report point to the fact that Farm Credit wishes to become a corporate lender to big business and to finance suburban housing and consumers who have little or no relationship to agricultural and rural America. Farm Credit System lenders have had the authority to finance farmer owned businesses that provide services directly related to producers on farm operating needs for decades. Over the years FCS lenders have gotten into more and more questionable types of business finance. Farm Credit wants to finance any ag related business and for the first time businesses that provide capital goods or equipment to farmers are those who would qualify under FCS regulations to be defined as farmers regardless of ownership requirement.

CoBank, the last remaining bank for cooperatives, exists to lend the farmer owned and farmer controlled cooperatives. They now seek the authority to finance corporate entities regardless of the organizational structure of the entity being financed. If granted these new authorities, CoBank would be allowed to finance entities that compete directly with farmer owned cooperatives. Unlimited authority to finance agri business would be a radical change in the direction of Farm Credit and would be harmful to the farmer owned businesses and farmer owned cooperatives. Farm Credit wishes to expand their current authority to finance homes in towns of 2,500 or less to cities of up to 50,000 people. There is no justification for such action. Rural America is not in cities of 50,000. What public policy mission does this fulfill?

FCS wants to render the ownership structure of the system irrelevant. Farm Credit was created as a farmer owned and farmer controlled cooperative. FCS lenders want Congress to remove the stock ownership requirement from statute and allow the board of directors of each FCS institution to determine how much stock each borrower is required to buy. Such action will result in FCS that is owned by favored class of borrower while others who borrow would be barred from voting or from receiving other benefits of ownership. We urge Congress to reject Farm Credit's expansion plan. The Farm Credit System was created to serve the credit needs of farmers and ranchers and farmer owned service businesses and farmed owned cooperatives.

They should not be allowed to abandon their mission to serve these borrowers while retaining the tax, regulatory and other special benefits to serve a new base of non-farm borrowers. Mr. Chairman, I have included recommendations for improvements to the USDA Farm Service Agency guaranteed loan program in my statement. Currently, banks write more than 93 percent of the loans in this program. I urge you to look at those recommendations. In summary, the American Bankers Association appreciates the opportunity to discuss the issues of credit availability in rural America. Thanks to the banking industry rural Americans enjoy a limited opportunity to finance farms, ranches, businesses and homes at competitive rates and prices.

We reject the Farm Credit System's claim that something is missing in rural America. Our system works well because Congress has wisely chosen to restrict the role play by government backed lenders that compete directly with the private industry. I will be happy to answer any questions that you may have.

[The statement of Mr. Greenlee appears at the conclusion of the hearing.]

Mr. HOLDEN. Thank you, Mr. Greenlee. Mr. Stark.

Mr. STARK. Mr. Chairman, if it would be all right, I would like to offer the mike first to the farmers. At Farm Credit we let farmers speak first, and I would like our director to speak first if that is okay.

Mr. HOLDEN. Without objection. Mr. Apple.

**STATEMENT OF ARMIN APPLE, DIRECTOR, AGRIBANK**

Mr. APPLE. Thank you, Mr. Chairman. I am here as a farmer from McCordsville, Indiana, and as borrower, stockholder, and Director of the Farm Credit System. I have been farming since my sophomore year in high school when I had borrowed equipment and 40 acres of rented land. Today I farm over 1,400 acres. I started borrowing from Farm Credit in 1972. My father borrowed from Farm Credit as do my daughter and son-in-law. I know what it means for Farm Credit to stand by you in good times and bad. This background is important because it is people like me that direct system institutions and it is people like me who will continue to do so in the future.

We have excellent managers that run our institutions and make sure they comply with all regulations and disclosure requirements. It is the directors that keep these institutions focused on agriculture and rural America. This is the Farm Credit System which undertook the Horizons Project. System director and management together studied the dramatic changes occurring in agriculture and in the rural communities on which agriculture depends. We obtained broad input and then identified how current regulations and law limit Farm Credit's ability to meet customer needs. While many issues were identified only four legislative items met our internal criteria that they enhanced Farm Credit's ability to meet customer needs while maintaining our focus on agriculture and rural America. Mr. Stark will describe those in detail.

I want to give you a sense of why change is necessary. In addition to being a farmer, I have been very active in my local community serving on several boards. I also spent 12 years as an elected county commissioner for Hancock County, Indiana, which made me a close observer of the change happening in my community. Our county is experiencing suburban sprawl. The population has grown and consolidation has occurred in agriculture, much of that due to farmers retiring. The bottom line is that there are fewer of us in rural crop production today to support the farm-related businesses we need to stay in business.

With about 600 farm proprietors remaining in a county of 58,000 residents the environment for farm-related businesses change. The typical small grain elevator disappears as does the local seed dealer and implement dealer. As this happens, the local banker can't justify having an agricultural loan officer on staff. Interest in servicing farm-related businesses also declines. There are other nonfarm businesses lending opportunities available. When that happens farm-related businesses are left with few competitive credit options to turn to, and that speeds up their departure. When the farm-related infrastructure goes, the challenge for farmers to stay in agriculture becomes that much greater.

Another trend occurs. Some local farmers start to adapt. A concentrated population brings the opportunity to adjust to higher value production. A field of feed corn might become a profitable field of sweet corn. A soybean field might shift to sod. Folks see ways to get more income out of high value land in order to resist the temptation of cashing out to development. To do this successfully though we need access to a whole new set of farm-related businesses different from what were there before. High value vegetable operations require a lot of labor that must be hired and managed. Pesticide application always has required care but greater regulation has increased the need for expertise especially in more populated areas.

Even producing organic vegetables requires consultants on pest management and soil fertility. These new farm-related businesses as well as the old ones that still remain continue to be there to support farming operations they require access to competitive and reliable capital providers that know agriculture and are committed to serving farm-related businesses. In many cases, Farm Credit can't directly serve those businesses. The Farm Credit Act says we are to support farm-related businesses necessary for efficient farm operations but as those businesses have changed dramatically and their business structures have changed, the law has not. I have described just one small case study of one county in Indiana. We can provide you with many more examples that don't involve suburban sprawl like the changing ownership structure of renewable fuel plants or the changing ownership of a local processing facility owned by a retiring farmer that provides an essential market for local producers or even the very small town that has grown by 50 people in population that Farm Credit can no longer provide home mortgage financing.

As the Farm Credit director, I take very seriously my responsibility for the stewardship of this system. We bring the benefit of access to national money markets, to agriculture and rural America, packaged in a cooperative organization that our farmers own. The changes we are suggesting won't alter our focus, our mission or our ownership, but only improve our ability to serve the changing needs of your agricultural and rural constituents. Thank you, and I will be happy to answer your questions.

[The statement of Mr. Apple appears at the conclusion of the hearing.]

Mr. HOLDEN. Thank you, Mr. Apple. Mr. Stark.

**STATEMENT OF DOUG STARK, PRESIDENT, FARM CREDIT SERVICES OF AMERICA**

Mr. STARK. Thank you, Mr. Chairman, and members of the subcommittee. I appreciate the opportunity to appear before you today on behalf of the Farm Credit System. I am Doug Stark, President and CEO of Farm Credit Services of America, headquartered in Omaha, Nebraska. Farm Credit Services of America is one of the 100 cooperatively owned financial institutions that make up the Farm Credit System. We serve farmers, ranchers, and rural businesses in Nebraska, Iowa, South Dakota, and Wyoming. The Farm Credit System has identified a number of things that we can do to help agriculture producers in rural communities adapt to the new and evolving realities they face. We are here today to ask for the committee's support for these proposals.

We are recommending two very modest and incremental changes to our basic lending authority that will provide more benefits to farmers and rural communities. We also recommend two technical changes to the law governing Farm Credit's cooperative stock. The first proposal would serve the needs of farming and fishing-related businesses. We ask Congress to recognize the modern business structures in agriculture by basing eligibility for Farm Credit financing on the activities undertaken by the company and not determined on the corporate structure under which the company operates.

Under the proposal businesses are primarily engaged in processing, preparing for market, handling, purchasing, testing, grading, and marketing farm or aquatic products would be eligible for Farm Credit financing. In addition, the proposal would make eligible businesses that are primarily engaged in furnishing farm and aquatic business services, capital goods or equipment to farmers, ranchers or producers of aquatic products. These are the very businesses that farmers and aquatic harvesters depend upon to support their operations. They are one step away from the farm gate. Farm Credit already finances many of these businesses. However, outdated law prevents us from fully serving the needs of this important sector of the agricultural economy.

We also believe that more rural residents should be able to obtain a competitively-priced Farm Credit mortgage loan. Since 1971 Farm Credit's ability to provide home mortgage financing for rural home buyers has been strictly limited to rural areas with less than 2,500 in population. This 36-year-old restriction no longer makes sense. We propose to modify the term of rural to conform it to the definition Congress included in the 2002 Farm Bill, which is any area other than a city or town that has a population of greater than 50,000 inhabitants, and the urbanized area contiguous and adjacent to such city or town.

This proposal has been subject to a great deal of mischaracterization. Our proposal, and our intent, has never included authorizing home mortgage lending in urbanized areas like Beverly Hills, California, Darien, Connecticut, or McLean, Virginia. In addition, this proposal to redefine rural has no impact on any other authority other than Farm Credit's home mortgage lending authority. We understand that opponents of this provision argue that it would permit Farm Credit to lend to anything in towns with less than 50,000 in population. That simply is not the case. We remain committed to our cooperative structure and farmer ownership and control. Nothing we propose has any impact on our cooperative structure nor does it impact farmer ownership or control of FCS institutions.

Instead we propose to lower the barrier to entry for customers of the Farm Credit System associations by eliminating the minimum stock requirement from the statute. Borrowers would still have to own stock but the cost of purchasing that stock could be significantly lower. This insures that we maintain our customer owned cooperative structure. We also recommend that Congress give CoBank's customer owner elected board of directors the authority to determine which of its customers is allowed to hold voting stock in that organization. This would allow CoBank's non-cooperative rural utility customer base to vote for directors to the CoBank board.

Mr. Chairman, these four proposals constitute our recommendations for updating the Farm Credit Act to meet the changing needs of rural customers. They are consistent with the system's traditional mission. The changes are quite modest and incremental. They will benefit agriculture and rural communities by offering greater access to a competitive, reliable, dedicated, and customer-owned source of credit. Thank you for holding this hearing today, and I look forward to the dialogue we will have here shortly.

[The statement of Mr. Stark appears at the conclusion of the hearing.]

Mr. HOLDEN. Thank you, Mr. Stark. Mr. Zippert.

**STATEMENT OF JOHN ZIPPERT, FEDERATION OF SOUTHERN COOPERATIVES, AND CHAIRMAN, RURAL COALITION**

Mr. ZIPPERT. Good morning. I want to thank the committee for inviting me. I am John Zippert. I am the Director of Program Operations of the Federation of Southern Cooperatives at our rural training and research center in Epes, Alabama, which is Sumter County, Alabama. I also am the chairperson of the Rural Coalition, and as such beyond our work with African-American farmers the Rural Coalition works with the Intertribal Agriculture Council, the National Latino Farmers and Ranchers Trade Association, the National Hmong American Farmers, and many other groups of people of color farmers, minority farmers, socially disadvantaged applicants. In the perspective of this hearing, I think I represent the 42 percent of the people Ms. Cooksie said were rejected and not considered more or less for loan applications.

Personally, I have been involved in this effort for over 40 years. I started as a teenager in the civil rights movement in Louisiana working with farmers in St. Landry Parish, Louisiana. In 1971, I moved with the federation to Sumter County where we have a 1,000 acre demonstration farming facility committed to our movement of cooperatives and credit unions among poor people in the south. I think I have a gray hair in my beard today for every black farmer I have worked with and tried to assist over the years, and of course this work has been against great obstacles and we really stand now at a position of crisis. We have only three percent of the black farmers that we had at the turn of the century in 1910 still in existence, and we have small groups of other farmers, native American farmers, Latino farmers, Asian-American farmers, and unless this farm bill does something to address these people the issue of the ownership of land in this country and the issue of involvement in minorities and agriculture will have a dim future. I think we have a last chance here in this farm bill.

We have a 20-page statement we made to the committee, and five minutes is impossible to deal with all of this. For instance, one of the things you heard today was that Farm Service is concentrating on beginning farmers and socially disadvantaged, but they don't make a distinction. When you get down to the county level, that means different things in different places in America, and if you look on page four of our statement that for instance the beginning farmers program as good as it is that 92.5 percent of the recipients have been white males, and only four percent of the recipients have been women, and 3.9 percent of them have been white women. Now this information comes from the requirement we asked you to put in the last farm bill, Section 10–708 to give us information by race, by gender of all of the programs of USDA.

So they produced 120,000 separate PBFs but they didn't integrate them. They didn't put them in the system that you could search with a computer so some of the information you need and we need that you asked for is not readily available to us to really evaluate these programs. I want to say that one of our main concerns is still foreclosures. We want you in the next farm bill to have an independent commission to look at every single foreclosure a Farm Service agency is about to carry out to make sure that people get all the benefits that they were supposed to receive. On pages 15 through 17 of our statement we have a detailed integrated program that would really help the constituents I represent in terms of outreach credit, risk management, collaborative marketing and all the rest.

And obviously I ran out of time but we really want to come and talk to you about what a meaningful farm bill would be for our constituents. Thank you very much.

[The statement of Mr. Zippert appears at the conclusion of the hearing.]

Mr. HOLDEN. Thank you, Mr. Zippert, and your entire testimony will be entered into the record, and we look forward to talking to you. Ms. Stettler.

## STATEMENT OF KAREN STETTLER, DIRECTOR, LSP FARM BEGINNINGS, ON BEHALF OF LAND STEWARDSHIP PROJECT

Ms. STETTLER. Good afternoon, Chairman Holden, and members of the subcommittee. My name is Karen Stettler. I am the Director of the Land Stewardship Project Farm Beginnings program, and I am happy to be here today to testify on the obstacles and the opportunities that are for beginning farmers and as it relates to credit. The Land Stewardship Project is a membership organization working primarily in rural committees in the Upper Midwest. My testimony reflects the realities and experiences of beginning, transitioning, and established farmers that we work with through the Land Stewardship Project Farm Beginnings training and education program. Sixty percent of the Farm Beginnings graduates are currently farming. In the last eight years, I have worked with hundreds of beginning farmers who have come from various backgrounds, current farmers, multi-generational families, those changing careers with little experience, all who are interested in a variety of agricultural enterprises from dairy to beef to hogs to community-supported agriculture.

We also have an equity building livestock loan program. There is opportunity in agriculture today. It is important to know that there are people who desire and are committed to farming. For example, in our 10th year of offering the Farm Beginnings program, we have more participants than ever, and this is true of other organizations around the nation who are offering similar programs. There are other opportunities right now that make getting into farming an exciting proposition. One is the demand for organic. Local and regional markets are another. Growing crops for bio-fuels and farmer support and training that works that are making a difference are all helping beginning farmers get started.

Despite the opportunities, obstacles remain. For America's next generation of farmers to take advantage of these opportunities we need to initiate good public policies that assist beginning farmers and ranchers in overcoming barriers to getting started and succeeding. From our experiences in the Farm Beginnings program where we work intimately with a segment of our farmers often in need of credit a couple of the common struggles we hear from people are lack of technical assistance in guiding applicants through the process and a need for education of FSA and other lenders about the broadening variety of farm enterprises. From the lender's side we hear that farmers are unprepared or lack the knowledge and tools needed to develop business plans. These obstacles can be overcome through community-based farmer training that helps beginning farmers develop the tools and know how to do sound business planning which will then assist the farmers in accessing affordable credit.

By focusing on financial training and business planning, beginning farmers are coming to the lending institutions with carefully thought out plans and the numbers to support it. The beginning farmer and rancher development program authorized in the last farm bill would fund local programs that introduce beginning farmers to not only financial and business planning but also goal setting, whole farm planning, and on farm education, in addition to connecting with established farmers through mentorships. Our experience has been that offering quality training and then ongoing community support is the best combination for beginning farmers success. The new farm bill should fund the beginning farmer and rancher development program. In our view, this is the single most important beginning farmer and rancher request in the 2007 Farm Bill.

Regarding the USDA credit programs, we believe that the existing loan structure can and has been successfully used in supporting beginning farmers. With some adjustments these programs can become more effective. The down payment loan program in the past has served beginning farmers well especially when there was higher interest rates in the '90s. To make this program more successful with today's realities of low interest rates an adjustment should be made to fix the interest rate provision to set it at four percent below the regular direct farm ownership interest rate or one percent, whichever is greater. The direct farm ownership and operation loans were last adjusted in the late '70s and '80s. We recommend increasing the loan limitations from $200,000 to $300,000 to reflect increased land values and overall higher farming costs. Along with loan limit adjustments, the authorization level for direct farm ownership and operating loans should be increased.

Individual development accounts would be another policy area that would aid beginning farmers in asset building. In summary, there are good opportunities in farming today for beginning and transitioning farmers. There are also obstacles and it is therefore important to have good public policies that provide smart, cost-effective start-up support and incentives for America's next generation of family farmers. The opportunity is in the 2007 Farm Bill. We cannot afford to let these opportunities slip by. The time to act is now. Thank you very much.

[The statement of Ms. Stettler appears at the conclusion of the hearing.]

Mr. HOLDEN. Thank you, Ms. Stettler. I thank all the witnesses for their testimony. A Member of the Subcommittee, who will remain anonymous, when they walked into the room said to the Ranking Member and I, whose idea was it to have this hearing anyway, and I think pretty much he was right on target. We don't have really have that many questions of where you stand on the issues, but we are really concerned with one thing, and that is that the credit needs are being met all across rural America and all across the agriculture community. So I would say to Mr. Stark and to Mr. Apple that again, and you pretty much covered it in your testimony as well as did Mr. Pinto and Mr. Greenlee, but first to Mr. Stark and Mr. Apple, if you can identify where you think there are gaps in credit, needs and concerns that are not being met by the commercial banks or not being met by any other lenders, and how you think the proposal by Farm Credit can address that.

Mr. STARK. I will take a first stab at that. Thank you for the question. I don't think that even as we looked at this project it wasn't as much about the gaps. It was about the issues that we put on the table, you and some members of the committee, providing competitive alternatives for producers in rural America. What we did with the Horizons Project initially was studied the changes that have occurred in rural America and in agriculture, and really not only looked back but tried to look forward in terms of what it is going to take to meet the changing needs of this very dynamic industry.

And so with that, we came to the table with what we thought were some very modest proposals that would still keep the Farm Credit System focused on agriculture as our primary and core business but in addition then allow the Farm Credit System to support those businesses where they are becoming very integrated with the agricultural community, and that is really the essence of where we are coming from.

Mr. HOLDEN. Mr. Apple, didn't you mention a situation in Indiana where the credit needs are not being met?

Mr. APPLE. Well, I think it is very much like Mr. Stark said. There is credit available, and there is always credit available no matter what the time is. It is just how much do you pay for it. And sometimes even in small communities some of the banks may not have the certain capacities to handle all of the particular credit for maybe one of these ag-related businesses so oftentimes the Farm Credit institutions and the local banks work in tandem with these businesses to provide these new businesses in these rural communities that can basically keep the jobs there, keep the young people in these communities. That is probably the goal that I would state there.

Mr. HOLDEN. Mr. Pinto and then Mr. Greenlee, are credit needs being met in rural America in the agriculture community?

Mr. PINTO. I feel like the fellow on television, the survey says no. I mean we explored—let us take your district, Congressman Holden. We have 26 financial institutions in the district. We have explored them. Their comments, I want to submit for the record. Generally speaking, there is an overabundance of availability. When these guys are talking about competitive alternatives and they are talking about credit availability the Farm Credit System is a retail provider. They already have the built-in advantages over the private sector. When they go to the market to get additional monies from Wall Street, when they get the tax break and everything, and even when Chairman Pellett alluded to the fact that competition is good, guess what, we employ that too but we just want it to be fair competition.

When you build in all these factors our reading of this is that we have not seen—of course someone can take an isolated pocket. When you take the 8,000 commercial banks and thousands and thousands of branches, and we have covered this nation quite well, I don't think you make national public policy based on isolated factors where there might be a lack of credit and if you do then you have to look at the balance and say where is the competition, and how can we make it a more level playing field.

Mr. HOLDEN. Mr. Greenlee, do you wish to add anything?

Mr. GREENLEE. I would pretty much agree with Mr. Pinto on his comments. There is an abundance of competition in rural America at least as we see it in rural Oklahoma and as I have seen across the country with the various members that I serve on the committee with. I think what has been mentioned here is an inference of competition into how it will affect it. I want to point out that it is not pure competition. It is an unlevel competition that we are looking at right now, and I would ask the committee to keep that in consideration as they seek expansion of this area. When it comes into residential home lending there is no doubt that there is an overabundance of available credit out there especially with the technology of on line lending and other services. It just does not make sense that any part of this country is being underserved.

Mr. HOLDEN. Thank you. Ms. Stettler, I appreciate your comments on beginning farmers, and I do not mean to ignore you or Mr. Zippert, but I want to ask a question about startup of beginning farmers because we are concerned about that. I am just curious, Mr. Stark and Mr. Apple, and then followup from Mr. Pinto and Mr. Greenlee, what does your portfolio look like with beginning farmers? Can a young farmer looking to get into the business look to you for credit and can you provide it?

Mr. STARK. Mr. Chairman, very definitely so, and I think that again is one of the things we probably don't do a good enough job of talking about is the what I would call the great service we provide to beginning operators. I would speak from our institutional perspective, we have many different programs all the way starting with loans to 4H and FFA kids. We have special programs that allow them to finance their 4H and FFA stock projects. We have scholarships and things along that line. But one of the key hallmarks of our program is what we would call a program to limited resource customers that are referred to here this morning basically those customers that can't qualify for credit on a conventional basis. We have 700 of those customers in the 4 states that we serve to individuals that could be coming right out of college buying their first tractor, their first farm, renting a farm to operate on, and it is for over $130 million.

In total our portfolio if you consider that we consider young as less than 35 years old, we have over 9,000 loans to customers that are in that category that are under 35 years of age. And so we think it is a great story that we have already done a very effective job at.

Mr. HOLDEN. I see my time has expired. Mr. Pinto, are the community banks and the commercial banks engaged with beginning farmers?

Mr. PINTO. Sure. We are looking—in our business, which is a regulated business, we are looking to be paid back, and unlike the lenders of last resort that USDA talked about, we have to make sure because of our regulators' oversight, and constant oversight, that what we do is prudent, fiscally responsible, so we just can't give it away. There has to be a quid pro quo there in the relationship between the borrower and the lender, and I think we have excelled at that.

Mr. HOLDEN. Thank you. The Chair recognizes the ranking member.

Mr. LUCAS. Thank you, Mr. Chairman. Jeff, let us visit about Jackson County, Altus, America. Farm Credit is present in your county and in addition to NBC, how many other banks are there?

Mr. GREENLEE. I believe there are seven other banks in Altus, and there are approximately four other banks in the outlying communities in Jackson County.

Mr. LUCAS. So in the case of NBC, what is the biggest loan that you could make to a creditworthy farmer or for that matter, anybody else?

Mr. GREENLEE. Legal lending limit is about $4.6 million of our bank organization. Because of our ownership structure, we have another bank that is under the same exact ownership that we generally participate loans out to go above that, and that can take our legal lending limit up to close to $10 million. However, because of relationships with area banks any organization that is looking at a loan larger than that, for example, if I can include this, we are working on a $20 million package for a cancer center in southwest Oklahoma, working with three regional hospitals. We were able to work with banks in the region to go above our legal lending limit to meet those needs. That is a rare moment but we can go above those limits and work with other banks and participate and take care of the needs.

Mr. LUCAS. Mr. Apple, in your part of Indiana, which county was it again?

Mr. APPLE. Hancock County, Indiana, east of Indianapolis.

Mr. LUCAS. East of Indianapolis. Describe for me the financial circumstances in your county. Obviously, Farm Credit is there. What other——

Mr. APPLE. Farm Credit is there. That close to Indianapolis there are a multitude in my particular county, a multitude of things in that particular area. As you move out county by county from the large metropolitan areas though, that does increase or does decrease because you have less population and just less demand for those particular services. So there are banks there, yes.

Mr. LUCAS. I asked the earlier panel, we discussed the general prosperity of the farm country out there, and I referenced that and credit and the cost of inputs and land and all those things going up, and I put this to all four of you in the financial business. How do you gauge the impact of land price changes, the trend over the last two—one, two, three, four, five years in that general time zone, are we seeing a consistent——

Mr. STARK. Your question is in terms of where land prices went? Certainly in almost all cases the four states we serve including South Dakota, we have seen significant increases in land prices even over the last six months particularly with corn and soybean prices moving up like they have. And so that varies by state though. South Dakota has probably been the most over a five and seven year time period been one of the highest in the rate of increases. Nebraska, however, has been very conservative relative to that so it does vary depending on the state and economic conditions of each state and the various laws and regulations that you state.

Mr. LUCAS. How would you describe land values in southwest Oklahoma, Jeff?

Mr. GREENLEE. They have certainly been increasing like the rest of the country. I think if you get a group of bankers together the first guy doesn't stand a chance as far as how high land prices are going in their area, but southwest Oklahoma certainly we have had lower per acre land prices than some other areas, but we have seen some great increases in the last five years. Most of that increase is coming in from non-farm demand.

Mr. LUCAS. Which leads me to my next question. Thinking back to those horrid days of the '80s that we all went through together, how would you describe the typical farm portfolio that you have, how much leverage is increasing or decreasing if there is such a thing as a typical farmer's loan portfolio either NBC or at Farm Credit?

Mr. GREENLEE. If I can answer that. I think we all would like to say we have learned our lessons. Unfortunately, bad loans are made during good times, and we can't really recognize that right now. We have some times over the last 10 years especially in the cotton industry with weather-related issues that we have portfolios that have gotten a little bit weaker. And then thanks to restructuring programs and working with other programs out there got those customers back on their feet and made some improvements. There is a lot of swing right now going on between road crop farmers who are enjoying some of the benefits with some higher grain prices versus some of your livestock producers. There is that swing going on that we are seeing right now. Some of our livestock producers, especially grass people who are doing grass cattle are not seeing as good returns as they have in the past.

Mr. STARK. In terms of portfolio, we feel very good about that. We have a philosophy, at least at Farm Credit Services of America, that we are going to be conservative in good times, we are going to be courageous in tough times, which means being consistent all the time regardless of the cycles. Actually going back three years ago, we started addressing this topic, and we lowered our advance rates on real estate loans because of the concern we had with escalating real estate prices. And so we took a conscious decision there. I have a year end portfolio management report that shows me on an ongoing basis what our penetration rates are on real estate and almost 80 percent of our portfolio is under a 60 percent loan value based on current prices. So, in essence, land values could drop 40 percent and those producers would still have equity in their land. And probably there is over 60 to 65 percent of that is less than a 50 percent loan to value so there is great equity in real estate even at today's prices even if something would change.

Mr. LUCAS. We did learn our lesson. Thank you. Thank you, Mr. Chairman.

Mr. HOLDEN. The Chair thanks the ranking member and recognizes the gentlewoman from South Dakota, Ms. Herseth.

Ms. HERSETH. Thank you, and thanks to all of you for your insightful testimony today. I would like to start with you, Mr. Stark and Mr. Apple, about this change in the home mortgage lending authorities. Horizons proposes to enable Farm Credit entities to do home mortgage lending in communities up to 50,000. Now, Mr. Stark, as I know you are aware, if adopted that would exclude Farm Credit from exactly two communities in South Dakota. And in rural America cities that size are generally considered small. They are often time regional hubs of economic activity, and they often have vibrant mortgage banking opportunities and enterprises that compete clearly effectively against one another.

So given that fact, why should Congress grant to the Farm Credit System such a significant increase in the size of community to which it can provide home mortgages?

Mr. STARK. Yeah, thank you for the question. That really is a good one because internally as we developed our own recommendations we wrestled a lot with that. What is the right number, is it 25, is it 50, is it higher, is it lower. What is right in South Dakota is not right in Pennsylvania, so we really wrestled with that a lot. We ended up coming back to the number and the definition that was already defined by Congress to define a rural area as a basis as some kind of external validation for what we could put in place.

While we recognize that only two communities in South Dakota would be excluded most people would say Huron, South Dakota is not a metropolitan area, for example, and we believe that those communities and a lot of the businesses that are housed there really benefit agriculture as well and so there is a great mission tied to allow the Farm Credit System to be able to support those kind of communities.

Ms. HERSETH. I appreciate your response. I live in Brookings, South Dakota. When you add in the students we are about 18,000 or so. And I hear what you are saying about communities like Brookings and Huron but I also know from my experience in Brookings as well as the folks that I know in Huron and Aberdeen and other communities that are under 50,000, I haven't heard concerns about the ability to get a competitive rate in a home mortgage in those communities given the competition that I think exists, not only with the banks, the commercial banks, that are in— and community banks in Brookings or Huron but also other mortgage lending opportunities whether they are in Sioux Falls, whether they are in Mitchell, Rapid City. So I appreciate your response and how you grappled with sort of the right size of the community.

Within your membership, I know that currently with the 2,500 or lower population that is the existing authority for the home mortgage lending, correct?

Mr. STARK. Right.

Ms. HERSETH. Where are you in terms of the 15 percent cap?

Mr. STARK. We are still fairly low in that. There is room there. At the same time, and we need to speak to that, we are not asking for the other limits in Farm Credit's authority for home mortgage to be changed. They have to be owner occupied, have to be single family, and we still have to stay within our current 15 percent cap, so we are not asking for the lid to be taken off and focus this into rental properties or those kinds of areas.

Ms. HERSETH. Thank you for that clarification as well. Mr. Pinto and Mr. Greenlee, and I think, Mr. Greenlee, you in your testimony suggested what I think the answer is going to be to this question, but let me pose it and explain where I am coming from on this. CoBank can currently lend farm cooperatives that seek to start ethanol plants and the like but many of these entities are changing their structures in a way that continues to have significant farmer involvement, and that was alluded to, I believe, in Mr. Stark's testimony and Mr. Apple's about these modern business structures that have evolved as the agricultural industry has evolved and these higher producers to be involved in some of the processing and marketing of their commodities and value added products.

Now would you pose any changes that would enable CoBank to continue to loan to groups with significant farmer involvement if they don't meet the current limits of CoBank's lending authority?

Mr. GREENLEE. I think the definition of farmer involvement is a question—I think a comment was made over here that perhaps you can window dress farmer involvement by the change of the board although the ownership is less than 50 percent or the control is less than 50 percent. The bottom line is in business control is everything. By having a board that is put on there that is predominantly by farmers or producers doesn't necessarily meet the definition of control. So I would oppose any change to that and keep the ownership requirements the same.

Ms. HERSETH. If I might, one follow up. Taking LLC, for example, where it is over 50 percent owned and controlled by individual farmers but they made decisions based on differential tax treatment of the structure whether it is a co-op or an LLC. Would you oppose a change to allow CoBank to lend to an LLC that really differed little in terms of the amount of farmer involvement, the farmer ownership, and the farmer control but because it changed, it transitioned from a co-op when it initially started to an LLC and so others followed suit and rather than using the cooperative structure use the LLC structure.

Mr. GREENLEE. Like a lot of things at face value that may seem appropriate but what it does is open the doors for other things to come in its place. I think the law as it is defined right now is very adequate and those fine line areas that you are talking about as far as corporate structures being set up those projects can still be met by the private sector. I don't think that those entities would be lacking in financing available.

Ms. HERSETH. Thank you, Mr. Chairman. I may submit an additional question for the record.

Mr. HOLDEN. The Chair thanks the gentlewoman and recognizes the Ranking Member of the Full Committee, Mr. Goodlatte.

Mr. GOODLATTE. Thank you, Mr. Chairman, and let me follow up on some of the questions of Ms. Herseth and Mr. Lucas. I think Mr. Pinto and Mr. Greenlee commented that the 50,000 cap on home loan lending population areas is something you oppose, and it is a dramatic increase. I am not sure that I would agree with that significant increase. But let me ask Mr. Greenlee and Mr. Pinto, is there any number above 2,500 that you would support increasing that to cover very small communities that are in rural areas and are not able to be served by Farm Credit Service at this point.

Mr. GREENLEE. Let me just say no.

Mr. GOODLATTE. Okay. I appreciate that, but let me follow up with that. Should it be 2,500 or should it be zero?

Mr. GREENLEE. We are not asking for the——

Mr. GOODLATTE. I know you are not asking for it. What do you think it should be?

Mr. GREENLEE. Realistically it should be zero because—

Mr. GOODLATTE. Okay. Let me follow up then on a question that Mr. Lucas asked. I think this is an important aspect of what we are talking about here. I very strongly support my banks in all of the areas of my district, large and small, and they serve a very vital need. But there are certain circumstances and there are certain times in which banks simply aren't there. And the Farm Credit System has the ability to offer loans because of the very subsidies that you have noted and complained about that you wouldn't take the risk on. So aren't we really talking here about whether or not there should be a Farm Credit Administration and Farm Credit System of lending in addition to what you are offering because right now in rural America times are in most places really good but there are really bad times as well, and during those times your banks by the very nature of their entity and their source of survival, you have to be accountable to the bottom line in a somewhat different way than the Farm Credit System does. Aren't they unable to lend in situations where Farm Credit can't, and shouldn't they be able to do that or should people simply not be able to get credit under those circumstances?

Mr. GREENLEE. Let me answer just briefly going around your question there and give by example your concern as far as when it comes to bad times, do banks tighten up where the Farm Credit System is not required to. If I can just answer that and just between 1984 and 1990 what we consider extremely bad times in agriculture. I think let the numbers speak for themselves. The Farm Credit System went from $61 billion in loans to $33 billion in 1990, a drop of 46 percent, while at the same time banks stood in there at $47 billion and went to $56 billion by the end of 1990, a 19 percent increase. In answer to your question, we are there in bad times as well as good times.

Mr. GOODLATTE. Let me ask Mr. Stark and Mr. Apple if they want to respond to that.

Mr. STARK. Well, I would agree that certainly we believe that there are opportunities for the Farm Credit System to be involved, and I am speaking to your question on the zero or the 2,500. We put the 50,000 limitation in there again going back to something that had already been tied in from a congressional mandate, and so we feel good about that. At the same time we recognize the banks have provided very good service over these years. We don't deny that. We also believe the Farm Credit System as has been stated here learned some very valuable lessons in the 1980s. We are very well capitalized at this point in time. We are well prepared through the situation we are in today to finance agriculture in these rural communities as we go forward and we are looking forward to that.

Mr. GOODLATTE. How would you differentiate yourself as a system from banks other than in the different administrative requirements and the different taxing requirements that you face that would enable you to justify a distinction here?

Mr. STARK. Well, a couple of ways. It is all about service, and that is what this whole program for us has been about anyway. It is about service to the customer. This has not been about what is good for the Farm Credit System or what is good for the commercial banks. It has been about what is good for the customer, and our focus is on that. So if we differentiate ourselves in terms of the home mortgage market or our farmer market we are going to make every attempt to differentiate ourselves based on service and quality of service.

Mr. GOODLATTE. Well, what about the issue of risk though? It is my understanding that the Farm Credit System was originally established for that very purpose. There was a belief a long time ago that there were certain circumstances and certain times in certain parts of America when traditional forms of lending based entirely on private enterprise and private credit wouldn't step in and lend money. Can you draw that distinction today?

Mr. STARK. Well, I believe we can. At the same time Congress has also expected us to run and you expect FCA to regulate us in a safe and sound manner. We make every attempt to serve customers in tough times. Another way that we have done that is through the specialization of the focus strictly on agriculture in rural America we have. We know we don't have any other option. We can't pull out into another line of business so we are forced to stay there, and we expect our directors to keep us there as well.

Mr. GOODLATTE. Can anybody tell me where the 2,500 number originally came from for home loan lending communities?

Mr. STARK. In 1917 that was a pretty big number.

Mr. GOODLATTE. Well, I know. Today it is not as big a number so is there some number that the four of you could agree upon that is less than 50,000 but greater than 2,500.

Mr. PINTO. Well, had we been involved in discussions and had we been aware of this whole process, I mean this proposal has been bandied about internally for two and a half years.

Mr. GOODLATTE. Sure, but that is simply a proposal by an outside group. The Congress is going to act based upon what we collectively think is in the best interest of consumers in rural America and the banks and the Farm Credit System to preserve and optimize all of them.

Mr. PINTO. My observation then, Congressman, would be as long as you continue the subsidy and the special status of the Farm Credit System, I would keep everything the same even at the 2,500. You are talking about a discrepancy in basis points anywhere from 30 to 200, the way the competitive nature of this whole thing is. And you used the word banks wouldn't lend in certain times. Well, banks cannot lend in certain times.

Mr. GOODLATTE. I acknowledge that. I don't think they should lend in certain times. The question is whether the Farm Credit System was established for the purpose of enabling loans to be made in certain times but when banks couldn't lend money because of the regulations and because of the fact that at the end of the day you got to have some money left in the bank. You can't just take any risk that someone might want you to take. I think neither can they but supposedly there was a difference that caused the creation of their system.

Mr. PINTO. Well, I think as long as they can keep the farm in the Farm Credit System we would support most of their proposals. They have gone well beyond the Farm Credit System.

Mr. GOODLATTE. My time has expired. Otherwise, Mr. Chairman, I would give Mr. Apple or Mr. Stark an opportunity to respond.

Mr. HOLDEN. If the gentleman wants to continue.

Mr. GOODLATTE. If they would like to respond to that observation which I think is a fair observation.

Mr. APPLE. There are a couple of things there that we had talked about, and we talk about an unfair playing field. It is probably correct but we are not sure which side has the advantage. The banks, of course, have the deposits and the ability to get the CDs and things like that that they can use for their capital and for their lending purposes which the Farm Credit System does not. We have the GSE status. As far as the tax status of the institutions there is some question there because several of the banks, a little over 2,000 of them, are Chapter S banks so their tax treatment is a lot different than what the regular commercial bank might be even that advantage somewhat there, and on the Farm Credit side the short and intermediate term loans are taxable, the income off of that is taxable. So it is not exactly just quite the appearance that we say it is nontaxable and taxable and that result.

The other thing on the home loans and the 2,500, our association that I am a member of in Indiana, Iowa, Kentucky and Tennessee, Farm Credit Services of America, has a county in Tennessee that has a county wide government so they are classified as one community. That is Lynchburg, Tennessee, where Lynchburg, Tennessee is, and that is kind of a famous little town, but they are unable because there is a 17,000 population in that entire county, they are unable to make a rural home loan in that county. So somewhere that number may not be 50,000 but somewhere in between I think probably would be a fair number.

Mr. GOODLATTE. One last question, Mr. Chairman, if I may, are there discussions going on between the independent community bankers and the American Bankers Association and the Farm Credit Services and the related institutions that work with you on trying to find some common ground here or is that a fruitless effort?

Mr. PINTO. They will start at lunch time. If anything is going to happen here it has to start at lunch time.

Mr. GOODLATTE. We would be encouraged by that.

Mr. STARK. Mr. Goodlatte, I would just like to add an example, you asked for examples of where the Farm Credit System has stepped up in the absence of other lenders, and a couple weeks ago we had a testimony hearing on the ethanol industry and renewable fuels, and clearly the Farm Credit System stepped up both for financing farmer equity and ethanol plants and directly funding ethanol plants in the absence of other credit that was available at that time, and they also are probably one of the largest holders of senior debt on ethanol facilities in the country at this point. So I think that is a good example of the budding industry where the system has stepped up to help support these rural communities.

Mr. GOODLATTE. Thank you, Mr. Chairman, and I apologize for taking the extra time.

Mr. HOLDEN. The Chair thanks the ranking member, and recognizes the gentleman from Kansas, Mr. Moran.

Mr. MORAN. Mr. Chairman, thank you very much and I may try to follow up on some of Mr. Goodlatte's observations and questions as well. This is a topic that is no fun. I assume that part of what we are about in trying to figure out Farm Credit's role and our commercial banker's role in lending to agriculture it revolves around this new proposal by Farm Credit, but my assumption is that that is the target because it is what is in front of us. Commercial bankers have much greater objections than just this proposal and it is with, I assume, what I just heard Mr. Apple help me begin to learn once again about the unlevel playing field, and so apparently there is a dispute between commercial bankers and Farm Credit as to who has the advantage.

This topic we have had before. I remember asking these questions to a different set of witnesses within the last two or three years about what is the distinction between Farm Credit's ability to access funds and the cost of those funds, and I would like to explore that again. Mr. Apple started down the path of indicating that there is uncertainly as to whether the Farm Credit System has the advantage or the commercial bankers have the advantage. Surely that is a determinable fact that one can determine what one's cost of funds are. There is a designed answer to whether or not it costs more money over time to raise money with deposits made by bank customers versus accessing funds through GSE.

I assume that there is a quantifiable amount of advantage or disadvantage that comes from the tax code, and in regard to property taxes, in regard to income taxes, in regard to the cost of funds is there an examination cost. Is there a difference between what Farm Credit goes through with the regulators as compared to what a commercial bank goes through? And it would be helpful to me if we could ultimately get to the point to understand who has the advantage and who has the disadvantage as we—I would guess that there is unless you are ready to convince me that Farm Credit was created for purposes of providing money to those who had greater risks to fill a nitch in the rural and agricultural lending opportunities for those who would otherwise not be creditworthy at a commercial bank. I assume ultimately in my mind this does revolve around whether or not there is a level playing field.

If Farm Credit's purpose continues today to be something different than what a commercial bank that is an important feature too. And so the question then becomes to me really it is quantifiable to who is Farm Credit lending to, who are commercial banks lending to. And then finally I don't—I guess I should never admit I don't know what is going on in rural America. My hometown in Kansas, I think the population today is about 1,000 less than when I graduated from high school. Today's population is about 1,900. And yet when I was growing up as a kid, I would assume since the '30s since banks were closed, we had one commercial bank in our community. We now have four. And I don't know whether—again I assume it is determinable whether those banks are lending to farmers, lending to rural America, making housing loans, or are they just collecting funds and sending that money off to be lent in some bigger city where the rate of return is greater. Does anyone have a response to just the way I see this?

Mr. PINTO. I think we all have a response but it is going to be a written response. I feel like a Shakespearian character. Somebody just handed me a note.

Mr. MORAN. I also would point out that your written testimony is lengthy in and of itself so you probably have covered all my points previously, both Farm Credit and the commercial banks.

Mr. PINTO. There is no question about it. If we had a chart together we can—and I think Doug can do the same thing. That might be best for you guys before you make your final determination. Just shooting from the hip, I would rather not shoot from the hip. I think this requires a written response to address.

Mr. MORAN. I am happy to know if I am asking the wrong question.

Mr. PINTO. You are asking the million dollar question.

Mr. MORAN. And I am happy to have your evidence of the numbers at a different point in time. Farm Credit, is this the right line of questioning?

Mr. STARK. Well, it is interesting that we probably both view it as the grass is greener on the other side of the fence. We envy their deposit taking with Federal backing, their access to the Federal home loan bank board, you know, their opportunities to tap into Fannie and Freddie as well as GSEs. They envy our GSE direct funding. I mean, I don't know, we could have this debate all afternoon and not reach a conclusion. Again, as we looked at the issues we really tried to focus on what is good for the customer in rural America, not what is good for Farm Credit institutions and commercial banks as institutions. We looked at what is good in the customer's eyes, and that is what we focused on. That is why we kept bringing our proposals back to that very issue. I don't think we have enough time to debate all the issues around the level playing field. Certainly, I think both of us would agree that we think the others have advantages. Our limited resource charter. We can go into other—all those things, as you said, really play into——

Mr. MORAN. Mr. Stark, then would your point be that regardless of whether we agree upon a level playing field the issue is about who is able and willing to make loans to agriculture in rural America? That is the crux of the issue is that as I look at this as policy maker what I ought to be looking at is how do we increase the amount of funds and lower the price of funds for rural America?

Mr. STARK. That is exactly it. What we came to the table with is what we thought was a proactive approach to serving people in rural communities. We weren't trying to undermine what anybody else was doing. We were trying to say how can the Farm Credit System bring solutions to rural America.

Mr. MORAN. Let me ask, if I may, Mr. Chairman, that then if you follow that, I assume then at some point in time that if you assume an advantage to Farm Credit then over time there is a disadvantage that will take away the role that commercial banks play in rural America so it ultimately can't just—even if it is just about service the level playing field comes back into play because to provide service I would think we would all agree that we want the commercial banks in the market as well.

Mr. STARK. We certainly do, and certainly the market data would show that they are very effective. And I think it really refutes the point that we are running them out of business. At 60 percent market share we have not driven commercial banks out of business.

Mr. MORAN. And my own hometown is somewhat intriguing to me but how can a town of 1,900 who lived with one commercial bank, one community bank for nearly my lifetime to this point, now have four. Something is going on in rural America that is different over time than it was in the past. My time is way past, but I appreciate the opportunity to explore this, Mr. Chairman. Thank you.

Mr. HOLDEN. Thank the gentleman. Ms. Musgrave.

Ms. MUSGRAVE. Mr. Chairman, we were talking about the 15 percent cap. Mr. Stark, I think, and Ms. Herseth said that. How close are you to that 15 percent cap?

Mr. STARK. Excuse me again?

Ms. MUSGRAVE. When Ms. Herseth asked the question about the home loans being able to be made in communities of 2,500 or less, and then she talked about the certain percentage that you were able to make, how close are you to the 15 percent cap right now?

Mr. STARK. We are significantly below it. I don't know what the actual number is. We could certainly supply that to you.

Ms. MUSGRAVE. Okay. I would really like to also talk about young farmers, minority farmers. What in the Horizons project is targeted specifically for this group?

Mr. STARK. Well, really there isn't anything specifically in here about young farmers other than the access, the expansion to be able to allow our ability to invest and finance non-farm or these businesses that we are talking about here. A lot of young producers have to have off farm jobs and they have to have other—they have other businesses that they may want to invest in. This allows the Farm Credit System to tie in to their farming operations. They get started in farming and also to help them with these other operations and in the communities that they live in and work other types of jobs.

Ms. MUSGRAVE. Thank you, Mr. Chairman. Thank you to the witnesses.

Mr. HOLDEN. The Chair wishes to thank the witnesses for this lively discussion and very important information gathering session that we had today. Under the rules of committee the record of today's hearing will remain open for 10 days to receive additional material and supplementary written responses from witnesses to any question posed by a member of the panel. The hearing of the Subcommittee on Conservation, Credit, Energy, and Research is adjourned.

[Whereupon, at 12:50 p.m., the Subcommittee was adjourned.]

**Statement by**
**Congressman Tim Holden**
***Hearing to review the availability of credit in rural America***
House Agriculture Subcommittee on
Conservation, Credit, Energy, and Research
March 27, 2007

I would like to welcome our witnesses and guests to today's hearing. I hope this hearing will provide a good perspective of how we can best help our agricultural producers and rural residents obtain credit and create opportunity for development.

Farmers have opportunity for credit from several sectors. The Department of Agriculture's Farm Service Agency issues direct loans and offers guarantees on loans made by commercial lenders. But FSA is only a lender of last resort for those who cannot obtain credit from the market.

The Farm Credit System, like commercial banks, makes loans to creditworthy farmers, and is *not* a lender of last resort. The Farm Credit System was created to provide a permanent, reliable source of credit to U.S. agriculture. Back in the early part of the last century, credit was often unavailable or unaffordable in rural areas. Many lenders avoided such loans because agriculture was such a risky business. So Congress created the Farm Credit System, which is authorized by statute to lend to farmers, ranchers, and harvesters of aquatic products. Loans may also be made to finance the processing and marketing activities of these borrowers, for home ownership in rural areas, certain farm- or ranch-related businesses, and agricultural, aquatic, and public utility cooperatives.

Commercial banks also lend to agricultural producers and businesses, as well as rural homeowners. Other sources of credit for agriculture include life insurance companies, and individuals, merchants, and dealers. Together, commercial banks, life insurance companies, and individuals and others provide 63% of total farm debt, without federal support or mandate.

Both the farm credit system and commercial banks also work collaboratively with each other, and with farm and commodity groups, agribusinesses, rural businesses, and civic leaders in search of financial solutions to a wide range of service and product needs.

This hearing today will review the availability of credit in rural America. I hope we can answer the questions: Are we doing enough to assist beginning and young farmers and ranchers to obtain credit? And are agricultural credit needs being met across America?

I look forward to hearing from the witnesses.

Opening Statement
Chairman Collin C. Peterson
House Agriculture Subcommittee on
Conservation, Credit, Energy, and Research
**Hearing to review the availability of credit in rural America**
March 27, 2007

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Thank you, Mr. Chairman. I appreciate your holding this hearing today, I welcome the witnesses and I look forward to hearing the suggestions and ideas from both of the panels this morning about the availability of credit in rural America, especially for farmers and ranchers.

There are new opportunities for rural America that have created an excitement in American agriculture like I have never seen before. The public demand for locally-grown crops, organics and other value-added products is expanding. The demand for home-grown renewable energy resources is a top priority of many of our constituents. In recent years, I have seen younger people, whether they are from multi-generational farm families or new to farming altogether, eager to move back to the country and meet this new demand.

While times in agriculture are changing, the familiar cost barriers to getting started in farming, especially for those new to it, still exist. Farmers take the kinds of financial risks many others would not dare take. Folks who are getting started and who want to be successful need to be able to tap into a network that can assist them with financing, marketing, communication, cash flow assessment, and asset management. Quite often, this kind of access will determine whether or not they can succeed.

Like everywhere else, rural communities need access to credit at reasonable rates. As we consider the Farm Bill later this year, it is important that we take any opportunities we have to strengthen this access.

I look forward to hearing from today's witnesses and I would particularly like to welcome Karen Stettler of the Land Stewardship Project in Lewiston, Minnesota. Her work with LSP's training and support programs and how they are meeting the needs of new farmers and ranchers will be especially helpful to our understanding of rural credit issues.

Once again, I welcome today's witnesses and I yield back my time.

# Agriculture Committee Republicans

Bob Goodlatte
Ranking Republican

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**Opening Statement of Ranking Member Frank D. Lucas**
**Subcommittee on Conservation, Credit, Rural Development and Research**
**Hearing to review Credit Availability to Producers**
**Tuesday, March 27, 2007**

Thank you Mr. Chairman for having this hearing today, which gives the members of this Subcommittee an opportunity to learn more about the availability of credit to producers today.

Providing credit to America's farmers and ranchers is a necessary and serious undertaking for many lenders in the United States. Today's hearing is going to provide a venue where we can discuss the various sources of credit available to producers through the Farm Service Agency, the Farm Credit System, and commercial banks.

Both the Farm Credit System and commercial banks have done an outstanding job servicing their communities' credit needs. It is Congress' job to ensure that credit needs are met in a manner that provides fair and equitable competition. Congress has spent a great deal of time the last few years modernizing America's finance laws. We must enable rural America to keep pace with the rest of the world.

According to the Congressional Research Service, commercial banks lend the largest portion of the farm sector's total debt at 37%. The Farm Credit System currently holds 30% of the farm sector's total debt, while the Farm Service Agency provides 3% of the debt through direct loans and guarantees another 4% of the market. These numbers reflect a healthy balance among our lending institutions.

There are several policy issues for us to consider as we discuss the next farm bill. Should we increase the $200,000 limit per farmer on FSA direct farm ownership and operating loans? What should the term limits be for producers to receive FSA direct and guaranteed operating loans? Should the Farm Credit Act of 1971 be updated?

There are many questions that will be asked today but none more important than discussing if producers have access to the credit they need. Access to credit is critical to all businesses, and agriculture is no different.

Today's witnesses will provide us insight as to the current status and availability of credit to producers and we must determine if any changes are needed regarding the current law. I look forward to hearing today's testimony.

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# Opening Statement of Ranking Member Bob Goodlatte
House Committee on Agriculture
Subcommittee on Conservation, Credit, Energy, and Research
Hearing to review the availability of credit in rural America

March 27, 2007

Mr. Chairman, I'd like to thank you for calling today's hearing.

Providing credit to America's farmers and ranchers is a serious challenge. Both the Farm Credit System and commercial banks have continued to do an outstanding job in their efforts to meet the credit needs of rural America.

Currently, commodity prices are at historic highs and the state of our agricultural lending institutions is strong. As the agriculture sector continues to expand with new and changing markets, such as renewable fuels, it is important to hold hearings like this to make sure the credit needs of producers are met now and in the future.

The Farm Credit System has been operating for over 90 years, successfully financing agriculture operations during good times and bad. This lender-owned institution serves a defined customer base, and I imagine we will hear several suggestions from their Horizons proposal on how they can better serve their rural customers. No matter what side of the discussion you are on, the statute affecting the Farm Credit System has not been updated in many years and this issue deserves the attention of this Committee.

While much will be made of Horizons, it should not dominate today's hearing. The Administration's Farm Bill proposal lists several programs that could help beginning and socially-disadvantaged farmers. I look forward to hearing not only the Administration's thoughts, but I also hope to hear the lenders' opinions on these proposals.

There are several Farm Bill issues in the credit title that need to be examined. The Farm Service Agency operates as a direct lender for producers in good standing who have trouble qualifying for credit. I am curious to hear if this program is being administered to better guard against delinquencies. I hope we can also discuss how we can move away from direct lending and move towards more loan guarantees, and if there are changes to the loan guarantee program that can get more dollars to qualified producers?

Today, we will hear from the financers who work with producers every day. They can give us valuable insight into any changes or discussions that need to be addressed in the next farm bill, and I look forward to their testimony.

Again, thank you Mr. Chairman for holding this hearing. I look forward to hearing from our witnesses today.

## SUPPLEMENTAL QUESTIONS FOR THE RECORD FOR ASSOCIATE ADMINISTRATOR GLENN KEPPY

## CONSERVATION, CREDIT, ENERGY, AND RESEARCH SUBCOMMITTEE HEARING MARCH 27, 2007

***Committee on Agriculture Staff***
Subcommittee on Conservation, Credit, Energy, and Research Staff Director—Nona Darrell
(202) 225-0420

Question Submitted by:
***Committee on Agriculture Majority Staff***
Legislative Contact—Nona Darrell
(202)225-0420

**1. Question: In your testimony you discuss the performance of the loan programs. How does your loss and delinquency rate compare to other Departments? Private lenders?**

Answer: FSA's guaranteed loan program performs very well. Based upon our information, current FSA loss and delinquency rates compare favorably to other Departments. The historical loss rate for SBA on their guaranteed business loans is 4.9 percent compared to FSA's 3 percent.

Through our outreach and training contacts, many Lender Association representatives have stated that this program is a model of public/private sector partnership. Private sector lenders believe the guaranteed loan program provides them the opportunity to provide credit to those borrowers who would not be able to meet their normal credit standards. However, even in our guaranteed loan program loss and delinquency rates will be higher than the private sector, because the law mandates that the Agency guarantee only loans to those who cannot obtain credit without the guarantee. Private sector lenders generally feel that loss rates as low as what we are currently experiencing in the FSA guaranteed loan program are close to what would be acceptable under their standards.

- FSA's current delinquency rate on guaranteed loans is 1.37 percent
- The Farm Credit System delinquency rate is approximately 0.67 percent.
- Rabobank (a commercial agricultural lender) farm loan delinquency was recently reported at 0.43 percent.

In the direct program, delinquency and loss rates are higher than the guaranteed program because direct borrowers are by nature higher risk operations. These are borrowers who cannot get credit even with a guaranteed loan. Taking into consideration that these are the highest risk loans possible, the performance in the direct loan portfolio is impressive. Direct loss rates are currently at all time lows.

- The FSA direct loan program delinquency is currently 8.6 percent.
- The FSA direct loan program loss rate in Fiscal Year 2006 was 2.6 percent.

**2. Question: FSA is the lender of last resort. Would you say you turn some applicants away? Why or why not?**

Answer: In FY 2006, 24 percent of all loan applications received by FSA in the direct program were either denied or withdrawn. In order to receive an FSA loan, an applicant must meet eligibility requirements (including a test for other credit), project a positive cash flow adequate to repay the loan, and provide collateral at least equal to the amount of the loan. If any of these three requirements cannot be met, the loan request is denied.

**3. Question: How does the agency reach out to minority and socially disadvantaged farmers?**

Answer: The Agency continues to emphasize the need to provide outreach to socially disadvantaged applicants (SDAs). The efforts focus on both process and results. FSA requires local offices to conduct and or attend outreach meetings and to increase public awareness of FSA programs through media stories and articles. The Agency has an outreach staff which is dedicated to conducting outreach activities and monitoring outreach activities in the states. From a results standpoint, the Agency's Strategic Plan includes performance measures and goals tied to increasing the amount of assistance to SDAs and improving service by decreasing the time it takes to process an SDA loan request. Program performance goals and employee performance standards are linked to these performance measures. From 1995 to 2006 the number of FSA direct borrowers who are Socially Disadvantaged farmers increased from 3,260 to 14,327.

**4. Question: How does that application process work in a disaster situation? Do you end up turning down applications for an emergency loan? Who would not qualify for an emergency loan?**

Answer: In most respects, the application process works the same way in disaster situation as it does in a non-disaster situation. The loan requirements for emergency loans are much the same as they are for other FSA farm loan program (FLP) loans. The main difference is that to receive an emergency (EM) loan, the applicant must demonstrate that they suffered a qualifying loss because of the disaster. The applicant must complete one additional form to provide information about their losses, insurance coverage, and other payments or benefits received as compensation for the loss. As with other FSA loan programs, an applicant for an emergency loan must meet eligibility requirements, project a positive cash flow adequate to repay the loan, and provide adequate collateral for the loan, or if unavailable because of the disaster, reasonable assurance of repayment ability. If any of these three requirements are not met, or the applicant did not suffer a qualifying loss, the loan request cannot be approved.

**5. Question: How does the emergency loan program carry over funds year to year? How much do you have on hand today? When do you expect that the carryover will be exhausted?**

Answer: For the past several years, FSA has operated the emergency loan program primarily with funding provided by a supplemental appropriation- Public Law 106-113, dated November 29, 1999. The Act stipulated that the budget authority appropriated therein for emergency loan funds will remain available until expended. Thus, unused emergency loan funds provided in the supplemental have been carried forward to the present. Based on recent history, the 2008 President's budget projected that the carry over funding would be sufficient to meet the demand for emergency loans during FYs 2007 and 2008.

As of the end of March, FSA has obligated $39 million in emergency loans during FY 2007 and had unobligated budget authority to fund an additional $76 million in emergency loans.

**6. Question: In your testimony you discuss the technological improvements to the loan program and many web-based tools available to users. What safeguards do you have in place to make sure personal information is secure?**

Answer: All CCE portable computers (i.e. laptops, notebooks, tablets) have been equipped with Encrypting File System (EFS) software to help protect privacy information. All electronic outputs containing privacy information are being encrypted before release or transmitted via a secure Virtual Private Network (VPN). Vendors processing data for the Agency are provided strict rules for securing the data while in their possession as well as return of the data to the Agency and/or destruction. All data outputs sent through the surface mail system are assigned a risk category and the appropriate mailing method is utilized based on this category. All Freedom of Information Act (FOIA) data outputs go through two independent reviews by Federal employees to ensure that no legally protected privacy information is contained. All non-FOIA requests for data must be authorized by an Agency official. Any recipient, such as a contractor of data that contains privacy information is provided with a privacy information disclaimer explaining their responsibility to adhere to Agency policies with respect to the handling and protecting of this privacy or sensitive data.

**7. Question: Is the FSA loan program subject to the same computer problems affecting the FSA's delivery of the commodity programs?**

Answer: The Agency loan program resides on the same infrastructure (i.e. servers and network) and utilizes some of the same application interfaces as the agency commodity programs. However, most of the Farm Loan software applications reside in a web-based environment. Consequently, we have not experienced the same volume or magnitude of problems affecting the commodity programs.

**8. Question: How has the web-based process impacted the application time? How long does it take to process a loan application? What authority do local loan offices have? When do applications need Headquarters approval?**

Answer: Loan processing time has decreased significantly since many loan processes have been moved to the web. For the period FY 2003 through FY 2005, the average processing time for a direct loan was 38 days. In FY 2006 processing time declined to 31 days and so far in FY 2007 it stands at 27 days. In the guaranteed loan program, for the period FY 2003 through FY 2005, the average processing time was 15 days. In FY 2006 guaranteed processing time declined to 13 days and so far in FY 2007 it stands at 10 days. The efficiencies gained by moving many of our loan processes into a web based environment are a major factor in the improvements in loan processing timeframes.

Local loan officers have substantial authority to make and service loans. The size of loan an employee may approve at the local level is based on an employee's training, experience and position. At the county or service center level, the approval limits are $500,000 for guaranteed loans and $175,000 for direct loans. The FSA District Director may approve guaranteed loans up to $500,000 and direct loans up to $175,000. Any loan over these amounts must be approved by the FSA State Executive Director (SED) or an employee to whom the SED has delegated his/her approval authority. Virtually all loans are approved within the state. The only applications sent to headquarters for a decision are those from an FSA state office employee, state committee member, or a close family member of a state office employee or state committee member.

**9. Question: We often hear about staffing shortages across the agency. Do you have enough resources and staff to meet the needs of producers in the field?**

Answer: The FY 2008 President's budget request provides the resources necessary to maintain service to producers at the level provided by recent appropriation acts. In recent years, some FSA loan officers have been required to split their time between multiple service center locations. FSA provides "supervised credit," which is essential for meeting the needs of our loan applicants. This is especially true as more of our borrowers are beginning and socially disadvantaged farmers who have historically needed greater financial and production counseling.

Because, the loan making process is a specialized activity, newly hired loan officers require, on average, two years of training to reach a moderate level of proficiency. Because of this long lead time, it is critically important that FSA hire loan officer trainees before the "need" arises.

According to a recent Strategic Capital Management study about 50 percent of our supervisory loan officers and 28 percent of all loan officers will be eligible to retire by the end of 2008. To meet the expected surge in retirements, the FSA Administrator has committed to reallocating existing resources to hire 100 additional loan officer trainees in FY 2007. We will continue to monitor the situation closely and will take additional steps as necessary to ensure a proper level of customer service.

**10. Question: The proposed $500,000 combined limit on direct farm operating and farm ownership loans is not indexed for inflation. However, the limit on guaranteed loans dating from 1998 is indexed for inflation. What is the rationale for indexing guaranteed loans and not direct loans?**

Answer: While there seems to be some consensus that the limits do need to increase, it is important to consider the budget implications of an increase to the limits. At the time the guaranteed limit was indexed, the amount of loan funds available were significantly less than the amount of funds being used. Those programs have grown with the limits such that almost all of the available program level is used. Demand for direct programs already meets or exceeds available program levels. Given the current budget situation, an increase in appropriations for the direct loan programs is not assured. While economic realities support an increase in the direct loan limits, indexing the limits would, over time, likely result in larger and larger direct loans to fewer and fewer farmers, and that situation is inconsistent with the objectives of direct loan programs.

**11. Question: Farmers may have more flexibility with the combined $500,000 cap, but the total is nonetheless only slightly higher than the current $400,000 total across the two types of loans. Given the increase in land prices and input costs since the mid 1980's, is a 25% increase in the combined loan cap sufficient?**

Answer: Currently, the direct farm ownership (FO) and direct farm operating (OL) loan programs are capped at $200,000 each. Under the proposal an applicant could receive a $500,000 FO or a $500,000 (OL). This is a 150 percent increase over the current limit. By having a combined limit instead of two individual limits, a farmer has the flexibility to request funding in a structure that would best meet the needs of their operation. Under current budget constraints, it is not realistic to expect that there would be adequate funding if the levels were raised high enough to completely finance most operations. The majority of FSA direct loans are made in participation with commercial lenders. The proposed limits would increase FSA's ability to finance higher cost operations but continue the leveraging of direct loans with private sector loans.

**12. Question: The 2002 farm bill required a study of the effectiveness of the delivery of USDA's direct and guaranteed loan program. The issue was whether the direct loan program was still needed, given shifts in many different government loan programs toward guaranteed loans. Why is a direct loan program still necessary? Shall we continue to reduce its size relative to guaranteed loans?**

Answer: The study you refer to reached a number of conclusions regarding the continued need for direct loans. The study concluded that "many of these borrowers (direct) appear unable to meet commercial credit standards and would likely have difficulty either continuing or beginning in farming, without access to direct loan programs. Therefore, their financial profile appears to be consistent with agency's mission of serving farm borrowers unable to access commercial credit and reasonable rates and terms, but yet able to project at least some level of debt repayment ability."

The study results also indicate that the direct lending delivery system is more focused on servicing groups considered socially or economically disadvantaged. A much higher share of total direct lending went to socially disadvantaged farmers and beginning farmers than in the loan guarantee program.

In another study, independent researches at the University of Arkansas verified that FSA direct loan programs are operating effectively, and make a significant, positive impact on the groups they are intended to serve. In one facet of their research, they studied loan originations in fiscal years 2000-2003 and found that 92 percent of the direct loans originated in those years went to small farmers, that is, farmers with less than $250,000 in gross sales. They found that although FSA farm loans assist only 4 percent of all farmers, because FSA farm loans are targeted to family farmers, an estimated 18 percent of all non-hobby family farmers depend on FSA for at least a portion of their financing.

The researchers also examined longer term outcomes of FSA's FLP. They reviewed the status of farmers who received loans between 1994 and 1996. The research found that 78 percent of the loans made during that period have been satisfied. They also found that of all the loan recipients during that period, only 11 percent left farming involuntarily.

In FY 2006, over 11,000 beginning and socially disadvantaged farmers received direct loan assistance from the Agency. In the direct farm ownership program, 86 percent of the loans made went to beginning and minority farmers. Although direct loan borrowers must be unable to get credit elsewhere, even with a guarantee, the program is performing fairly well. The FSA direct loan program delinquency is currently 8.6 percent. The FSA direct loan program loss rate in Fiscal Year 2006 was 2.6 percent. While these rates are higher than those of commercial lenders, they are impressive given that every direct borrower was deemed too high a credit risk by a commercial lender.

The Administration's farm bill proposals would intensify the focus of the direct loan programs to SDA and beginning farmers. During the Secretary's listening sessions, the need to help beginning farmers was a recurring theme. Given the need, the direct loan program should be maintained. Eliminating the direct program would take away an important means of strengthening and diversifying many farm communities and eliminate opportunities for many potentially successful farmers across the country.

**13. Question: What has been USDA's experience with the pilot program to guarantee contract land sales as established under the 2002 farm bill (7 U.S.C. 1936)? The program was authorized as a pilot through FY2007, and was to guarantee loans made by a private seller of a farm to a qualified beginning farmer on a contract land sale basis. How would USDA rate the success of this program? Why is USDA not requesting its reauthorization?**

Answer: The Beginning Farmer and Rancher Land Contract Guarantee Pilot Program, implemented in September 2003, was originally available in six States - Indiana, Iowa, North Dakota, Oregon, Pennsylvania, and Wisconsin. There have been very few applications, and only one guarantee was approved during the first two years of the program. In September 2005, California, Minnesota, and Nebraska were added to the pilot in an effort to increase program participation. It is disappointing to report that only one additional land contract has been guaranteed since 2005. Based on virtually zero participation, we have concluded the program is not effective, and do not recommend it be reauthorized.

**14. Question: Does the Administration have a position on expanding the lending authority of the Farm Credit System (FCS)? Does FSA see any gaps in agricultural lending that need attention? Does the White House have a broader position on expanding the role of GSE's relative to free-market lenders?**

Answer: USDA has taken no position on expansion of FCS lending authorities. By statute, FSA emergency loans are only available to family-sized farmers. Farmers who are above family-sized are not currently eligible for FSA credit assistance.

**15. Question: Did the agency discuss waiving term limits on either the direct or the guaranteed side? It appears that even if you did, the decision was made to continue to support term limits since you appear to be shifting the emphasis of those who can receive support to beginning and socially disadvantaged producers.**

Answer: We fully support the continued waiver of borrower term limits for the guaranteed loan program. The legislative language developed to implement the Secretary's Farm Bill Proposals includes a provision to continue the suspension of the guaranteed program term limit through 2012. With regard to the direct loan program, no change to term limits for direct loans has been proposed.

**16. Question: What generally happens to a borrower that reaches their maximum number of years of eligibility? How many get credit elsewhere? Are these folks generally current on their loans? Does the agency lose money in these situations?**

Answer: At this time, FSA does not capture this type of specific information about individual borrowers who have reached the maximum years of eligibility. Additionally, FSA does not have verifiable information on how reaching the maximum number of years of eligibility impacts on the status of the borrower's accounts. FSA loan officers work closely with borrowers who have reached their loan limits to obtain loans through the use of subordinations. FSA has a successful graduation program in place that moves borrowers from Agency credit to the commercial sector when their financial condition allows them to do so. In FY 2006, 2,824 direct loan borrowers (3.83 percent) were able to graduate. Borrowers who have reached their loan limits may, or may not be financially capable of obtaining commercial credit to meet their needs.

**17. Question: Do you believe your borrower training requirements are strong enough? Perhaps Ms. Cooksie can give us some historical context on the road to trying to strengthen the supervision of borrowers by FSA employees.**

Answer: Yes, the Agency believes that the current borrower training requirements are adequate. An applicant can be required to take financial training and/or production training. There are specific criteria and guidelines in place for a training course to be approved and all vendors who want to conduct training must be approved by the National Office. Failure to take the training will result in the borrower being unable to receive any future assistance from the Agency until the training is completed. The training requirement was first put in place to help alleviate a need that had been identified by Agency personnel and borrower advocacy groups. Many borrowers did not understand farm finances and as a result could not manage them. Borrower training has served to help new and existing borrowers fully understand the financial implications of their farming operation and has helped many borrowers become successful operators.

**18. Question: One of the proposals in the various farm bill marker bills that are being developed is to establish a guaranteed loan program specifically for conservation projects. Do you view a separate program as necessary? Given that you can only lend to those who can't get credit elsewhere, is it something that is needed?**

Answer: We are not familiar with the proposal referred to in the question. The existing guaranteed loan program, both farm ownership and operating loans, can be used for conservation purposes. Many conservation projects are worthwhile from an environmental quality standpoint, but do not contribute additional income to the operation to facilitate repayment of the loan. To date, such requests have not been common and we do not view a separate program as necessary.

**19. Question: The gentleman who's testifying on behalf of the ABA, mentions a lawsuit settlement that a bank in Oklahoma faced because of the definition of "average agricultural loan customer". Can you tell us any more about this situation?**

Answer: The FSA regulations for the guaranteed loan program prohibit lenders from charging interest rates to guaranteed loan customers that are higher than the rate provided to their average loan customer. Specifically, the regulation states that "neither the interest rate on the guaranteed portion nor the unguaranteed portion may exceed the rate the lender charges its average agricultural loan customer." This requirement is in place to assure that a guaranteed loan borrower does not pay a default risk premium larger than that of an "average agricultural customer," since the FSA guarantee eliminates most of that risk to the lender.

The Oklahoma bank to which you refer was sued by borrowers alleging that the bank charged interest rates that exceeded this limit. We are currently discussing the issue with lender groups and weighing alternatives to clarify the issue, while continuing to protect the borrower as well.

**20. Question: The ABA proposes changing your current definition of what constitutes a "family farm" for utilizing your programs. What is your current definition? What do you think of their suggestion to allow anyone who files a Schedule F with the IRS?**

Answer: Currently under FSA regulations a family farm is defined as a farm which produces agricultural commodities for sale; produces enough income, along with dependable non-farm income, to pay operating expenses, loan payments, and family living expenses; is managed by the borrower, and has a substantial amount of the labor necessary provided by the farmer and their immediate family; a reasonable amount of seasonal labor may be used.

The Agency strongly opposes allowing anyone who files a schedule F to be considered a family farm. They might be a farm, but may well be extremely large. From inception, the loan programs now operated by FSA loan programs have been limited to smaller farmers. We see no need to broaden the program in a way that would support very large farms, particularly when loan funds may be limited and a large farm would potentially receive a loan at the expense of several smaller farms.

**21. Question: In his testimony, Mr. Zippert brings up how you determine who is a "beginning farmer". He mentions that you require 3 years of experience or management. How do you define experience? Does time spent working for someone else as a farmworker or hired hand qualify?**

Answer: The definition of a qualified beginning farmer or rancher used by FSA in farm loan programs is specified by statute, at 7 U.S.C. 1991 (a)(11). The 3 year requirement for experience or involvement in the operation of a farm is a separate statutory requirement (7 U.S.C. 1922(b)(1), ... participated in the business operations of a farm or ranch for not less than 3 years...) only for direct farm ownership loans. It does not apply to any of the other Agency loan programs. The agency defines "participated in the business operations of a farm or ranch" as being the owner, manager or operator of a farm business, or having been employed as a farm manager or farm consultant, or by having worked on a farm with significant responsibility for day-to-day management decisions. We believe the intent of the requirement was for the beginner to have at least some experience in farm business decision making prior to taking on a large debt to buy farm, and administer the program accordingly.

**22. Question: The Administration's farm bill proposal advocates a move to targeting 70% of direct operating loan funds to beginning and socially disadvantaged farmers and ranchers. What is the current breakdown of how much is going to which type of producer? You also indicate that 100% of direct farm ownership loans should go to these same producers. Again, I'd like to know the current breakdown. I'd also like to know how you see the usage between beginning and socially disadvantaged producers working out. Are you concerned about producers in one region of the country being more able to access limited funding when it is available?**

Answer: By statute, 35 percent of direct operating loan funds are targeted for beginning farmers until September 1 of each fiscal year. In addition, 15 percent of direct operating funds are set aside for exclusive use of minority and female farmers.

In the direct farm ownership loan program, 24 percent of the loan funds are set aside for minority and female farmers while 70 percent of available funding is reserved for beginning farmers until September 1.

The Agency has set performance targets for each program based upon the funding targets. Each state receives an individual funding allocation in both the direct operating and farm ownership programs. Thus, certain regions do not have an advantage in use of funds due to an earlier planting season. Also, loan funds are managed in a way that provides opportunities for funding of approved loans to all states, regardless of the seasonality of their need. Examples of these management techniques are national reserve and a "pooling" and redistribution of available funds during the fiscal year.

During FY 2006, 53% of direct operating funds and 78% of direct farm ownership funds went to beginning farmers or ranchers. During that same time period, 13% of direct operating and 16% of direct farm ownership funds went to minority and female farmers and ranchers.

**23. Question: You mention that a good chunk of FSA's credit employees may be eligible to retire soon. Is the agency having problems hiring new employees?**

Answer: According to a Strategic Human Capital Management study, many Farm Loan employees will be retiring very soon. The Loan Officers on average are retiring within 3 months of their retirement eligibility date. Of those who are in supervisory positions, 50% will be eligible to retire between now and 2008. Of all FSA Loan Officers, 28% are eligible to retire between now and 2008.

FSA Farm Loan Officers functions are critical to the effective delivery and service of Agency Farm Loan Programs (FLP). Because the position requires specialized training, it is essential that resources to support the Farm Loan Officer Training program be allocated prior to announced retirements.

**24. Question: What is FSA doing to address the computer and closure problem our constituents are having across the country?**

**Computer Issue Answer:** At the direction of the Secretary of Agriculture, FSA, working with the Offices of the Chief Financial Officer and Chief Information Officer, has developed a detailed plan for the stabilization and augmentation of the Web-based environment, or Common Computing Environment (CCE), used to administer FSA's farm programs. This plan contains a detailed analysis of what hardware, software, and personnel resources are needed to allow reliable and sufficiently responsive software program delivery for the Agency's county office staffs to provide quality service to FSA's customers. The Agency has designated a limited amount of funding from its FY 2007 Budget to begin this stabilization process, and is working with USDA's Office of Budget and Program Analysis and the Office of Management and Budget (OMB) to identify further resources.

In addition, FSA is working with OMB to finalize a longer term business plan for a significant modernization of FSA's business delivery. This plan includes finalizing the ongoing migration of business processes from obsolete legacy systems as well as the development of a fully integrated delivery system in accordance with the requirements mandated by Congress and OMB. This project will "retire" the 1980's era system and allow FSA's field staff and customer base to access the full range of program benefits via the internet.

However, it is not anticipated that this system will be funded, developed, and implemented in time to deliver program benefits for the next crop year. This is why there is an urgent need for stabilization and augmentation of the CCE. Stabilization and augmentation of the CCE will improve "current" program delivery using the legacy systems and will provide the additional "backbone" needed to continue migration of the legacy systems to the web.

**Restructuring Answer:** FSA is committed to coordinating with Congress, State officials, stakeholders, local groups and customers to ensure that FSA offers the best service possible.

FSA has asked each of its State Executive Directors (SEDs) to conduct an independent local-level review of the effectiveness of FSA offices in their State. SEDs and State Committees (STC) were asked to form review committees to identify the optimum network of FSA facilities, staffing, training and technology for their state, giving consideration to existing budgetary resources and staffing ceilings. As a result of this decentralized, localized methodology, there is no comprehensive national plan or formula for identifying the optimum network of FSA offices.

State Executive Directors and the State committees submit proposed plans for each state. FSA's Deputy Administrator for Field Operations reviews the proposed changes, and those recommendations are shared with the potentially affected Congressional delegation. SED's hold public meeting in the counties proposed to be closed as mandated by Congress. FSA is committed to open and transparent communications and will coordinate communication efforts with area farmers, ranchers, and stakeholders. State plans are proposals, and consideration will be given to comments made at the public meetings. A final plan will be developed and submitted to Washington, D.C., for approval after the public meetings are held. FSA has not hastily gone through this process but carefully taken each step in a thoughtful manner. Everyone will have the opportunity for comments during the public meetings.

We recognize the importance of FSA to agricultural communities and farm operations in rural America. However, we do not feel that we can continue to do business as we have in the past. Agriculture is a dynamic and changing industry; therefore, FSA must constantly review the way it positions resources so that it can maintain its tradition of excellent customer service.

An important option available to producers is the ability to choose their administrative headquarters. If an office is closed, producers will be given the option to choose the county FSA office where they wish to conduct business. If another contiguous county is more convenient for individual producers, they will be allowed to choose that office for their business needs. The flexibility of producer choice is an important part of consolidation efforts.

The ultimate goal of this process is to increase the effectiveness of FSA's local delivery. FSA is committed to working with its partners to ensure that America's farmers and ranchers continue to receive excellent service long into the future.

March 26, 2007

The Honorable Collin Peterson
Chairman
House Committee on Agriculture
1305 Longworth House Office Bldg.
Washington, D.C. 20515

The Honorable Bob Goodlatte
Ranking Member
House Committee on Agriculture
1305 Longworth House Office Bldg.
Washington, D.C. 20515

Dear Congressmen:

We the undersigned associations representing community banks throughout the United States oppose efforts by the Farm Credit System (FCS) to include an expansion of the System's lending authorities in the 2007 Farm Bill. The FCS has developed a set of proposals, known as the Horizons Project, which would dramatically expand the System's lending, including allowing FCS loans to commercial businesses and for all types of mortgage financing in cities with populations up to 50,000.

These proposals will not cause any new loans to be made that banks and other non-governmental lenders would not otherwise make. Instead, they will adversely impact small cities and rural communities all over America by displacing from those markets community banks that lack the tax-preferred status and government sponsored enterprise (GSE) funding advantage of the Farm Credit System. The Horizons proposal will fundamentally alter the mission of the Farm Credit System by redirecting resources toward general commercial and mortgage lending, into cities and suburbs and away from agricultural lending.

In an October 2000 public statement, the U.S. Department of the Treasury pointed out that the FCS, as a GSE, is a heavily subsidized system that enjoys competitive advantages over private sector banks. Treasury stated: "GSEs are an exception to our general approach of avoiding differential treatment among financial institutions. **The potential benefits that GSEs bring to a particular market must be balanced, therefore, against potential risks to the financial system and potential effects on market competition.**" In a May 2, 2001 letter to the Farm Credit Administration, Treasury objected to an FCA proposal doing away with geographic lending constraints on FCS institutions, stating: "Because FCS associations lend much like [private sector] banks, it is tempting to think of them as just another competitor in the agricultural credit market. **But they are not just another competitor: They are a lender to which the government has given significant competitive advantages.**" (Emphasis added)

Community banks are committed to rural America and the prosperity of the people who live there. Of the nation's 8,500 community banks, forty-four percent are in towns of less than 5,000 people. Nearly sixty percent are in towns of less than 10,000 people. Banks provide approximately 40% of all agricultural loans in the country and are the largest source of credit for American agriculture and a primary source of credit for consumers, business and economic development in their communities. FCS proposals that weaken the competitiveness of community banks will harm rural America. We ask that you oppose adoption of the Horizons Proposals in the 2007 Farm Bill and any other legislation. Thank you.

Arkansas Community Bankers Association
Bank Holding Company Association
Bluegrass Bankers Association (BBA) in Kentucky
California Independent Bankers
Community Bankers Association of Alabama

Community Bankers Association of Georgia
Community Bankers Association of Illinois
Community Bankers Association of Kansas
Community Bankers Association of New Jersey
Community Bankers Association of NH
Community Bankers Association of Ohio
Community Bankers Association of Oklahoma
Community Bankers of West Virginia
Community Bankers of Wisconsin
Connecticut Bankers Association
Connecticut Community Bankers
Florida Bankers Association
Hawaii Bankers Association
Heartland Community Bankers Association
Independent Bankers Association of New York State
Independent Bankers Association of Texas
Independent Bankers of Colorado
Independent Banks of South Carolina
Independent Community Bankers Association of Maine
Independent Community Bankers Association of New Mexico
Independent Community Bankers of Minnesota
Independent Community Bankers of South Dakota
Independent Community Banks of North Dakota
Indiana Bankers Association
Iowa Independent Bankers
Iowa's Community Bankers
Kentucky Bankers Association
Louisiana Bankers Association
Maine Association of Community Banks
Massachusetts Bankers Association, Inc.
Massachusetts Independent Bankers Association, Inc.
Michigan Association of Community Bankers
Michigan Bankers Association
Minnesota Bankers Association
Missouri Independent Bankers Association
Montana Independent Bankers
Nebraska Bankers Association
Nebraska Independent Community Bankers
New Hampshire Bankers Association
North Carolina Bankers Association
North Dakota Bankers Association
Pennsylvania Association of Community Bankers
South Carolina Bankers Association
South Dakota Bankers Association
Tennessee Bankers Association
Vermont Bankers Association

Virginia Bankers Association
Virginia Association of Community Banks
Washington Financial League
Washington Independent Community Bankers Association
Wisconsin Bankers Association

THE FINANCIAL SERVICES ROUNDTABLE

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March 27, 2007

The Honorable Tim Holden
Chairman
Subcommittee on Conservation, Credit, Energy, and Research
Committee on Agriculture
U.S. House of Representatives
Washington, DC 20510

The Honorable Frank Lucas
Ranking Member
Subcommittee on Conservation, Credit, Energy, and Research
Committee on Agriculture
U.S. House of Representatives
Washington, DC 20510

Dear Chairman Holden and Ranking Member Lucas:

The Roundtable appreciates your leadership in holding this hearing to examine the availability of credit in rural America. Our companies play a significant role in providing credit in rural America and we believe this hearing will help to highlight the amount of credit commercial banks and private lenders provide in rural America. In this hearing, Members should also consider the role of the Farm Credit System (FCS), our nation's oldest Government Sponsored Enterprise (GSE), in meeting its original mission and <u>not</u> expanding into areas more than adequately served by the private sector. The FCS, with its significant tax and lending advantages, has the ability to undermine the competitive marketplace and supplant private sector lenders.

**<u>Roundtable Members, Rural America and Agriculture Lending</u>**

The Financial Services Roundtable represents 100 of the largest integrated financial services companies providing banking, insurance, and investment products and services to the American consumer. Member companies participate through the Chief Executive Officer and other senior executives nominated by the CEO. Roundtable member companies provide fuel for America's economic engine, accounting directly for $50.5 trillion in managed assets, $1.1 trillion in revenue, and 2.4 million jobs.

The Roundtable represents many of the largest agriculture lenders in this country, along with insurance companies involved in agriculture lending and credit companies that provide lending for equipment and vehicles used in agriculture.

More specifically, The Roundtable represents 9 of the 10 largest agriculture lenders, who hold more than $17 billion in agriculture loans. In addition we represent 4 of the 6 insurance companies that account for nearly 6% of total farm lending.

Our companies are located in communities throughout the rural America. In surveying our membership, we know that we have member companies located in and serving every congressional district in the country.

**Examining the Role of the Farm Credit System**

The Farm Credit System (FCS) was created by Congress some 90 years ago to provide credit to farmers and ranchers. Fundamentally, GSEs, such as the FCS, were chartered to offer services in markets that were not adequately served at a point in time. At the time the FCS was established, credit was hard to come by in rural America with commercial banks either not permitted, or unable to take on the risk associated with agriculture ventures.

Over the years the FCS has changed, expanding far beyond its original mission. Today, FCS institutions provide mortgage loans to rural homeowners and lend to agricultural product processors and marketers and farm-related service businesses. The FCS customer base has also shifted from the young, beginning and small farmers and ranchers to larger borrowers with 58% of FCS loans over $500,000 and 24% over $5 million.

As the FCS has expanded, credit has become more widely available in rural America through commercial banks and private lenders. Today, rural America is served by a variety of lenders, including Roundtable members, community banks, and other lenders.

With the greater availability of credit in rural America, it is important that the mission, current role, and future role of the FCS be carefully considered. The FCS as a GSE, which is subsidized by taxpayers, is using its significant tax and credit-cost savings to compete against commercial banks and other tax-paying private-sector lenders. An expert, who has studied the FCS, has estimated that the FCS has a 70 basis point lending advantage in non-real estate lending, and a 155 basis point advantage in real-estate-secured lending.

The lending and tax advantages of the FCS distort and therefore harm the competitive marketplace, and supplant the services of private lenders. The Roundtable believes a competitive marketplace can best serve the credit needs of agricultural and rural America and that competition should be encouraged. We urge the Committee and Congress to critically examine the role of the FCS and oppose efforts to protect or expand the role and mission of the FCS in areas amply served by the private sector.

We appreciate your consideration of our views and thank you for your leadership on this issue.

Best regards,

Steve

Steve Bartlett
President and CEO

THE FARM CREDIT COUNCIL

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**FOR IMMEDIATE RELEASE**
**March 27, 2007**

**Contact: Mike Mason**
**(202) 879-0850**

## Farm Credit Presents Congress With Proposals To Help Better Serve U.S. Agriculture and Rural America

**WASHINGTON** – Calling for Congress to ensure that U.S. agriculture and rural America have reliable access to capital to meet changing needs, the Farm Credit System today presented lawmakers with a modest three-point plan to update its service to American farmers, ranchers and rural families.

"Today's farmers, ranchers and rural entrepreneurs are on the leading edge of a global agricultural economy. Farm Credit's research has made it clear that rapid change requires greater flexibility on the part of the institutions that U.S. agriculture and rural America rely on. Yesterday's ways of doing business simply will not work to ensure the continued success of agriculture and America's rural communities," said Bruce Nelson, a Farmington, Wash. farmer who serves on the board of Northwest Farm Credit Services in Spokane and as Chairman of the Farm Credit Council Board of Directors.

"Farm Credit today provides an efficient, customer-owned system to move capital from national money markets to agriculture and rural America, but decades old law that has not been updated to reflect today's business structures and population change hampers Farm Credit's ability to support progress," added Armin Apple, a McCordsville, Ind. farmer who also serves on the Farm Credit Council Board as well as the board of Minnesota-based AgriBank.

For over 90 years, the Farm Credit System (FCS) has advanced its mission to maintain the quality of life in rural America and on the farm by providing sound, dependable and competitive financing and related services. Facing a rapidly changing global marketplace and structural change, American farmers, ranchers and rural entrepreneurs need reliable access to a broad range of financial services and expertise in order to capitalize on emerging growth opportunities.

To modernize Farm Credit's ability to serve agriculture and rural America and maintain farmer control, Farm Credit proposed the following incremental changes to current law:

- **Providing More Financing Options for Farm- and Fishing-Related Businesses:** This proposal would increase the competitive credit options for farm- and fishing-related businesses by allowing more of them to borrow from Farm Credit. Eligible businesses would be limited to those primarily engaged in providing needed inputs directly to producers (such as local farm equipment dealers, feed and seed dealers, commercial fishing vessel repair services, etc.) or that purchase or handle farm products directly from producers (such as local grain elevators, value-added processors, etc.). Farmers and aquatic producers rely on a strong rural infrastructure of related businesses to support their operations – without these businesses, farmers, ranchers, and producers of aquatic products won't survive.

- **Making Competitive Home Mortgage Choice Available to More Rural Families:** Farm Credit currently can provide home mortgage loans only to residents of towns with populations of 2,500 or fewer. This limit has not been adjusted since 1971. Since the, Congress has renewed the definition of "rural" for many USDA programs, and today includes areas up to 50,000 in population. This proposal would permit Farm Credit to make mortgage credit available for moderately priced, single-family, owner-occupied homes in additional rural towns consistent with that USDA definition, just as it does today in very small towns. Farm Credit would remain bound by a requirement that rural home mortgage lending cannot exceed more than 15 percent of a Farm Credit association's loan portfolio, thereby limiting risk exposure as well as its position in the local mortgage marketplace.

- **Modernizing Farm Credit's Ability to Set Cooperative Stock Requirements:** The current minimum stock purchase requirement for borrowers from Farm Credit associations was set twenty years ago when System capital levels were low. Today, however, the capital levels of all Farm Credit associations substantially exceed the minimum requirements. Local association directors would be given the flexibility to set the minimum stock-purchase requirement. The proposal would not alter requirement that voting stock only be held by farmers. Also, the board of the one Agricultural Credit Bank in the System, CoBank, should have the flexibility to give more of its stockholders the right to vote in board elections.

Farm Credit presented these proposals at a hearing today before the House Agriculture Committee's Subcommittee on Conservation, Credit, Energy and Research. Testifying on behalf of Farm Credit were Mr. Apple and Doug Stark, President and CEO of Farm Credit Services of America, a Farm Credit association serving Iowa, Nebraska, South Dakota and Wyoming.

"For nearly 90 years, the Farm Credit System has been rural America's customer-owned partner," Mr. Stark said. "Tomorrow's agriculture – more complex, more diverse and more consumer-driven than ever before – requires more industry cooperation, community collaboration, financial support and investment, dependable infrastructure and updated public policy, in order to ensure continued success and a bright future for rural America."

# # #

**NOTE TO EDITORS:** The House Agriculture Committee will make available an audio feed of the hearing, which can be accessed at http://agriculture.house.gov/hearings/audio.html. Photos of the hearing will be posted at http://www.flickr.com/photos/farmcredit.

*The Farm Credit System is rural America's customer-owned partner. Farm Credit helps maintain and improve the quality of life in rural America and on the farm, through its constant commitment to competitive lending, expert financial services and advice, and a feeling of partnership with its customers. The Farm Credit Council is the national trade association representing the interests of the institutions of the Farm Credit System. For more information visit* www.fccouncil.com.

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Statement of the National Association of REALTORS®

to the House Agriculture Subcommittee on Conservation, Credit, Energy, and Research

Hearing on the Availability of Credit in Rural America

March 27, 2007

The NATIONAL ASSOCIATION OF REALTORS® represents a wide variety of housing industry professionals committed to developing and preserving the nation's housing stock and making it available to the widest range of potential homebuyers. The Association has a long tradition of support for innovative and effective Federal housing programs and we work diligently with the Committee and the Congress to fashion housing policies that ensure Federal housing programs meet their mission responsibly and efficiently.

Access to safe, fair and affordable mortgage credit is important to all Americans, but the need is especially dire in rural areas. Nearly 20% of the U.S. population lives in non-metropolitan areas. Housing conditions in rural areas are generally worse than in urban or suburban neighborhoods. Federal rural housing programs are instrumental in providing affordable housing opportunities to low- and moderate-income rural homebuyers. The National Association of REALTORS® supports a long-overdue increase in the population cap for areas that can be served by the Farm Credit System.

The Farm Credit System and its network of customer-owned lending institutions were created by Congress more than 90 years ago, to make much-needed credit available to America's farmers, ranchers, producers and harvesters of aquatic products, their cooperatives, and farm-related businesses. Consistent with their mission, Farm Credit System institutions also make loans to help finance home purchases in rural areas.

The Farm Credit Act of 1971 (12 U.S.C. 2019) limits the size of towns whose residents can be served by Farm Credit System for the purposes of financing purchases of homes to those with populations of 2,500 or fewer. While this limit may have been adequate to address the needs of rural residents and businesses in 1971, the nature of rural America has changed considerably since that time. In 2002 Congress changed the definition of "rural" in the Consolidated Farm and Rural Development Act to apply to communities that have a population of less than 50,000 and are not suburbs of an urban city or town. However, this definition was not extended to the Farm Credit System's home loan program.

Many agriculturally-related businesses are located in towns with populations in the 2,500 to 50,000 population range and are no longer located on or adjacent to farmland as was once the case. According to the 2000 federal census, more than 5,800 of these towns and small cities are located throughout America. The Farm Credit System is currently unable to serve the needs of potential borrowers who are located in these areas.

Housing finance constitutes a small (but important) portion of the business of the Farm Credit System institutions' lending activity. By statute, home loans cannot represent more than 15% of the Farm Credit portfolio. In 2005, loans to purchase homes totaled $2.9 billion. Although a small factor in our nation's trillion dollar housing finance system, it is vital for those families in rural America who otherwise would be denied an opportunity to realize the American dream of home ownership because of a lack of readily-available, reasonably-priced credit. We encourage Congress to support a long-overdue increase in the population cap to 50,000 for areas that can be served by the Farm Credit System's home loan program.

In closing, the National Association of REALTORS® appreciates this opportunity to comment on the needs for mortgage credit in rural areas. Many of our rural citizens face a serious housing crisis. All but 11 of the 200 counties with the highest poverty rates in America are rural, and housing assistance for these areas is sorely needed. We thank the Subcommittee for its attention to the needs of rural communities, and we urge your support of changes to the Farm Credit System that will provide rural homebuyers safe, fair and affordable access to credit.

Testimony
Submitted for the United States House of Representatives
Committee on Agriculture Subcommittee on Conservation, Credit, Energy, and Research
March 27, 2007
Review of Credit Availability in Rural America

# Assessing the Availability of Credit in the USDA Farm Service Agency and Recommendations for the 2007 Farm Bill

**Statement Submitted for the Record by**
**The Federal Managers Association**
**USDA National Association of Credit Specialists – Farm Service Agency**

1641 Prince Street ▪ Alexandria VA 22314-2818 ▪ Tel: (703) 683-8700 ▪ Fax: (703) 683-8707
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Chairman Holden, Ranking Member Lucas and distinguished members of the Subcommittee on Conservation, Credit, Energy, and Research:

On behalf of the over 1,500 managers in the USDA Farm Service Agency, the National Association of Credit Specialists of the Farm Service Agency (NACS-FSA), and the nearly 200,000 managers in the federal government whose interests are represented by Federal Managers Association (FMA), please allow us this opportunity to present our views before your Subcommittee. As federal managers, we are committed to carrying out the mission of our agency in the most efficient and cost effective manner while providing necessary services to needy farmers and ranchers We truly appreciate your interest and leadership in ensuring the credit needs of America's farmers and ranchers are met.

The mission of the Farm Service Agency is to "administer farm commodity, credit, environmental, conservation, and emergency assistance programs for farmers and ranchers." As Loan Managers, we work daily with farmers and ranchers who, for a variety of legitimate reasons, do not qualify for direct loans from private lenders. In such cases, FSA offers both direct and guaranteed loans to assist qualified farmers and ranchers start a family-sized agricultural endeavor, expand an existing operation, or restructure their obligations to help them overcome an economic, financial or weather related hardship. To achieve our mission, the agency provides direct operating and farm ownership loans of up to $200,000. We also guarantee loans made by commercial lenders to assist qualified family-size farm operations to become successful even though they do not meet commercial standards at the onset of their operation. Ideally, the goal for these small loans is for farmers and ranchers to graduate through the process from receiving direct loans from the government, to having the government guarantee a loan from a private lender, to establishing their own sustainable line of direct private loans.

From our perspective, FSA's farm loan programs are in good standing. The agency has highlighted that loan funds are in high demand and loan default and loss rates are low. With few exceptions, the program changes made with the passage of the 2002 Farm Bill have pleased its customers, commercial lenders, farmers and ranchers. The bill authorized the Farm Loan Program to modernize its delivery tools, regulatory rules and resource infrastructure to better serve rural Americans. Despite budget shortfalls and a growing disparity in information technology resources, significant enhancements have been achieved in the use of existing modern technology and expansion into Web-based programs. We are in the final stages of streamlining loan program regulations and updating our forms. This effort should result in the elimination of approximately 38 regulation manuals. Any remaining documents in use will be automated to improve cost savings, enhanced efficiency and easy access for internal and external customers.

We do not wish to overshadow the many accomplishments of the Agency and the incredible work being conducted by the dedicated managers and employees of its workforce. However, as responsible stewards of the taxpayers' dollars, we find it necessary to express some concerns for the future economic well being of rural America and the continued effectiveness of the programs that we administer. Rising interest rates, high agricultural production costs, high capital investment costs, increasing costs of living, the probability of less generous commodity program benefits, shrinking agricultural profit margins, a declining number of lenders offering credit to family-size farm operations, outdated information technology resources and a "human capital crisis" of increasing attrition rates at the Agency are all indications that a potentially devastating scenario could cripple the strength and stability of the farm loan program. We recognize the inherent risks of the cyclical agriculture industry that we are in and understand that no degree of preparation will allow us to save every family farm, rural business, rural school or rural community from market conditions.

There are a number of issues which we believe will further improve the farm loan program and allow it to maintain its stability. We proposed some of these reforms in 2001 and 2002 during consideration of the 2002 Farm Bill. More specifically, addressing term limits on direct and guaranteed loans and increasing loan limits are a few issues that we recommended as further improving the effectiveness of the program, but were ultimately omitted from the 2002 Farm Bill. As we face the expiration of the 2002 Farm Bill, this seems like an opportune time for Congress to act on reforming these important credit issues during the reauthorization of the Agriculture, Conservation and Rural Enhancement Act.

## REFORMS TO THE FARM LOAN PROGRAM

### END THE TERM LIMITS

The phrase "term limit" is used to describe rules limiting the number of years that a customer can be enrolled in the FSA direct and guarantee loan programs. The term limits for direct loan programs are seven to ten years depending on the type of loan received. A customer who is unable to obtain credit from commercial sources can only receive loans from the agency for seven to ten years at which point the farmer or rancher must either have built up a strong enough credit to go to a private lender or face the alternative of being unable to sustain their operations. Term limits do not have any caveats or exclusions for natural disasters, falling prices or random occurrences such as a ban imposed on the American beef industry by the Japanese government. Term limits are hard and fast dates that set forth a get lucky or get out mandate seemingly unsuitable for a need based federal farm loan program. The reality is many needy farmers and ranchers are unable to apply for loans because of these arbitrary term limits.

In our line of work, these are not just theoretical examples. Day in and day out, we encounter good, hard working people who just need a little more assistance or a little more time to stay afloat. For instance, a Wisconsin dairy farmer who cannot apply for credit to rebuild his dairy barn that burned down, or the Texas farmer with a terminally ill wife who suffered two consecutive years of crop failures as a result of a severe drought, is unable to secure credit to continue a farm operation that has traditionally been profitable. As a farm loan manager, these arbitrary standards put us in the unenviable position of turning away otherwise qualified applicants such as a forty year old apple orchard farmer from Washington forced to sell a third-generation farm after 20 years of ownership because three consecutive years of low apple prices eroded her financial condition and prevented her from securing commercial credit, or more than 375 Indiana farmers who will not be eligible for FSA loans unless the term limits are removed. These are real scenarios collected from our members across the country that reflect the reality of a farm loan program established to aid people in these situations, but are rendered useless due to the unfortunate bureaucracy.

A similar situation is occurring on a family farm in South Dakota. The family has one year of FSA direct operating loan eligibility remaining. In this area, farmers lost the majority of three grain crops over the past four of five years. Our corn yield has plummeted from around 76 bushels per acre to 47 bushels per acre during the past 10 years. Unfortunately, federal crop insurance does little to assist farmers in areas that suffer multiple crop failures. With only one year of FSA loan eligibility remaining, it is not likely that they will be able to prosper enough to meet commercial lending standards within the next 12 months. The family will lose their safety net and their source of financing within one year. Eliminating direct term limits would allow this customer, and others in similar situations, to continue to obtain their financing from FSA regardless of the number of years they have received loans.

The amount of capital required to maintain a viable farming operation is staggering. In the best of times the profit margins are slim, often requiring more than seven to ten years to build the equity and profitability that commercial lenders require. FSA loan programs are a critical part of the safety net that was created to assist viable family-size farmers and ranchers who are unable to secure commercial credit at affordable rates and terms. By neglecting this issue, we are hindering the sustainable development of rural farmers and ranchers by forcing term limits instead of working with the fluctuating markets and unique agricultural environments.

Provisions contained in the 2002 Farm Bill allowed for a two-year waiver of direct operating loan term limits on a case-by-case basis. Although it was appreciated, this band-aid did not fix the problem and the agency must then deny essential services to a large number of farmers and ranchers. One farm loan manager from Texas reports that a prolonged drought and term limits will force 23 of his customers to seek a new line of work within twelve months with approximately 80 percent of the 130 direct loan borrowers in that area to follow within a few years since they do not meet today's "chain bank underwriting standards." A loan manager in Wisconsin reported that 63 of 103 direct loan borrowers in his area will become ineligible for direct loans before the next Farm Bill is signed. As these families exit the farming business, liquidate their assets and move to the city to find work, the rural community and rural economy will suffer a devastating blow. It is possible to prevent this and help encourage sustainable rural agricultural development.

Term limits also apply to loans made by commercial lenders that are guaranteed by FSA. Term limits on guaranteed loans were waived through the end of 2006, and it was only through congressional action last year that the provision was extended through the end of the 2002 Farm Bill. Waiving the term limit rule on FSA guaranteed loans did not jeopardize the integrity or effectiveness of the program in any way, and guaranteed loan activity remained healthy while loan default and loss rates remained low. Therefore, we strongly recommend that the Committee support Farm Bill provisions to eliminate term limit rules on FSA direct and guaranteed farm loan programs.

By failing to address the elimination of this bureaucratic matter, we are denying the Agency a tool that will be essential in our efforts to save viable farm operations and provide stability to rural economies when the seas get rough and rural America needs us most. The get lucky or get out term limit rules should be eliminated in favor of agency graduation, market placement and credit elsewhere provisions that are already in existence. When properly applied, graduation, market placement and credit elsewhere rules are effective in assuring that FSA is not competing with private industry in providing essential credit to farmers and ranchers.

FSA's loan portfolio is in good shape and internal policies and procedures can be put into place to limit loans and encourage graduation. Competition for financial viable operations is keen. As such, we strongly recommend that the direct loan limits on farm ownership and operating loan limits be eliminated. We are not recommending this modification as a way to impair the loan making structure or create an unbalanced risk for the federal government. Rather, it is a way to use government resources as they were intended to be used in a profoundly helpful program such as this.

**INCREASE THE FARM LOAN LIMITS**

Loan limits describe the maximum amount of dollars that an applicant can borrow from FSA. As managers, we also struggle with the hindrance of the limits placed on the level of loan we may make at a given time. FSA's direct operating loan (OL), which is used to finance production expenses, machinery, equipment, vehicles, livestock or other short and intermediate term farm business ventures, has a limit of $200,000. Direct farm ownership (FO) loans, which are used to finance the purchase or improvement of real estate, also have a $200,000 loan limit. These loan limits were established more than 20 years ago and do not meet the needs of modern day operations. Production and capital costs increased significantly over the past 20 years. Today agricultural operations require larger capital and larger start-up financing. Direct OL and direct FO loan limits need to be adjusted to allow FSA to effectively serve family-size farmers and ranchers in all areas of this nation.

A farm loan official from Wisconsin reported to us that a farmstead costing less than $200,000 20 years ago is currently selling for at least $650,000 and they are lucky if a $200,000 loan is enough to purchase a ten acre farmstead. East and West coast states are realizing an even larger spread between our current loan limit and the amount of funds needed to finance the purchase of a modest family-size farm.

Of greater concern is that our operating loan limit is preventing FSA from meeting the needs of customers. A loan manager from Washington reports that a typical 50 acre fruit production operation in his area requires $150,000 operating capital annually, and they do not sell their crop from one year before needing funds to produce the following year's crop. This means this customer will need $300,000 of operating credit for a short period of time when only $200,000 is available from FSA. This also does not take into consideration his credit needs for machinery and equipment with the agency on a term loan. The Washington loan official, with just reason, claims that we are setting beginning farmers up and "directly participating in their demise" because our loan limits are not sufficient to meet the needs of the customers that we are attempting to assist. Similar stories may be heard from loan officials in Georgia, Florida, California, Iowa, Minnesota or any other state in the country. Agricultural production, start up and capital costs 20 years ago are not a reasonable baseline for use in establishing loan limits today.

We urge the Subcommittee to consider raising the loan limits for direct operating loans to at least $300,000 along with the direct farm ownership loan limit. We would also like to suggest that Direct FO limits be raised to $300,000 but with conditions on financing over $200,000. Conditions on loans made for real estate purchases between $200,000 and $300,000 need to include provisions which require joint financing. This provision would engage more commercial lenders to participate with FSA lending and help save loan funds. Present backlogs of Direct FO applications indicate that if the loan limit was raised, less customers would be served. This is especially true for real estate loans (FO loans) where there are usually large backlogs waiting for funding. To help address this concern and encourage customers to utilize the participation loan program, wherein at least 50 percent of the required funds are obtained from a commercial lender, we would suggest that the participation loan rate for farm ownership loans be the lower of the current 5 percent rate allowed by statute or 1.5 percent less than the farm ownership cost of money rate in effect at the time of loan approval or loan closing. Assuring that there is at least a 1.5 percent interest rate break for utilizing the participation program will help entice applicants to secure at least half of the needed loan from a commercial lender and will help them qualify for a commercial loan.

**SUPPORT IMPROVEMENTS TO THE BEGINNING FARMER DOWN PAYMENT PROGRAM**

Maintaining a safe and abundant food supply is critical to our economic stability and national security. To accomplish this objective, it is imperative for us to assist the next generation of farmers and ranchers in taking over the family sized farms and ranches. Agricultural lending to new and beginning farmers presents a whole set of circumstances unique to the lending community. Credit availability to this group of prospective farmers and ranchers is very tight due to their inherent lack of equity. The commercial lenders in the agricultural market require at least 25- 35 percent equity to obtain financing. This requirement makes it impossible for new and beginning farmers to obtain their first real estate loan. In this example, the farmer has likely spent everything they have back into the farm to get the short term assets and debts in order. When real estate becomes available to purchase, they do not have the means for a down payment. FSA's farm ownership loans can provide this financing directly to an eligible applicant up to 100percent of the appraised value of the real estate. Although funding of this loan program has been shortened, we encourage expanded authorities in both FO and OL lending to help reach these new and beginning operators.

The following are a few items that we would suggest for improving the FSA Beginning Farmer Down Payment loan program:

- Drop the interest rate for beginning farmer down payment farm ownership loans to the lesser of 4 percent or 3 percent below the farm ownership cost of money rate.
- Reject the Administration's proposal to skip the first payment. Provisions already in place allow for unequal payments when prudent.
- Extend the term of the loans to 20 - 25 years. This will enhance the applicant's repayment margin and allow them a better chance of being successful.
- Remove the $250,000 cap on the value of the property purchased.
- Decrease the down payment required from 10 percent to 5 percent.
- Add socially disadvantaged applicants (SDA) farmers and ranchers as eligible applicants.
- Add first time farm real estate buyers as eligible applicants to help facilitate the transfer of assets from one generation to the next.

**PREVENT THE INCREASE OF GUARANTEED LOAN FEES**

According to the American Bankers Association (ABA), the FSA guaranteed loan programs are a remarkable success story representing a supreme example of a true public-private partnership that will suffer considerably if new fees are incurred. We agree with ABA's assessment of the resulting problems from increasing the guaranteed fees. At present, the fees are modest and the guaranteed loan programs are performing as intended. Program usage has been strong. Loan default and loss rates have been low. ABA's concern that an increase in fees will have a significant adverse effect on FSA guaranteed loan programs is valid. However, we believe that the impact of such an action will be much greater than ABA has reported.

In FY07, the administration proposed doubling the fees which farmers and ranchers pay for the use of the guaranteed program. This idea was eliminated in the budget process after objections from the lending community and our members. We ask that the Committee add a provision to the 2007 Farm Bill that will require Congressional approval of any future USDA guaranteed loan fee increases.

**CONCLUSION**

It is our contention that the Farm Service Agency's Farm Loan Program loan portfolio is in good financial standing. The USDA Farm Loan Program makes it possible for beginning, financially strapped or multi-generational family farmers and ranchers to compete in the market place. The 2002 Farm Bill aided the efforts of the FSA in achieving its mission, but we have grave concerns that a number of pending credit issues on the horizon could place at risk the taxpayer's investment in the agency's loan portfolio.

We recommend the elimination of term limits as a means to free up farm loan managers to make sound financial decisions in offering loans to qualified recipients who otherwise would be ineligible because of the current regulations. It also means preventing scenarios like a Georgia family of five –a farming father, and a stay at home mom – from defaulting on their loan because they reached the term limit and could not find a private lender to take on the small farm as an investment. As the cost of living goes up, so goes the cost of maintaining and establishing farms and ranches. Rural America has not been immune to the cost increases of a growing national economy, and the federal government farm loan program limits should keep up with the growth. In order to reap rewards of investment, it is important to provide loans that will adequately assist in the cost of farm and ranch maintenance. It is time to increase the loan limit from $200,000 to at least $300,000. Additionally, charging substantial increases in guaranteed fees to commercial lenders only adds to the financial burden of the farmer or rancher seeking private loans from the same commercial lenders.

We are the men and women who work with American farmers, ranchers and their communities everyday. We see the potential of so many worthwhile applicants, and take to heart the work we do. We are dedicated and committed members of the federal workforce serving rural America. Thank you for the opportunity to present our perspective on the state of the farm loan programs.

STATEMENT OF SAVI HORNE, ESQ.
EXECUTIVE DIRECTOR

on behalf of

THE NORTH CAROLINA ASSOCIATION OF BLACK LAWYERS' LAND LOSS PREVENTION PROJECT

to the

U.S House of Representatives
Committee on Agriculture
Subcommittee on Conservation, Credit, Energy and Research

Washington, DC
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**Introduction**

My name is Savi Horne. I serve as the Executive Director for the North Carolina Association of Black Lawyers Land Loss Prevention Project (LLPP). Founded in 1982 to address the systemic causes of land loss by African-American landowners, the Land Loss Prevention Project (LLPP) is a 501(c) (3) non-profit law firm. Based in Durham, North Carolina, LLPP provides free legal assistance to limited resource farmers and landowners that are struggling to retain ownership of property interests.

Land Loss was founded to address land loss among African-American landowners. Its founders saw epidemic losses of land by farmers and other landowners who had once been thriving foundations of our rural communities. Land Loss, as a law firm, primarily uses legal strategies in its work with North Carolina landowners.

**Working with the Credit Needs of Minority Farmers**

Minority farmers and ranchers face many unique credit problems and we truly appreciate the opportunity to provide this written testimony on their behalf. This statement represents some of the most common difficulties faced by farmers attempting to obtain credit from the USDA. Access to credit is vital, as it then affects the levels of participation in other programs of the agency. As the lender of last resort, the USDA also serves an important role in assisting small and minority farmers to enter, re-enter, and revitalize agriculture in the United States.

**TITLE V: FARM CREDIT**

The Farm Credit title generally reauthorizes USDA farm lending programs and provides greater access to USDA farm credit programs for beginning farmers and ranchers. This bill increases the percentage that USDA may lend for down payment loans, extends the duration of these loans; and establishes a program to encourage beginning farmers to be able to purchase farms on a land contract basis. Under the Secretary's guidelines the rules for borrower eligibility are somewhat relaxed, as are lending rules for beginning farmers and ranchers.

While we agree with many of the changes that are proposed, it will be just as important to carry the intent of Farm Ownership Loan Program to operating type loans. There are many beginning and socially disadvantaged producers who begin their operations on leased land due to the high cost of purchasing land and will need operating and chattel loans coupled with future farm or ranch purchase.

**Beginning Farmer Program**

The Beginning Farmer Program, although intended to assist new farmers to enter agriculture, has significant barriers for many producers that may have spent their whole lives working on a farm, but are not eligible to participate in the program.

The eligibility criteria at 7C.F.R. § 1941.12(a)(6) states:

> *Have participated in the business operations of a farm or ranch for at least 3 years out of the 10 years prior to the date the application is submitted . . .*

We agree that beginning farmers and ranchers need to have experience and or education. However, both the credit provisions and the resulting regulations must clearly state the types of documentation that indicate this experience. Many local and state offices will not accept any documentation other than IRS tax forms in which a 1040F is filed. The manner in which FSA interprets the above regulation to mean *tax forms only* is a problem for producers. Second, we do not perceive that it is the intent of this Bill to prohibit the experience gained by growing up on a farm, experience gained as a farmworker, farming experience in another country, or subsequent education that a beginning farmer or rancher has achieved.

Also, there were many farmers that lost land due to the discriminatory practices of the Agency, as documented by civil rights lawsuits against the USDA. The beginner farmer program should recognize this fact by expanding the definition of who is a "beginning farmer" to specifically include those farmers taking over the farm from their family members that lost the land or farming operation as a result of discrimination. Many of these children or family members worked on the farms but their experience is not recognized by the existing standards. We feel that assisting with the reentry of farmers or in the succession planning of aging farmers, particularly those that have faced discrimination, should be an important goal of the credit title and there should be specific provisions for this group of farmers.

As regulations become more streamlined, providing clear intentions behind the interpretations becomes critical. We believe that on this critical issue, the new Farm Bill must contain language that eliminates the exclusion from participation that currently exists.

**Targeting Of Funds**

As your Committee considers recommendations to target all credit to beginning and socially disadvantaged farmers and ranchers, it will be important to consider how this recommendation may ultimately affect the availability of credit. We strongly advise that both the beginning farmer and rancher program as well as the needs of limited resource farmers and ranchers be determined based on adjusted gross income rather than establishing a ceiling that is merely driven by the type of operation that is planned.

Also, directing resources generally to beginning and Socially Disadvantaged Farmers and Ranchers without a more specific direction with respect to the proportions of funds for either population may have the impact of disadvantaging one or the other of these populations. One example is brought to light in the Farm Service 2003 report on the participation in Beginning Farmer Down Payment Program. This report shows that approximately 92% of the funds were used by white males. This problem must be addressed by directing targets to specific programs and/or populations.

**Eligibility**

FSA determines creditworthiness based on a credit report. It appears that the Agency does not use the credit score itself, but uses the report to determine how an applicant has paid his bills. This analysis of current and delinquent accounts serves as a means to show credit history. The Agency uses the report to show the farmer's "pattern and practice" and in this manner creditworthiness is determined. We request that the new Farm Bill consider the following additions to the language:

Comprehensive creditworthiness language must be added for instances where the past history is affected by disaster; family medical issues, or livestock health problems. If the detrimental credit is a direct result of the disaster, allowances and/or exceptions to patterns and practices must be included. FSA currently allows for circumstances that are beyond the applicant/borrowers' control but often times the related analysis is not considered in light of disaster years. As disaster issues are considered, it is also important to remember that disaster program payments do not often occur simultaneously with the disaster year--for example, disaster payments for 2003 were not received until 2005.

A statutory addition to the Farm Bill that mandates consideration of these factors will enable those farmers and ranchers who have faced successive years of drought or hurricane damage to access USDA programs, and maintain their operations.

**Feasibility**

When FSA begins to determine the feasibility of an operation, the Agency relies heavily on history or past performance. While this may be an acceptable practice there are two areas that the new Farm Bill must address:

When calculating historical performance, FSA does not allow for changes in an operation or crops grown. In fact, agricultural credit penalizes a farmer/rancher who reacts to market changes. One example is the vegetable grower who now uses irrigation that was installed under EQIP Program (NRCS). The new plan is still required to meet his/her historical data based on the *non-irrigated* data. Once again we find some offices that will allow the additional production while others will not, so it is critical to socially disadvantaged participants that this specific language is included that will allow for these changes.

Disasters continue to affect feasibility since FSA uses historical data. The Farm Bill must address this with mandatory language that will allow producers to use county averages for all disaster years during the historical data period. In the event that a majority of the history is affected, the new language must implement a policy that yields revert to county averages.

Another concern is that farmers face difficulty when they have transitioned to growing organic, specialty crops, or value-added crops because the price data for those crops is not readily available or is not reflected by the county averages. This affects applications for both credit and disaster assistance. USDA needs to expand its reporting to reflect emerging markets.

**Borrowers Training**

Borrowers training inadequately address the needs of small and minority producers. Many farmers grow specialty vegetables with specialty markets and learning how to handle 1000-acres of corn is of no benefit to them. Another problem is that in some areas the classes are not being scheduled routinely and as a result, borrowers are not timely meeting their obligations. Borrowers who agree to take borrower training are found to be acting in "bad faith" because they have not completed this training, even if through no fault of their own. This leads to a determination of ineligibility, because they have not completed this training within one year. There is also no standard curriculum that meets the needs specific to the area. These programs do not adequately provide the knowledge needed for borrowers to efficiently meet FSA requirements including knowledge of terms, security agreements and borrower agreements. One problem is that some FSA programs are geared toward filing taxes and continuing agricultural education, rather than meeting the needs of the beginning farmer by providing a more basic understanding of what is required by FSA. One-on-one technical assistance programs and education helps participants stay current, meet filing requirements, and can reduce loan delinquencies.

**Special Needs of Youth**

Many rural youth, and particularly minority and American Indian youth living on reservations with widespread poverty, can benefit from increased access to youth loans. Organizations working with this program have been able to use the USDA/FSA Youth Loan Program to the benefit of many young entrepreneurs. With proper program education, financial training and technical assistance, this has been a valuable program.

Currently, the youth loan program is for young people from 10 – 20 years old and provides up to $5,000 to begin a modest income-producing business. Loans can be used for both farm and rural businesses. USDA/FSA is proposing that this program be changed so that it is applicable to agricultural use only. It is important to our rural youth, and therefore all of our rural communities that this funding continues to be for *both* agricultural and rural business operations.

**Transparency and Accountability in Farm Loan Programs**

**Accessing Services of the Farm Service Agency**

There continue to be examples of FSA personnel erecting barriers that prevent access to FSA services and programs. We have heard examples of Farm Loan personnel discouraging applicants seeking information *prior* to receiving a completed application. Often these barriers are attitude, insensitivity, a lack of translation, and lack of knowledge in working with minority producers.

**Transparency**

FSA Farm Loan Programs have made improvements in the manner in which the loan programs are administered but we want to emphasize that transparency and accountability does not happen only from a report and numbers. For the Agency to truly work to the benefit of all farmers and ranchers, the Agency must analyze the data that is being generated, be better trained in working with minority producers and be held accountable for their mistakes and actions.

Currently, FSA is streamlining all of their regulations and moving to utilizing handbooks. We are quite concerned, as the handbooks are Agency interpretation of the Code of Federal Regulations and are *not* published for public comment. These interpretations in turn are derived from regulations that are far more general than have existed before. While the Agency is publishing handbooks on their web page, there are still many farmers and ranchers that do not have access to computers or high speed internet connections. The Farm Bill should address this issue of transparency so that farmers and ranchers can actually access the information that directly affects their lives.

**Education**

In addition we find that FSA does not, in many cases, provide applicant/borrower education so that their clients know all of their responsibilities in carrying out loan requirements. When loans are closed FSA often has the Borrower sign a "Borrower's Agreement". This agreement is signed at loan closing and may contain language about new purchases and other specific issues that FSA wants added to the agreement. It is not always made clear to the farmer what obligations they have incurred when signing these agreements and it should not be necessary, nor is it feasible, for every applicant to bring a lawyer with them when they sign papers with FSA. A borrower is told that he/she cannot increase debt and later finds out that the agreement applies not only to farm debt but also includes family debt. If this occurs, (and the farmer incurs additional debt) there is no recourse for the borrower as he/she is no longer eligible for any additional services from FSA, including loan servicing. The borrower does not even realize that he/she is ineligible until he/she submits a new application or requests servicing. We are quite concerned because regulations discuss "bad faith" as and issue of conversion. However, the regulations remain silent on borrower agreements, but once the term "bad faith" is applied, the effect is the same. It is really heartbreaking to see farmers and ranchers working to protect their security and follow what they think FSA wants them to do and find themselves charged with bad faith because of the lack of education that FSA should have provided at loan closing.

To prevent these problems, the new Farm Bill must mandate that FSA farm loan personnel be held responsible for their lack of commitment to education and insuring the success of these borrowers. In addition, language must be added that will allow a farmer or rancher to have recourse if this occurs. We suggest that FSA be required to meet with the borrower as soon as any issue that the Agency disagrees with is identified and that the Farm Bill require this meeting prior to any determination of bad faith. We also request FSA be required to use post approval for these actions if the borrower is able to demonstrate that he/she had a lack of understanding of these issues and is honestly working to carry out the terms of the agreement.

In addition, the Farm Bill must contain additional language on subordinations. This is an important piece of agricultural credit that allows FSA, if they are well collateralized, to give the bank a first lien position on a certain items of collateral. FSA remains collateralized and the farmer/rancher benefits, as this is often the first step to graduation. The Farm Bill should recognize that FSA is the lender of last resort and banks have their own set of criteria on how that farmer is to operate. There are instance where borrowers find themselves in conflict between the requirements of the private lender and the USDA. The farmer may be following their banker's instructions, but FSA determines that the borrower is not following agency agreements on security released to the bank. While we do not expect that FSA release its security interest, the fact remains that the agency, borrowers, and bankers have to work together and that relationship must be explained fully.

**The Guaranteed Loan Program**

Many farmers have difficulty effectively utilizing the guaranteed loan program. In some areas, the guaranteed loan program is only successful if the area is dependent on agriculture. Banks in more industrialized areas are not willing to provide agricultural loans, with or without a guarantee. Equally important is the fact even with a guarantee, the applicant still has to meet banking standards for collateral. Some banks are requiring a range of somewhere between 65 – 85% maximum loan to collateral amounts.

Even with the assistance of the Down Payment Loan Program, many farmers and ranchers cannot come up with even a 5% down loan payment. Considering today's cost of land, it is not uncommon for the farmer or rancher to need $50,000 in order to participate in this program. We therefore urge this Committee to look to alternative sources of financing. We recommend that the Farm Bill include language that the FSA loan guarantee program requires a bank to consider this guarantee as collateral. We do not believe that it is either the intent of Congress or of the Agency to utilize the guaranteed program to protect banks. Thus we request that the program be used, to extent possible, to help minority farmers and ranchers enter farming and ranching. In order for the guaranteed loan program to truly work for minority farmers/ranchers FSA needs to work with this Committee to obtain additional appropriations for the interest assist program. Many bankers that accept FSA guaranteed loans consider the loan too risky if interest assist is needed the first year. The new Farm Bill must contain language that the interest assist program must be considered at the inception of a loan to insure success. This will eliminate the position of having to deal with loans that may become delinquent. As important as this program is, current funding levels allow only a small percentage of borrowers to participate in this program and currently this limited funding is appropriated to Chattel and Operating Loan Programs only. We encourage you to recommend to the Appropriation Committee that funding for interest assist be expanded to cover farm ownership loans in sufficient amounts to make the beginning farmers programs more workable and accessible to minority farmers and ranchers.

**Preferred Lender Agreements**

We recognize that FSA has set up specific lender criteria so that bankers are more willing to work with the guaranteed loan program. We also understand the need to streamline paperwork. Although the Preferred Lender Program is the program that was designed to address these issues, FSA should not be allowed to help banks at the expense of and without consideration for borrower rights. When FSA signs a lender agreement with a bank that has a preferred lender status the Agency receives an insignificant amount of paperwork and is required to provide only a minimal amount of oversight as long as the bank does not have a significant number of loss claims. What this means to a borrower is that he/she does not know how he can work with the bank nor does anyone provide oversight at lack of borrower restructuring.

Some banks are not making necessary releases to farmers, and in some areas have actually been denying these producers family living monies and the families are relying on local food banks. This is happening as production checks go to the bank rather than the borrower and the bank may or may not give anything to the borrower. There is very little that anyone working with these producers can do but request the bank to make these releases.. In fact Preferred (PLP) lenders are not required to submit annual analysis to FSA, but rather perform an annual analysis in accordance with their Lender's Agreement. To rectify this situation the new Farm Bill must contain additional language that will establish language for mandatory restructuring with interest assistance, family living releases and an FSA annual review of the banks' guaranteed loans. This assessment must not be a report that all loans are current but what is actually happening on the farm or ranch. This Committee should also consider requiring the Agency to exercise more oversight over these loans so as to protect the borrowers.

**The Continuation Policy**

The 1987 Ag Credit Act authorized the continuation policy operating loan. This provided loans to farmers to cover necessary operating and family living expenses for one year while the farmer was in the process of being restructured. We request that this Farm Bill reinstate this policy to allow for the provision of these continuation loans during restructuring or servicing of delinquent loans.

**Disaster Programs**

Natural disasters have an important impact on a farmer's ability to access credit and to operate his/her farm business successfully. Disaster funding and other programs, like the Disaster Set Aside, are an important agency response that can assist farmers back to their feet. Several years ago, Congress implemented a program to set-aside debt for farmers and ranchers who have lost production due to natural disasters. This has been a very successful program known as 1951-T. This is a program that with only one exception has only been allowed to be used one time. We strongly urge this Committee in light of the numerous recent disasters to also make this program available when a farmer or rancher has successive years of natural disasters, regardless of delinquency status. If a delinquency is related to a natural disaster, the farmer should not be prevented from participating in programs that can assist them in rebuilding their businesses.

**Appraisals**

Currently, FSA is following the Uniform Standards of Professional Appraisal Practice (USPAP) appraisal regulations. This means that all appraisals are assessed at the highest and best use rather than as agricultural lands. We understand that this is a requirement under USPAP standards. However, these appraisals affect access by of entering farmers as well as existing borrowers who request restructuring. Appraisals have also been a problem in valuation under the Shared Appreciation Agreements. Farmers should not be penalized because they desire to maintain agricultural lands when much of the real estate surrounding them is going toward development.

We strongly urge the Committee to look at how many of the state preservation programs evaluate land based on agricultural land use and authorize similar language in the Farm Bill and to initiate programs that offer tax credits to retiring farmers and ranchers who are willing to work with beginning farmers and ranchers.

**Term Limits**

In our work with limited resource farmers, we are quite concerned about the existence of term limits. FSA credit is very important to our producers is an important resource to many of our farm families that face the uncertainty of farming as a profession and have limited liquid financial resources. We strongly recommend that term limit language allow exceptions for limited resource minority farmers. In addition some of our small produce growers are on limited acreage and are working to diversify their operations or produce organic crops. They may also being trying to access NRCS programs so that they can become more efficient on their small farms. However, these changes, whether in operations or marketing, take time. The Farm Bill must require that minority farmers and ranchers are not denied operating credit or servicing simply because of term limits. Congress through this Committee should eliminate any and all term limits on FSA loans. Farmers face many issues that are beyond their control, such as natural disasters, livestock diseases, physical health problems, low prices and uncontrollable markets. To say that these issues should be solved within a certain timeframe is inequitable and counter-productive. It will also lead to the loss of more of our small farmers, since the reason they received loans from FSA in the first place is because they couldn't access private sources of financing.

**Restructuring**

One of the greatest obstacles that we face are the drop-dead timelines for farmers who request restructuring of FSA loans. Once a request for servicing is submitted, however, FSA does not often adhere to its' own timelines. In one example, a group has worked with participants who have submitted a completed application to FSA and does not have a decision, after years, on restructuring. Sometimes a rationale is provided, and sometimes it is not. When the agency does not make a decision in a timely manner, the information submitted in the application becomes outdated. Combined with the effect of disasters, and the fact that interest accrues on a daily basis, it is easy to understand the high, and ever-increasing levels of debt and the fact that minority producers can not cash-flow.

On repeated requests to the Agency and FSA for consideration of this issue, it has been repeatedly stated that FSA does not have the authority to waive interest. This seems questionable, as the USDA will not pay interest for more that 210 days to a guaranteed lender (7 C.F.R. § 762.49). In addition we request that the Committee review 31 C.F.R. § 901.9 (Standards for the Administrative Collection of Claims). We strongly urge this Committee to mandate that FSA does have the authority to waive interest. In the event that this does not occur, the Farm Bill should authorize statutory language that will prevent farmers and ranchers from losing their farms and ranches due to the lack of FSA adherence to guidelines. We do not accept as true that FSA can claim that they will not pay interest based on a bank's lack of follow-through while holding farmers and ranchers liable for the actions of FSA.

**Appeals**

In some instances, the Farm Service Agency is not adhering to the mandates of National Appeals Division Hearing Officers, by continually requiring updated paperwork (including new farm and home plans) rather than implementing the decision of the Hearing Officer or Director. Far worse, some farmers/ranchers are receiving only a *verbal* decision from FSA. Because of historical instances of discrimination faced by minority farmers, we are working with farmers/ranchers that have a preconceived notion that they will not be approved for agency programs. This occurs because of the FLM/FLO actions in the past and it is imperative that all decisions be in writing. Just as important is the fact that when decisions are verbal, farmers and ranchers are denied not only access to credit programs but access to the appeals process as well. Some of these verbal denials are coming prior to an application having been submitted.

We request that the new Farm Bill have statutory language that includes language that mandates that FSA move to the next step if they are overturned by the National Appeals Division and that this statue establish specific timelines for implementation following an appeal decision. This language must also include that if FSA is overturned, implementation is not a request for new information but that the appeal decision means that they cannot go back to that issue if they have not sought an additional appeal. Feasibility is a good example of this. When a farmer prevails at the NAD hearing and then the FSA requests a new plan, it totally offsets the appeal determination as more likely than not NAD has deemed the operation feasible.

**Distances to Offices**

The last issue that must be dealt with if FSA wants to truly fulfill its mission, is that something must be done about the distances that farmers and ranchers have to travel to offices. In one instance, a farmer is located 400 miles from the FSA office. With farmers and ranchers being encouraged to e-file or travel long distances due to the closure of offices and service centers, an increasing number of farmers do not feel that the FSA programs benefit them. Also these distances further lessen FSA's ability to work with applicants/borrowers especially as it relates to education, oversight, and overall ability for FSA to meet with borrowers on issues that arise. We urge the continued use of satellite offices with regular schedules and that the new Farm Bill require continued use, rather than closure of these valuable offices.

All of these issues are related to the Credit Title of the Farm Bill, in that they directly affect the farmers' ability to support their family and contribute to their community and the economy. Many farmers, due to disasters, high prices of land, and increasingly narrow, non-existent, or negative profit margins, need the assistance provided by the Credit Title of the Farm Bill to maintain their farm businesses. The Land Loss Prevention Project also supports the comments already submitted by our colleagues at the Rural Coalition, Federation of Southern Cooperatives, and the National Tribal Development Association.

In conclusion we want to thank you for your attention to these important credit issues and we will be glad to furnish you with any additional information that you may need.

Respectfully Submitted by:

Savi Horne
Executive Director,
Land Loss Prevention Project

APPENDIX B: Committee on Agriculture – U.S. House of Representatives
Information Required From Non-Governmental Witnesses

Biographical Sketch
Savi Horne, Executive Director
NCABL Land Loss Prevention Project
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Savi Horne is the Executive Director of the North Carolina Association of Black Lawyers, Land Loss Prevention Project. The Land Loss Prevention Project is a non-profit, public interest law firm with an overarching mission of providing legal expertise, community education, and advocacy skills to help farmers and rural landowners who face legal, economic, and environmental challenges. Integral to our legal services program is the North Carolina Rural Environmental Equity Project, which was developed at the request of grassroots groups to formulate legal strategies in addressing environmental racism and public health issues facing local communities. The Land Loss Prevention Project is a founding partner organization of the Black Family Land Trust (BFLT). The BFLT mission is to protect Black owned land in the southern United States through employment of land conservation and community development tools. Savi is co-chair of the BFLT Education Committee and is a member of the board. Savi serves on several national sustainable agriculture and small farms boards: National Campaign for Sustainable Agriculture, National Family Farm Coalition and the Rural Coalition.

National Tribal Development Association
American Indian Credit Outreach Initiative

Need a helping hand?

# STATEMENT OF LOU ANNE KLING
# PROJECT ADMINISTRATOR
# AMERICAN INDIAN CREDIT OUTREACH INITIATIVE

on behalf of

## THE AMERICAN INDIAN CREDIT OUTREACH INITIATIVE

to the

U.S House of Representatives
Committee on Agriculture
Subcommittee on Conservation, Credit, Energy and Research

Washington, DC
Hearing on March 27,2007

For More Information Contact
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**Introduction:**

My name is Lou Anne Kling. I serve as the Project Administrator for the National Tribal Development Association (NTDA) American Indian Credit Outreach Project (AICOI). This Initiative is a partnership under a Cooperative Agreement with the Farm Service Agency. The National Tribal Development Association is headquartered on the Rocky Boy Indian Reservation, Box Elder Montana. The American Indian Credit Outreach Initiative project has sixteen (16) satellite offices located on or near reservations throughout the United States. The project provides outreach, education and technical assistance to American Indian Farmers, Ranchers and Indian Youth.

Prior to serving with this project, I worked for the Minnesota Department of Agriculture doing farm advocacy during the 1980 farm crisis and served as the Minnesota State Director of the Farmers Home Administration and was the Deputy Administrator at the National Farm Service Agency Farm Loan Program. While in Washington, DC, I also developed the National Office of Outreach for the Farm Service Agency.

**Working with the Credit Needs of American Indian Farmers and Ranchers:**

American Indian farmers and ranchers face many credit and USDA access problems; thus we truly appreciate the opportunity to provide this written testimony on their behalf. NTDA/AICOI provides outreach, educational, and one-on-one technical assistance to American Indian Tribes and producers in twenty-eight (28) states under a Cooperative Agreement with the Farm Service Agency. This service is delivered by seventeen Liaisons throughout our service area. During FY 2006, we were able to assist in funding approximately $13 million for American Indian Tribes, Farmers, Ranchers and Youth, and provide outreach to more than 16,000 producers and Tribal entities.

Our testimony is a result of our work on behalf of the distinctive needs of American Indian farmers and ranchers along with the issues we have identified that affect greater USDA participation in their programs.

**Special Needs of American Indian Youth:**

Many American Indian youth live on reservations where poverty is widespread. Traditionally these Tribal youth are located in remote rural areas where youth have few opportunities. In order to solve youth at risk problems on the reservations most Tribes, if not all have developed "Indianpreneurship" programs that will enable Tribal members to lift themselves out of the cycle of poverty. To date we have been able to use the USDA/FSA Youth Loan Program to the benefit of these youth. With proper program education, financial training and technical assistance this has been a valuable program.

The youth loan program is for youth 10 – 20 years old and will provide youth up to $5,000 to begin a modest income producing business. Currently these loans can be used for both farm and rural businesses. USDA/FSA is proposing that this program be changed so that it is applicable agriculture use only. Approximately one-third of all the youth that we have worked with have started small businesses for non-agricultural purposes. In other words, youth on reservations that are traditionally non-agricultural will be denied participation in this program. We strongly urge this Committee to either continue this program as it is now, or to keep in place until a like program can replace.

**Unique Needs of American Indian Credit:**

Consistent language that pertains to American Indians, Tribes, Tribal governments, Alaska Native Corporations and all other written documents must be used in the Farm Bill, Agency regulations and USDA policy statements. The existing inconsistency from program to program has been used for program denial for American Indian producers who apply for USDA/FSA assistance.

**Challenging Issues:**

We continue to see personnel putting up barriers to FSA services. We have examples of Farm Loan personnel discouraging applicants seeking information **prior** to receiving a completed application. Often these barriers are attitude, in others it is insensitivity and lack of knowledge working with American Indian Tribes and producers. We find many offices in which it is evident that there is a total lack of knowledge on the part of the Farm Loan personnel in dealing with tribal trust land issues. More crucial is the lack of knowledge displayed by FSA personnel regarding Tribal sovereignty.

In many traditional tribes, agriculture mirrors tribal customs and traditions. FSA does not or will not recognize traditional crops and livestock. As examples, in the Midwest, we have the example of wild rice production not produced in man made "fields"; or in the Pueblos of New Mexico where corn is produced in accordance with traditional farming practices. Neither of these crops by FSA standards meets "conventional practices" language. On rare occasion if or when they are accepted, yields are so reduced that the farmer will not cash flow. Further, eligibility criteria have to be met that will assure the Agency that the applicant can be successful. As these crops do not meet standard USDA/FSA requirements for **accepted practices** (the equivalent to non-Indian agriculture practices) producers are deemed ineligible. The end result is that traditional farmers and ranchers are denied access to FSA credit, farm program and disaster programs on both feasibility and eligibility.

Tribal farms/ranches are not eligible for the emergency loan program. If the regulations are taken as written and interpreted, to meet the eligibility criterion, these farms would include having the "majority" of their tribal members **eligible** for an FSA loan. Not only does this language not recognize delegated Tribal authority and Tribal law, the burden of the paperwork to gather all the information needed for an eligibility determination is unreasonable. In other words this is a criterion that is impossible to meet. Couple this requirement with the fact that the farm is incorporated under Tribal law which FSA does not recognize by regulations and regardless of the amount of loss experienced, the farm or ranch is ineligible to participate in the Emergency Loan Program. **We strongly urge this Committee to insure that the Farm Bill, Regulations and Interpretations are written in a manner that will not prohibit American Indian participation as they are now.**

As an example, regulations at 7CFR 1941.4 Definitions; the definition for ***Corporation*** states:

*For the purpose of this regulation, a private domestic corporation created and organized under the laws of **the State(s)** in which the entity will operate a farm.*

This language totally eliminates any farm incorporated under Tribal law. We have been questioning this regulation for the past three years as FSA loan credit, especially the Emergency loan program is very important to American Indian producers. We had a local office that would not recognize Tribal Sovereignty, and suggested that we get a letter from the state so that the farm meets the corporate definition. We strongly recommend that the New Farm Bill provisions contain inclusive language on all credit programs so that American Indian producers who apply for USDA/FSA credit programs are served in a like manner to their non-Indian counterparts.

In addition to the above example we continue to have American Indian farmers and ranchers denied access to these programs as USDA/FSA is not well trained to understand and work with the Tribal Uniform Commercial Code. We have been asked to furnish completed UCC's. This is not a requirement for non-Indian producers. We have been further advised that American Indian participants would be ineligible for loans as the lien could not be perfected. This is simply not the case. We strongly request that FSA credit program personnel be held accountable and mandated to work with Tribes in their local areas and to be trained to work within Tribal law as well as state law. A basic knowledge of working with Tribal Courts would benefit American Indian farmers and ranchers who ought to have the same opportunities as their non-Indian neighbors.

The limited resource producer proposed amendment to add trust land is good, but must handled in a manner that does NOT impose a restriction that would require a tribal member to be farming or ranching on trust land only, as not all Indian land is in trust status. Unless this language is carefully written, many limited resource American Indian farmers and rancher will have little benefit from this amendment.

## TITLE V: FARM CREDIT

The Farm Credit title generally reauthorizes USDA farm lending programs and provides greater access to USDA farm credit programs for beginning farmers and ranchers. This bill increases the percentage that USDA may lend for down payment loans, extends the duration of these loans; and establishes a program to encourage beginning farmers to be able to purchase farms on a land contract basis. Under the Secretary's guidelines the rules for borrower eligibility are somewhat relaxed, as are lending rules for beginning farmers and ranchers.

While we agree with many of the changes that are proposed, the need in Indian Country will tend to be just as important to carry the intent of Farm Ownership Loan Program to operating type loans. This will be critical in Indian Country due to the complex issues involving Trust lands. We do envision that there will be American Indian producers who will benefit from farm ownership but in our experience American Indian producers, because of trust land issues, will need greater assistance from operating/chattel loans as beginning farmers and ranchers. In fact after preparing many applications for beginning farmers and ranchers, we believe that there will be many socially disadvantaged producers who will need to begin their operations on leased land due to the high cost of entering farming and ranching and will need operating and chattel loans coupled with future farm or ranch purchase.

We strongly recommend that the spirit and the intent of the Farm Bill be carried over to the regulations, to FSA interpretations and to the USDA personnel themselves as we often find the opposite to these intentions to be true.

Addressed below is an example of an obstacle that continues to be a roadblock for American Indian farmers and ranchers when they try to participate in a beginning farmer program:

The eligibility criteria at 7CFR 1941.12(a)(6) states:

> *Have participated in the business operations of a farm or ranch for at least 3 years out of the 10 years prior to the date the application is submitted . . .*

We agree that beginning farmers and ranchers as a requisite need to have experience and or education. However both the credit provisions and the regulations must state clearly the **needed documentation**. Far too many local and state offices will not accept any documentation other than IRS tax forms in which a 1040F is filed. The manner in which FSA interprets the above regulation to mean **tax forms only** is a double problem for American Indian producers. First this interpretation does not recognize the fact that if farm income is derived from the reservation these forms are not filed. Second we do not perceive that it is the intent of this Bill to prohibit the experience gained by growing up on a farm or ranch or subsequent education that a beginning farmer or rancher has achieved, is a matter of fact only and means nothing to the farm loan officer when considering the beginning farmer's eligibility. As regulations become more streamlined, the attitude behind the interpretations becomes critical. We believe that on this critical issue, the new Farm Bill must contain language that totally eliminates the exclusion from participation that this interpretation mandates.

## Targeting Of Funds:

As your Committee considers recommendations to target all credit to beginning and socially disadvantaged farmers and ranchers, it will be important to consider how this recommendation may ultimately affect the availability of credit. We strongly advise that both the beginning farmer and rancher program as well as the needs of limited resource farmers and ranchers be determined based on adjusted gross income rather than establishing a ceiling that is merely driven by the type of operation that is planned.

Also, directing resources generally to beginning and Socially Disadvantaged Farmers and Ranchers without a more specific direction with respect to the proportions of funds for either population may have the impact of disadvantaging one or the other of these populations as is indicated in the Farm Service 2003 report for the Beginning Farmer Down Payment Program participation. This report shows that approximately 92% of the funds were used by white male as an example. This problem must be addressed by directing targets to specific programs and/or populations.

**Completed Applications:**

Many FSA offices require a signed lease (BIA) to have a completed application. This is a requirement for a beginning farmer or rancher without the farmer/rancher knowing if he/she will have the start-up capital to begin his/her operation. We are in agreement that FSA or any lender needs to know that the operation does have a place to farm or graze cattle however with that said; FSA must recognize that a signed lease is a contract. In Indian Country more often than not since these leases come through BIA we request that the Farm Bill mandate an agreement with Tribes, BIA or BLM that establishes a procedure that will assure that if capital is available a lease is available. This agreement between the agencies will then allow FSA the knowledge to make sound loan making decisions

**Eligibility:**

FSA determines creditworthiness based on a credit report. The Agency does not use the credit score but uses the report to determine how an applicant has paid his bills. This is an analysis of current and delinquent accounts that serves as a means to show a credit history. The Agency term is "patterns and practices" and in this manner creditworthiness is determined. We request that the new Farm Bill consider the following additions to the language:

Creditworthiness comprehensive language must be added for instances where the past history is affected by a disaster or family issues or livestock health problems. If the detrimental credit is a direct result of the disaster, allowances and/or exceptions to patterns and practices must be included. FSA currently allows for circumstances that are beyond the applicant/borrowers' control but often times the related analysis is not considered in light of disaster years. As disaster issues are discussed it is also important to remember that disaster program payments do not often occur simultaneously with the disaster year! As an example 2003 payments were not received until 2005.

Adding this language to the Farm Bill so that it becomes regulatory is critical for American Indian farmers and ranchers who have faced successive years of drought or live in hurricane areas.

**Feasibility:**

When FSA begins to determine the feasibility of an operation, the Agency relies heavily on history or past performance. While this may be an acceptable practice there are two areas that the new Farm Bill must address:

When calculating historical performance, FSA does not allow for changes in an operation or crops grown. In fact agricultural credit penalizes a farmer/rancher who reacts to market changes. Some examples that we have recently experienced is the vegetable grower who now uses irrigation that was installed under EQIP Program (NRCS). The new plan is still required to meet his/her historical data based on the **non-irrigated** data. Once again we find some offices that will allow the additional production while others will not so it is critical to socially disadvantaged participants that this specific language is included that will allow for these changes.

Disasters continue to affect feasibility since FSA uses historical data. The Farm Bill must address this with mandatory language that will allow producers to use county averages for all disaster years during the historical data period. In the event that a majority of the history is affected, the new language must implement a policy that yields revert to county averages

**Borrowers Training:**

This training continues to inadequately address the needs of American Indian farmers and ranchers as American Indian farmers and ranchers have special needs in dealing with BIA lease information while others have unique traditional operations. This is especially true for small farmers. Many of these farmers grow specialty vegetables with specialty markets Learning how to handle 1000 acres of corn is of no benefit to them. In other areas we are finding that classes are not being scheduled routinely and hence borrowers are not timely meeting their obligations leading to ineligibility for not completing this training within one year. There is no standard curriculum that meets the area needs including the amount of time required for attendance. We have found class time ranges from a 2 day session to 6 years to complete. In our experience with these programs they do not adequately provide the knowledge needed for borrowers to efficiently meet FSA requirements including knowledge of terms, security agreements and borrower agreements. One of the problems causing this is that FSA contracts with programs that are geared toward filing taxes and continuing agricultural education rather than beginning farmer needs including a basic understanding of what is required by FSA. Through our education and one-on-one technical assistance programs, we have learned how that education has helped our participants stay current and is actually reducing loan delinquencies and issues of not following FSA requirements.

**Transparency and Accountability in Farm Loan Programs:**

FSA Farm Loan Programs have made improvements in the manner in which the loan programs are administered but we want to emphasize that transparency and accountability does not happen only from a report and numbers. For the Agency to truly work to the benefit of American Indian farmers and ranchers, the Agency must analyze the data that is being generated, be better trained in working with American Indian producers and be held accountable for their mistakes and actions.

There are several key areas that the Farm Bill must address if the Agency is committed to serving American Indian farmers and ranchers. Currently FSA is streamlining all of their regulations and moving to utilizing handbooks. We are quite concerned, as the handbooks are Agency interpretations of the CFR regulations and are not be published for public comment. These interpretations in turn are derived from regulations that are far more general than have existed before. While the Agency is publishing handbooks on their web page, in Indian Country we find that many of the farmers and ranchers that we work with do not have access to computers or high speed internet connections. In addition we find that FSA does not, in many cases, provide applicant/borrower education so that their clients know all of their responsibilities in carrying out loan requirements. This is more than just a Handbook issue.

When loans are closed FSA often has the Borrower sign a "Borrower's Agreement". This agreement is signed at loan closing and may contain language about new purchases and other specific issues that FSA wants added to the agreement. Far too many times we find that these borrowers are told they cannot increase debt only to find out later that the agreement means not only farm debt but their family debt also. We also see many borrowers who agree to take borrower training finding themselves in 'Bad Faith" because they have not completed this agreement. Once lack of understanding from the borrower has occurred there is no recourse for the borrower as he/she is no longer eligible for any additional services from FSA, including loan servicing. The borrower does not even realize that he/she is ineligible until he/she submits a new application or requests servicing. We are quite concerned **because regulations discuss bad faith as conversion and remain "silent" on borrower agreements.** It is really heartbreaking to see farmers and ranchers working to protect their security and follow what they think FSA wants them to do and find themselves charged with bad faith because of the lack of education that FSA should have provided at loan closing as is required. To prevent these problems. The New Farm Bill must mandate that FSA farm loan personnel be held responsible for their lack of commitment to education and insuring the success of these borrowers. In addition, language must be added that will allow a farmer or rancher to have recourse if this occurs. We suggest language that FSA be required to meet with the borrower as soon as any issue that the Agency disagrees with is identified (we have examples that farmers and ranchers do not know that this has occurred for four years) and that the Farm Bill require this meeting prior to a bad faith issue determination. We also request FSA be required to use post approval for these actions if the borrower is able to demonstrate that he/she had a lack of understanding of these issues and is honestly endeavoring to carry out these agreements.

In addition to the above, the Farm Bill must contain additional language on subordinations. This is an important piece of agricultural credit that allows FSA, if they are well collateralized, to give the bank a first lien position on a certain items of collateral. FSA remains collateralized and the farmer/rancher benefits as often this is the first step to graduation. Language needs to be added to the Farm Bill that recognizes that FSA is the lender of last resort and banks have their own set of criteria on how that farmer is to operate. Far too many times we find borrowers who are following their banker's instructions but FSA determines that the borrower is not following their agreements on security released to the bank. While we do not expect that FSA security is not to be maintained, the fact remains that borrowers and bankers have to work together and that relationship must be explained to both fully.

<u>Guaranteed Loan Preferred Lender Agreements</u>:

We recognize that FSA has set up specific lender criteria so that bankers are more willing to work with the guaranteed loan program. We also identify with the need to streamline paperwork. And we understand that the Preferred Lender Program is the program that addresses these issues. Nevertheless, those of us working with the guaranteed loan program need to point out that this is not a program in which FSA ought to be allowed to help banks at the sake of and without consideration for borrower rights. When FSA signs a lender agreement with a bank that has a preferred lender status the Agency receives an insignificant amount of paperwork and in our experience provides almost no oversight as long as the bank does not have a significant number of loss claims. What this means to a borrower is that he/she does not know how he can work with the bank nor does anyone provide oversight at lack of borrower restructuring. We also find that banks are not making releases to farmers and ranchers and in some areas have actually been denying these producers family living so that the families are relying on local food banks. This is happening as production checks go to the bank rather than the borrower and the bank may or may not give anything to the borrower. There is very little that anyone working with these producers can do but request the bank to make these releases. In fact Preferred (PLP) lenders are NOT to submit annual analysis to FSA, but rather perform an annual analysis in accordance with their Lender's Agreement. To rectify this situation the new Farm Bill must contain additional language that will establish language for mandatory restructuring with interest assist, family living releases and an FSA annual review of the banks' guaranteed loans. This assessment must not be a report that all loans are current but what is actually happening on the farm or ranch.

**Distances to Offices:**

The last issue that must be dealt with if FSA wants to truly fulfill its mission, is that something must be done about the distances that farmers and ranchers have to travel to offices. With farmers and ranchers being encouraged to e-file or travel long distances we are finding in Indian Country an ever increasing number of farmers and ranchers who do not feel that the FSA programs benefit them and thus are not worth the effort. Also these distances further lessen FSA's ability to work with applicants/borrowers especially as it relates to education, oversight, and overall ability for FSA to meet with borrowers on issues that arise. We urge the continued use of satellite offices with regular schedules and that the new Farm Bill require continued use rather than closure of these valuable offices.

**Guaranteed Loans:**

In Indian Country as well as in other areas that we work where there a high number of minority farmers and ranchers, the guaranteed loan works only if the area depends on agriculture. Banks in industrial areas are not willing to work on agricultural loans with or without a guarantee. Paperwork issues have somewhat worked themselves out but in these areas as in the Southeast, this program is not available to minority farmers. It is important that the new Farm Bill recognize this. Equally important to American Indian farmers and ranchers is the fact even with a guarantee, the applicant still has to meet banking standards for collateral. We are experiencing a range of somewhere between 65 – 85% maximum loan to collateral amounts that the bank will consider. We are familiar with the Down Payment Loan Program and the proposed amounts. On most of the reservations that we serve, we are working with farmers and ranchers who cannot come up with even a 5% down loan payment. Considering today's cost of land it is not uncommon for the farmer or rancher to need $50,000 in order to participate in this program. This just does not happen in Indian Country as is stated in the FSA 2003 report. We therefore urge this Committee to look to alternative sources of financing. We recommend that the Farm Bill include language that the FSA loan guarantee program requires a bank to consider this guarantee as collateral. We do not believe that it is either the intent of Congress or of the Agency to utilize the guaranteed program to protect banks. Thus we request that the program be used to extent possible to help minority farmers and rancher enter farming and ranching. In order for the guaranteed loan program to truly work for minority farmers/ranchers FSA needs to work with this Committee to obtain additional appropriations for the interest assist program. Many bankers that do FSA guaranteed loans consider the loan too risky if interest assist is needed the first year. The new Farm Bill must contain language that the interest assist program must be considered at the inception of a loan to insure success. This will eliminate the position of having to deal with loans that may become delinquent. As important as this program is, current funding levels allow only a small percentage of borrowers to participate in this program and currently this limited funding is appropriated to Chattel and Operating Loan Programs only. We encourage you to recommend to the Appropriation Committee that funding for interest assist be expanded to cover farm ownership loans in sufficient amounts to make the beginning farmers programs more workable and accessible to minority farmers and ranchers.

**Disaster Programs:**

Several years ago, Congress implemented a program to set-aside debt for farmers and ranchers who have lost production due to natural disasters. This has been a very successful program known as 1951-T. However currently, this is a program that with only one exception has only been allowed to be used one time. We strongly urge this Committee in light if the numerous disasters that we have had to make this program available when a farmer or rancher has successive years of natural disasters.

**Appraisals:**

Currently FSA is utilizing USPAP appraisal regulations. This means that all appraisals are handled at the highest and best use rather than as agricultural lands. We understand that this is a requirement under USPAP standards. These appraisals however affect many entry farmers and ranchers as well as existing borrowers who need restructuring. They have also been a problem in the Shared Appreciation Agreements that have come due. We strongly urge the Committee to look at how many of the state preservation programs evaluate land based on agricultural land use and authorize similar language in the Farm Bill and to initiate programs that offer tax credits to retiring farmers and ranchers who are willing to work with beginning farmers and ranchers. Thos of us who were actively farming in the 1980's remember the effects of high land values and the affect that these values had on agriculture when land prices no longer equated to our loans.

**Term Limits:**

As we work with American Indian farmers and ranchers, we are quite concerned about term limits. Many of our participants are limited resource ranchers who farm or ranch on trust land. They are dealing with cattle prices, land issues and drought. Unlike their non-Indian neighbors, when cattle prices increase, equally BIA raises lease rates so that there is no gain to them. Therefore, FSA credit is very important to our producers. We strongly recommend that term limit language allow exceptions for limited resource minority farmers. In addition some of our small produce growers are on limited acreage and are working to transition into irrigation as an example. They are working with NRCS programs so that they become more efficient on their small farms but these changes whether in operations or marketing, take time. The Farm Bill must require that minority farmers and ranchers are not denied operating credit or servicing simply because of term limits. Congress through this Committee should eliminate any and all term limits on FSA loans. Farmers have all kinds of natural disasters, livestock diseases, physical health problems, low prices and uncontrollable markets and to say that these can be solved within a certain time frame is counter productive since many of these issues are beyond their control.

**Restructuring:**

One of the greatest obstacle that we face working with American Indian farmers and ranchers is the fact that we are on drop-dead timelines as is the case for our farmers and ranchers who request restructuring. However the reverse is not true as it is very rare that FSA adheres to timelines once a borrower asks for servicing. We have worked with participants who have had a completed application in to FSA for years and still have not had a decision on restructuring. Sometimes we know why, other times we do not. In one case that we have worked on FSA, 4 years later is asking for updated plan information as the information is too outdated. Combine the length of time that FSA does not adhere to their timelines, the total number of disasters that many of these producers have faced and the fact that interest is accruing daily and you can better understand why minority farmers and ranchers can no longer cash flow when they up date their information. We have discussed interest accrual on a number of occasions with the Agency and FSA has repeatedly stated that they do not have the authority to waive interest. We question if this is true as they certainly will not pay interest for more that 210 days to a guaranteed lender as is evidenced by 7CFR762.49. In addition we request that the Committee review 31CFR901.9, Standards for the Administrative Collection of Claims. We strongly urge this Committee to review and mandate that FSA has the authority to waive interest or in the event they do not, authorize statutory language that will prohibit farmers and ranchers from losing their farms and ranches due to the lack of FSA adhering to guidelines. We just do not accept as true that FSA can claim that they will not pay interest based on the banks lack of follow through while holding farmers and ranchers liable for the actions of FSA.

**Appeals:**

FSA is not adhering to appeal implementation and far worse we are all beginning to work with farmers/ranchers with only a **verbal** decision from FSA. In Indian Country we are working with farmers/ranchers have a preconceived notion that they will not be approved because of the FLM/FLO actions in the past and it is imperative that all decisions be in writing. Just as important, is the fact that when decisions are verbal, farmers and ranchers are denied not only access to credit programs but access to the appeals process as well. We have found that often these verbal denials are coming prior to an application having been submitted.

We request that the new Farm Bill have statutory language that includes language that mandates that FSA move to the next step if they are overturned by the National Appeals Division and that this statue establish specific timelines for implementation following an appeal decision. This language must also include that if FSA is overturned, implementation is not a request for new information but that the appeal decision means that they cannot go back to that issue. Feasibility is a good example of this. When a new plan is requested it totally offsets the appeal determination as more likely than not NAD has deemed the operation feasible.

**Tribal Concerns:**

Throughout our western plains, we have American Indian producers who breed and train working horses that are used on local ranches. Many of these small ranches do not have cattle. In many of these states FSA recognizes the need and have established guidelines for numbers of the total horses that are allowed. We request that the Farm Bill address the importance of working horses to western ranches and establish that they are a vital part of agriculture. In so doing these ranchers will be able to participate in FSA programs, especially disaster programs.

In conclusion we want to thank you for your attention to these important credit issues and we will be glad to furnish you with any additional information that you may need.

Respectfully Submitted by:
*Lou Anne Kling*
American Indian Credit Outreach Initiative
Project Administrator

APPENDIX B: Committee on Agriculture – U.S. House of Representatives
Information Required From Non-governmental Witnesses

Biographical Sketch
Lou Anne Kling
National Tribal Development Association
American Indian Credit Outreach Initiative
Granite Falls, MN
320-564-4808
Email: Louanne@indiancreditoutreach.com

I was born and raised on a family farm north of Granite Falls, Minnesota, with four brothers and one sister. Our farm was a family diversified working farm including dairy, beef, pork, chickens and small grain. It was a great background for my adult career as a farm advocate for all family farmers, and ranchers.

After fifteen years of administrative experience with agricultural organizations at the local, state and national level and by serving as a director for various agencies, including, Farm Service Agency, Farmers' Home Administration and Minnesota Department of Agriculture I am skilled in administering outreach programs, training and supervising outreach coordinators in each state, loan servicing, loan origination, program development, legislative and regulations efforts, cash flows and finance/balance sheets.

In my professional experience I have served in the following positions:

**National Director, Farm Service Outreach Program** 1996-2000

I was responsible for developing, administering and coordination outreach programs for the administrator and the National Farm Service Agency. I also developed and instituted outreach training for the FSA State Executive Directors, provide briefing sessions for the Undersecretary and Secretary of Agriculture, set up "town hall" meetings to better serve the Department of Agriculture customers and developed and coordinated appointments to Outreach Coordinators for each state.

**Deputy Administrator, Farm Credit Programs (FSA)** 1993-1996
**Assistant Administrator of Farmers Programs (FmHA)**

I successfully merged the farm loan program into the new Farm Service Agency during the reorganization of the United States Department of Agriculture. I was responsible for supervising loan making, loan servicing and program development at the national level for the now abolished Farmers Home Administration and the new Farm Service Agency. I also had to insure adherence to program rules and regulations approved for the national office, developed training programs for state and county loan officers, and was the administrator of an 18B financial bank. I also negotiated with the Senate Agriculture Committee on credit provisions needed in the 1996 Farm Bill.

Other job tasks before this time were spent on the development of the Minnesota Farm Advocate Program, and the Neighbors United Resource Centers.

I serve on the Land Stewardship and the Farmers Legal Action Group, Inc. Board of Directors. I also serve on local and church boards.

Some awards accomplishments I have achieved are:

- Family Farm Champion Award (2006)
- Numerous Awards from USDA (1993-2000)
- Minnesota rural Future Leadership Award (1991)
- National Public employees Roundtable (1998)
- Minnesota University Women's Leadership (1988)
- Minnesota McKnight Human Services (1987)
- Co-author of Farmers Guide to FmHA (sold more than 55,000 copies)
- Listed in Who's Who of American Women
- Profiled in documentary "There but by the Grace" family farm film

**Testimony of Glen Keppy**
**Associate Administrator for Programs**
**Farm Service Agency**
**United States Department of Agriculture**

**before the**

**House Committee on Agriculture**
**Subcommittee on Conservation, Credit, Rural Development and Research**
**United States House of Representatives**
**March 27, 2007**

Mr. Chairman, and members of the committee, thank you for the opportunity to appear before you to review the current state of Farm Loan Programs (FLP) at the Department of Agriculture. I am pleased to be able to share vital administrative and FLP accomplishments by the Farm Service Agency (FSA) over the past several years. We will provide a brief overview of our key programs, a comparative analysis of current trends versus where we were ten years ago, and perspectives of ongoing implementation challenges we face as we continue to administer FLP. Finally, we will provide an overview of the recommendations of the Administration's 2007 farm bill proposals for the Credit title.

**Farm Loan Programs Overview**

FSA makes direct and guaranteed farm ownership (FO) and operating loans (OL) to family-size farmers and ranchers who cannot obtain commercial credit from a bank, Farm Credit System, or other lenders (Chart 1). FSA loans can be used to purchase land, livestock, equipment, feed, seed, and supplies. Our loans can also be used to construct buildings or make farm improvements.

Under its Farm Ownership and Farm Operating Loan programs, FSA has the following amounts outstanding:

- Direct Farm Ownership: $2.881 billion
- Guaranteed Farm Ownership: $5.478 billion
- Direct Operating Loan: $2.290 billion
- Guaranteed Operating Loan: $3.748 billion

Emergency loans are also available to help producers recover from losses in counties, and contiguous counties, that are declared or designated as disaster areas or plant and animal quarantine areas. Other programs include the Indian Tribal Land Acquisitions Loan Program (ITLAP) and the Boll Weevil Eradication Loan Program.

FSA loans are often provided to beginning farmers, ranchers and applicants designated by statute as socially disadvantaged (SDA) who cannot qualify for conventional loans because they have insufficient financial resources. FSA also provides temporary assistance to established farmers who have suffered financial setbacks from natural disasters, or whose resources are too limited to maintain profitable farming operations at commercial lending rates and terms.

FSA guaranteed loans provide conventional agricultural lenders with up to a 95 percent guarantee of the principal and/or interest should the borrower default. The lender is responsible for servicing a borrower's account for the life of the loan. All loans must meet certain qualifying criteria to be eligible for guarantees, and FSA has the responsibility to monitor the lender's servicing activities. Farmers first apply to a conventional lender, which then arranges for the FSA guarantee.

FSA makes and services direct FO and OL loans. We provide direct loan customers with credit counseling and supervision so they have a better chance of success in their farming operation. To qualify for a direct loan, the applicant must meet the eligibility criteria as well as show sufficient repayment ability and pledge collateral to fully secure the loan.

**Modernization Trends**

Agriculture is a very dynamic industry. Recent changes in the operating environment have been enormous. This requires that FSA also must be aggressive in keeping pace and must modernize our operations.

Briefly, our recent accomplishments include:

*Farm Business Plan.* Business plans for FSA borrowers are now processed through a Web based system. This provides access to "real time" data on our portfolio while sharing data among our automated systems. This system also provides a reporting option. We have established some standard reports that reveal the financial status of our portfolio. In the future, we will be developing additional reports that will allow us to assess the impact of economic changes in the agricultural sector so that we can anticipate their impact on our borrowers. This also allows lenders to electronically provide information to FSA on guaranteed loans. In the future, we expect that borrowers and applicants using this software will be able to provide their financial information to us via the Web.

This system has allowed our loan officers to conduct more extensive and meaningful financial analysis of our borrower's portfolios thus enhancing their opportunities for success and graduation to commercial lending. We recently added a new feature that allows our loan officers to order applicant credit reports from the three major reporting companies through this system. We expect this to improve the application processing time.

Currently, we are moving all of our automated systems to the Web. When this project is completed we will eliminate duplicate data collection and farm loan services will be delivered more efficiently. Our employees will be able to conduct USDA business from any location where there is broadband, WIFI or dial-up Internet access. This will allow us to conduct business with producers at locations and times convenient to them. Additionally, this information will be stored on a centralized server allowing employees to quickly access portfolio information and provide real time management reports.

Guaranteed Loans are processed under the Guaranteed Loan System (GLS), an integrated software system shared between USDA's Rural Development and FSA. GLS has been Web enabled since May 2001, with ongoing refinements to make it more efficient and user-friendly. Lenders will soon have access to the system to electronically submit status reports.

*FLP Streamlining.* FLP is in the final stages of streamlining regulations on its direct loan programs (guaranteed loan regulations were streamlined in 1999). This streamlining effort will provide FSA employees with additional time to devote to servicing other customer needs. Once implemented, it will deliver the following three key benefits:

1) Consolidate and reorganize 13 Code of Federal Regulations (CFR) parts into five parts and 42 instruction manuals into four handbooks;
2) Modify loan making and servicing processes within current statutory authorities; and
3) Improve, rather than eliminate, existing program processes.

*Farm Loan Programs Risk Assessment (FLPRA).* FSA developed a risk based oversight program to identify areas for potential risk in our portfolios. State reviews are conducted by national FLP staff once every five years and by state office staffs who must review one-third of their service centers each year. Potential risk areas are separated into three broad categories:

1) Program Management;
2) Program Objectives; and
3) Financial Integrity.

Data is obtained from the FLP automation sources. This process was piloted in FY 2005 and implemented in FY 2006. To date, fourteen states and 187 service centers have been reviewed.

*800-Number.* In February 2006, FSA introduced a new 24-hour, toll-free line that borrowers can call to get information on their accounts. They can check their current account status, loan balance, due date of the next installment, historical data on their various loans, and general information – such as the amount of interest paid – to help them in calculating their income taxes.

**Comparative Framework: That Was Then – This Is Now**

The quality of our portfolio has improved significantly due in large part to our modernization efforts, better customer service and the dedication of FSA employees, as well as the much improved farm financial environment of the past seven years.

FLP continues to emphasize the importance of processing applications in a timely manner. Between FY 2001 and FY 2006, FLP reduced its direct application processing timeframes by thirteen days (30 percent), and reduced guaranteed processing timeframes by five days (28 percent).

*Loss Rates.* In FY 2006, losses in the direct loan program fell to their lowest level since 1986 – just 2.9 percent. FSA has experienced a steady decrease in direct losses over the past decade, from a high of 11 percent in FY 1996 (Chart 2).

Losses for FY 2006 in the guaranteed loan program were 0.4 percent, the lowest level since 1985 (Chart 3).

*Delinquency Rates.* As with losses, the direct loan delinquency rates are at historic lows for the past two decades at 8.1 percent for FY 2006 (Chart 4). This is the result of steady and dramatic decreases from a 23.8 percent delinquency rate in FY 1995. The decrease was facilitated by expanded authority, since 1996, to offset federal payments, salaries and income tax refunds to delinquent borrowers.
In the guaranteed program, the FY 2006 delinquency rate was 1.45 percent, the lowest since 1995 (Chart 5).

*Foreclosures.* Foreclosure rates continue to be very low in the direct loan program. In 2006, FSA participated in 198 foreclosures, including cases initiated by other lenders against individuals who also had loans with FSA. This represents less than one-third of 1 percent of the agency's direct loan caseload, and is a slight decrease from the previous two years, when the rate was just over the one-third of 1 percent level.

*Inventory Properties.* Inventory farm properties – those that have come into government ownership through voluntary conveyance or foreclosure – are also at historic lows with just 100 farms covering 18,000 acres in FY 2006. Just a decade ago, FSA held nearly 1,800 farms covering 598,000 acres. Many of those inventory properties were sold to established and beginning farmers, providing those individuals with prime opportunities to expand or create new operations.

*Graduation Rates.* Federal law requires FSA to "graduate" its borrowers to commercial credit when they have made sufficient progress to be able to qualify for loans from other lenders. They are assisted by the agency in refinancing their direct loans with FSA guaranteed loans from commercial lenders. Some 2,824 direct loan borrowers (3.83 percent) were able to graduate in FY 2006, a percentage comparable to the rates over the past ten years.

*Beginning and SDA Farmer Participation.* FSA has annual performance goals in place for field offices that reflect the Government Performance and Results Act requirements. These goals include increasing lending to beginning and SDA farmers and ranchers.

FSA continues to provide assistance to minority farmers in greater proportions than their demographic percentage of the total farming population (Chart 6 / Table 1).

FSA has increased the amount of loan funds obligated to beginning farmers and ranchers and to SDA applicants. The FSA direct loan beginning farmer caseload increased from 3,474 in 1995 to 16,828 in 2006. During this same period the FSA direct SDA caseload increased from 3,260 to 14,327. Guaranteed caseloads for beginning farmers and ranchers and SDAs were first reported in 1997. The FSA guaranteed beginning farmer caseload increased from 3,617 in 1997 to 8,236 in 2006. During this same period, the FSA guaranteed SDA caseload increased from 1,730 to 3,014.

**Independent Study Results**
Now, these improvements just cited are not our only assessments. Independent research verifies that FSA direct loan programs are operating effectively, and make a significant,

positive impact on the groups they are intended to serve. Researchers at the University of Arkansas recently conducted a comprehensive review of FSA direct loan programs. In one facet of their research, they studied loan originations in fiscal years 2000-2003 and found that 92 percent of the direct loans originated in those years went to small farmers, that is, farmers with less than $250,000 in gross sales. They found that although FSA farm loans assist only 4 percent of all farmers, because FSA farm loans are targeted to family farmers, an estimated 18 percent of all non-hobby family farmers depend on FSA for at least a portion of their financing.

The researchers also examined longer term outcomes of FSA's FLP. They reviewed the status of farmers who received loans between 1994 and 1996. The research found that 78 percent of the loans made during that period have been satisfied. They also found that of all the loan recipients during that period, only 11 percent left farming involuntarily. Bear in mind that all of these farmers cannot get commercial financing when they come to FSA for a direct loan.

In one key finding, the researcher concluded that the direct FLPs are largely servicing the intended clientele based on the agency's mission, given that direct loan recipients typically have weakness in their financial profiles and would likely have difficulty qualifying for commercial credit. Study findings, and other indicators in this testimony, clearly show that FSA's FLPs are doing a remarkable job of accomplishing what can only be described as challenging program objectives, as well as controlling operating costs and losses.

**Ongoing Challenges**
As we look ahead in the ever-changing environment, FSA will face significant and ongoing challenges in the years to come. Some of the most prominent are term limits, loan limits, staffing constraints, and finding ways to help beginning farmers overcome the barriers to enter production agriculture.

*Term Limits.* The statute presently limits a borrower to direct OL loans in each of seven years, with an additional one-time, two-year waiver on an individual case basis:

- There are more than 7,000 FSA borrowers who can only receive direct operating loan assistance one more year from the agency; and
- There are more than 11,000 FSA borrowers who can only receive direct operating loan assistance two more years from the agency.

Without FSA direct loan assistance, many of these borrowers may be forced out of farming as they may not have access to the capital necessary for them to conduct their farming operations.

The statute presently limits borrowers with guaranteed OL loans to 15 years of eligibility, with receipt of a direct OL loan also counting as a year of eligibility for guaranteed OL loans. The 2002 Farm Bill suspended enforcement of this provision through December 31, 2006, but Congress recently extended the suspension through September 30, 2007.

Once the statutory suspension expires, more than 3,800 borrowers are ineligible for any further assistance. An additional 1,600 borrowers will become ineligible for further assistance after 2007.

*Staffing Challenges.* We estimate that as many as 26 percent of FSA's current loan officers will be eligible to retire by the year 2009.

On average, it requires about two years to hire and train a loan officer in order to provide the level of effective supervision, expertise and customer service needed to maximize every opportunity for success for FSA borrowers. The two year training window for new loan officers complicates an already cloudy staffing forecast.

FSA's portfolio and borrowers could be exposed to financial risk if retirement attrition projections for loan officers are even marginally accurate. A large percentage of FSA borrowers are either beginning farmers or financially stressed borrowers who need financial supervision. FSA loan officers provide this supervised credit which requires a complete knowledge of FSA programs, finances, and agriculture enterprises.

**2007 Farm Bill**

The unique features of FSA farm loan programs have made them a key resource for beginning and socially disadvantaged farmers for many years. The Administration's farm bill proposals for the Credit title will enhance the ability of farm loan programs to meet the special needs of beginning and socially disadvantaged farmers and ranchers. Several obstacles make it difficult for these two groups to launch production agriculture operations. There are several underlying factors that create barriers, including:

1) Initial capital investment;
2) High land values;
3) Inability to access credit;
4) Lack of farm succession planning;
5) Increasing interest rates; and
6) Higher energy costs.

The farm bill proposals will make farm loan programs even more useful in overcoming these barriers and help these farmers and ranchers become established and financially secure.

The specific provisions are:

*Targeted funding.* We recommend increasing the statutory target for direct OL funds for beginning and SDA farmers to 70 percent. Additionally, we propose increasing the direct FO target for beginning and SDA farmers to 100 percent. Increasing the target levels would provide additional assurance that beginning and SDA farmers have financing options to purchase farmland and then operate those farms. We also recommend changes to the timing and method of pooling funds to assure that the funds may be used to meet the needs of these applicants nationwide.

*Beginning Farmer Downpayment Loan Program.* Our proposal would enhance the existing Beginning Farmer and Rancher Downpayment Loan Program to increase the opportunities for the next generation of farmers. The proposal would reduce the existing four percent interest rate to two percent. The first annual payment would be deferred for one year. The $250,000 cap on the value of property that may be acquired would be eliminated, and the minimum producer contribution would be reduced from 10 percent of the property purchase price to five percent. In addition, the program would be expanded to include socially disadvantaged farmers and ranchers as eligible applicants. These changes would make the program a better fit for the situations that confront beginning and socially disadvantaged farmers.

*Loan Limits.* The maximum amount an individual may receive in FSA Farm Loan Programs is specifically prescribed in the Consolidated Farm and Rural Development Act (CONACT). The CONACT direct operating loan limits have not changed since 1984; the current limit is $200,000. Direct FO loan limits were increased to the current $200,000 level in 1978.

The maximum direct loan amounts specified in the CONACT have not kept pace with increases in the cost of farm land and production inputs. We propose to increase the existing limits of $200,000 for direct FO and $200,000 for direct operating loans to a maximum of $500,000 for any combination of the two loan types. The higher, combined limit will allow a better matching of loan type, amount, and purpose to an individual applicant's credit needs.

We believe these three proposals will improve access to capital, providing more opportunities for and improving the competitiveness of beginning and socially disadvantaged farmers.

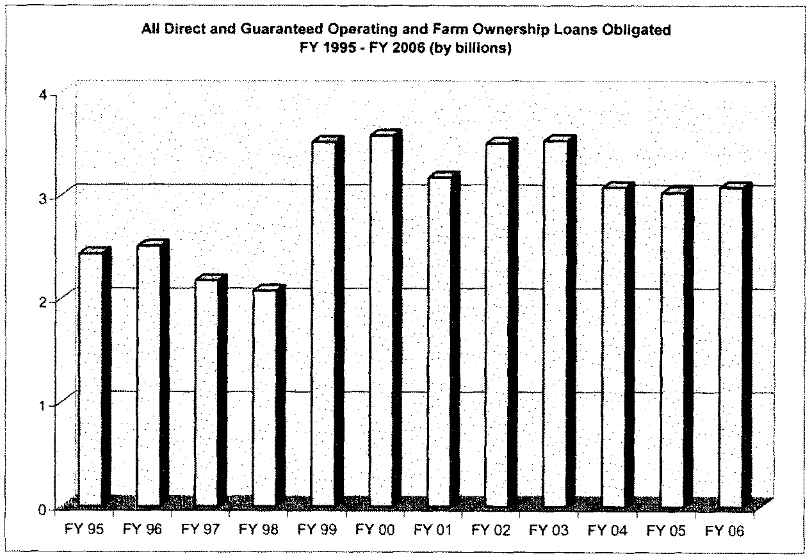
**Conclusions**
Through modernization efforts, maintaining focus on program objectives, and the hard work and dedication of FSA employees, FSA farm loan programs has made great strides in improving program performance. Loan failures and losses have declined which is a strong indication that the program mission of helping farmers become successful is being accomplished. At the same time, increased assistance to small, beginning, and minority farmers, reflects remarkable success as well.

However, more challenges lie ahead. Government resources are increasingly limited and the agriculture production landscape is changing. The structure of agriculture continues to change as most farms become larger and increasingly more reliant on technology, resulting in increased capital needed to gain entry. The cost of assets required to operate a farm continue to increase as well. These changes pose significant barriers and challenges to the groups that FSA farm loan programs are intended to assist. These issues create major challenges for the agency as well, since the success of the program depends on those whom the programs are intended to serve. To keep pace with these changes, we will continue efforts to modernize the delivery system, and to refine and adjust program requirements and operations to maximize the opportunities for our nation's small, beginning, and socially disadvantaged farmers and ranchers.

Because of our rural delivery system and experienced loan officers, the FSA farm loan programs staff is well positioned to continue the high quality delivery of existing programs and new initiatives to assist small, beginning, and minority family farmers. We look forward to working with this Committee to address the challenges we face in accomplishing this worthwhile mission to strengthen family farmers and rural America.

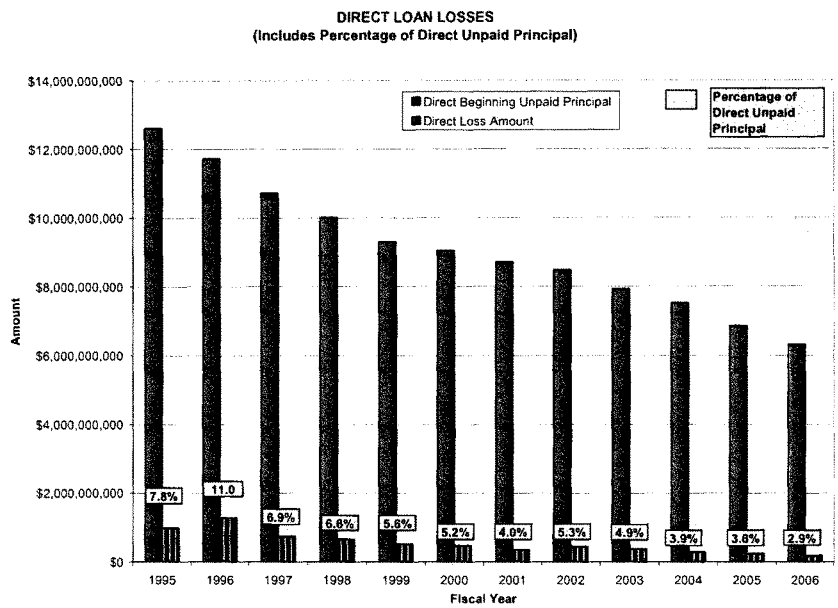
**APPENDIX**

**Chart 1**

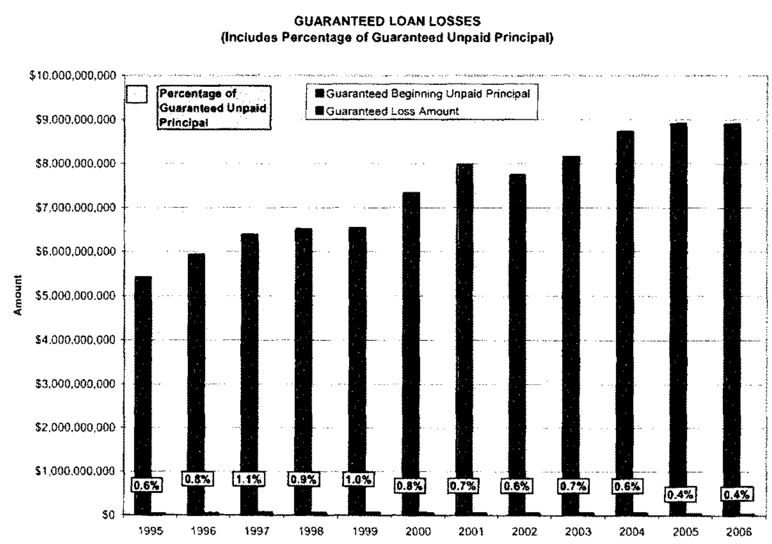



*$ Billions*

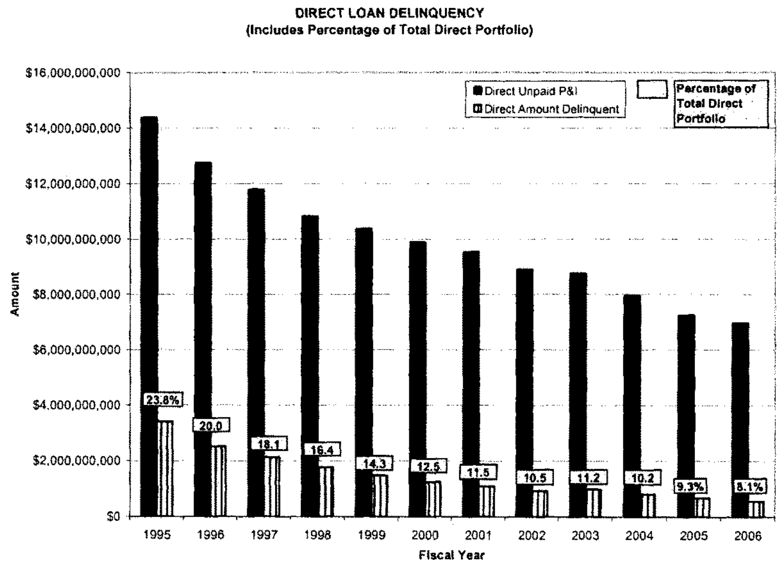
## Chart 2



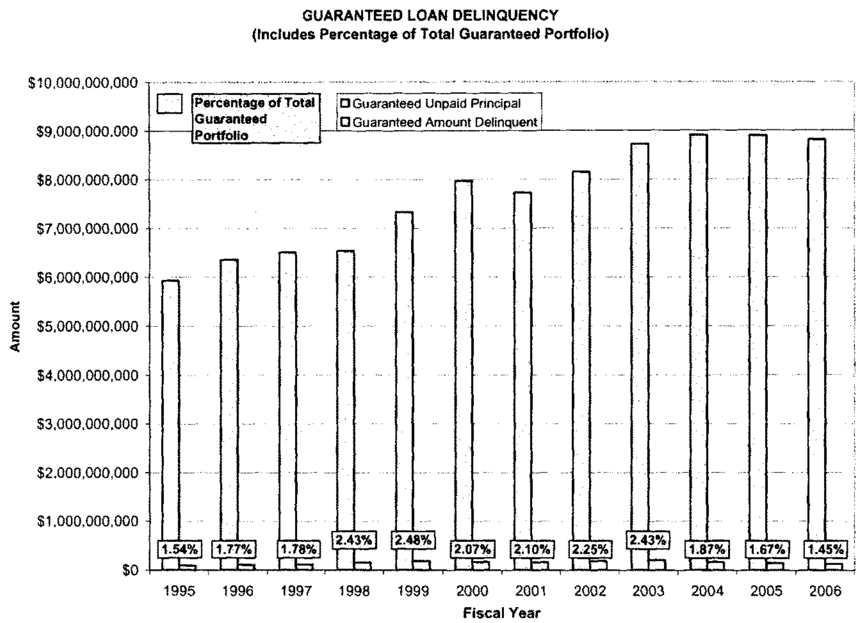

## Chart 3



## Chart 4


DIRECT LOAN DELINQUENCY
(Includes Percentage of Total Direct Portfolio)
Direct Unpaid P&I
Direct Amount Delinquent
Percentage of Total Direct Portfolio
$16,000,000,000
$14,000,000,000
$12,000,000,000
$10,000,000,000
$8,000,000,000
$6,000,000,000
$4,000,000,000
$2,000,000,000
$0
Amount
23.8%
20.0
18.1
16.4
14.3
12.5
11.5
10.5
11.2
10.2
9.3%
8.1%
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
Fiscal Year

## Chart 5


GUARANTEED LOAN DELINQUENCY
(Includes Percentage of Total Guaranteed Portfolio)
Percentage of Total Guaranteed Portfolio
Guaranteed Unpaid Principal
Guaranteed Amount Delinquent
$10,000,000,000
$9,000,000,000
$8,000,000,000
$7,000,000,000
$6,000,000,000
$5,000,000,000
$4,000,000,000
$3,000,000,000
$2,000,000,000
$1,000,000,000
$0
Amount
1.54%
1.77%
1.78%
2.43%
2.48%
2.07%
2.10%
2.25%
2.43%
1.87%
1.67%
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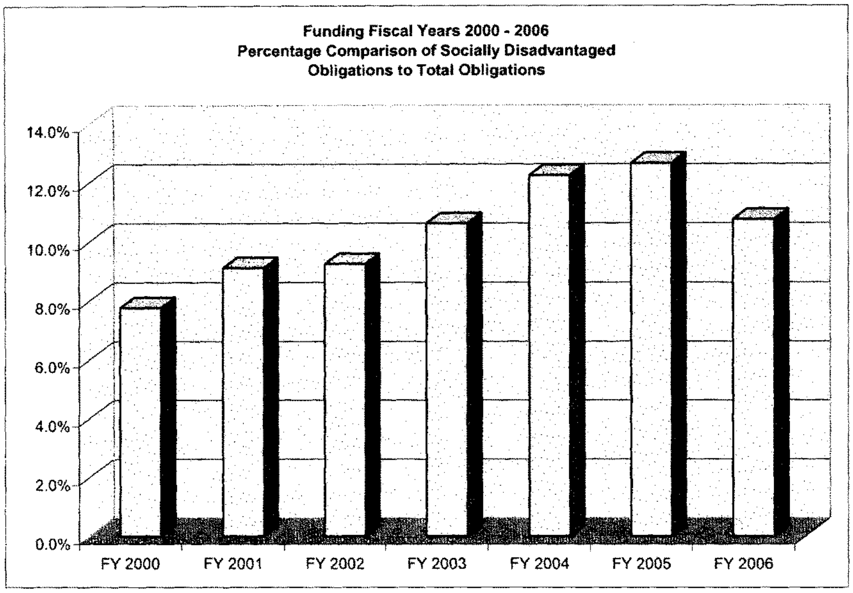
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
2006
Fiscal Year

## Chart 6




*Percentage of Obligations to Total Obligations*

## Chart 6 / Table 1

**FY 2006 BORROWER CASELOAD BY RACE**
**(As Compared to 2002 Census Data)**

| | Percent of 2002 Census Population | Percent of FY 2006 Direct Caseload | Percent of Population being served by FSA Direct Farm Loans | Percentage of FY 2006 Guaranteed Caseload | Percent of Population being served by FSA Guaranteed Farm Loans |
|---|---|---|---|---|---|
| White | 97.46 | 88.23 | 3.08 | 95.28 | 1.70 |
| Black | 1 37 | 3 63 | 8 96 | 0.82 | 0.79 |
| Asian/Hawaiin | 0.44 | 0.86 | 6.57 | 2.24 | 8.79 |
| Amer Ind/Al Nat | 0.73 | 2.95 | 13 67 | 1 49 | 3.53 |
| * Hispanic | N/A | 4 21 | N/A | 0.28 | N/A |
| Other | N/A | 0.12 | N/A | 0.10 | N/A |

* Hispanic Americans are not a separate category within the 2002 Census of Agriculture, therefore, no reliable comparison can be established.

STATEMENT OF NANCY C. PELLETT
CHAIRMAN AND CEO
FARM CREDIT ADMINISTRATION
BEFORE THE HOUSE AGRICULTURE SUBCOMMITTEE ON CONSERVATION, CREDIT, ENERGY, AND RESEARCH
MARCH 27, 2007

Chairman Holden, Ranking Member Lucas, and Members of the Subcommittee, I am Nancy Pellett, Chairman and CEO of the Farm Credit Administration (FCA or Agency). On behalf of my Board colleagues, Dallas Tonsager and Leland Strom, I am pleased to be here this morning to participate in this important hearing.

## MISSION OF THE FARM CREDIT ADMINISTRATION

The FCA is an independent arm's-length safety and soundness regulator established by Congress to oversee the operations of the Farm Credit System (FCS or System). Specifically, we are responsible for approving regulations and examining the institutions of the Farm Credit System, the Government-sponsored enterprise (GSE) that Congress established to improve the income and well-being of American farmers and ranchers by furnishing sound, adequate, and constructive credit and closely related services to them, their cooperatives, and to selected farm-related businesses. We also regulate and examine Farmer Mac, which provides a secondary market operation for agricultural mortgage loans. The Agency accomplishes its mission in two important ways — through examination and regulations.

## EXAMINATION

First, FCA ensures that the System and Farmer Mac remain safe and sound and comply with the applicable law and regulations. Specifically, our risk-based examinations and oversight strategies focus on an institution's financial condition and material risk exposures, as well as its board's and management's abilities to direct its operations. Our oversight and examination strategies also evaluate each institution's efforts to serve all eligible borrowers, including young, beginning, and small farmers and ranchers.

On a national level, we actively monitor risks that may affect groups of System institutions or the entire System, including risks that may arise from the agricultural, financial, and economic environment in which the System institutions operate. Our job is not to forecast specific events, but to understand the environment so we can take steps in advance to help System institutions take preemptive actions before adverse conditions result.

Examiners use a risk-based examination and supervision program to differentiate the risks and develop individualized oversight plans for each FCS institution. We set the scope and frequency of each examination based on the level of risk in the institution. In addition, we continuously identify, evaluate, and proactively address risks within each institution. Examiners scope their oversight and examination activities on their assessment of an institution's internal control environment and the institution's board and management's ability to manage risks, both present and future. When needed, we direct institutions to implement appropriate corrective actions to address weaknesses examiners identify.

Risks are inherent in lending, and managing risks associated with a single sector of the economy, such as agriculture, can be particularly challenging for lenders. If FCA discovers unwarranted risks, we work with an institution's board and management to establish a plan of action to mitigate or eliminate those risks. Appropriate actions may include reducing risk exposures, diversifying its portfolio of risks, increasing capital, or strengthening risk management practices. In those cases where the board and management are unable or unwilling to take appropriate action, the Agency has broad authority under the Farm Credit Act to take a variety of enforcement actions including supervisory letters, written agreements, and cease and desist orders. We also have authority to issue capital directives when necessary to maintain an institution's financial viability. In extreme cases, we can remove or suspend management, issue civil money penalties, and/or liquidate the institution.

**REGULATORY ACTIVITY**

The second way FCA accomplishes its mission is through regulatory activity. The FCA approves corporate charter changes and adopts regulations, policies, and other guidelines that govern how System institutions conduct their business and interact with their customers. Congress has given the FCA Board statutory authority to establish policy and prescribe regulations necessary to ensure that FCS institutions comply with the law and operate in a safe and sound manner. The Agency's regulatory philosophy is to establish a flexible regulatory environment that enables the System, consistent with statutory authority, to offer high-quality, competitively priced credit to farmers and ranchers, their cooperatives, rural residents, and other entities on which farming operations depend. This translates into developing balanced, well-reasoned, flexible, and legally sound regulations. We strive to ensure that the benefits of regulations outweigh the costs of implementation; maintain the System's relevance in the marketplace and in rural America; and ensure that FCA's policy actions encourage member-borrowers to participate in the management, control, and ownership of their GSE institutions.

I would like to give the committee a brief status report on a few of our notable regulatory projects this past year. In 2006 we completed a final rule on governance that established governance standards throughout the FCS — strengthening the independence of System institution boards, fostering the increased involvement of member-borrowers in System governance, and improving transparency in public disclosures. Our governance rule is consistent with the best practices found in the financial marketplace today, balanced to reflect the unique cooperative structure of the Farm Credit System. We believe the provisions of the governance rule are among the most comprehensive of all GSE financial regulators. The Agency also completed a final rule on disclosure and reporting requirements for FCS institutions that will improve the transparency of published disclosures, strengthen board and management accountability and auditor independence, and increase shareholder and investor confidence in the System.

The FCA Board also approved revisions to the Farmer Mac Risk-Based Capital Stress Test (RBC model). We adopted a final regulation this past November to ensure a more accurate reflection of the risk in Farmer Mac's operations. We completed these amendments in response to changing financial markets, new business practices and the evolution of the loan portfolio at Farmer Mac, as well as continued development of industry best practices among leading financial institutions. The Agency is also studying the possibility of further revising the Farmer Mac Risk-Based Capital Stress Test to better accommodate the evolving terms and structure of certain program business underwritten by Farmer Mac.

The Agency also issued a proposed rule last fall on processing and marketing that is focused on allowing agricultural producers to capture more of the value-added dollar. The rule recognizes the evolving sophisticated legal structures that farmers now use when engaging in processing and marketing business activities. The rule does not involve expanding the System's authority to lend to businesses that only have a tangential relationship to agricultural or producers operations. Instead, the proposal is focused on assisting, through System financing, only those agricultural or producer processing and marketing entities that are truly integrated and are a logical extension of bona fide farmer and rancher operations. We will carefully examine all the comments submitted, and our Board will likely vote on a final rule later this year.

**CONDITION OF THE SYSTEM AND FARMER MAC**

Mr. Chairman, now let me turn briefly to the condition of the Farm Credit System. The System is a nationwide network of borrower-owned *cooperative* lending institutions and affiliated service entities that lend to agricultural and to rural America. I would like to highlight several of the underlying fundamentals of the System's cooperative business structure that are important to keep in mind.

1. Cooperatives are organizations that are *owned* and *controlled* by their members who benefit from the use of the cooperative's products, supplies, or services.

2. Boards of System lending institutions include elected directors from the voting membership of each institution, and a limited number of outside directors to supplement specific experience. Accordingly, the directors of System lending institutions are elected by their owner-users. Management does not sit on any boards of System lending institutions.

3. System lending institutions, as cooperatives, generally pay a portion of profits in patronage to their member-owners based on use of the cooperative's services. In contrast, owners of investor-owned businesses are typically not the users and dividends are paid to the owner based on stock ownership.

4. For the year ending 2006, 86 of 100 System institutions declared a total of $718 million in patronage to its member-owners. This amount represented 30 percent of 2006 combined net income of all System institutions.

The System comprises five banks and 95 associations that are the direct lenders to farmers and ranchers. I am pleased to report that the System's overall condition and performance remained strong throughout 2006. As the regulator, we take our job very seriously, and I am proud to say that FCA has played a major role in bringing the System back from the tough times of the 1980s to its present extremely healthy condition. Also distinguishing the FCS from other GSEs is the Farm Credit Insurance Fund. The Insurance Fund provides added protection for investors in Systemwide securities. The FCS is the only GSE afforded this level of protection.

The FCS is fundamentally sound in all material respects, and it continues to be a financially strong, reliable source of affordable credit to agriculture and to rural America. The quality of loan assets, risk-bearing capacity, stable earnings, and capital levels collectively reflect a healthy Farm Credit System. Capital levels continued to be strong, especially when compared with the System's risk profile. Asset quality remained high, loan volume growth was strong, and favorable credit conditions enabled the System to achieve nearly $2.4 billion in earnings for the 12 months ended December 31, 2006.

The Farm Credit System has earned more than $1 billion per year consistently beginning in 1993 and more than $2 billion per year beginning in 2004. As a result capital remains strong and is made up largely of earned surplus, the most stable form of capital. The System also continues to enjoy strong credit ratings from the rating agencies.

Farmer Mac is a stockholder-owned, federally chartered instrumentality established in 1988 to create a secondary market for agricultural real estate and rural housing mortgage loans. It provides secondary market services through a network of agricultural lenders and intermediaries that includes commercial banks, FCS banks and associations, life insurance companies, and mortgage companies. As of December 31, 2006, Farmer Mac's portfolio of loans, guarantees, and standbys totaled $7.3 billion. During 2006, Farmer Mac experienced significant growth in its outstanding portfolio of program assets.

One of the Agency's highest priorities continues to be the development and implementation of examination and oversight programs that meet the high standards and expectations of the Congress; investors in System debt obligations; the farmers, ranchers, and cooperatives that own System banks and associations; and the public at large. Our programs and practices have worked well over the years and have contributed to the present safe and sound overall condition of the System and Farmer Mac, yet we will continue to challenge our staff to evolve and meet the challenge of regulating and examining the increasingly complex nature of agricultural and rural America lending and financing.

## CREDIT OUTLOOK AND OPPORTUNITIES FOR THE FCS

The System loan volume reflects the System's activities in meeting its public policy purpose of providing for the credit needs of agricultural producers and rural America. Overall, agriculture has experienced several years of strong financial performance, which has resulted in high credit-quality agricultural loan portfolios, stable lender returns on agricultural loans, and increased competition for creditworthy agricultural producers. The underlying agricultural economic environment that supports this favorable financial performance is due to higher commodity prices, increasing land values, and for the 40 percent of farmers that receive them, the safety-net provided by government farm support programs. Of course, farm incomes vary a great deal by farm size, geographic location, and commodity specialties.

It is also important to note that economic growth in the off-farm rural economy is an increasingly important part of farm family income and helps make total incomes less vulnerable to the cyclical nature of the agricultural economy. Farmers rely on the income from off-farm employment and from their own off-farm business enterprises to stabilize their income stream and help with repayment of their business debt. In fact, smaller and intermediate farms obtain more than 80 percent of household income from nonfarm sources. Even for commercial farms, USDA estimates that off-farm income represents between 20 and 40 percent of farm household income.

Based on the underlying economic factors, including higher production input costs over the past few years, we have seen considerable growth in the Farm Credit System's loans outstanding. USDA projects an increase in the System's overall market share of farm business debt to 32.6 percent in 2006 from 31.7 percent a year earlier. I note that the share of this debt held by commercial banks also increased last year to about 42 percent. The System's share is increasing because of enhanced marketing efforts and new business development, competitively priced credit to the System's borrow-owners, increased distribution of patronage refunds, new products, and collaborative efforts with commercial banks, especially through loan participation and syndication activity. The System's three largest lending segments continue to be real estate mortgage loans at 45.8 percent, production and intermediate-term loans at 23.3 percent, and agribusiness lending at 17.1 percent of the portfolio. Overall, System loan volume grew by 16.2 percent in 2006 compared with 10.3 percent in 2005, reflecting strong growth in all three of these business segments.

We believe that agriculture and rural areas will continue recent favorable financial trends and will demonstrate a growing need for competitive credit and financially related services. Rapidly rising input costs including feed, fertilizer, fuel, and capital equipment; the rising cost of farm land; and the needs of related industries in rural areas will keep the demand for debt rising. It will take the financial resources and expertise of all rural lenders to provide this credit, in many cases working together, as commercial lenders and System institutions have been doing for some of the larger loans. In addition, the FCA, through our examination and regulatory programs, will continue to strongly encourage the System to make its best effort to provide credit and services to young, beginning, and small farmers as well as work with USDA's Farm Service Agency in making guaranteed loans to these farmers.

As the landscape of agriculture and rural America continues to change, the Agency is continually studying and endeavoring to understand how these changes will affect the System's safe and sound mission achievement. For example, with the new emphasis on renewable fuels, specifically ethanol, various System institutions have responded by providing financing for this emerging market. Just a few weeks ago in this Subcommittee you heard from a System representative regarding its commitment to funding renewable fuel projects. As the regulator, FCA will be supportive of these important projects while continuing to ensure the System's safety and soundness.

Just to add a word of caution, however, history has taught us that we cannot expect the favorable financial conditions that have existed in the agricultural sector for several years to continue. Uncertainties such as high and volatile energy prices, the longevity of the ethanol boom and its impacts throughout the agricultural economy, a new farm bill, international trade agreements, and the usual weather and production risks are some of the factors that will affect the longevity of the current conditions. As identified by other regulators, there are signs in other lending segments, like housing and commercial real estate, of potential future credit weaknesses and general economic risks. These regulators point to concentration issues, an easing of underwriting standards, and systemic liquidity exposure. Agriculture and rural America are affected by some of the same general economic risks impacting other lending segments, including economic growth here and abroad, the value of the dollar, the global trading environment, inflation, interest rates, and employment opportunities, while also being exposed to the risks noted above. Through our oversight effort, we remind System institutions to maintain constructive underwriting standards, solid credit administration and effective portfolio risk management practices, all of which help to mitigate the potential economic risks in agricultural lending. This is important, given the System needs to be a reliable source of credit to agricultural producers not only in good economic times, but also when economic times turn stressful and other lenders constrict credit or other sources of liquidity to agricultural producers and rural America.

Mr. Chairman, as you well know, the health of rural America is so crucial to the future of agriculture and our country. If we continue to encourage young people and new entrants to get involved in agriculture, then rural America must offer the basic infrastructure and amenities that will bring them back to the rural areas. We believe the System has a Congressional mandate to assist in providing credit and capital for these important projects and must play a meaningful role going forward in strengthening rural America. Directly linked to this is the importance of serving young, beginning, and small farmers. The System continues to increase its service to these important groups, and FCA will continue to closely examine that service to ensure that these important groups are served in a constructive, safe, and sound manner.

One of the ways we have encouraged System institutions to continue their service to underserved groups and rural communities is to use the broad investment authority provided in the Farm Credit Act. FCA issued guidance in January 2005 that gave System institutions a provisional opportunity to make mission-related investments through pilot programs supporting investments in rural America. Many of the investments are made in the form of a bond or other security instrument. The pilot programs are intended to strengthen the System's mission to provide for an adequate and flexible flow of funds, under specified conditions, to agriculture and to rural communities across the country. Further, the pilot investment programs are intended to provide FCS institutions with greater flexibility to partner with Government agencies and with other agricultural and rural lenders in fulfilling their mission objectives. Through these programs, the Agency is looking to gain a better understanding of the diverse financing needs of agriculture and rural communities and how FCS institution investments could help increase the availability and efficiency of funds to these markets.

These investments include rural housing mortgage securities; bonds that provide funding for economic development; infrastructure; essential community facilities; and revitalization and stabilization projects. One program that I was particularly pleased to see is aimed at helping starter farmers or cooperatives obtain greater access to funds needed to begin or continue operations. Through a subordinated debt arrangement, the program provides investments for working capital purposes of up to $50,000 for young and/or beginning farmers for terms of up to five years. Thus far, the program has funded a goat cheese operation, an apple orchard, and a vegetable operation. While we believe these programs are important for agriculture and rural America, I do want to make it clear that FCA is cognizant that safety and soundness must come first. We place appropriate conditions on each pilot program to limit risk exposures, and we can revise our approval any time safety or soundness becomes an issue.

Before I close, Mr. Chairman, I would like to provide you with a few thoughts and proposals as the Subcommittee and later the full Committee looks toward crafting a credit title for the next farm bill. First and foremost, the FCA is the safety and soundness regulator of the System. Most of our time and certainly the majority of our resources are dedicated to the examination function by our Office of Examination. Similar to the Office of the Comptroller of the Currency, you should know that the Farm Credit Act provides the Agency with all the regulatory, enforcement, and supervisory tools that we need to carry out our responsibilities in this regard. The regulatory framework established by the Agency has resulted in a strong cooperative federation of agricultural lenders that are well capitalized and operate in a safe and sound manner.

Along with safety and soundness, the Agency also has a responsibility to monitor and address how well the System is carrying out its mission as established by Congress. Overall, we believe that the System does a very good job of using the authorities provided under the Farm Credit Act to meet the needs of farmers and ranchers and other authorized borrowers across the country. There are, though, two areas where we think the Subcommittee should consider changes in law.

First, we see a need to clarify the System's ability to use two existing USDA programs to serve farmers and others in rural America. I am suggesting that the Subcommittee make a technical review of the Rural Business Investment Company program so that changes can be made to allow System institutions to participate in the program as originally intended. Briefly, the 2002 Farm Bill (section 6029) created a rural business investment program that was designed to promote economic development and create wealth and job opportunities among individuals living in rural areas and help meet the equity capital investment needs primarily of smaller enterprises located in rural areas. The law envisioned two types of rural business investment companies (RBIC), one that would leverage its own capital with a grant of Government funds, and one that would not receive Government funding (nonleveraged). System institutions were made specifically eligible to participate, and would like to be part of a nonleveraged program or RBIC. USDA regulations do not provide for the creation or certification of nonleveraged RBICs. This issue was also discussed at the Subcommittee's hearing last March.

Second, along with a review of the RBIC, a technical change to the loan-to-value requirements of the Farm Credit Act (section 1.10) would assist farmers and other rural Americans of modest means to take advantage of the guarantee programs of the USDA and perhaps other Government agencies. Under current law, if a loan is guaranteed by Federal, State, or other Government agency, a System institution may lend up to 97 percent of the appraised value of real estate held as security. This limitation does not serve a useful safety or soundness purpose in the case of guaranteed loans. In particular, we are aware of a USDA program that guarantees 100 percent, in some cases slightly greater than 100 percent, of the appraised value of the real estate. These programs are designed to assist moderate- and lower-income individuals and families to acquire or retain real estate in rural areas. Specifically, I would suggest that the statute be amended to allow the FCA to provide, through regulations, that the loan-to-value requirement may exceed 97 percent in the case of guaranteed loans.

Additionally, the Farm Credit System Insurance Corporation (FCSIC) will be suggesting technical changes to the statute that would allow its premium authority to match premium assessments to the Farm Credit System debt it ensures. The changes would enhance investor protection by increasing the amount FCSIC can collect to recapitalize the Insurance Fund. Board Member Leland Strom, in his role as Chairman of the FCSIC, has submitted a letter to the Committee that further explains the issue and would be pleased to visit with you or your staff to discuss it.

As you consider these possible changes, we would be pleased to provide you with draft legislative language at the appropriate time if that meets the needs of the Subcommittee.

**CLOSING**

In closing, as we continue to see major changes in agriculture and in rural America that will continue to change the lending landscape, the FCA is committed to maintaining our excellence in examination and being the strong, arm's-length regulator that Congress intended. We will also continue to craft thoughtful and sound regulations that will ultimately benefit the all-important end users whom we must always keep in the forefront of our minds — the farmers and ranchers in rural America. Mr. Chairman, thank you for allowing me to testify today. This concludes my statement and I will be happy to answer any questions.

INDEPENDENT COMMUNITY BANKERS of AMERICA

America's Community Bankers Shaping Our Future

Testimony of

**Frank A. Pinto**
**Pennsylvania Association of Community Bankers**

On behalf of the

Independent Community Bankers of America
and
America's Community Bankers

Before the

**Congress of the United States**
**House of Representatives**
**Subcommittee on Conservation, Credit, Energy, and Research**
**of the**
**Committee on Agriculture**

Hearing on

**"The Availability of Credit in Rural America"**

March 27, 2007
Washington, D.C.

## Statement of Frank A. Pinto

Good afternoon. Chairman Holden, Ranking Member Lucas, and Members of the Subcommittee. I appreciate being invited to testify on the important topic of credit availability in rural America. It is an honor to be here this afternoon representing the Independent Community Bankers of America (ICBA[1]) and America's Community Bankers (ACB[2]). My name is Frank A. Pinto. I currently serve as President of the Pennsylvania Association of Community Bankers (PACB[3]). PACB is affiliated with both ACB and ICBA, and in 2005-6 I served on ACB's Board of Directors.

Our testimony this morning is divided into three sections.

**Section one** discusses the role of community banks serving rural areas and the availability of credit in rural America.

**Section two** discusses proposals and activities of the Farm Credit System and the reasons why we object to what we quite frankly see as a very unconstructive, dangerous and overreaching agenda.

**Section three** discusses some of our concerns with the FCS's regulator, the Farm Credit Administration (FCA) and suggests that reforms are needed.

Our testimony also explains that the FCS is pursuing broad expansion powers in the legislative arena while at the same time the FCA has scheduled agenda items on the regulatory docket that would allow FCS to broadly finance non-farm credit needs and provide financially related services. The FCS is in essence pursuing a strategy of 'double-dipping' in an effort to become commercial banks while retaining government sponsored enterprise (GSE) status and advantages.

Mr. Chairman, community banks are very involved in providing credit to rural America. We have listed the benefits that community banks bring to local and rural areas. These benefits to rural America compare well against the rapidly consolidating number of Farm Credit System institutions, many of which are no longer locally-based, but rather regionally based. It is important to understand the important role that community banks play in rural America because it directly factors into the question of credit availability in rural America.

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[1] The Independent Community Bankers of America represents the largest constituency of community banks of all sizes and charter types in the nation, and is dedicated exclusively to representing the interests of the community banking industry. With nearly 5,000 members, representing more than 18,000 locations nationwide and employing over 268,000 Americans, ICBA members hold more than $908 billion in assets, $726 billion in deposits, and more than $619 billion in loans to consumers, small businesses and the agricultural community. For more information, visit ICBA's website at www.icba.org.

[2] America's Community Bankers is an independent national trade association that represents the nation's community banks of all charter types and sizes. ACB members pursue progressive, entrepreneurial and service-oriented strategies in providing financial services to benefit their customers and communities. For more information about ACB, visit www.americascommunitybankers.org.

[3] PACB represents, exclusively, the interests of almost 200 community banks across the state of Pennsylvania. Despite the differing structural makeup of our member institutions (commercial banks, savings banks & thrifts), they all share a strong commitment and philosophy -- meeting the financial needs of their community and citizens through hometown, quality service. PACB and its members believe that "community" banks are better able to serve their local area than financial entities whose policies are not set locally and thus may not meet local needs. What sets community banks apart is their commitment to keeping the people of their communities first in the list of considerations for every financial decision they make.

# Section I – Credit in Rural America

## Community Banks Benefit Rural America

- Community banks focus attention on the needs of local families, businesses, and farmers.
- Community banks channel their loans to the neighborhoods where their depositors live and work, helping to keep local communities vibrant and growing. They do not take deposits from one state and lend in other states.
- Community bank officers are generally accessible to their customers on site. They are often headquartered at locations close to their daily customer dealings.
- Community bank officers are typically deeply involved in local community affairs and are physically and emotionally attached to the communities where their bank and branches are located. Community bankers are involved with their local school boards, hospitals, and involved in economic and community planning initiatives.
- Many community banks are willing to consider character, family history and discretionary spending in making loans.
- Community banks offer nimble decision-making on business loans with decisions made locally rather than needing loan approval from a headquarters office far removed from the community.
- Because community banks are themselves small businesses, they understand the needs of small business owners. Their core concern is lending to small businesses, farms and consumers.

## Serving Rural America in Good Times and Bad

The commercial banking industry is the largest single sector provider of credit to American agriculture, supplying nearly forty percent of agriculture's credit needs. Community banks have consistently been the largest provider of agricultural credit within the commercial banking sector.

In fact, more so than any other lender segment, including the FCS, community bankers serve their rural customers in both good times and bad. Community banks have no other option than to stick with their customers through thick and thin as their bank's success is tied to the success of their communities. This fact was painfully evident during the agricultural credit crisis of the 1980s when hundreds of community banks were allowed to fail while the FCS received a federal bailout through a $4 billion line of credit to the U.S. Treasury.

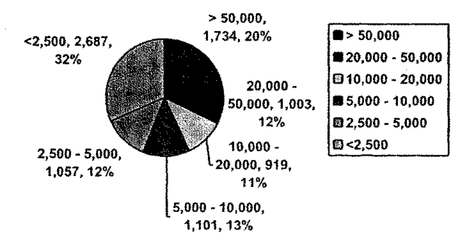
In addition, community bankers are often the catalysts for developing and attracting new and expanded businesses opportunities within their communities to ensure the long-term economic viability of their communities.

## The Availability of Credit in Rural America

To understand the availability of credit in rural areas it is helpful to know how many community banks serve rural America. There are approximately 8,500 community banks in the U.S. Eighty percent of these banks, nearly 6,800 institutions, are in cities of less than 50,000 people, or what some would call non-metropolitan areas.

Nearly seventy percent of all community banks, approximately 5,800, are located in communities of less than 20,000 people. Slightly less than 5,000 banks, or fifty-seven percent, are in communities of less than 10,000 people. Approximately 3,800 banks, about forty-five percent, are in towns of less than 5,000 people. Over thirty percent of all community banks, approximately 2,700 institutions, are in communities of less than 2,500. Thousands of community banks serve smaller, remote, rural areas.

**Number of Community Banks by Population Size**

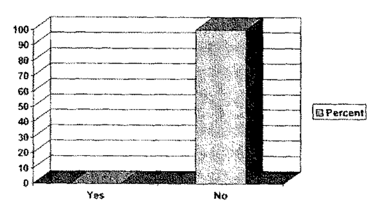



These statistics reveal that there are numerous financial institutions that are ready, willing and able to continue serving the credit needs of rural America. The thousands of community banks serving rural areas provide a substantial and unique delivery system of credit for rural customers. **These numbers do not include the additional thousands of bank branches that serve rural areas, nor do they count other non-governmental lenders such as finance companies, insurance companies, credit unions, and others.**

## Survey Results

The ICBA recently conducted a survey to over 1,000 randomly selected rural bankers geographically dispersed across all regions of the U.S. Approximately three hundred bankers returned responses to our survey, more than three times the number of lenders within the FCS. These bankers are keenly aware of the credit needs of rural communities since they finance commercial businesses, farmers and ranchers, and consumers every day. The findings provide the Members of the Subcommittee clear answers to questions regarding the availability of credit in rural areas.

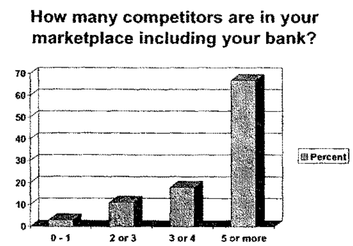
**Is there a lack of credit available in your marketplace?**




When specifically asked the question: *"Is there a lack of credit available in your marketplace, Yes or No?"* **one hundred percent of the respondents answered "NO".**

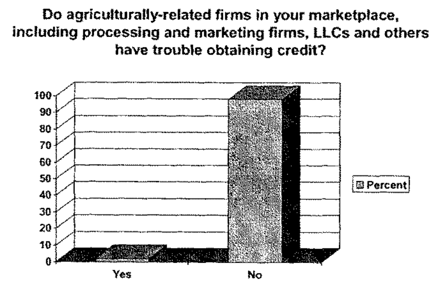
Survey Findings

1. **There is No Lack of Credit in Rural America**
2. **There is No Lack of Competition in rural America**




Approximately two-thirds of the banks in our survey reported having *five* ***or more*** *competitors in their local marketplace.*

The vast majority of respondents also observed that adoption of proposals by the FCS for new legislation in the farm bill and by FCA to expand eligibility of processing and marketing firms that are not farmer owned and controlled, but rather investor-owned and controlled, would *undermine competition, not enhance it.* This is due to the negative impact that heavily subsidized FCS lenders would have on the ability of private sector lenders to continue offering specialized lending and expertise in the agricultural and rural marketplace.




We also asked whether the array of agricultural related businesses in rural markets have trouble obtaining credit. Respondents overwhelmingly reported that agri-businesses do not have trouble obtaining credit.

Survey Findings

3. **There are numerous private sector lenders serving local markets**
4. **Agribusiness and commercial firms have no trouble accessing credit**

It is also quite revealing to view the actual comments of bankers responding to the question of whether allowing FCS expanded powers to lend to agribusinesses and commercial businesses in rural areas would enhance competition. Samples of their responses follow.

**Sample Banker Comments**

- We already have 6 banks, two credit unions, Ford Motor Credit, GMAC financing, American Express Financial, State Farm Insurance/Bank.
- There are already multiple sources of credit available to all of the commercial and agricultural accounts in this area.
- Their tax preferred status would keep the current banks from competing
- Too many banks are now competing for market share.
- These firms are already being serviced by existing financial institutions.
- Local tax paying banks cannot compete with subsidized lenders, consequently no competition.
- It would effectively stifle competition since FCS does not play by the same rules. Eventually it would decrease competition with smaller banks selling out.
- Our customers already have the choice of several banks as well as seed companies, feed companies, co-ops, etc.

- In our community, lending is cutthroat. If FCS wants to compete, please remove their subsidy and let them pay taxes like our bank.
- There are 40 bank and credit union locations within 25 miles.
- Credit is available in our community for any viable borrowing entity. Competition from surrounding banks ensures fair pricing.
- There is no shortage of lenders in our market, we are outside of the corn belt, but there are other types of producers in our area that are serviced by local banks, and there are plenty of banks in our market area. I don't see how a subsidized lender would help but to drive out competition by not competing on a level playing field.
- We currently have more than a dozen financial firms vying for the same business - competition is already fierce and probably under priced to risk.
- Competition is sky high in my area and Farm Credit does not help competition but merely monopolizes a community due to their unfair balance sheet financing.
- It would not provide an "enhancement" since credit is readily available and at reasonable terms.

## Results of the 1996 Rural Manufacturing Survey

USDA's Economic Research Service (ERS), in cooperation with Washington State University, conducted the 1996 Rural Manufacturing Survey (RMS) to address a number of questions relating to rural manufacturing businesses. This report considered such issues as whether rural manufacturers were adopting computerized automated production technologies and new management practices, skill levels of rural workers, adequate labor availability and, other key issues including **access to credit**, services, local infrastructure, and schools. The report noted that "Globalization of industry means the ability to compete in world markets is crucial to business success and job creation." (Emphasis added)

Interviews were conducted with 2,844 manufacturing establishments in non metropolitan areas of the United States and 1,065 establishments in metropolitan areas. Respondents were representative of establishments with 10 or more employees in all manufacturing industries. The report's goal was to provide a unique source of information on rural businesses that could serve as a vital tool for rural policymakers in USDA, Congress, other Federal agencies, and State and local governments.

The survey reported this significant finding in terms of the availability of credit for rural businesses:

> "Fifty-seven percent of nonmetro manufacturers reported a major expansion or modernization during 1992-1995, with nearly two-thirds of those companies using funds borrowed from a bank or savings and loan. **Capital seems to be equally available for both metro and nonmetro manufacturers.**" (Emphasis added)

The report also stated in its conclusion: **"The similarity of the metro and nonmetro responses suggests that capital is equally available to metro and nonmetro manufacturing establishments.**"

## Irrefutable that the FCS is a Heavily Subsidized Competitor

That the FCS, as a government sponsored enterprise, is heavily subsidized is not a point that can be easily dismissed. For instance, when FCA, at FCS's bidding, proposed a 'National Charter' framework to unleash all FCS lenders into any geographic market, the Treasury Department, in a May 2, 2001 letter, raised several concerns to FCA. One concern was whether it was necessary to introduce a heavily subsidized GSE retail lender into markets that are well served by the private sector. Treasury noted:

> "But the existence of such (private sector) competitors again suggests that the market failures that have existed in the past in providing agricultural credit may no longer exist. **We question whether enabling a GSE-subsidized competitor to better compete in this market advances a public purpose ... the System is a GSE, operating with a federal charter, a federal mission and federal subsidies.**" (Emphasis added)

In an October, 2000 public statement the Treasury pointed out the FCS is a heavily subsidized enterprise that enjoys competitive advantages over the private sector.

> **"GSEs are private sector entities created by Congress and given a special set of benefits by Congress to accomplish a public purpose. Like other GSEs, the FCS is limited to a particular line of business – providing credit and related services in agricultural communities – and receive various government benefits that lower the System's operating costs and enable it to borrow at rates much lower than other financial institutions.**
>
> **"Some of these benefits include an exemption from registering securities with the SEC and exemptions from federal state, and local taxes** ... GSEs are an exception to our general approach of avoiding differential treatment among financial institutions. **The potential benefits that GSEs bring to a particular market must be balanced, therefore, against potential risks to the financial system and potential effects on market competition."** (Emphasis added)

The Treasury Department's letter also stated:

> "Because FCS associations lend much like private sector banks, it is tempting to think of them as just another competitor in the agricultural credit market. **But they are not just another competitor: they are a lender to which the government has given significant competitive advantages.**" (Emphasis added)

The Treasury Department noted at the time that expanding FCS's powers through unlimited geographical constraints **"might well diminish competition and innovation** in the medium- to long term **by driving other competitors from the market.**" (Emphasis added)

Simply put, driving private sector competitors out of the rural marketplace harms rural America. Furthermore, it is not credible for FCS/FCA to claim that commercial banks as well as other types of private sector competitors have comparable subsidies.

As the Treasury Department's comments emphasize, expanding the powers of the FCS must be balanced with the potential harm to the financial system and the potential effects on the competitive landscape of the rural marketplace. FCA's proposal makes no effort to achieve this common sense balance and therefore will be quite harmful to rural America in many respects.

### A New "Groundhog" Day

Mr. Chairman, it seems that with the FCS and their legislative proposals, every new Congress is another 'Groundhog Day', in reference to the popular movie. In practically every new Congress we were told by FCS and the FCA that the FCS needs new powers. In 1995, for example, during debate on the 1996 farm bill, FCS witnesses testified that they 'needed' new lending authorities. The rationale was similar then to what is being expressed today. FCS stated that "new production techniques, export markets, increasing foreign and domestic competition, and environmental regulations are dictating the way American agriculture does business." This sounds eerily familiar to the Horizons pitch of 2007.

In fact, many of the same proposals touted then are being dusted off under the guise of the System having done a new, major, internal assessment to address changing trends in rural America.

In 1995, on several occasions FCS witnesses stated, "We also believe that FCS should be given the authority to directly lend to those rural businesses related to agriculture." FCS witnesses also asked for expanded mortgage lending authorities and the removal of borrower stock and borrower rights requirements.

We have only received FCS's legislative proposal in just the past few days. This proposal contains very similar, but apparently even more dramatic initiatives than those mentioned above. The System, of course, did not share their legislative proposals with the banking industry, demonstrating that they knew the proposals are overreaching. What the System is requesting could cause the demise of hundreds, perhaps thousands, of community banks.

## Section II – FCS Issues

### FCS's Agenda: Becoming the New Commercial Bankers

The FCS is a government sponsored enterprise. As the Treasury Department noted, GSEs are granted special benefits by Congress to accomplish a public purpose. The 'mission' of GSEs is limited by Congress in recognition of the special competitive advantages that GSEs have over private sector lenders. As the Congressional Research Service (CRS) noted in their January 2007 report, "Each GSE is given certain benefits such as implicit federal guarantees or tax exemptions, presumably to overcome barriers faced by purely private markets. FCS is the only direct lender among the GSEs; other GSEs such as Fannie Mae are secondary markets." As CRS noted, "most investors feel the federal government will not allow a GSE to fail."

By proposing expanded powers legislation, just as they have during previous farm bill debates, the FCS is seeking to leverage its significant competitive advantages as a GSE into direct lending to the commercial business sector and to essentially perform the same role as commercial banks.

**FCS Proposal on Commercial Business Lending** – The FCS proposes to lend to non-farmer owned and non-farmer controlled corporations (persons) engaged in virtually any activity that benefits farmers. In other words, any business that 'touches' farm products or engages in activities that either directly or indirectly benefit farmers would become eligible to borrow from the FCS. The only nominal constraint is the requirement that the business be 'primarily engaged' in these activities, an undefined term in FCS's proposal that FCS apparently hopes would be left to their captive regulator to liberally interpret.

However, the FCA certainly has lost any credibility in terms of enforcing mission compliance due to the agency's recent actions.

As one respondent to the banker survey stated:

> "**I am a former Farm Credit Administration examiner, now working with a community bank. As an examiner, I oftentimes was uncomfortable with the extent to which farm credit institutions strayed from their chartered purpose.** Now, as a community banker, I am disturbed with the System's push to gain further powers. **It is unfortunate that community banks, institutions that oftentimes are the bedrock of small community economies, are being assaulted by the Farm Credit System and enabled by the Farm Credit Administration.**"

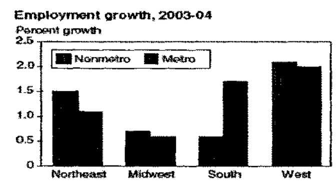
FCA's recent proposal to increase the eligibility of processing and marketing firms illustrates the point. Current regulations provide that a borrower is eligible for FCS financing for a processing or marketing operation only if the borrower is eligible to borrow from the FCS under statutory definitions *or is a legal entity in which eligible borrowers own more than 50 percent of the voting stock or equity*. The proposal would eliminate this specific requirement and replace it with a series of subjective determinations that would look to the circumstances regarding the control, the authority, or the dependent financial condition of the legal entity that would make them eligible borrowers. The proposal, however, does not provide guidance or specificity on the process that will be used to make such determinations, and provides no indication that there would be any public input, oversight or ability to challenge a funding decision. The proposal eliminates the objective regulatory limitation on the ability of a FCS entity to finance a borrower and replaces it subjective and unenforceable criteria.

The FCS's latest legislative proposal would allow very subjective interpretations of the statute. The FCS is proposing to eliminate much of the system of deliberate constraints established by Congress to prevent abuse of the FCS's GSE advantages which would: 1) significantly damage private sector lenders in rural America; and 2) create a powerful incentive for the FCS to lend to businesses only tangentially linked to agricultural producers, and certainly not owned and controlled by bona fide farmers, ranchers, and aquatic producers and harvesters. The first result would significantly weaken a vibrant network of private sector lenders that are essential to a competitive market for credit in rural areas. The second result would distract the FCS from concentrating its activities on those it is intended to serve. As a consequence, community banking and private enterprise would be weakened, the implicit burden on government and taxpayers would be expanded, and public benefits would not be conferred where needed or intended. Moreover, there is no evidence that the private sector is not serving these borrows; to the contrary, community banks are active in these markets and serve their customers very well.

FCS's latest legislative proposal appears to allow FCS to finance small to medium size businesses on Main Street as well as large corporate entities, including large, diversified manufacturers and retailers, even publicly traded firms. While FCS suggests these firms be agribusinesses – a new class of borrowrers, FCS would be authorized to finance – the term 'primarily engaged' would be defined by the regulator in the broadest manner possible. FCS's rationale for this proposal appears to be that somehow having a subsidized lender driving private sector competitors out of the marketplace will result in greater economic activity and result in more jobs, thus benefitting rural communities.

FCS argues that it is trying to grow the economic pie in rural America – an amazing argument given that FCS has not consulted with the banking industry on its proposals. However, statistics indicate that rural employment growth is comparable percentagewise to employment growth in metro areas. Job growth in rural areas is a key concern of community bankers and they work hard to bring jobs to their communities.

**Employment Growth Rural vs Metro**

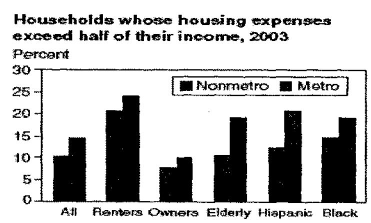



Forcing many community banks out of rural areas, the inevitable result of FCS's proposals, would harm the ability of rural areas to stimulate job growth. Additionally, FCS is asking Congress to take a huge leap of faith, that dousing rural America in subsidized credit when these markets already have an abundance of lenders and credit available is the answer to creating more jobs. This is a highly suspect assumption. The 1996 Rural Manufacturing Survey referenced above explained that credit access is not the chief factor leading to new job creation: **"Many rural development efforts are aimed at improving access to credit,** transportation and tele-communications infrastructure, and technical assistance. **In this survey, however, both rural and urban businesses tend to report these as being relatively minor problems.**" (Emphasis added)

**FCS Proposal on Mortgage Loans in Cities** – There are many troubling aspects of FCS's proposal to offer all types of mortgage products in cities of 50,000 people. This is a dramatic increase not only in population allowed but in types of borrowers allowed and size of loans allowed. Income from such loans is tax exempt, which again allows FCS to cherry-pick the prime credits from private sector lenders.

Even the most casual observer realizes that the mortgage markets are awash in credit for credit worthy borrowers. FCS is certainly not going to target low-income borrowers under these authorities. Furthermore, with these authorities, FCS would be able to offer mortgages in areas surrounding nearly every major U.S. city, including suburbs of Washington DC and New York City.

Housing Stress



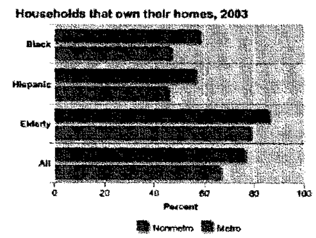

FCS has stated its desire previously in allowing individual FCS institutions to determine their own loan limits in order to allow FCS to finance very large mortgage loans. An example given in the 'confidential' FCS Horizons report regarded financing homes in bedroom communities where houses were selling for $600,000. **Other GSEs have conforming loan limits and requirements to apportion a percentage of their income into affordable housing funds for low-income individuals.**

The FCS also indicated a desire in this report to finance developers, multi-family housing projects and offer home equity loans. This would mark a dramatic shift by FCS away from serving farmers and towards serving non-farmers for non-farm lending purposes. **Home equity loans can be used for any purpose including any non-housing related and non-farm purpose.** This will allow FCS over time to dramatically shift their attention away from serving farmers.

USDA statistics offer very revealing information regarding housing, comparing metro to nonmetro areas in terms of housing stress and home ownership. **Housing stress is greater across all categories in metro areas than it is for nonmetro areas.** Sectors reviewed include renters, owners, the elderly, Hispanic and Black.

**USDA statistics also show a higher degree of homeownership for nonmetro areas than for metro areas.** All categories were looked at including Black, Hispanic, and the Elderly. This information raises numerous questions, including a very basic one: what is the need to allow FCS to expand into mortgages beyond towns of 2,500? As stated earlier, over 2,500 banks are located in towns of this size and this population level is representative of the size of many rural communities.

Congress intended FCS to focus on rural, remote areas and even gave them a tax exemption for doing so. Has FCS ever reported the extent to which it serves these rural, remote areas? We have previously asked the FCA to report such data but have not gotten a satisfactory response. Congress should not reward FCS with the authority to serve a significantly expanded market when the market is already awash in credit. Many would wonder why a tax subsidy should be afforded to a GSE to lend to high net worth consumers. This scenario completely distorts public policy precedents of targeting subsidies towards low-income households / borrowers. We also emphasize that FCS housing proposals do not target high stress borrowers, minorities, the elderly or low-income borrowers.



Source: Calculated by ERS using data from the 2003 American Housing Survey

**FCS Proposal to Remove Borrower Stock Requirements** – FCS proposes to allow individual institutions to determine whether they require borrowers to purchase stock. Requiring borrowers to own stock is a fundamental tenet of cooperatives. FCS has in the past sought to justify their special benefits on the basis of their cooperative nature. This proposal undermines FCS's cooperative nature and has numerous troubling ramifications.

One outcome would be FCS urging their regulator to also remove borrower rights requirements, which were established by Congress in the mid 1980s as a result of FCS's heavy handed treatment and liquidation of thousands of farmer borrowers.

Another outcome would allow businesses and individuals to borrow from FCS without any stock ownership and without any commitment to the FCS as a 'cooperative'. If FCS wants to lend to almost any borrower that commercial banks lend to and do away with its cooperative principals over time, then FCS should simply allow its institutions to convert their charters to banks.

One would also expect non-farm businesses and other 'eligible borrowers' to be able to purchase any product over the internet without being a farmer-owner of the FCS. This would allow FCS to engage in broad commercial and consumer lending. It would also result in complaints of discriminatory treatment as some borrowers will be required to purchase stock and others will not.

This would create different classes of "owners" with one class allowed voting stock and a second class of borrowers without voting privileges and without the benefits of belonging to a cooperative. Borrowers' stock requirements are already minimal with borrowers required to purchase stock equal to *the lesser of* two percent of the loan amount or $1000.

## FCS Experiencing 'Unprecedented Growth'

As mentioned, Mr. Chairman, we seem to go through a semi-annual rite in every new Congress of being presented expanded powers proposals by FCS and their regulator. These proposals are typically not based on any credit need in rural America but rather a desire by FCS managers to grow their empire. And the empire has grown quite dramatically over the last decade.

For example, FCS loan volume has tripled since 1994, from $55 billion to over $155 billion. FCA stated recently that the FCS is experiencing 'unprecedented growth' in assets of over 14% as of the end of the third quarter, 2006. FCS net income in 2006 will approach $2.5 billion. Furthermore, FCA recently stated, **"Loan volume grew by over 12 percent (in 2006). This represents the System's highest growth rate since 1981."**

**FCS has achieved this dramatic growth under current authorities. If this rate of growth continues, FCS will double their assets within five years; quadruple their assets within ten years and grow their assets by ten times within a decade and a half.**

When presented with such facts, FCS representatives try to suggest that 'commercial bankers are experiencing record profits.' FCS doesn't, however, portray an accurate picture. What FCS doesn't explain is that the growth of FCS institutions far exceeds the growth of community banks in rural areas. For comparison, the average return on assets (ROA) of FCS institutions in 2005 was 1.6%. For commercial banks, the ROA was much smaller as of year-end 2006, with banks of under $1 billion reporting a 1.14 percent ROA.

There is an even greater disparity for smaller community banks. As FDIC Chairman Sheila Bair pointed out earlier this month: "There are challenges. For example, the return on assets for the smallest institutions – those with total assets under $100 million – was only 0.93 percent. These banks typically have higher overhead expenses and fewer means of generating non-interest income than their larger competitors. Also, a persistent flat-to-inverted yield curve and stiff competition on both sides of the balance sheet have created a difficult operating environment. **As a result, net interest margins have narrowed to an 18-year low** (emphasis added). While this erosion has occurred across the spectrum of institutions, shrinking margins tend to disproportionately affect you. This is because community banks typically derive most operating revenue from net interest income."

FCS has utilized its GSE tax and funding advantages to grow much more rapidly than the private sector with the highest growth rate since 1981, a time just prior to the FCS collapse and subsequent bailout by the federal government. FCA stated in its Feb. 9 Memorandum to FCS lenders: "System loan volume has continued to grow very rapidly from many sources." FCS lenders are experiencing this unprecedented growth under current authorities. No new powers are needed for the System.

## FCS Lenders Target Customers Least in Need of Subsidized Financing

As was noted in a recent letter to the committee, **Non-farm lending is the new "Horizons" that FCS is seeking. Horizons will not cause new loans to be made.** The new authorities will be used by FCS lenders to shift loans off the books of local, tax-paying community banks and onto the books of larger, more regionally based, tax-exempt, FCS institutions. This will cause a significant tax loss to state and local governments, making it more difficult for rural communities to maintain an adequate level of services, schools, roads and other necessary infrastructure.

The former FCA chairman admitted this potential threat during a public hearing in June, 2003, stating: **"GSEs produce a variety of indirect and direct public benefits and costs in the marketplace ... Public costs, for example, result from a GSE's reduced or limited tax liability** ...". (Emphasis added)

The typical experience of bankers is that FCS lenders consistently choose to serve mainly the prime credits in the marketplace. While FCS and FCA like to claim that the FCS has done a better job recently in serving young, beginning, and small farmers, this simply is not the real world experience of community bankers serving the agricultural markets. Survey responses of bankers were quite revealing in this regard. Sample comments included the following:

- **In no case has FCS EVER refinanced a farmer from our bank that was in trouble from years of drought or falling commodity prices. They always use their unfair advantage to take the best customers.** (Emphasis added)
- As a past employee of the FCS I am very aware of its history and original charter. Since the consolidation of 1986 the FCS has greatly changed how it does business and who it wants to do business with. Its matrix lending has limited their customer base to a select group of the very best farmers.
- The competition in our market is already fierce. When FCS competes in our market, they only target the very best customers and then they take advantage of their government sponsored funding sources and lower operating expenses to buy the customers' business.
- They are able to skim the best customers away from commercial banks based on interest rate differential.
- **Typically, Farm Credit cherry-picks the market leaving the banking community to address the needs of marginal or struggling enterprises. The hallmark of Farm Credit is only those who don't need their help qualify.** (Emphasis added)
- They are in our area and only talk to the large farmers of our bank
- **The FCA has a history in our community of coming in and "cherry-picking" our best customers. This is definitely detrimental to all of the banks in the area.** (Emphasis added)
- It continues to appear that FCS is simply interested in the "cream of the crop" in our area and is very aggressive in rates and terms. I can only imagine that this will continue if they are granted expanded powers to serve non-farm operations and consumer needs.
- FCS's mission seems to be attempting to "cherry-pick" our best customers by low-ball pricing due to their GSE status.
- We are able to provide agricultural financing in our area. FCS only loans to the strongest and larger operations in our area. We have lost a number of loans to FCS because of their ability to offer lower interest rates to strong borrowers.
- Farm Credit has a tendency to finance only the lower risk operations in the marketplace. **Most of the borrowers that they take on could obtain financing any number of places.** (Emphasis added)
- FCS has been able to cherry pick the best customers that the banks would like to have but our costs of funds are higher then what FCS has.

- We see local FCS offices cherry picking our largest and most financially secure farmers, and giving them interest rates much lower than prime rates offered by large banks, giving them an unfair business advantage against us.
- The FCS has become a system that "cherry picks" the best customers using interest rates to do so.
- The FCS does not do beginning farmer and small farm loans unless their parents are good customers of theirs and willing to guarantee the loan.
- **The local Farm Credit office advertised for a credit officer. The criteria included calling on operations that were over $500,000 in gross sales. What happened to the original mission?**

FCA should enforce the predatory pricing prohibitions in current statute and prevent the System from operating as a GSE whose apparent public mission has become one of cherry picking the best loans in the markets in which they compete. The comments above provide ample, real evidence that the FCA is allowing the FCS to get away with focusing on cherry picking the best loans. This situation would only be exacerbated under FCA's proposals, which make no attempt to target any verified underserved market or low-income borrowing categories.

The FCS likes to say that their proposals just offer 'more competition'. But as the above surveys reveal, there are thousands of lenders competing for business in rural America every day. As the Treasury Department stated: "The potential benefits that GSEs bring to a particular market must be balanced, therefore, against potential risks to the financial system and potential effects on market competition." Remember the law of unintended consequences. American farmers aren't afraid of competing in foreign markets, but they want a level playing field. So do we.

## Section III – FCA Issues / Recommendations

### Has FCA Delegated Agency Supervision Over Mission Compliance?

Bankers have often complained about FCS's lack of mission compliance. That FCS lenders have often skirted their charter in an illegal manner is public knowledge. In fact, former FCA Chairman Michael Reyna made the following statement during a June, 2003 public hearing:

> **"While it is unclear whether it is a case of system institutions "asking for forgiveness, rather than asking for permission," today's hearing is also being held because of questions and concerns among our examiners who are increasingly finding violations of these same regulations.**
>
> **"For example, our examiners are finding some System institutions financing non-agricultural commercial enterprises that exceed the borrower's agricultural operations in terms of assets or income. Similarly, some institutions have been found financing the acquisition of agricultural real estate by developers**; and, still others have been found to be financing the construction of houses for persons who own agricultural land but have minimal or no farming income.
>
> Are these instances examples of a GSE attempting to fulfill its mission and congressionally mandated charter? **Or are they instances of "mission creep" and attempts by some to use a GSE -- a public tool -- chartered by Congress to serve agriculture, for very different purposes; purposes that legitimately could and should be served by private sector lenders?"** (Emphasis added)

FCA's recent liberal, creative and questionable interpretations of statute are quite alarming since it appears that mission compliance is now being determined by FCS institutions. This appears to be the gist of comments recently made by FCA. For example, FCA's Chairman, recently stated:

> "First, you have been hearing about the changes in the way we examine and have begun to experience this ... we are now doing it differently ... We are relying on your good governance and your internal systems of controls more and more ... we are committed to continue making sound policy decisions that address System mission accomplishment ... we have worked to provide appropriate flexibility while holding System institutions responsible for making the right decisions in financing borrowers within the System's charter."

In fact, a Feb. 9, 2007 FCA memo to FCS institutions, FCA seemed to express concerns about FCS's neglecting the issue of mission compliance, stating:

> **"Meeting those needs does not include non-mission related real estate development or speculative purposes. Such lending practices are not consistent with FCA regulations and may significantly increase risk to the overall favorable reputation enjoyed by the System at large. System lenders must ensure that they maintain** sound credit and **a sound reputation** by focusing on agricultural and rural lending permitted by FCA regulations § 613.3000 and § 613.3005, as was recently clarified by guidance found in Examination Bulletin 2006-2. **If your institution is growing at a significant rate**, you should be sure that growth is consistent with the FCS mission."

Why has FCA apparently abdicated its oversight over mission compliance to individual FCS institutions? In regards to the last sentence of this statement, we raise the question as to why the admonition to better monitor mission compliance relates only to those FCS institutions 'growing at significant rate'. Has FCA given those who may interpret their growth as not significant wider latitude to avoid mission compliance? Raising these issues of mission compliance indicate internal FCA awareness of abuses. If illegal practices were occurring in the commercial banking industry, bank regulators would make them public. **FCA needs to publicize illegal activities of FCS associations. We need greater transparency from FCA.**

## Ineligible Lending & Deposit Taking

In addition to lax attention to mission compliance, FCA has developed several novel approaches that allow FCS lenders to skirt the law and engage in ineligible lending activities. This is appalling behavior for a federal agency supposedly accountable to the public.

**Exemption Letters** – A November 26, 2006 article in the *Des Moines Register* noted that the former FCA chairman "ended the (FCA) board's practice of issuing letters to institutions who wanted cover for lending practices that might be questioned later." Federal banking regulators have not had similar allowances for banks.

**Investment Bond Program** – Bankers are also perplexed and amazed at the FCA's development and implementation of a series of broad-based pilot programs under the name "Investments in Rural America". Under this program FCA is allowing FCS lenders to engage in loans that would otherwise be illegal if the loans are labeled as "investments" on the institutions' books. An October 2006 article by ArborOne (ArborOneACA.COM) explained that the FCS institution had made its first-ever health facility 'loan'.

The article noted that the financing was a loan both in the article's headline and the text. Their justification was that: 1) ArborOne had an expanding role within the rural community; 2) there is now a broader interpretation of FCS institutions' role helping rural communities prosper and grow; and 3) FCS is "now able to serve more people in more ways by opening new doors and stretching our boundaries." Community banks in this market reported they were quite willing to extend financing for this loan. This is a perfect example of how FCS and FCA's expansion efforts are undermining private sector capital.

It is particularly perplexing that FCA has covered this program in a shroud of secrecy. FCA did not issue a proposed regulation on the "Investments in Rural America Program" The full committee has in the past reprimanded FCA for not complying with the Administrative Procedures Act when the agency tried to impose the National Charters proposal without a public comment process. When the National Charters program did see the light of day through a public comment process, intense criticism from a variety of sources both within and from outside the System and from the Treasury Department led to FCA's withdrawal of the proposal.

It appears that history is repeating itself with FCA's Investment Bond program and the astonishing lack of public information available. For example, FCA failed to provide any details on the program to a FOIA request. In fact, the agency responded with a ten page document that blacked out most or all of the materials relating to the following categories: Issues/Decisions, Background, Recommendation, and Financial Profile data. The agency stated that it had also redacted 128 pages of additional material. The FCA's FOIA response in essence provided no useful information on the program and no understanding of its purpose or need. Such responses from FCA seem typical of the agency and reflect an appalling lack of transparency and secret dealings for a federal agency.

The CRS, in a March, 2007 briefing paper, provided this description:

> "Selected FCS institutions also have begun investing in "agricultural and rural community bonds" as a pilot project, with the approval of FCA. The bonds, issued by private or public enterprises, are assets to the FCS institution with structured payment terms. **The bonds effectively result in loans to businesses and communities, some of which may not otherwise qualify for FCS loans. For the FCS institution, the bonds are treated as an investment and thus not subject to loan eligibility regulations."** (Emphasis added)

This program has no real basis in statute or legislative history. It was never discussed nor contemplated by Congress. It makes a mockery of congressional efforts to place appropriate constraints upon the FCS, as a subsidized, special purpose GSE lender. **We strongly urge the Subcommittee to request FCA halt the program and provide all background information on this program for public review. FCA needs to prohibit non-mission related activities of FCS institutions. FCA should also be required to testify annually to Congress, providing an evaluation of the performance of the FCS in carrying out its mission and provide assurance that no ineligible lending activities are occurring. We need more transparency from the FCA.**

**Deposit Taking** – In yet another example of allowing abusive practices, bankers complain the agency is allowing FCS institutions to essentially engage in deposit taking, check writing and cash management services. These practices take money out of local communities that community banks would otherwise use to finance loans in these same communities. FCS lenders have even promoted the idea that cooperatives and customers should not leave their money in local institutions but allow larger FCS lenders to engage in various cash management arrangements through a large commercial bank. This practice harms rural communities and siphons local deposits from the very rural communities that FCS says it wants to help with expanded powers.

Bankers have also been told by local customers that FCS institutions are offering checking accounts in addition to lines of credit needed to repay loans, clearly inconsistent with statute and legislative history. Implementing deposit taking mechanisms is a totally inappropriate practice for FCA to allow and is harmful to rural communities. These programs are simply a method by FCS to prevent borrowers from using products and services offered by community banks.

## Non-Farm Lending & Financially Related Services

FCA plans to propose this year broad new scope and eligibility provisions allowing FCS to finance the non-farm credit needs of farmers. If FCS's legislative proposals were adopted, this would dramatically expand the categories of borrowers eligible for non-farm financing with the term 'bona-fide farmers and ranchers' apparently applying to virtually anyone. FCA attempted the same regulatory expansion in the mid-1990s. At that time, FCA proposed allowing 'farmers' to receive non-farm financing from FCS equal to the value of their farming assets. Agricultural assets are valued at well over a trillion dollars. FCA also proposed removing any requirement that 'farmers' actually have any agricultural credit needs financed as part of an overall financial package. Such proposals are simply outrageous. FCS was established to serve farmers and ranchers. Allowing FCS to finance all non-farm needs of anyone labeled a farmer, even though they have no agricultural credit needs, is ridiculous.

FCA also intends to propose allowing FCS entities to engage in a broad range of financially related activities. Again, the focus by the FCS and the FCA is to become commercial bank like. Former FCA Chairman Reyna succinctly pointed out during the 2003 public hearing:

> "**Government-sponsored enterprises, like the Farm Credit System, are established to serve a specific public purpose, rather than a general public purpose.** For example, Fannie Mae and Freddie Mac were established to facilitate the flow of funds to housing; whereas, the System was established to do the same for agriculture. **Commercial and community banks, in contrast, are chartered to serve a more general public purpose.**" (Emphasis added)

## USDA Guaranteed Loan Programs

Mr. Chairman, the USDA's guaranteed farm loan programs continue to be important to many customers of community banks. We urge adequate funding levels be maintained in the new farm bill. There are several issues relating to the administration of the farm loan programs which bankers will want to address with the subcommittee in the near future. The elimination of borrower term limits and USDA's regulations regarding the setting of interest rates are two issues of concern.

## Conclusion -- Reforms Need

Mr. Chairman it is quite clear that rural America is awash in credit. It is also clear that the FCA is not supervising sufficiently to prevent the FCS to engage in illegal lending and abusive and harmful lending practices. **The former chairman of the FCA stated in the Des Moines Register article that the FCA board should be expanded to include additional members with regulatory backgrounds. We wholeheartedly agree. There is clearly a need for greater public transparency, accountability and reform.**

Banker representatives will soon be presenting the committee with a number of very positive reform minded ideas. We will also propose ways for community banks and FCS lenders to work together in a mutually beneficial manner, rather than the 'winner-take-all' proposals put forth by the FCS. We realize that typically the FCS has refused such suggestions because they desire a totally unlevel playing field tilted in their favor. The FCS was granted privileged GSE status in an effort to bring capital from Wall Street to serve agriculture. Rather than shifting dramatically away from serving real farmers, FCS appears intent on pursuing the demise of many community banks by unwarranted legislative and regulatory proposals. The FCS should seek a more constructive path and work cooperatively with community banks to finance the agricultural sector and FCS should be a key source of funding for commercial banks.

We are aware that FCA reports there was a total of $14 billion in 'participations and syndications' conducted in 2006. However, FCA has not broken down this dollar figure by how much was actually done in participations with community banks. FCA has not indicated what categories of financial activities it includes in the categories. Syndications are typically very large financial transactions. **Furthermore, if FCS and the FCA achieve their legislative and regulatory agenda, there will be no incentive for FCS lenders to engage in loan participations with community banks.**

**Mr. Chairman, eighty percent of the 8,500 community banks are in rural areas. There is ample credit available and fierce competition for loans.** While FCS proposals to expand their powers are a regular occurrence in Washington, the double whammy of legislative and regulatory changes the FCS is pointing at the community banking industry is both dangerous and overreaching. **Congress should not pursue any legislative agenda that displaces rural community banks from the rural marketplace. FCS should be required to pursue a much more constructive agenda going forward and we look forward to discussing ways to achieve this outcome with the committee.**

Thank you.

*Testimony of*

*W. Jeff Greenlee*

*On Behalf of the*

AMERICAN **BANKERS** ASSOCIATION

*Before The*

United States House of Representatives

Committee on Agriculture

Subcommittee on Conservation, Credit, Energy, and Research

March 27, 2007

AMERICAN
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March 27, 2007

Mr. Chairman and members of the committee I am pleased to be here today representing the American Bankers Association (ABA) to discuss the availability of credit in rural America.

My name is Jeff Greenlee and I am President of NBanC in Altus, Oklahoma. NBanC, also known as NBC Bank, is a community bank chartered in Tulsa, OK, with banks located in Tulsa, Altus, Enid, and Kingfisher, Oklahoma. NBC is a member of NBC Corp. of Oklahoma, a bank holding company which also owns a separately chartered bank: NBC, Oklahoma City.

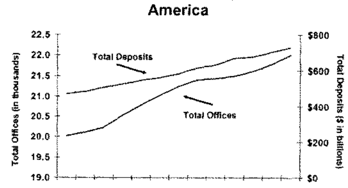
I serve as president of the Altus, Oklahoma location of NBC. The Altus bank has total loans of $37 million of which thirty-five percent are agricultural. The population of Altus is approximately 20,000 people, and much of the rest of our loan portfolio is somehow related to financing rural businesses and rural consumers. I also serve as the Vice Chairman of the American Bankers Association's Agricultural and Rural Bankers Committee.

ABA, on behalf of the more than two million men and women who work in the nation's banks, 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.

**Banks Provide the Credit That Drives the Rural Economy**

I am pleased to report to you that the banking industry in the United States with 8,681 banks and savings institutions operates nearly 22,000 banking offices in rural and small town America. The rural and small town presence our industry provides guarantees that rural Americans have the same access to financial products and services that urban Americans enjoy. To give you an example of the scale of what the banking industry manages in rural America, consider the fact that rural and small town

**Banking Offices and Bank Deposits in Rural* America**




* Represents rural and small town areas

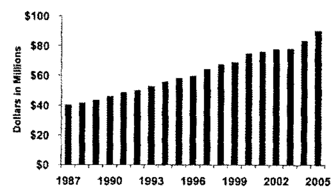
Source: FDIC

deposits in banks are estimated to be around $720 billion.

In the area of agricultural production and agricultural real estate finance, the banking industry had $106.9 billion loaned to America's farmers and ranchers at the end of 2006. This is the most credit banks have ever had outstanding to farmers and ranchers in the history of our country.
I am pleased to report to you that the agricultural loan portfolio is performing very well. The willingness of the banking industry to lend to this sector continues to be robust, and the availability of choices producers have to select from numerous competitive offers to finance their operations has never been higher.

People from other countries often visit our banks to learn more about how well the private sector handles the credit demands of agriculture and rural America. Many times they come from countries that have tried numerous experiments with government backed lenders of one type or another, and in every case they come away with a keen appreciation of the value of our privately capitalized, non-government financial institutions.

**Growth in Agricultural Lending by Banks**




Source: USDA

I report this information to you not to brag about what we have achieved as an industry, but to point out to you that our system is unique, efficient, and is the result of over 200 years of positive and negative experience. We have a unique and enviable system of agricultural and rural banking in this country, and it is a system that should be carefully cultivated so it continues to grow and flourish.

Congress deserves some of the credit for what we have achieved in financing rural America too, since federal agricultural policy has, for more than 70 years, provided farmers and ranchers with the safety net they need to be able to withstand the vagaries of weather, globalization, economic setbacks, and other uncontrollable factors. Bankers, who understand how these complex programs work, have the certainty they need to be able to forecast loan repayment, a critical factor in the credit making process. This certainty in being able to forecast repayment, along with stable asset values and knowledge of agriculture by the bankers who do the lending, is why the banking industry provides forty percent of all agricultural credit, making the banking industry the largest supplier of credit to American agriculture.

By providing the safety net that supports agriculture, Congress strengthens the ability of farmers and ranchers to obtain the credit they need. Farmers and ranchers benefit greatly from this, as do the rural communities they live in, because they purchase their inputs from the retailers in those communities, they send their kids to school there, and they shop on Main Street.

Federal energy policy has further contributed to the exciting economic activity taking place today as rural America is seen as our nation's greatest hedge against dependence on foreign oil. The banking industry has been an early and active participant in the development of the biofuels industry, and in the development and commercialization of other sources of renewable energy such as wind power.

Rural America, with unlimited resources to be tapped to help our nation meet the challenges of energy production in the future, is an exciting place to live and bank these days, and I am confident that the banking industry has the resources to meet the future financial needs of rural America as we retool to become a producer of food *and* energy.

**The Role of Government Backed Lenders in Rural America**

No discussion on the availability of credit in rural America could be complete without an examination of the role played by government backed lenders. Ninety years ago, Congress created the Farm Credit System (Farm Credit, FCS, or System), a government backed retail lender that enjoys considerable tax advantages (an effective combined state and federal tax rate of 3.4 percent in 2006 [1]), which further relies on taxpayers who "loan" the FCS their credit rating so FCS can borrow lendable funds in the government sponsored bond market at very advantageous rates. Further, when the Farm Credit System collapsed in 1987 it received a $4 billion line of credit from the Treasury.

The other government backed lender that we have had experiences with since the founding of our country has been the government itself. Following the farm debt crisis of the 1980s, the experience USDA had as a direct lender was very costly to the federal treasury. Since that time, USDA has transitioned from being a direct lender to farmers and ranchers to a provider of credit guarantees to banks who then use their capital and expertise to lend to farmers and ranchers. That transition has been positive. Later in my testimony I have some specific recommendations for you to consider that would further improve the USDA, Farm Service Agency guaranteed farm loan program.

**The Farm Credit System is a Government Backed Lender That Wishes to Lend Anywhere But the Farm**

For over a year, the Farm Credit System has publicized its Horizons Project. FCS has touted how it assembled all of the stake holders in rural America to solicit opinions about what the FCS should do next. First and foremost, I wish to point out to you that no representative of the Farm Credit System ever consulted with the American Bankers Association, or to my knowledge, with any banker in the country. As you listen to their story about all of the people they consulted, please know that the banking industry was not invited to participate in their project. The Horizons Project is really just about expanding the System. It is not sound policy, and it would set the FCS on a path that would take them further than they are today from financing agricultural producers.

Secondly, it is important to know that this is not about giving the Farm Credit System additional authorities to make more credit available to farmers and ranchers, since FCS has ample authority provided by Congress that allows them to offer farmers and ranchers every possible credit opportunity.

Third, in order to fully appreciate where the FCS wants to land next, it is important that we examine what the Farm Credit System is today; because that will give you an indication of what kinds of deals they will want to do in the future.

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[1] Calculated from the "Combined Statement of Income" found in the *2006 Annual Information Statement* published by the Federal Farm Credit Banks Funding Corporation, page F-6.

The following information was gleaned from the *2006 Annual Information Statement* issued by the Federal Farm Credit Banks Funding Corporation:

- Net income in 2006 was $2.46 billion
- Farm Credit had an effective combined state and federal tax rate that amounted to just 3.4 percent of net income
- FCS had $123.4 billion in loans outstanding at the end of 2006, and total assets of $162.9 billion
- Between 2005 and 2006 loans grew at a 16.2 percent rate, which is considered to be rapid growth by federal banking regulators --- in fact, FCA warned System institutions about "significant asset growth that may contribute to increased risk…" in an informational memo issued to all System institutions on February 9, 2007.
- 58 percent of FCS lending in 2006 was in loans over $500,000
- 24 percent of FCS lending in 2006 was in loans over $5 million
- $18.5 billion of FCS bank and association capital on12-31-06 was unallocated surplus, meaning it is capital within the FCS that has no clear ownership, which is a curious condition for an institution that claims to be "borrower owned." Just 16 percent of all Farm Credit bank and association capital is clearly allocated to the "farmer-borrowers."

Clearly, FCS is a large, fast growing institution with a concentration of its credit to large borrowers. In fact, the average FCS institution is 13 times larger than banks the Federal Deposit Insurance Corporation defines as an "Ag Bank."

**What is the Farm Credit System's Horizons Effort Really About?**

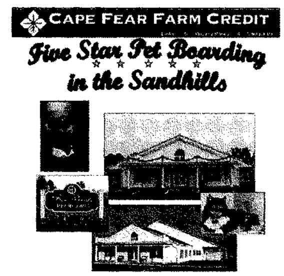
Farm Credit is seeking expanded authorities from Congress and from their regulator. The recommendations in the Horizons report, the proposed legislative language they have just released, and the proposed rules they have convinced their regulator to issue all point to the fact that Farm Credit wishes to become a large scale commercial lender to big businesses, and to finance suburban housing and consumers who have little or no relationship to agriculture or to rural America.

Farm Credit System lenders have, for decades, had the authority to finance farmer owned businesses that provide services directly related to a producer's on-farm operating needs. Initially it was understood that these "farm related" businesses were limited to custom combining, hoof trimming, on-farm cattle de-lousing, and other similar services delivered to producers on their farms. Over time, FCS lenders have looked increasingly at the commercial lending space and have desired to expand into more and more business financing that is, at best, marginally related to agriculture.

This has, in recent years, led to FCS loans to businesses such as luxury pet hotels, trucking companies, restaurants, tourist destinations, golf courses, duck camps and other types of businesses that do not fit the mission established by Congress.

We have closely monitored these developments over the years and we have voiced our concerns to the federal regulator of the FCS, and yet these instances of questionable lending continue to crop up.

From a 2004 Farm Credit System institution's annual report.




Five Points Pet Resort offers *your pet, your family member, your friend* the very best in boarding with luxury accommodations, exceptional attention and incomparable professionalism.

CoBank, the last remaining bank for cooperatives, is chartered specifically to lend to farmer owned, farmer controlled cooperatives. CoBank is not satisfied with this limitation of authority and now seeks the authority to finance corporate entities regardless of the organizational structure of the entity being financed. If granted these new authorities, CoBank would be allowed to finance entities that compete directly with farmer owned cooperatives.

**FCS Desires Major Expansion into Corporate Finance**

It is clear from the legislative language that Farm Credit has released that they seek to circumvent their mission of financing businesses that provide for the "on-farm operating needs" of farmers and ranchers in order to shift their attention and resources to any business that processes, markets, handles, purchases, tests, grades, distributes, or markets farm or aquatic goods. In addition, they seek to finance, for the first time, businesses that provide capital goods or equipment to farmers or to those *who may qualify under FCA regulations to be defined as farmers.*

Further, FCS proposes to create a new class of borrower, the Agribusiness. The language that FCS has released creates a new class of borrower who would be eligible to borrow from the associations, the Farm Credit Banks, and from CoBank. The new Agribusiness borrower would not have to be a farmer-owned business or a farmer-owned cooperative to be able to borrow from any Farm Credit institution. The Agribusiness borrower would not have any requirement that product thru-put be owned by farmers or ranchers, nor is there any restriction that limits the scope of the businesses other than qualifier that the business is "primarily engaged" in providing a wide range of <u>services</u> and <u>goods</u> to those who meet FCA's regulatory definition of a farmer, rancher or harvester of aquatic products. The term "primarily engaged" would be defined later by the regulator. Our experience with the regulatory process at the Farm Credit Administration is that they will seek the broadest possible definition of who is "primarily engaged" as they work to enable FCS institutions to engage in all kinds of new financing activities.

Creating the Agribusiness borrower may seem to be fairly innocuous until you consider the vast range of businesses that process, market, handle, purchase, test, grade, distribute, or market farm or aquatic goods or that provide capital goods and equipment to farmers, or those *who may qualify under FCA regulations to be defined as farmers.* Suddenly FCS entities would be eligible to finance very large corporate entities such as equipment manufacturers or floor plan dealer inventory.

What FCS is seeking is a major expansion and it raises a public policy question-- what does Congress want the Farm Credit System do?

**FCS Desires Major Expansion into Urban Home Lending**

One of the positive aspects of the American economy is the opportunity for a majority of its citizens to acquire financing for a home. Home mortgage financing is efficient, competitive, and widely distributed among all Americans. The Farm Credit System recognizes that home lending is a profitable business to be in, and they are seeking to expand their current authority to finance homes in towns of 2,500 or less to cities of up to 50,000 people. There is no justification for such action. I can tell you that in Oklahoma, rural America is not in cities of 50,000. What FCS is proposing would enable them to engage more fully in financing homes for retirees, second homes for urban residents, and developing subdivisions. What public policy mission would be fulfilled by allowing FCS lenders to finance homes in cities with up to 50,000 people?

**FCS Wants to Dilute Farmer Ownership of the Farm Credit System in Order to Pursue Consumer Lending**

Finally, FCS is suggesting to Congress that the basic ownership structure of the System be rendered irrelevant. Farm Credit was created 90 years ago as a *farmer-owned and farmer-controlled cooperative.* Today, in order to borrow from a Farm Credit System lender, borrowers must buy $1,000 of FCS stock, or purchase stock equal to two percent of the loan (2 percent), *whichever is less.* This is a low threshold for FCS borrowers to meet. More importantly, ownership of some FCS stock helps to remind FCS borrowers that FCS is a cooperative organization which follows certain cooperative guidelines and accepts cooperative governance. In exchange, FCS benefits from various special provisions of law Congress enacted for cooperatives.

Now FCS lenders are trying to convince Congress to remove the stock ownership requirement from statute and to allow the "local" boards of directors of each FCS institution to determine how much stock each borrower is required to buy. Such action will result in a future FCS that is "owned" by one favored class of borrower while others who borrow would be barred from voting, or from receiving other benefits of cooperative membership. This will only increase the questions that already surround the ownership of the $18.5 billion in unallocated capital that was on the books of FCS institutions at year end 2006.

**ABA Strongly Opposes Expansion of the Farm Credit System**

We urge Congress to reject Farm Credit's expansion plan. The banking industry, along with other private sector lenders, is financing rural America today and has more than enough capacity to meet rural America's needs in the future. The Farm Credit System was created to serve the credit needs of farmers, ranchers, rural home owners, farmer-owned service businesses, and farmer-owned cooperatives. They should not be allowed to abandon their mission to serve these borrowers while retaining the tax, regulatory, and other special provisions of law that now apply to them.

**The USDA, Farm Service Agency Guaranteed Farm Loan Programs are an Example of How Government Backed Credit Programs Should Work**

I am pleased to report to you that the relationship between the banking industry and FSA is strong and that we are all working together to provide credit to farmers and ranchers who would not be able to get credit without the guaranteed loan program. Thanks to the determination of my peers around the country, and the willingness of FSA to constantly make adjustments and improvements to their programs, the FSA guaranteed farm loan programs enabled 46,000 farmers and ranchers to have 62,500 loans with an outstanding principal balance of $8.9 billion at the end of FY 05.

Every year approximately $2.2 billion of new credit is advanced under the FSA guaranteed loan program, in the form of approximately 10,300 new loans. Loans are made to purchase and improve farm real estate, build new farm buildings, make conservation improvements, purchase machinery, livestock, and crop inputs, and refinance debt.

The credit made available under these programs is going to modest sized farms and ranches as the average guaranteed loan in FY 05 was $212,000. Twenty-six percent of all FSA guaranteed loans made in FY 05 went to farmers and ranchers who FSA defines as beginning farmers, and nearly twelve percent of all guaranteed loans were made to farmers and ranchers who FSA classifies as socially disadvantaged farmers. These loans are made for purposes that we all agree are "agricultural".


**The Transition from Direct USDA Lending to Credit Guarantees Has Gone Well**

For the last 30 years Congress and succeeding administrations have supported the transition from direct USDA loans to providing credit guarantees to private sector lenders (and government backed lenders like the Farm Credit System). Private sector lenders do a better job of underwriting and servicing agricultural credits, and FSA's role is to oversee the lenders. In addition, instead of hiring a large field staff to administer a direct loan portfolio, the guaranteed loan programs leverage the assets of the commercial lenders to do the field work. However, guaranteed loans do not work for every farmer and rancher. Even with a 90 percent guarantee against potential loan losses, not all producers can qualify for this type of credit. Congress and succeeding administrations have continued to fund a direct loan program to meet the needs of these very limited resource farmers.

**Banks Make the Most Guaranteed Loans**

I am pleased to report to you that banks make more loans under the FSA guaranteed loan programs than anyone else. Today, there are 3,222 lenders that participate and of that number, 93 percent or 2,987 are banks.

**FSA Guaranteed Loan Losses Have Been Very Modest**

Considering the fact that FSA guaranteed loans are made to those farmers and ranchers who have some sort of credit deficiency, the losses incurred under the program have been very modest and have been comparable to non guaranteed lending by banks and other lenders. This is a great success story that does not get told enough. Loan losses are low because banks make the initial credit decision, and are responsible for servicing the loan from cradle to grave. In addition, private sector lenders know that FSA will not pay on the guarantee until the lender liquidates and accounts for all of the collateral that was pledged for the loan. Private lenders must strictly adhere to FSA policies and procedures in order to ensure that the guarantee will be honored in case of a loan loss. Any bank that has had experience with guaranteed loan liquidations knows that FSA is very thorough in their settlement procedures. Over the years, led by the American Bankers Association, the banking industry has worked closely with FSA to ensure that bankers understand the unique responsibilities that come with the credit guarantee.

**Recommendations for the USDA, FSA Guaranteed Loan Program to be included in the Next Farm Bill**

**ABA Requests Level Funding for the USDA, FSA Guaranteed Loan Programs Recommendation:**

We request level funding for the FSA guaranteed loan program, at a level that would allow annual guaranteed loan making in the $2.5 to $3.0 billion range, which is consistent with annual demand over the past few years. In addition, we support permanent legislative language that would prohibit USDA from raising fees without Congressional authorization.

**Use of the Term "Average Agricultural Loan Customer Interest Rate" Should be Abandoned**

Banks and other lenders that make loans using FSA guarantees are supposed to price guaranteed loans based on a concept that is impossible to define. Due to the inability of anyone to objectively define the concept, banks that make guaranteed loans have been exposed to increased lender liability. For example, last year a small bank in Oklahoma was forced to pay $2.127 million to settle a lawsuit based on the claim that the bank charged the customer an interest rate that was higher than the "average agricultural loan customer rate."

The statute authorizing the guaranteed loan program, for loans sold into the secondary market (7 USC Sec. 1929(h) (2)), states the following:

> "the interest rate payable by a borrower on the portion of a guaranteed loan that is sold to the secondary market under this chapter may be lower than the interest rate charged on the portion retained by the lender, but shall not exceed the average interest rate charged by the lender on loans made to farm and ranch borrowers."

The Farm Service Agency has taken this definition from the federal statute and has applied it to all FSA guaranteed loans. FSA's handbook, "Guaranteed Loan Making and Servicing" (2-FLP) requires that each lender comply with the following:

> " Neither the interest rate on the guaranteed portion nor the unguaranteed portion may exceed the rate the lender charges its average agricultural loan customer."

We do not believe that FSA has done an adequate job of objectively defining "average agricultural loan customer" because they do not know what it is. Is that an average rate on all loans that are currently outstanding at a particular institution? Is it on loans of the same duration? Is it for all types of loans made to anyone who is a farmer or rancher? The statute is unclear, and FSA's regulation is equally problematic. Essentially both the statute and the regulation attempt to define what cannot be clearly and objectively defined.

Market forces should determine the rate of interest charged on loans guaranteed by FSA just as market forces determine the interest rate charged on all other financial products offered by banks. The agricultural credit marketplace is very competitive. The Internet has created a great deal of transparency about interest rates, loan terms, and collateral requirements. The marketplace is transparent. Attempts to impose an artificial cap on interest rates have backfired. Instead of it being a protection to the borrower, it has exposed the lending community to additional lender liability, resulting in a reduction in the number of banks and other lenders that are willing to use the program. The net result will be that fewer farmers and ranchers will get the credit they need. The small bank in Oklahoma I spoke about earlier will no longer use the program.

**Recommendation:** The provision in statute should be repealed, and FSA should eliminate all references to pricing from their regulation. Market forces should determine the price of credit. As the regulations currently stand, any bank that writes a guaranteed loan is exposed to additional lender liability because no one can consistently define who is an average agricultural loan customer. The statute and the regulation does not protect borrowers. Instead of making more credit available, more lenders will not use the program.

**The Resumption of Borrower Term Limits Will Represent a Significant Obstacle to Credit Access for Farmers and Ranchers**

In the mid 1990s, Congress sought to limit the amount of time that a borrower would be eligible for either direct or guaranteed credit from FSA. *The Farm Security & Rural Investment Act of 2002* suspended what is commonly referred to as borrower term limits. ABA supported the suspension. When the legislation expires on September 30, 2007, term limits will again take effect and the result could be devastating to those farmers and ranchers who still need the additional support that an FSA guarantee provides them in meeting their credit needs.
While we strongly support the idea that all farm and ranch businesses should be able to stand entirely on the strength of their individual balance sheet and earnings statements, we recognize the reality that there will always be a number of farms and ranches who will require some type of credit enhancement in order to continue to fund their operations. Requiring these firms to meet an arbitrary deadline for eligibility is inconsistent with the program.

**Recommendation:** Language imposing borrower term limits on FSA direct and guaranteed loans should be repealed.

**The Family Farm Definition Needs to Be Based on Fact, Not Subjective Factors**

Over the years FSA has attempted to define a family farm, for purposes of determining eligibility, in many different ways. These attempts, no matter how well intended, have failed.

For example, the current definition requires lenders to subjectively determine if the farm is "***recognized*** in the community as a farm," and that it "has a ***substantial*** amount of the labor requirements for the farm and non-farm provided by the borrower's immediate family," and that it "may use a ***reasonable amount*** of full-time labor and seasonal labor during peak loan periods." (2-FLP pages 6 and 7, emphasis added)

We are concerned that some legitimate family farms do not qualify for a guaranteed loan because of the subjective nature of the definition. Without a definition that can be objectively defined and clearly documented, there will continue to be uneven application of the definition around the country resulting in some legitimate family farmers being denied credit.

**Recommendation**: FSA should adopt a definition that can be objectively measured and documented. We recommend the definition of a family farm be that the entity being financed files a federal farm tax return (1040 Schedule F or appropriate corporate form). If the entity has farm income and expenses, it will file a farm tax return.

**Summary**

The American Bankers Association appreciates the opportunity to discuss the issue of credit availability in rural America. Rural Americans enjoy unlimited opportunities to finance their farms, ranches, businesses, and homes at competitive rates and terms. We reject the Farm Credit System's claim that something is missing in rural America.

Our system works so well because there is so much competition, and because Congress has wisely chosen to restrict the role played by government backed retail lenders that compete directly with the private sector while at the same time creating ways for public resources to be leveraged by the private sector to address the needs of limited resource farmers and ranchers. We urge you to continue this policy.

I will be happy to answer any questions you may have.

***The Farm Credit System:***
***Rural America's Customer-owned Partner***

Testimony of

**Doug Stark**
**Chief Executive Officer**
**Farm Credit Services of America**
**Omaha, Nebraska**

on behalf of the

**Farm Credit System**

before the

**Subcommittee on Conservation, Credit, Energy and Research**
**House Committee on Agriculture**

March 27, 2007

**Doug Stark Testimony**
**Subcommittee on Conservation, Credit, Energy and Research**
**3/27/07**

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear today to testify on behalf of the Farm Credit System. My name is Doug Stark and I am the Chief Executive Officer of Farm Credit Services of America, headquartered in Omaha, Nebraska.

FCS of America is one of the 100 cooperatively owned financial institutions that together make up the Farm Credit System. FCS of America serves farmers, ranchers, and rural businesses in Nebraska, Iowa, South Dakota, and Wyoming. We have over 66,000 customer/owners and 940 employees. At the end of 2006, we had some $10.4 billion in loans outstanding. As a cooperative, a sizeable portion of our profits are shared directly with our customer/owners with the balance staying in the organization for their use and that of future generations. We just completed a distribution of $45 million in profits, which brings the total distribution over the last three years to $150 million to these customer/owners.

The Farm Credit System, in total, has more than 460,000 customers and serves every State in the Union. Farm Credit was created by Congress more than 90 years ago to ensure that America's farmers and ranchers had access to competitively priced credit in good times and bad. Over the years, Congress added to Farm Credit's mission to ensure that farmer-owned cooperatives, farm-related businesses, rural homebuyers and rural utilities also enjoyed the benefits of a lender dedicated to meeting their financial needs.

The hallmark of the Farm Credit System continues to be our cooperative structure, meaning "customer-ownership." Each Farm Credit lending institution is owned by its customers, those farm families, individuals and businesses who borrow from us. Many our Farm Credit institutions, like us, have put our profits back in the hands of producers in the form of patronage refunds. Last year alone, Farm Credit paid its customer/owners $644 million in patronage refunds.

By any measure, Congress' decision 90 years ago has been a success. Today, the agricultural producers, rural businesses, and others that are eligible to receive financing from Farm Credit enjoy vigorous competition to meet their lending needs. Farm Credit provides a constant source of liquidity in these markets – irrespective of financial conditions in the industry. Farm Credit reverses the traditional flow of funds out of rural areas. We are very efficient in accessing the world's financial markets and delivering these funds to rural America.

Today, Farm Credit sells debt on the nation's money markets on a daily basis to bring capital to rural America on behalf of our customer/owners. Demand for Farm Credit debt is strong worldwide. This strong demand from investors ensures that Farm Credit can pass on competitive interest rates to agricultural producers and our other customers. Farm Credit works diligently to protect the demand for its debt securities. The financial markets, through various rating agencies, expect Farm Credit to withstand a vigorous evaluation irrespective of its GSE status. Our ability to issue debt on a daily basis at competitive rates is one of the primary benefits we can bring to rural America.

To protect the demand for Farm Credit securities, we maintain financial strength throughout the Farm Credit System. We maintain a very strong capital base. At yearend 2006 Farm Credit had some $24 billion in capital which represents 15% of our total assets. In addition, we fund an insurance fund which insures investors in System debt securities. That fund held over $2.3 billion at the end of last year. Offsetting these strong financials in the minds of investors, however, is Farm Credit's lending focus on a single sector of the economy. We remain largely a monocline lender and investors understand that limited diversity in a loan portfolio concentrates risk. Our status as a GSE, however, reassures investors who look intensely at portfolio concentration. This GSE status continues to be critical our ability to continue to bring benefits to rural America and agriculture. The benefits of Farm Credit's GSE status flow entirely to our customer/owners who reinvest in their own operations and stimulate local economies through their local spending.

One item I would like to highlight from the statement is our results in serving young, beginning, and small farmers. Our customer/owners are committed to helping continue the transition in agriculture to the next generation of producers. They are also committed to ensuring a future for small producers. During 2006, Farm Credit made more than 58,000 loans to beginning farmers for well over $9 billion. This represents about 18% of the total loans made by Farm Credit in 2006. We are proud of the success we have had in meeting the needs of these producers.

**Farm Credit HORIZONS**
The preamble to the Farm Credit Act called for the System to "serve agriculture and rural America" and because of this commitment to agriculture and rural America, Farm Credit undertook a project called HORIZONS. Over two years ago, the Farm Credit Council board, comprised of farmer directors from all over the Farm Credit System, joined the Presidents Planning Committee, a leadership group, to sponsor a strategic planning initiative known as the HORIZONS Project. The purpose of the project was very straightforward – to study how U.S. agriculture is changing as a result of global competition, technological advances, the changing tastes of consumers worldwide, and a host of other factors.

Our farmer/owners wanted to know how the businesses that agriculture relies on are changing and how changes in rural economic conditions are impacting future opportunities for all producers, especially young, beginning, and small producers. In addition, we studied how current regulations and law impact the ability of Farm Credit System institutions to meet the needs of customers in today's marketplace and the one we see developing. In the process, we sought out the advice and guidance of numerous academics as well as farm, commodity, and rural organizations throughout the country that represent our marketplace.

**Doug Stark Testimony**
**Subcommittee on Conservation, Credit, Energy and Research**
**3/27/07**

The HORIZONS project findings were published in a report we issued in January, 2006. We have, informally, provided copies of this report to members of Congress and their staff, along with rural stakeholder groups across the country. To date we have distributed some 50,000 copies of the report. In addition, we have distributed to our customer/owners and others over 400,000 brochures summarizing the report's findings and conclusions. In response, we heard back from tens of thousands of farmers indicating their support for our effort. These farmers appreciate that the Farm Credit System they own is concerned for and actively engaged in improving the future of U.S. agriculture and rural America.

A copy of the final report from the HORIZONS project is included along with my statement today. I ask that the report be included in the hearing record.

The HORIZONS report noted that advancements in technology, the growth of suburban areas, and economic pressures both within and without the U.S. have had the twin impact of both forcing change in agriculture and rural America -- while at the same time fostering exciting new opportunities. The report noted how farmers are more dependent than ever on farm-related businesses that provide farmers both critical inputs and marketing opportunities for their production; how farmers have become increasingly reliant on diversifying their income sources; and how vitally important rural job opportunities are especially to young and beginning farmers struggling to build equity in their operations. The report also points out how Farm Credit is constrained by several provisions in the Farm Credit Act that prevent us from directly meeting the needs of today's agriculture as it changes.

In short, the report confirmed what all of us in agriculture had been feeling for many years. The world has changed dramatically. From markets to production to technology to consumer demands, agriculture has changed. From population shifts, to employment trends, to demographic changes, our rural communities have changed as well. We see the pace of change accelerating into the future.

Having studied and documented the changes, we have identified a number of things that Farm Credit can do to help agricultural producers and rural communities adapt to the new and evolving realities they face. As a GSE, Farm Credit has been given a mission by the Congress. That mission is to help ensure the health and wellbeing of U.S. agriculture and rural communities. We believe that it is an important part of that mission to make recommendations about how we might best accomplish that mission. That is the reason we are here today.

**Legislative Recommendations**
Specifically, there are two areas where our basic lending authority could be changed to provide more benefits to farmers and rural communities. In addition, we recommend that two technical changes be made to the law governing Farm Credit's cooperative stock.

**Doug Stark Testimony**
**Subcommittee on Conservation, Credit, Energy and Research**
**3/27/07**

The changes to our basic lending authority are incremental in nature. In both cases, the changes we propose are not new types of lending authority. Instead, both are changes designed to adapt our current lending authority to modern business structures or rural economies. If enacted, these changes would address the shortcomings we have found in our ability to help farmers, ranchers and rural residents.

Farm and Fishing-related Businesses

The first proposal relates to Farm Credit's ability to serve the needs of *farm- and fishing-related businesses.*

Today some farm- and fishing-related businesses can receive financing from Farm Credit but not others. Some marketing and processing firms are eligible but not others. This is confusing to our customers, makes no sense in today's marketplace, and limits the benefits provided by Farm Credit financing to a select few businesses that meet antiquated guidelines in the Farm Credit Act.

Let me offer a few examples.

A *feed mill* owned by a farmer is eligible for Farm Credit borrowing if that farmer processes a bushel of his own grain through it. However, if that same farmer stops processing his own grain, he looses eligibility. Similarly, if that same farmer reorganizes the family business and transfers ownership to his daughter as a part of his estate planning and that daughter does not grow any grain, the feed mill can no longer benefit from Farm Credit financing.

Another example is that of an *apple processing plant* currently owned by an apple grower and financed by Farm Credit. The plant is going to be shut down because the current owner is ready to retire and does not want to make an investment to upgrade equipment. The plant is critically important for the local apple industry. Under current law, Farm Credit can't directly finance an interested buyer who wants to purchase and refurbish the plant unless that buyer grows apples that will be processed by the plant.

A third example would be a *custom spraying company* that seeks to expand its operation. Let's say the company approaches Farm Credit because we have previously financed the equipment they use for applying their product directly on farms. We must decline the loan because their expansion involves their local retail outlet for agricultural chemicals -- rather than the on-farm application of product.

We are asking Congress to recognize the modern business structures in agriculture. We are recommending that eligibility for Farm Credit financing in this area be determined by the activities undertaken by the company – and not determined by the corporate structure under which the company operates. Under the proposal, businesses that are PRIMARILY ENGAGED in:

**Doug Stark Testimony**
**Subcommittee on Conservation, Credit, Energy and Research**
**3/27/07**

> ***Processing, preparing for market, handling, purchasing, testing, grading, distributing, or marketing farm or aquatic products***

would be eligible for Farm Credit System financing.

In addition, the proposal would make eligible businesses that are PRIMARILY ENGAGED in:

> ***Furnishing farm or aquatic business services, capital goods, or equipment to farmers, ranchers, or producers or harvesters of aquatic products.***

These are the very businesses that farmers and aquatic harvesters directly depend on to support their operations. These are the businesses that are one-step away from the farm gate. Farm Credit already finances many of these types of businesses. The outdated provisions of the Farm Credit Act, however, prevent us from fully serving the needs of this important sector of the agricultural economy.

<u>Rural Home Mortgage Lending</u>
We believe that more rural residents should be able to obtain a competitively-priced Farm Credit mortgage loan.

For the last 36 years, Farm Credit's ability to provide home mortgage financing for rural homebuyers has been strictly limited to rural areas with less than 2500 in population. Congress gave Farm Credit home mortgage lending authority in 1971 and included the 2500 population limit. Rural America has changed since 1971 and this number is outdated and deserves to be updated.

In a number of rural areas around the country, medium-sized towns are annexing surrounding towns. In other rural areas, city and county governments are consolidating to create one middle-sized jurisdiction. In both of these instances, homebuyers lose eligibility for Farm Credit financing.

Today, the Farm Credit Act gives the Farm Credit Administration the authority to define "rural" for the purposes of Farm Credit's home mortgage lending authority. The law essentially though requires a two tiered test to determine eligibility. First, it must meet the definition of rural, which FCA defines as "open country." Secondly, no matter how open or rural the area is, it can't have a population greater than 2500.

We propose to modify the definition of "rural" to conform it to the definition Congress included in the 2002 Farm Bill. The 2002 Farm Bill changed the definition of "rural" as it appears in the Consolidated Farm and Rural Development Act (Con Act). The Con Act governs USDA rural development, housing and many other lending programs.

**Doug Stark Testimony**
**Subcommittee on Conservation, Credit, Energy and Research**
**3/27/07**

The definition adopted by Congress for the Con Act is as follows (emphasis added):

> ***"rural area" shall mean any area other than—***
> ***(A) a city or town that has a population of greater than 50,000 inhabitants; and***
> ***(B) the urbanized area contiguous and adjacent to such a city or town.***

We recommend that Congress update Farm Credit rural housing limit to include this definition.

This proposal has been subject to a great deal of mischaracterization. Our proposal, and our intent, has never included authorizing home mortgage lending in urbanized areas like Beverly Hills, CA; Darien, CT; or McLean, VA. None of these places, or places like them could ever be described as "rural" irrespective of their population.

In addition, this proposal to redefine "rural" has no impact on any other authority than Farm Credit's home mortgage lending authority. We understand that opponents of the provision argue that it would permit "Farm Credit to lend to anything in towns of less that 50,000 in population." That is simply not true. This proposal would apply only to home mortgage lending activity.

The proposal also does not alter significant existing limitations on Farm Credit's home mortgage lending authority. Currently, other than the "rural" definition, there are three additional restrictions on home lending by Farm Credit. We do not propose to change these. For a rural home to be eligible for FCS financing, it must be:

- Moderately priced
- Single-family, owner-occupied; and
- Loan-to-value ratio no greater than 85% (unless a guarantee).

Finally, there is an overall limitation on the amount of home mortgage lending available for Farm Credit. By statute, home mortgage loans can represent no more than 15% of Farm Credit's total loan portfolio. Measured against today's Farm Credit portfolio, this means Farm Credit can have no more than $13 billion in rural home mortgage loans. By comparison, the U.S. home mortgage market is some $9 trillion. If Farm Credit maxed-out its portfolio limit in home mortgage loans, it would still amount to only 0.14% of the U.S. market for home loans.

Modernizing Cooperative Stock Requirements
Our final two recommendations do not affect our lending authorities. Instead, these recommendations are designed to modernize certain aspects of the cooperative stock owned by Farm Credit System customers.

**Doug Stark Testimony**
**Subcommittee on Conservation, Credit, Energy and Research**
**3/27/07**

We remain committed to our cooperative structure and farmer-ownership and control. Nothing we propose has any impact on our cooperative structure nor does it impact farmer-ownership or control of FCS institutions.

Instead we propose to lower the barrier to entry for customers of Farm Credit System associations. We ask that Congress give local FCS boards of directors the ability to determine how much investment is necessary for a farmer to maintain in order to borrow from Farm Credit. Today, when a farmer wants to borrow from Farm Credit, he or she is required to purchase cooperative stock in amount equal to the lesser of $1000 or 2% of the loan he or she receives.

This minimum stock purchase requirement was put in place in 1987 as a way to ensure that Farm Credit institutions had adequate capital to support their operations. This minimum level is no longer necessary to capitalize FCS institutions.

Today, Farm Credit capitalizes itself based on retained earnings from its ongoing operations. At year end, borrower stock represented only 5.4% of Farm Credit's total $24 billion in capital. This amount is financially irrelevant to Farm Credit's ongoing financial strength. As a result, it only serves today as an unnecessary cost and as a barrier to entry for farmers who want to borrow from Farm Credit. This is especially true for young, beginning, and small producers.

We are asking Congress to eliminate the minimum stock purchase requirement from law. **Very importantly, though, we will keep the requirement that borrowers purchase some stock as a condition of borrowing from Farm Credit.** This ensures that we maintain our customer-ownership, cooperative structure.

Eliminating the minimum stock requirement would not affect the amount of farmer control over the Farm Credit System. Under our rules – which would not be changed by the proposal – any farmer, irrespective of how much stock he or she has in Farm Credit, is permitted one vote in the organization. This one-person, one-vote principal is an important part of our cooperative structure and ensures that small farmers are well represented in the organization. So, the proposal to lower the amount of stock required would not affect governance or voting in the organization.

The final part of our stock recommendation applies only to CoBank. We recommend that Congress give CoBank's customer/owner-elected board of directors the authority to determine which of its customers is allowed to hold voting stock in the organization.

Today, CoBank lends directly to farmer-owned cooperatives, rural electric cooperatives, rural telephone cooperatives, and other non-cooperatively structured rural utilities – in particular, small rural telephone companies and rural water systems. CoBank's cooperative customers are permitted by law to vote for directors to CoBank's board of

**Doug Stark Testimony**
**Subcommittee on Conservation, Credit, Energy and Research**
**3/27/07**

directors. CoBank's non-cooperatively owned customers – those rural telephone companies and water systems – are not permitted to vote. These customers are required to purchase stock and become a member of CoBank as a condition of getting a loan but are not allowed a voice in CoBank's governance. This is simply unfair to these customers.

We recommend that CoBank's Board of Directors be allowed the discretion to permit these customers to vote in CoBank board elections.

Mr. Chairman, these four proposals constitute our recommendations for updating the Farm Credit Act to meet the needs of our customers. I think you can readily see that they are consistent with the System's traditional mission. These are in fact quite modest and incremental changes that nonetheless will prove very advantageous to agriculture and rural communities, by offering greater access to a reliable, dedicated, customer-owned source of credit.

Thank you for holding this hearing today and I would be pleased to answer your questions.

***The Farm Credit System:***
***Rural America's Customer-owned Partner***

Testimony of

**Armin Apple**
**Farmer Elected Director**
**AgriBank, FCB and The Farm Credit Council**
**McCordsville, Indiana**

on behalf of the

**Farm Credit System**

before the

**Subcommittee on Conservation, Credit, Energy and Research**
**House Committee on Agriculture**

March 27, 2007

**Armin Apple Testimony**
**Subcommittee on Conservation, Credit, Energy and Research**
**3/27/07**

Mr. Chairman, thank you for the opportunity to appear before the Subcommittee this morning. My name is Armin Apple. I am a farmer from McCordsville, Indiana and I appear here this morning as a borrower/stockholder of my local Farm Credit association, Farm Credit Services of Mid-America, as well as a director of AgriBank and the Farm Credit Council.

As a bit of background, I started farming when I was a sophomore in high school with a tractor, borrowed equipment and 40 acres of rented land. By the time I graduated from high school I was farming 250 acres with a crop share lease. Today I farm over 1,400 acres of corn, soybeans and soybeans for seed.

I have been borrowing money from Farm Credit since 1972. My father, who also farmed, borrowed from Farm Credit before me, and my daughter and son-in-law who live in southern Indiana borrow from Farm Credit as well. I know first hand what it means to have Farm Credit stand by you in good times and bad, and, as you can see, for over three generations my family has benefited from having access to a lender dedicated to serving agriculture and our rural community.

This background is important because this Committee needs to understand that it is people like me that provide the direction to Farm Credit today, and it is people like me who will continue to do so in the future. While we rely on excellent managers to run our institutions day-to-day and to make sure our institutions comply fully with all of the regulations and disclosure requirements associated with a modern financial institution, ultimately it is the farmer stockholders and the directors elected by those stockholders that keep these institutions true to serving our mission. It is not in my interest, the interest of my daughter and son-in-law, or the interest of future generations to have Farm Credit lose its focus on serving agriculture and rural America.

It is with this focus that the Farm Credit System undertook the HORIZONS project. System directors and management together engaged in a strategic planning effort that studied carefully the dramatic changes that are occurring in agriculture and the rural communities on which agriculture relies. We received input from more than a dozen different academic studies that we commissioned. We involved people from throughout the country studying the various market segments that comprise agriculture as we find it today, and we asked them to consider what those trend lines meant for agriculture in the future. We consulted with our local farm and commodity groups. After doing this work, we then considered how current regulations and law limit the ability of Farm Credit institutions to meet customer needs.

Our focus, therefore, was on understanding the trends, understanding what the likely needs of agriculture going forward would be and discovering how Farm Credit might best help meet those needs. The net result was a long list of issues that needed to be addressed. Only four legislative items met our internal criteria which focused us on

**Armin Apple Testimony**
**Subcommittee on Conservation, Credit, Energy and Research**
**3/27/07**

seeking the changes in Farm Credit necessary to meet customer needs while keeping our focus on agriculture and rural America. Mr. Stark will be describing those in detail shortly.

I want to give you a feel for why change is necessary. As the members of this committee know, in rural areas we all wear many hats. As I have described, I am a farmer and a Farm Credit director, but I also am involved in my community in other ways. I am a member of my local church board of trustees and the church council and I have been chairman of my local township's volunteer fire department board. In addition for the last twelve years, I was an elected County Commissioner for Hancock County Indiana and served for one-third of that time as the commission president. I've got the scars to prove that I know what local government is all about – to face constituents when the roads don't get plowed, water isn't available or when taxes might need to be raised because we have a new mandate or two that needs to be addressed.

Hancock County is directly east of Indianapolis and it is being impacted by suburban sprawl. During my time as a county commissioner the population of the county increased by almost one-third to about 58,000 people. We have experienced a considerable amount of consolidation in agriculture but so far much of that has been due to farmers retiring. While some farmland has been lost to development, these retirements have freed up some land for those of us that lease crop land, but it also has meant that today there are fewer of us in row crop production to support the traditional business infrastructure which we require to stay in business.

In a changing county such as mine, where there are about 600 farm proprietors remaining, the businesses we rely on start to change. For instance, the typical small grain elevator disappears along with the local seed dealer and implement dealer. As this happens, the local banker might even think twice about whether he should continue to have an agricultural loan officer on staff. When that happens, they tend to lose interest in servicing farm-related businesses as well because these businesses may be one of dozens of business lending opportunities open to them. For us producers, these businesses are a life-line. When that infrastructure goes, our challenge to stay in agriculture becomes that much greater.

But the other thing that begins to happen is that some in agriculture start to adapt as well. With more concentrated population comes the opportunity to adjust a farm operation to higher value production, to value-added products or to turn to specialty crops. A field of feed corn, might become a much more profitable field of sweet corn because you have a ready local market. A soybean field might shift to sod because there are homeowners close by that will buy it. What had been row crops might shift to vegetables that are readily sold at a local market. If we are going to resist the temptation of cashing out to development and preserving agriculture and open space, we need to figure out how to get more income out of what we have. And if we are going to do this successfully, we need access to a whole new set of farm-related businesses, different from what were there before.

**Armin Apple Testimony**
**Subcommittee on Conservation, Credit, Energy and Research**
**3/27/07**

Today's farmers have many things to manage. Many have off farm jobs and I see many responsibilities being contracted out to others that may have more expertise and more training to do a job both right and more efficiently. Applying pesticides in an urbanizing area comes with the potential for many problems. Even producing organic vegetables to meet a market opportunity requires us to seek out expertise on an ongoing basis that may not have existed in our area before. These new farm-related business players that we come to rely on, as well as the old ones that still remain, both require access to a ready, reliable and understanding capital provider whether it be at a time of start up or to support on-going business operations. They need a lender that can work with them, one that understands agriculture and what it takes to be successful in this new environment.

Another significant new opportunity for agriculture has been in the area of renewable fuels. As the committee knows Farm Credit has been heavily involved in supporting the ethanol industry. While we share the belief that the economic benefits of these projects should stay in the hands of agriculture and other local individuals to the extent possible, the challenge that we already face is that the scale of the required investment to achieve success is enormous. This clearly means that farmers are not going to be the only ones that are the majority investors in projects that will convert a significant portion of our fuel from being oil based to carbohydrate based. Not all farmers are willing to risk all of the retirement equity in their land to achieve a national policy goal of greater energy independence, and we should not expect them to do so either. As these new locally based plants change to include more non-farmer ownership, the limitations of current law prevent Farm Credit from continuing to make our significant experience available as a direct lender to the bio-based, renewable fuels industry.

The bottom line is this. When the current version of the Farm Credit System's enabling law was written back in 1971, the Congress made clear that one of the purposes of the System was to support farm-related businesses necessary for efficient farm operations. In the thirty-six years since then, the types of businesses on which farmers rely have changed dramatically, as have the business organizational structures that are being used to manage the risk of these businesses. Unfortunately, the language that limits the System's ability to serve farm-related businesses has not kept pace and it now needs to be revised.

Mr. Chairman, the HORIZONS project was a good faith, focused effort to determine what the future needs of our customers will be and how we can help meet those needs. I mentioned that there were many recommendations that did not involve legislation – I want to mention just two of those so you have a feel for what I am talking about -- one involves a Farm Credit System-wide task force to study the programs we have in place to serve the needs of young, beginning and small farmers.

Each Farm Credit association already has in place programs targeted specifically at serving the needs of young, beginning and small farmers and we are doing a good job of serving them. Just so you know, in 2006 Farm Credit in total made about $5.4 billion of

**Armin Apple Testimony**
**Subcommittee on Conservation, Credit, Energy and Research**
**3/27/07**

direct loans to young farmers – those under the age of 35 and representing our next generation of farmers. My local association this year will provide over $1million in grants just to support education, training and other programs to assist young farmers in the four states we serve. In my association about 80% of our farm loans are to individuals that are either young, beginning or small. Despite the excellent record we already have, our Farm Credit System task force is working to identify and implement even more creative ways for us to work with these groups.

Another task force is looking at the issue of diversity – what can we do to successfully recruit more minorities into our workforce, into our directorship and to make sure we are meeting the needs of all farmers. We believe our loan portfolio reflects the demographics of today's agriculture, but we need to make sure that we are doing everything we can to serve the changing face of agriculture as well.

As a Farm Credit director I take very seriously my responsibility for the stewardship of this System. The Congress charged us with ensuring that Farm Credit be a permanent system of credit for agriculture which will be responsive to the needs of all types of agricultural producers having a basis for credit. While some may think it is good sport to whine about their perceived competitive disadvantage in the face of our efforts, every day in the marketplace there are beneficiaries to our mutual competitive zeal and those are your constituents and my fellow farmers and rural residents. If the competitive landscape were so lopsided, how is it that commercial banks have about 60% of the market share and Farm Credit has about 30%?

We bring the benefit of access to national money markets to agriculture and rural America packaged in a cooperative organization that our farmers own. After celebrating our first 90 years of doing so last year, we look forward to another 90 years of success for the future. What Mr. Stark will describe for you are the proposed incremental changes to what Farm Credit is already doing. They won't change our focus, our mission or our ownership, but only improve our ability to serve the changing needs of your agricultural and rural constituents. I will be happy to answer any questions you might have.

Federation of Southern Cooperatives/Land Assistance Fund

Rural Coalition/
*Coalición Rural*

**STATEMENT OF JOHN ZIPPERT**

**on behalf of the**

**FEDERATION OF SOUTHERN COOPERATIVES/
LAND ASSISTANCE FUND**

**and the**

**RURAL COALITION/COALICIÓN RURAL**

**to the**

**U.S. House of Representatives
Committee on Agriculture
Subcommittee on Conservation, Credit, Energy, and Research**

**Washington, DC
March 27, 2007**

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**Introduction**

My name is John Zippert. I am Program Director of the Federation of Southern Cooperatives/Land Assistance Fund and Chairperson of the Rural Coalition. I personally have worked on promoting equity in poor rural communities for more than 40 years, starting in St. Landry Parish Louisiana with the Congress of Racial Equality. I have worked with the organizations I represent today for many years.

For many years, I have worked with African American Producers in Alabama and the southeast in accessing credit and developing cooperatives. I also worked with producers in the aftermath of Hurricanes Katrina, Rita and Wilma in seeking disaster and recovery assistance.

In addition, I have personally assisted over more than 1000 farmers in Alabama in the preparation of claims and other documents in response to the Pigford v. Glickman Consent Decree. I have done this work in a paralegal capacity, under the auspices of the Chestnut, Sanders and Sanders law firm in Selma, one of the law firms connected to the class counsel in the lawsuit.

**Relevant Experience of Our Organizations**

We appreciate this opportunity to provide testimony to this Subcommittee as you begin important work on the credit provisions of 2007 Farm Bill. The organizations I represent are uniquely qualified to provide input and recommendations. Collaboratively and for many years, the organizations we represent have served as the primary and often only source of technical assistance and support to a significant proportion of the minority farmers in this nation.

The ***Federation of Southern Cooperatives/Land Assistance Fund*** has for almost 40 years worked with African-American farmers and landowners in some of the poorest counties in the nation. Our membership includes over 75 cooperatives and credit unions. Through our outreach program, we provide land and agriculture-related assistance to over 12,000 rural families.

The Federation implements its various programs throughout the southeast but is concentrated primarily in Alabama, Mississippi, South Carolina, Georgia and north Florida. Over the years, we have worked one on one with minority farmers and their cooperatives to develop new enterprises. A great deal of our work has had to be focused on saving black-owned farms and assisting their owners to fairly access farm credit and other farm programs and services. We assisted hundreds of farmers in seeking redress for discrimination and in responding to the class action settlement in Pigford v. Glickman. Of necessity, we have also sought legal and legislative remedies to assure fair and equitable service to minority producers, and with the Rural Coalition, as noted below, have led efforts to secure legislation that provides more equity in farm programs.

The ***Rural Coalition/Coalición Rural,*** of which the Federation is a founding member, is an alliance of over 80 culturally and regionally diverse rural community-based organizational in the US and Mexico. We have served minority and other limited resource producers for almost thirty years. The members of our Coalition include some of the most diverse and experienced minority farm organizations including the Intertribal Agriculture Council, representing more than 80 Indian Tribes; the Rural Advancement Fund, which has worked with African American producers for more than 50 years; the North Carolina Association of Black Lawyers Land Loss Prevention Program; the National Hmong American Farmers, Inc.; the National Latino Farmers and Ranchers Trade Association and many more.

Collectively, the Federation, and the Rural Coalition and its members and allies, have worked with thousands of farmers on the intricacies of their dealings with USDA and to seek structural change both administratively and in policy to assure equity and accountability in programs and services.

Over the past decade, we have supplied documents, analysis and testimony to the Civil Rights Action Team, the National Small Farms Commission, the US Congress and the US Civil Rights Commission. A half dozen of us served on the National Small Farms Commission, and we have also participated on other committees and in many sessions with the Secretary and the staff of the Department. We have led efforts to institute the USDA Partners meeting, held annually for the past three years to allow USDA to develop relationships and understanding of the work and experience of its Community Based Organization Partners.

Our collaborative legal and legislative work included the 1987 Agriculture Credit Act, the Minority Farmers Rights Act of 1990 that was accepted as section 2501 of the 1990 Farm Bill, the 1994 Agriculture Reorganization Act, and the Waiver of the Statute of Limitations that removed a critical barrier to the settlement of the longstanding class action lawsuits. Over the years, we have also worked on disaster response, especially following hurricanes Katrina, Rita and Wilma.

We have also worked with this Committee on the most recent 2002 Farm Bill. We appreciate the support the members of this committee who helped assure that structural changes instituted to promote equity were included in that bill.

**Introduction to Our Findings and Recommendations**

The average age of farmers continues to rise, especially among African American and other socially disadvantaged producers. For many years, inadequacies and inequities in programs and services have hastened the loss of African-American and other people-of-color owned farms. Access to credit is essential for all agricultural producers and those who aspire to be agricultural producers. This committee has the ability to take the actions needed to assure that new generations of people of color farmers and ranchers will have access to land and production.

In my years of work with the Federation of Southern Cooperatives/Land Assistance Fund, I have never met a black farmer who was not discriminated against. I believe the same is true for most of the diverse group of African-American, Latino, American Indian, Asian American and female farmers I have encountered within the Rural Coalition. As you well know, there remain issues surrounding the settlement of the Pigford v. Veneman and other still pending class action lawsuits against USDA that need to be addressed. We will provide a supplemental appendix for the record with updated statistics of the status of this settlement and on late claims.

For the past several months, our organizations have worked with a group of colleagues who represent a wide and diverse array of minority farmer and farmworker organizations called the Farm and Food Policy Diversity Initiative. As you begin your work on the 2007 Farm Bill, we share with you the collective wisdom of our organizations and our partners on some essential changes that Congress can and should make in order to prevent the actions that necessitated legal action in the first place and assure transparency and accountability in the provision of services.

We want to help bring about the day when African American and other minority farmers can turn their attention to growing crops and revitalizing rural communities instead of filing complaints and lawsuits to secure the equitable service to which they are entitled in the first place.

Because of the cumulative effects of many years of discrimination and neglect, we are also proposing remedial measures and special services intended to reverse the impact of years of discrimination and neglect on many minority farmers. Our other recommendations include actions that can be taken to improve services to the many farmers who have suffered disasters in recent years, and some ideas on how to assure that new farmer programs will also serve socially disadvantaged producers.

We also propose a moratorium on all pending accelerations and foreclosures against socially disadvantaged farmers and ranchers, with a complete review of these cases, in order to close this chapter of discrimination in farm programs and move to a new one that supplies justice and equity that are our rights in a democratic society.

**Barriers to Equitable Service**

The United States Department of Agriculture Farm Service Agency and its predecessor agencies were designated by Congress as the lender of last resort for agricultural producers. Because agriculture remains a complex and inherently risky enterprise, few banks that serve rural areas are prepared to provide the credit that farmers need. As such, USDA has remained a critical source of credit for socially disadvantaged farmers and ranchers and for new farmers.

Yet socially disadvantaged producers, for a complex set of reasons, still lack access to the credit they urgently need to develop viable operations. While the USDA and others have recommended directing many or most resources to socially disadvantaged and beginning farmers, this directive alone will not ensure the credit access that socially disadvantaged farmers and ranchers really need. Nor will FSA fulfill its mission as a lender of last resort.

We call your attention first to the definition of "beginning farmer." As members of the Policy Team of the Farm and Food Policy Diversity Initiative have pointed out, a producer who meets the definition of beginning farmer should be able in fact to qualify for commercial credit. Farm Service Agency in 2003 began issuing the transparency and accountability reports as required in Section 10708 of the 2002 Farm Bill. The report on the Beginning Farmer Down Payment Loan Program for 2003 indicates, as shown in the chart below, that 92.5 % of its recipients where white male. Only four percent of the recipients were women, and of these, 3.9% where white.

USDA

## Program Participation Report

Program National Summary

Fiscal Year: 2003

## Farm Service Agency

BEGINNING FARMER DOWN PAYMENT LOAN PROGRAM

| | MALE | | FEMALE | | UNKNOWN | | |
|---|---|---|---|---|---|---|---|
| | Hispanic or Latino | Not Hispanic or Latino | Hispanic or Latino | Not Hispanic or Latino | Hispanic or Latino | Not Hispanic or Latino | Undisclosed Ethnicity |
| | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator |
| White | < 3% | 92.5% | < 3% | 3.9% | 0% | < 3% | |
| Black | 0% | < 3% | 0% | 0% | 0% | 0% | |
| AIAN | < 3% | < 3% | 0% | 0% | 0% | 0% | |
| Asian | 0% | < 3% | 0% | < 3% | 0% | 0% | |
| HPI | 0% | 0% | 0% | 0% | 0% | 0% | |
| Other | < 3% | < 3% | < 3% | 0% | 0% | 0% | |
| Multi | 0% | < 3% | 0% | 0% | 0% | 0% | |
| Unclass | | | | | | | 0% |
| Total | < 3% | 94.2% | < 3% | 4.0% | 0% | < 3% | 0% |

We believe that the Congress should further investigate why this is so, and what factors in the design and delivery of the program are responsible for the very low participation by socially disadvantaged producers, especially because Hispanic producers, for example, constitute one of the fastest growing populations of new entrants into agriculture. **Also, the very low proportion of women producers who participate also warrants examination, as this is another example of a population whose participation in agriculture is growing.**

As we have researched this question, we have several suggestions: the definition of beginning farmer still requires three years of management of experience. How this experience is defined and accounted for by the department may have a bearing on who is accepted into the program. We recommend, for example, that experience as a farmworker be counted towards the qualification for beginning farmers. In addition, the standards for credit worthiness are as stringent or more stringent than the standards used by commercial lenders.

As this committee considers the recommendations to target all credit to beginning and socially disadvantaged farmers, it will be important to consider how this recommendation may ultimately affect the availability of credit. For example, farmers who have left the peanut and tobacco programs or who are otherwise transitioning to different crops may be in need of credit for this transition. Also, directing resources generally to beginning and socially disadvantaged farmers and ranchers without more specific direction with respect to the proportions of funds for either population may have the impact of disadvantaging one or the other of these populations, most likely socially disadvantaged producers.

It is also important to realize that socially disadvantaged producers have historically had very low participation rates in commodity and conservation programs. The billions of dollars in federal support provided for these programs only reaches a small percentage of these producers. The reasons for lack of access to federal farm programs are also complex. However, the net impact of this exclusion has often affected the size of operations and the quality of the land accessible to socially disadvantaged producers, leaving less equity in the hands of socially disadvantaged farm families. As a result, credit scores may be lower and it may be more difficult for these families to at first meet the stringent creditworthiness standards FSA requires.

We believe that special attention will need to be paid to these definitions and situations in order for USDA to fulfill its mission as lender of last resort, and in order to assure access to credit for socially disadvantaged farm families who wish to enter or continue in agriculture.

**Transparency and Accountability in Farm Loan Programs** -In recent years, the Farm Service Agency has routinely reported that loans to socially disadvantaged farmers are made in 30 days or less, and on par with loans to other farmers. FSA staff throughout the nation can report these statistics with respect to their own county and state. With these statistics as a sole reference point, it would appear that all is well with respect to access to credit and delivery of services.

We believe these statistics are not a true picture of the actual situation. We urge the committee to look further and to establish some of the measures we have long proposed in order to move beyond the appearance of equity to real equity in services, and the establishment of new generations of people of color farmers on the land.

Over the years, we have observed and documented many practices that serve to discourage and separate minority farmers from the programs and services they need. We will briefly review some examples of these practices and some solutions we recommend.

**Discouragement of Applications and Services** - At the National Immigrant Farming Initiative meeting in February in Las Cruces, New Mexico, a Hmong farmer approached our Executive Director from Wisconsin. "How big is a farm?" she asked the ED. In attempting to understand the reason for her question, we determined she had been turned away by the local FSA office after being told her operation was not a farm. However, this producer reported that she owned land and sold more than $1000 of produce a year. She did not understand why she was turned away and had not been asked to provide information to be listed on the County SCIMS list.

In the aftermath of hurricanes Katrina and Wilma, we held a training session for some 50 Latino producers in Dade County, Florida. Four members of the FSA staff attended the session at our request. The producers present reported a typical pattern: following these and previous disasters, they called the county office to request disaster assistance. The office confirmed reports that they producers were told there was no assistance available. The answer was technically correct at the time, as it is usually long after a disaster that Congress approves aid.

However, the producers were not told to come into the office to sign up on the SCIMS list, or to begin the application process for any available programs, or of requirements to take out crop insurance. The FSA staff reported that they were too busy to schedule appoints and have the farmers come in. As a result, the farmers—some repeatedly and after multiple disasters--were never informed of the many services FSA might provide, of the need to have crop insurance in order to qualify for most emergency aid, and of records they needed to keep to qualify for the emergency conservation program. They also were not included on the county list to receive newsletters and other important information and notifications, including loan and insurance deadlines and notification of funds available. As a result of not being included on the SCIMS list, farmers were also being missed in the Census of Agriculture.

During the training, the FSA staff registered over one quarter of the farmers who attended who had not previously been included on the SCIMS list or received any service from USDA. Other farmers were informed of the documents they needed to bring and of the need to go into the office in the future to register. However, the outreach function that FSA needs to perform routinely was only completed because the Farm Aid supported training and organizations, including ours, went to the county to inform farmers of the services to which they are entitled.

FSA should be required to tell all farmers who request any service of the need to be listed on the SCIMS list and of their right to make an application whether or not the office is inclined to view them as qualified.

**First Come, First Served Standard**– FSA credit program funds are delivered by state and county based on the number of farmers, the size of operations, etc. Previous investigations by GAO and IG have found that despite the fact that socially disadvantaged farmers had been denied credit, this practice did not constitute discrimination because the applications were only denied due to lack of funds.

However, this standard is manifestly unfair when farmers are discouraged from applying for programs, are not included on county lists or otherwise informed in a timely manner of the availability of funds. If a local office wished to assure funds for some farmers over others, there is the risk that a conflict of interest is created without some independent verification that all farmers receive the same information and ability to access the funds.

We believe this situation is especially serious with regard to the provision of disaster loans. While we do believe loan limits need to be raised, we caution the Committee that increasing these limits without increasing the level of funding may in fact exacerbate the potential inequities of accessing limited pools of loan funds.

**What Constitutes an Application** – FSA does not consider a farmer to have applied for loan until the loan application is complete. While improvements have been made in informing farmers what documentation is necessary for an application, we have heard many stories of lengthy processes where additional information is requested. For some farmers- eg- American Indian producers who often live long distances from county offices, the need to return to the office with additional documents greatly lengthens the application process.

However, the final rule 12CFR Part 202, Regulation B, Docket No R-1008, implementing the Equal Credit Opportunity Act states:

*(e) Applicant means any person who requests or who has received an extension*

*of credit from a creditor, and includes any person who is or may become contractually liable regarding an extension of credit...*

*(f) Application means an oral or written request for an extension of credit that is made in accordance with procedures used by a creditor for the type of credit requested. The term application does not include the use of an account or line of credit to obtain an amount of credit that is within a previously established credit limit. A completed application means an application in connection with which a creditor has received all the information that the creditor regularly obtains and considers in evaluating applications for the amount and type of credit requested (including, but not limited to, credit reports, any additional information requested from the applicant, and any approvals or reports by governmental agencies or other persons that are necessary to guarantee, insure, or provide security for the credit or collateral). The creditor shall exercise reasonable diligence in obtaining such information.*

According to this regulation, an applicant includes a person who has requested credit, and an application includes oral and well as written requests for credit. While an application is defined as made in accordance with procedures used by a creditor, the regulation makes a distinction between an application and a completed application.

Thus, in order to evaluate the fairness of the system FSA has in evaluating applications, we recommend that Congress direct that FSA revise its reporting system to reflect the period of time it takes to process a credit application from the first submission of an application to the completion of the process. This would be a fairer reflection of the time period needed for processing.

We also recommend that Congress amend the 10708 requirements of the farm bill to require FSA to report on the national, state and county level by race, gender and ethnicity, the months in loan funds were disbursed under each type of loan program.

It makes a great deal of difference whether a loan is disbursed early in the planting season or at a later date.

**Receipt for Service** – Since 2002, we have proposed to the department and to Congress that USDA be required to provide to all farmers and ranchers a time and date stamped "receipt for service." This receipt should be provided whenever any farmer requests an application or service. The receipt should details the name of the farmer or prospective farmer, the location of the office by county, what was requested, what was provide and not provided, if a request was not met, why the application or service was not provided, and what follow-up action is recommended or required. A copy of the receipt, which could be generate electronically, should be given to the farmer, and one maintained in the office. Because these receipts would not be used to evaluate applications for programs and services, Congress should also include authority and require FSA and other agencies to collect data by race, gender and ethnicity using both self-identification, and identification by the agency when the first is not provided, in order to evaluate its responsiveness.

This receipt would be critical to assuring equity for programs that are provided on a first come first serve basis, and to document situations where farmers and prospective farmers are discouraged from seeking and applying for benefits.

In addition, it would also document and allow Congress and the Department to review to the county level the actual dates on which all applications were received by the agency, and to identify places where some farmers and ranchers may receive information, services and approval more immediately than others.

USDA responded to our recommendations for a receipt for service by instituting a Customer Comment Card. This card does not serve the same purpose as a service receipt and goes back to the same complaint generated system of accountability that has hampered fairness for many years.

**Creditworthiness** - Many of the laws that govern farm credit arose from the agricultural credit crisis in the 1980's. While borrowers rights and other protections were included, the experience of losses by the government, primarily with respect to emergency loans, led to the inclusion of good faith provisions and stringent creditworthiness standards.

In the present time, evaluation by FSA of creditworthiness is a factor that prevents many socially disadvantaged producers from securing credit. Our member organizations have reported that FSA's system of determining creditworthiness is often a factor that results in the denial of applications. We believe the FSA scoring system should be reviewed based on the following standards in ECOA (final rule 12CFR Part 202, Regulation B, Docket No R-1008):

> *(p) Empirically derived and other credit scoring systems—(1) A credit scoring system is a system that evaluates an applicant's creditworthiness mechanically, based on key attributes of the applicant and aspects of the transaction, and that determines, alone or in conjunction with an evaluation of additional information about the applicant, whether an applicant is deemed creditworthy. To qualify as an empirically derived, demonstrably and statistically sound, credit scoring system, the system must be:*
> *(i) Based on data that are derived from an empirical comparison of sample groups or the population of creditworthy and noncreditworthy applicants who applied for credit within a reasonable preceding period of time;*
> *(ii) Developed for the purpose of evaluating the creditworthiness of applicants with respect to the legitimate business interests of the creditor utilizing the system (including, but not limited to, minimizing bad debt losses and operating expenses in accordance with the creditor's business judgment);*
> *(iii) Developed and validated using accepted statistical principles and methodology; and*
> *(iv) Periodically revalidated by the use of appropriate statistical principles and methodology and adjusted as necessary to maintain predictive ability.*
> *(2) A creditor may use an empirically derived, demonstrably and statistically sound, credit scoring system obtained from another person or may obtain credit experience from which to develop such a system. Any such system must satisfy the criteria set forth in paragraph (p)(1)(i) through (iv) of this section; if the creditor is unable during the development process to validate the system based on its own credit experience in accordance with paragraph (p)(1) of this section, the system must be validated when*

*sufficient credit experience becomes available. A system that fails this validity test is no longer an empirically derived, demonstrably and statistically sound, credit scoring system for that creditor.*

Congress should review the FSA credit scoring system and the methods that it has used to develop and validate this system. It should determine if this system is periodically reviewed and maintains predictive ability. As the lender of last resort, FSA standards for all loans should be less stringent when compared to commercial lending. Congress should request that FSA compare its standards with those of commercial lenders.

Because of this history of discrimination that has held this agency liable for hundreds of millions of dollars of losses caused by the practices of the agency itself, Congress should assure that this system take into account the influence of these practices on the creditworthiness of the producers who now seek loans.

Congress should also determine to what extent approval of credit rests on access to income from other federal farm programs, and the degree to which the creditworthiness of socially disadvantaged farmers is affected by the degree of access they have to other programs.

The 10708 Transparency and Accountability Requirements should be amended to include a report on the number and percentage of farmers by race, gender and ethnicity who participate in multiple USDA programs, and the level of total benefits that are provided to producers by race, gender and ethnicity.

**Waiver of Interest** – In the wake of entreaties to declare moratoriums and take other action to resolve the crisis facing socially disadvantaged farmers who have suffered discrimination and all farmers who have faced serious losses as a result of the hurricanes of 2005, repeated drought and other national disasters, FSA has repeatedly asserted that it lacks the authority to waive interest

We recommend that this committee determine in fact whether any additional authority is required to provide this authority to FSA. For example, are the Standards for the Administrative Collections of Claims, 31CFR901.9 on Interest, penalties, and administrative costs adequate for this purpose?

*(g) Agencies shall waive the collection of interest and administrative charges imposed pursuant to this section on the portion of the debt that is paid within 30 days after the date on which interest began to accrue. Agencies may extend this 30-day period on a case-by-case basis.* ***In addition, agencies may waive interest, penalties, and administrative costs charged under this section, in whole or in part, without regard to the amount of the debt,*** *either under the criteria set forth in these standards for the compromise of debts,* ***or if the agency determines that collection of these charges is against equity and good conscience or is not in the best interest of the United States.***

*(h) Agencies shall set forth in their regulations the circumstances under which interest and related charges will not be imposed for periods during which collection activity has been suspended pending agency review.*

The fair resolution of all outstanding claims related to discrimination by the Farm Service Agency certainly should be considered a matter of equity and good conscience, and in the best interest of the United States. We recommend the committee review this authority, and also require FSA to report on its compliance with paragraph h of this section.

**We also urge that the committee review the regulations instituted following the disasters in 2005 that allowed the suspension of payments on loans for farmers in declared disaster areas, but without any waiver of interest, and that required a balloon payment of all the deferred payments and interest in January 2007. A report on the number and location of loans that may be forced into acceleration because of an inability to make this balloon payment should be made, and Congress should undertake any retroactive and remedial action necessary to prevent additional loss of farms in the wake of disasters.**

**Appraisals** – Over the years, we have received continued complaints for farmers on the fairness of the appraisals used for loan approvals. Standards for appraisals should be reviewed and assurance of equal credit opportunity protections be established.

While in small rural communities, testing programs such as those widely used in mortgage lending are more difficult to establish, the Congress should consider ways to work through the Comptroller of the Currency to provide funding and guidance for some measure of testing to bring to light problems in both direct and guaranteed lending programs of the department, especially with regard to appraisals.

**Right of First Refusal on Inventory Property** – In the 1987 Agriculture Credit Act, this committee wrote the very first provisions designed to begin assisting socially disadvantaged farmers and ranchers. On provision of this law afforded socially disadvantaged farmers and ranchers the right of first refusal on inventory property. When Congress subsequently instituted programs for beginning farmers and ranchers, it replaced the right for socially disadvantaged farmers and ranchers with the right of first refusal for beginning farmers.

This situation is instructive and illustrates why in the 2007 farm bill debate, careful attention needs to be paid to securing an appropriate balance in credit law (and other areas of the Farm Bill) to the needs of these two populations. At a minimum, we suggest that the right of first refusal be restored first for socially disadvantaged farmers and ranchers, and then for other beginning farmers and ranchers.

**Loan Limits** – We agree with proposals to increase loan limits especially for farm ownership loans to more accurately reflect the current costs farmers face. But at the same time, we encourage this committee to consider the impacts we have outlined above, and the need to provide more funding for direct loans.

**Transparency and Accountability** – The federal government has been held liable for hundreds of millions of dollars of payment to farmers who won discrimination claims primarily in credit programs. While we would argue that most socially disadvantaged farmers were also denied access in many ways to other federal farm programs, their right to seek damages is only secured for credit programs.

Virtually all actions to assure fair service by FSA and other USDA actions arise from individual complaints made by farmers and ranchers. In Section 10708 of the 2002 Farm Bill, Congress adopted Transparency and Accountability requirements that require the department to provide data at the national, state and local level on participation rates by race, gender and ethnicity for each program that serves farmers.

FSA has been the most responsive agency in providing the data required under this section.

However, the usefulness of this data has been severely compromised by the matter of presentation used in the reports that are compiled by the Office of the Assistant Secretary for Civil Rights. Instead of providing searchable databases, the Office of the Assistant Secretary has presented the participation rates down to the county level as 120,000 separate PDF charts.

Ostensibly, the reason for this method or presentation is in order to protect the privacy of the lone socially disadvantaged farmer who may participate in a particular program of the department in a particular county. The US Census and the Census of Agriculture have developed other methods and defaults to protect privacy that do not compromise the integrity and usefulness of the data.

In addition, USDA has not provide, as required in 10708, a report that compares the participation of farmers by race, gender and ethnicity in programs as compared to their representation in the Census of Agriculture

Earlier in this testimony, we provided the 10708 report for the Beginning Farmer Down Payment Loan Program. In the appendix we have provided 10708 reports for other programs. A review of all of these programs would show that the participation rates of socially disadvantaged producers are abysmally low. Only in programs specifically constructed, for example, to serve American Indian farmers, is participation assured. The highest level of participation in any other program we found in our review was participation of 8% to 9% by African American producers- in the peanut buyout program.

The 10708 requirements are a very important tool for the department and Congress to develop an independent assessment of the problems in service delivery and program structure that may present barriers to equitable participation of producers. This data should be presented in a format that will allow real comparisons between similar counties and states that would allow service delivery issues to be identified and rectified, and would also allow Congress to determine where program structures and rules may be responsible for barriers to service.

County level data, and comparisons at that level to Agriculture Census numbers will allow agencies, farmers, and the organizations that represent them not only to identify programs where participation is inadequate. It will also allow outreach services and remedial actions to be taken. In addition, Congress should require that this data be utilized in the evaluation of all programs and in performance reviews of staff. In the 2002 hearing in the House Agriculture Committee, USDA testified that in the wake of the massive discrimination liabilities against the department, only an handful of staff received reprimands or any other personnel action. The lack of accountability to agencies and staff continue to foster a climate that leaves no consequence for actions that are contrary to the interests of socially disadvantaged producers, taxpayers and the United States.

We recommend that USDA be asked immediately to provide the required report comparing Agriculture Census data to the participation reports, and for its proposals on how immediate changes can be made in order to provide 10708 data in a useful form. We will provide to the committee proposed language to amend 10708 in order to assure this requirements provide the system of review that is vital to assuring quality programs and fair service.

**Interest Subsidies** – FSA has authority and does provide subsidized interest for farmers. Congress should assure that funds are adequate for this program, which is important to farmers. In addition, FSA should provide a 10708 report on participation in this program.

**Farm Loans and Disasters** – Emergency loans are critical to producers in the face of disasters. In addition, measures to protect the ability of farmers to manage current loans are also needed. However, in order to allow these to help farmers in a manner that will prevent placing them later in a precarious situation, we recommend the following measures:

- ➢ Review and provide any additional authority to allow FSA to suspend the accrual of interest in times of disaster, and take additional measures as necessary to allow delay in payments.
- ➢ Add payments to end of loans and allow extension of loans
- ➢ Extend PL 108-324 to remove the limit of coverage for farmers who have experienced multiple disasters
- ➢ Set in place an automatic disaster set aside for payments on direct FSA and RHS loan installments due in January 2007. Enable and encourage private lenders with guarantees to do the same.
- ➢ Complete suspension of offsets
- ➢ Expand servicing for 90 days past due loans
- ➢ Provide Loan forgiveness for those who will never be able to pay or who have suffered losses that reduce the value of collateral
- ➢ Allow appeal between agencies – when denied by Farm Service Agency and Small Business Administration, allow appeals to both.

**Credit and Indian Agriculture** - The United States Government through Farm Service Agency remains the largest source of lending for Indian Reservations. Farm lending programs need to increase their focus on youth lending as well as new farmer lending. The present beginning farmer program needs to be modified to realistically fit a beginning farmer. Present criteria limits participation to only those that have adequate capital that would allow borrowing at any commercial credit source.

- Increased effort must be put forth to facilitate the insurance that trust lands stay in trust during the debt servicing process of FSA. The new administration of the Department of Interior may be receptive to the transfer of trust title between Interior and FSA. The options presented by the 98 Credit Amendments need to be utilized by FSA, BIA and Tribes.

- Increased participation in FSA lending programs would take place if qualifying Tribal Credit Branches were allowed guaranteed lender status.
- The Tribal Credit Outreach Program should be expanded to cover a minimum of 18 states, where the largest Indian populations exist. The Extension Indian Reservation Program must be expanded to its original authorization and design that was 85 extension agents and a minimum budget of 6 million dollars.
- Offices on Indian Reservations - In Section 2501 of the 1990 Farm Bill, Congress prohibited USDA agencies from paying the cost of offices on Indian Reservations. Authority should be restored to FSA and other agencies to cover the cost of offices on Indian Reservations.
- The Indian Land Acquisition Program, which allows protection of tribal lands, should be expanded, and a similar program established for other socially disadvantaged producers.

**Experience** – Many new entry producers have strong experience in agriculture either as farmworkers or in the case of many refugee and immigrant farmers, experience as producers in other countries. While legal residents are eligible for loan programs, it is critical that FSA recognize farm and management experience gained as farmworkers or as producers in other countries as experience in qualifying for a loan.

**Moratorium on Accelerations and Foreclosures for Socially Disadvantaged Farmers and Ranchers** - African American producers have experienced a stunning 97% loss of farms since 1920. Special strategies and emergency action to stem this loss, and to reduce land loss for American Indian and other socially disadvantaged producers. The most urgent need is an immediate moratorium to protect African American farmers and ranchers who now face imminent foreclosure following inadequate protection and outcomes of civil rights complaints and individual and class action lawsuits. This immediate stay should be applied as well to other filed discrimination cases and administrative complaints that are pending for all socially disadvantaged farmers and ranchers.

In the Farm Bill, we propose that Congress declare a moratorium that provides an immediate stay on all accelerations and foreclosures against all socially disadvantaged farmers and ranchers and establish a review commission to be charged with reviewing all pending actions against socially disadvantaged farmers and ranchers. In addition, Congress should provide clear authority requiring the Secretary to waive interest and offsets, and to write off interest for all such cases during the review; and to forgive loans in cases where government action or inaction led to the foreclosure action.

This Independent Socially Disadvantaged Farmer Foreclosure Review Commission should:

- Determine whether farm land foreclosed and accepted for review by the commission complies with applicable laws or regulations, and
- Determine if actions or inactions of the government led to the foreclosure action.
- Review and improve upon the credibility and accuracy of the USDA Farm Credit Foreclosure process and procedures,
- Report programmatic inefficiencies to the House and Senate Agriculture Committee that include recommendations for legal remedies to address wrongful foreclosures against African American and any other socially disadvantaged producers.

**Proposals for New Programs to Restore Equity** – In order to begin the process of restoring access to socially disadvantaged producers who have been severely compromised in their ability to access land and operate viable operations, we propose a new credit program, and we encourage the committee to support and endorse a more comprehensive approach to assist this population of farmers to engage with the full range of USDA programs and Services.

**New Low Documentation Loan Program for Socially Disadvantaged Farmers and Ranchers** – Many socially disadvantaged producers with small-scaled diversified operations could achieve real viability with more flexible financing tools. We recommend that this committee establish a new socially disadvantaged farmers and rancher flexible loan program. We recommend that this be established at a maximum level of $50,000 per loan and that it be operated as a renewable line of credit that the producer may draw on again in future years when the balance is reduced below the limit.

We recommend that the interest rates be below market rates, and that a quick approval low documentation process be used. The lower loan rate reduces risk to the agency, but allows the flexibility that many producers need. Authority should also be provided to make individual loans for members of cooperatives of groups of farmers in order to allow development of value added and cooperative businesses that can best be conducted beyond the level of the individual.

**Socially Disadvantaged Producers Risk Management and Market Access Initiative** – We recommend that Congress establish a new comprehensive program to assure protections and market access that socially disadvantaged farmers need to attain financially viable operations that benefit also the poor rural communities where many of the live.

We share this recommendation with this subcommittee because we believe a comprehensive approach to service for this population would reduce the risk and increase opportunities for socially disadvantaged farmers with respect to loan programs as well.

This initiative is a comprehensive legislative approach designed to:

- preserve and build land ownership by Socially disadvantaged farms and ranchers
- bring socially disadvantaged producers into USDA programs and assure more accurate counting of this population in the Census of Agriculture;
- contribute to rural communities, and
- to address the following challenges socially disadvantaged farmers and rancher face:
    - risk management and disaster protection,
    - Secure access to land, credit and markets
    - Facilitate transition from tobacco and peanuts and other crops and to organic productions, value added,
    - Improve record keeping, general farm and financial management practices and meeting all regulatory requirements

Under this initiative, funding and technical assistance will be provided directly to farmers and ranchers, including beginning socially disadvantaged producers and farmworkers seeing to become farmers and ranchers, and who meet the criteria in order to carry out the applicable functions. Community Based organizations would receive direct support from RMA to supply the technical assistance

Eligibility: A socially disadvantaged farmer or ranchers.

- Qualification level – The producers is awarded an Initial payment of $5000, half paid in advance. The producer must within one year prepare IRS schedule F or a qualified substitute for members of Indian Tribes. The producer must also sign up for any crop insurance or NAP programs for which he or she is qualified, and must register at the FSA office, and FSA must provide his or her name to the National Agriculture Statistics Service for inclusion in the next census of agriculture. A qualified Technical Assistance Provider will receive $2000 to assist the farmer in preparing these documents and accessing these services and in preparing a plan to apply for participation in Tiers I, II and III. The producer is also encouraged and may use technical assistance to be included in the Minority Farm Registry or complete the Census of Agriculture if applicable in that year.

  The producer must remain qualified at this level in order to participate in Tiers I, II or III.

- Tier I Direct payments of $10,000 per year to complete at least 3 of the following:
  - A farm and home plan,
  - Applications for any USDA program for which he or she is eligible
  - An estate plan,
  - A risk management plan, including accessing family health insurance
  - A conservation plan
  - Land acquisition
  - Disaster protection or mitigation
  - Plan to transition to another crop or crops
  - A qualified Technical Assistance Provider will receive $3000 to assist the farmer in accessing these services

- Tier II – Direct payment of $25,000 per year to complete at least 3 of the following:
  - Meet standards for GAP, Organic certification
  - Make a marketing plan
  - Access liability or other expanded insurance, including revenue insurance
  - Access farmers markets or improved marketing contracts
  - Make a plan to meet other regulatory requirements, including labor and pesticide health and safety standards, Livestock and Animal ID
  - Mentor another farmer
  - Qualifies for SARE
  - Irrigation and other production assistance
  - Waste management

  - A qualified Technical Assistance Provider will receive $4000 to assist the farmer in preparing these documents and accessing these services

- Tier III – Direct payment of $45,000
    - Cooperative development and the development of value-added enterprises.
    - Infrastructure development
    - Enter nutrition programs such as school lunch, WIC, farmers market, senior nutrition, etc.
    - Energy
    - Rural Development
    - A qualified Technical Assistance Provider will receive $5000 to assist the farmer in preparing these documents and accessing these services

ADDITIONAL PROVISIONS

- Make this a program under the commodities title and locate in RMA Outreach and Civil rights office.
- Community-based organizations would provide technical assistance.
- Provide Funds for additional staff for RMA regional offices and at headquarters.
- Authorize and Support the Small Farms Emphasis Program to work across agencies at USDA to assure coordination of services for socially disadvantaged farmers under this program.
- Include automatic entry into some USDA programs for completion of certain tiers.

**Conclusion**

We appreciate this opportunity to share our insights and recommendations with you. We are most willing to answer now or in the future any questions you may have or to offer any assistance we are able to the committee or to the Secretary to make USDA-Farm Service Agency Credit programs and services more equitable.

## APPENDIX A

## SAMPLES of USDA 10708 National Program Participations Reports

### Program Participation Report

**Program National Summary**

Fiscal Year: 2003

### Farm Service Agency

**PEANUT QUOTA BUYOUT PROGRAM**

| | MALE | | FEMALE | | UNKNOWN | | |
|---|---|---|---|---|---|---|---|
| | Hispanic or Latino | Not Hispanic or Latino | Hispanic or Latino | Not Hispanic or Latino | Hispanic or Latino | Not Hispanic or Latino | Undisclosed Ethnicity |
| | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator |
| White | < 3% | 45.3% | < 3% | 32.8% | < 3% | < 3% | |
| Black | < 3% | 8.4% | < 3% | 8.5% | 0% | < 3% | |
| AIAN | 0% | < 3% | 0% | < 3% | 0% | < 3% | |
| Asian | 0% | < 3% | 0% | < 3% | 0% | < 3% | |
| HPI | < 3% | < 3% | 0% | < 3% | 0% | < 3% | |
| Other | < 3% | < 3% | < 3% | < 3% | < 3% | < 3% | |
| Multi | 0% | < 3% | 0% | < 3% | 0% | < 3% | |
| Unclass | | | | | | | 0% |
| Total | < 3% | 54.1% | < 3% | 42.7% | < 3% | < 3% | 0% |

### Program Participation Report

**Program National Summary**

Fiscal Year: 2003

### Farm Service Agency

**GUARANTEED FARM OPERATING LOAN PROGRAM**

| | MALE | | FEMALE | | UNKNOWN | | |
|---|---|---|---|---|---|---|---|
| | Hispanic or Latino | Not Hispanic or Latino | Hispanic or Latino | Not Hispanic or Latino | Hispanic or Latino | Not Hispanic or Latino | Undisclosed Ethnicity |
| | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator |
| White | < 3% | 40.6% | < 3% | < 3% | < 3% | 54.7% | |
| Black | < 3% | < 3% | 0% | < 3% | < 3% | < 3% | |
| AIAN | < 3% | < 3% | 0% | < 3% | 0% | < 3% | |
| Asian | < 3% | < 3% | 0% | < 3% | 0% | < 3% | |
| HPI | 0% | < 3% | 0% | < 3% | 0% | < 3% | |
| Other | < 3% | 0% | < 3% | 0% | < 3% | < 3% | |
| Multi | 0% | 0% | 0% | 0% | 0% | 0% | |
| Unclass | | | | | | | 0% |
| Total | < 3% | 41.8% | < 3% | < 3% | < 3% | 55.8% | 0% |

## Program Participation Report

**Program National Summary**

**Fiscal Year:** 2003

### Farm Service Agency

**NON-RECOURSE MARKETING ASSISTANCE LOAN AND LOAN DEFICIENCY PAYMENT PROGRAM**

| | MALE | | FEMALE | | UNKNOWN | | |
|---|---|---|---|---|---|---|---|
| | Hispanic or Latino | Not Hispanic or Latino | Hispanic or Latino | Not Hispanic or Latino | Hispanic or Latino | Not Hispanic or Latino | Undisclosed Ethnicity |
| | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator |
| White | < 3% | 71.2% | < 3% | 24.9% | < 3% | < 3% | |
| Black | < 3% | < 3% | 0% | < 3% | 0% | < 3% | |
| AIAN | < 3% | < 3% | < 3% | < 3% | 0% | < 3% | |
| Asian | 0% | < 3% | < 3% | < 3% | 0% | < 3% | |
| HPI | 0% | < 3% | 0% | < 3% | 0% | < 3% | |
| Other | < 3% | < 3% | < 3% | < 3% | < 3% | < 3% | |
| Multi | 0% | < 3% | 0% | < 3% | 0% | < 3% | |
| Unclass | | | | | | | 0% |
| Total | < 3% | 72.3% | < 3% | 25.8% | < 3% | < 3% | 0% |

## Program Participation Report

**Program National Summary**

**Fiscal Year:** 2003

### Farm Service Agency

**CONSERVATION RESERVE PROGRAM**

| | MALE | | FEMALE | | UNKNOWN | | |
|---|---|---|---|---|---|---|---|
| | Hispanic or Latino | Not Hispanic or Latino | Hispanic or Latino | Not Hispanic or Latino | Hispanic or Latino | Not Hispanic or Latino | Undisclosed Ethnicity |
| | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator | Participation Indicator |
| White | < 3% | 68.9% | < 3% | 27.8% | < 3% | < 3% | |
| Black | 0% | < 3% | 0% | < 3% | 0% | < 3% | |
| AIAN | < 3% | < 3% | < 3% | < 3% | 0% | < 3% | |
| Asian | < 3% | < 3% | 0% | < 3% | 0% | < 3% | |
| HPI | < 3% | < 3% | < 3% | < 3% | 0% | < 3% | |
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**Statement of**

**Karen Stettler**

**Land Stewardship Project Farm Beginnings ® Director**

**For the Credit Hearing**

**Of the**

**Subcommittee on Conservation, Credit, Energy, and Research**

**U.S. House of Representatives Committee on Agriculture**

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Good morning Chairman Tim Holden and Members of Conservation, Credit, Energy and Research Agriculture Subcommittee. Thank you for the opportunity to testify on credit and beginning farmer issues which are critically important to agriculture and rural communities. My name is Karen Stettler and I serve as Director of the Land Stewardship Project's Farm Beginnings program. My testimony today is on behalf of the Land Stewardship Project and the Sustainable Agriculture Coalition.

The Land Stewardship Project (LSP) was founded in 1982 and is guided by a mission to foster an ethic of stewardship for farmland, promote sustainable agriculture, and to develop sustainable communities. LSP is primarily a rural membership organization which works nationally, and in Minnesota, focusing on farm and environmental issues. Our work encompasses three primary program areas: a Community Based Food System program which supports local and regional food systems and efforts that connect farmers and consumers; a Policy and Organizing Program which organizes people to successfully impact corporate and government policies that affect their lives at the federal, state and local level; and a Farm Beginnings program aimed at training and assisting new farmers getting started on the land.

LSP's Farm Beginnings program is a farmer-led educational training and support program designed to help people who want to evaluate and plan their farm enterprise. Individuals enrolled in the program participate in a 10 month course where they attend classes focused on values clarification, goal setting, whole farm planning, business plan development, as well as attendance of on-farm workshops highlighting low-cost, sustainable farming methods. While enrolled in the Farm Beginnings program, participants are also paired with existing farmers who serve as mentors. Since 1997 when LSP started the Farm Beginnings program, over 300 people have graduated from the course. Of those graduates 60 percent are currently farming.

For the purpose of my testimony today I will focus on the following points:

- opportunities that are available for new farmers and ranchers in agriculture;
- obstacles beginning farmers and ranchers face in getting started; and
- public policy solutions to help address some of the barriers beginning farms face such as struggles to obtain reasonable credit and the lack of access to beginning farmer and rancher education and training programs.

The Land Stewardship Project's depth of knowledge on these issues is rooted in the real experiences of our members and communities in which we work. I hope my testimony is informative as policy options are evaluated to increase the vitality and opportunities in rural America.

**Opportunities in Agriculture**

Great opportunities in agriculture now exist because of advances in emerging markets and an increasing consumer demand for a variety of local or value-added agriculture products. Beginning farmers and ranchers are well positioned to take advantage of these opportunities.

These new entrepreneurs are often more flexible in responding to markets, able to take on more risk but lower debt loads than many conventional enterprises. In our experience, the new entrepreneurs also bring diverse backgrounds but a common spirit of determination to the profession of farming.

The growth in organic agriculture over the last ten years is one of the most remarkable advances in our food system. Consumer demand for organic food has grown 15-20 percent a year over the past decade. With such a growing consumer demand for organic food, the need for organically-certified producers is immense, with imports growing due to a lack of sufficient U.S. production. New farmers and ranchers are well positioned to take advantage of this and other similar burgeoning markets high quality, differentiated products that support family farming and the environment. New farmers and ranchers are less bound by previous commitments to and investments in conventional farming operations, giving them more flexibility in responding to growing markets. The pricing structure of organic and other premium markets also allow beginning farmers to start with lower equity and on smaller scales, building their farming enterprises one step at a time.

Other premium markets are also expanding. Currently companies such as Niman Ranch Pork Company are paying premiums above the cash market price for livestock that is raised naturally, without antibiotics, and to a specified animal husbandry standard. Growth in this area is evident. Chipotle Mexican Grill, a food chain who sources Niman Ranch Pork, just opened their 600$^{th}$ restaurant nationwide. In testimony provided to the Minnesota State Legislature by Chipotle Mexican Grill marketing consultant Mike Fuller on a package sustainable agriculture bills the message was clear, "We're really proud to offer naturally raised meats but we can't get enough of it," said Fuller. "We've proven there is a demand for this kind of food and funding these research initiatives would make it possible for us to get more of these products locally."

Fuller went on to explain how the restaurant chain cannot get enough Niman Ranch pork to meet their demand. For individuals willing to raise livestock at consumer-driven animal wellness standards great opportunities exist. Other emerging premium markets include the growth of demand for grass-fed beef, which because of specific feeding regimens results in health benefits associated with high levels of omega 3 fatty acids. Because specific feeding regimens take greater management skills, beginning farmers and ranchers who are often starting with fewer animals have an added advantage: the ability to focus more time on individual care of livestock. Being able to reap the rewards of premium markets such as Niman Ranch Pork Company and grass-fed beef allows new farmers and ranchers to grow their farming operations and to succeed.

In addition there is an increase in consumer interest in purchasing food through emerging local and regional marketing systems. This phenomenon is gaining traction and has allowed new farmers to capture more of the consumer dollar for the products they sell. The growth in Community Supported Agriculture farms, farmers' markets, and direct marketing opportunities of farm products to consumers and restaurants has expanded in recent years.

Lastly, the potential of sustainable farm-based energy cropping systems is an exciting and new development in agriculture. There is still much to learn about sustainable biomass systems, but new farmers may be well positioned to get in on the ground floor and take advantage of new energy crops.

**Desire to Farm**

Not only are there increasing opportunities in agriculture, but our experiences and the experience of other organizations working with beginning farmers and ranchers leads us to believe we are experiencing a boom in the number of people who desire to farm.

According to John Baker, Beginning Farmer Center Administrator for Iowa State University and the President of the National Farm Transition Network, the ratio of qualified and potential successors desiring to farm and those farmers who are willing to provide such an opportunity by transferring the operation is 10 potential successors to every 1 farmer. Marion Bowlan, Director of Pennsylvania Land Link, reports that since 1994 when they established their database which connects individuals looking for land to farm with landowners interested in selling or renting, the ratio of successors to existing farmers is 3 to 1. LSP's Farm Beginnings program faces a similar situation. Often times we've had to turn away potential students due to large demand and classes at full capacity. After offering Farm Beginnings in Minnesota for 10 years, we have in no way outstripped demand for the program. The 2006-07 class includes the greatest numbers of participants we've ever had and inquires about the next session continue to be made. In response to demand, we have also now helped start Farm Beginnings classes in Illinois, Missouri and Nebraska.

**Obstacles Beginning Farmers and Ranchers Face**

Despite opportunities in agriculture, beginning farmers and ranchers continue face a number of very significant barriers to getting started. A changing landscape in rural America requires a new paradigm when considering what public policies can reinvigorate the countryside. For starters, new farmers and ranchers are much more diverse than previous generations. In addition to next-generation farmers from multi-generational farms and ranches, this new generation includes former farm workers, people from non-farming backgrounds such as mid-life career-changers, and college graduates who have chosen farming as their first career. They include more women than ever, as well as families with Hispanic, Somali, Hmong, and Eastern European backgrounds.

Whether or not they are from a farming background, this diverse new generation of farmers and ranchers faces a set of very difficult challenges and needs. Adequate access to credit, training, technical assistance, land, and markets are critical to their success. For socially disadvantaged farmers, many of whom may have faced bias and discrimination and who are historically underserved by USDA programs, the obstacles can be especially difficult to overcome.

For my testimony today I will concentrate on just two of the many barriers and struggles beginning farmers and ranchers confront that are connected but also present their own unique qualities:

- Difficulty beginning farmers and ranchers experience when attempting to obtain affordable credit.
- A lack of support networks and educational and training programs for new farmers and ranchers.

**Barriers to Accessing Credit**

One struggle beginning farmers and ranchers face when seeking funds for land acquisition or operating capital is accessing reasonable credit. This Subcommittee and Committee has demonstrated great leadership since the 1990 Farm Bill and the 1992 Agricultural Credit Act in formulating new credit policies that attempt to serve beginning farmers and ranchers. In general, our evaluation of current Farm Service Agency (FSA) lending provisions, including the Beginning Farmer and Rancher Down Payment Loan Program and farm ownership and operating loan targeting provisions, are working reasonably well, though their effectiveness can be improved with some policy modifications in the new farm bill.

In our view, though, one of the most important hurdles to obtaining credit for beginning farmers is getting them to the point where they can apply for FSA loans or credit from private lenders. Farmers, including beginners, need to do careful preparation and planning before approaching an institutional or private lender. Helping beginning farmers develop the tools and know-how to do sound business planning is the best way to assist farmers in achieving affordable credit.

In 2002-03, the Land Stewardship Project conducted a Farmer Lenders Survey which was sent to 1,550 sustainable farmers, agriculture lenders and agriculture educators. The survey focused on the perception, knowledge, and practice concerning sustainable agriculture and credit-related issues. With a 39% response rate the surveys provided useful insight that fortified our assumptions to the barriers farmers and beginning farmers face when trying to access credit either from an institutional or private lender.

According to the farmer respondents nearly two-thirds use a local source for credit. This relationship between local banks and farmers appears to be where the majority of lending takes place. The symbiotic relationship between local banks and farmers is critical in rural America. The survey also found that when assessing major barriers to accessing credit 25 percent of farmer respondents chose lack of external funding as the major challenge they faced in implementing sustainable agricultural practices.

From our experiences in the Farm Beginning program, where we work intimately with a segment of farmers often in desperate need of credit, some of the more common struggles we hear from participants attempting to obtain FSA loans are:

- the volume of paper work and application process is overwhelming and daunting enough to turn people away;
- the lack of technical assistance in guiding applicants through the process;
- a lack the knowledge and tools needed to develop business plans; and
- there is a need for education of FSA and other lenders about the broadening variety of farm enterprises.

Responses from lenders to our survey were consistent from what we had heard from FSA loan officers: one of the biggest barriers to providing credit to all farmers was a lack of an appropriate business plan.

Through our Farm Beginnings work we have run into cases where new farmers are trying alternative enterprises or production systems that do not fit traditional lending patterns and therefore they struggle to obtain credit. One family LSP worked with in Wisconsin was starting an alternative enterprise that included an on-farm bakery and use of permaculture (a long-term cropping rotation). In 2003, the family decided to expand their farming enterprise. A total of 16 different banks turned the family away despite the solid business plan they had prepared. After unsuccessful attempts to obtain credit the couple resorted to more desperate measures and financed their expansion on credit cards. In 2005, under duress, the family participated in a continuing education class following up on the Farm Beginnings course they had taken in 2000. After redrafting their farm business plan and working through a network of friends, they were able to sit down with a FSA loan officer and finally get a loan.

In many cases working with Farm Beginnings graduates we have found that obtaining sufficient amounts of credit takes a creative approach and a number of different lending options bundled together. For example, one option that a number of Farm Beginning graduates take advantage of is the use of a partnership between the Land Stewardship Project and Heifer International. The partnership allows beginning farmers to secure livestock loans. Through the livestock loan farmers build equity. This added equity allows for greater leveraging power when accessing credit through a lender. We have had graduates who receive a livestock loan and build equity for a number of years and then use that equity to leverage credit through a participation loan from a local lender in conjunction with an FSA loan.

Both scenarios above contain a common thread to their success, a connection to a community based organization providing networks and training to overcome barriers that beginning farmers face when trying to obtain credit. One obvious solution to helping farmers overcome hurdles to obtaining credit is support for additional community-based beginning farmer and rancher education and training programs.

Building equity through livestock loans or saving through development accounts puts farmers in a better position to access credit whether through FSA or a local lender.

**A Lack of Beginning Farmer and Rancher Education and Training Networks**

One of the most underserved communities in agriculture is beginning farmers and ranchers. The lack of educational and training programs when compared with the number and diversity of individuals interested in farming is astounding.

Perhaps the most critical component to succeeding in farming is having clear expectations and realizations of what new farmers and ranchers can accomplish when they start. Financial and entrepreneurial training programs can assist new farmers and ranchers with goal setting; marketing and communication skills development; whole farm decision-making; and financial monitoring including assets management, credit preparation and cash flow assessment.

In addition, educational and training programs for beginning farmers and ranchers lends to a framework that builds networks between farmers. Mentor/apprentice relationships can provide new farmers and ranchers with a sounding board as they get started on the land. The value of on-farm experience can be irreplaceable for new farmers and ranchers. Unfortunately few such apprenticeship programs exist.

Beginning farmer and rancher training programs run by community-based organizations in partnership with local, state, and federal agencies and institutions are increasingly important as the supply of future farmers diversifies beyond the sons and daughters of multi-generation farm families. The few sparsely distributed partnerships and training courses across the nation that exist are operating on shoe-string budgets and largely surviving because of the dedication of talented instructors and strong community bonds. If there ever was a place to make an argument for the infusion of federal support for long-term economic development and stability, beginning farmer and rancher training programs present a very case. The 2007 Farm Bill represents an important and timely opportunity to make this investment in the future of rural America.

**Public Policy Solutions to Support Beginning Farmers**

Over the next two decades, an estimated 400 million acres of agricultural land will be transferred to new owners and will either remain in production or be converted to non-agricultural uses. The future health and vitality of agriculture and the food system will depend on public policies that encourage a new generation of farmers and ranchers to work in agriculture.

The 2007 Farm Bill should include a major, cross-cutting initiative that addresses in a comprehensive fashion the needs of beginning farmers and ranchers. The "Beginning Farmer" initiative should provide beginning farmers and ranchers with tools they need to successfully enter farming or ranching, to be good stewards, to be innovative and entrepreneurial, and to be better able to respond to the rapidly changing demands of the marketplace.

Since 1990, Congress has begun to incorporate provisions into the farm bill that are specific to beginning farmers and ranchers, especially in the area of farm credit. These existing efforts should be improved and expanded. We recommend the following revisions and additions.

**Beginning Farmer and Rancher Down Payment Loan Program**

The Down Payment Loan Program was established by the 1992 Agricultural Credit Act and implemented by USDA beginning in 1994. The special loan program reflects the dual realities of increasingly scarce federal resources and the significant cash flow requirements of most new operations. It combines the resources of the Farm Service Agency, the beginning farmer, and a commercial lender or private seller. Because the government's share of the total loan cannot exceed 40 percent of the price, limited federal appropriated dollars can be spread to more beginning farmers.

Under the program, FSA provides a down payment loan to the beginning farmer of up to 40 percent of the farm's purchase price or appraised value, whichever is less. This loan is repaid in equal installments for up to 15 years, at a 4 percent interest rate, and is secured by a second mortgage on the land.

The beginning farmer must provide an additional 10 percent of the purchase price in cash as a down payment. The total purchase price or appraised value, whichever is less, cannot exceed $250,000. The remaining 50 percent of the purchase price must be financed by a commercial lender or a private seller on contract. This financing may use assistance from a state beginning farmer program, which can frequently provide lower interest rates and longer repayment terms than other loans from commercial lenders. The loan or contract must be amortized over a 30-year period but can include a balloon payment due anytime after the first 15 years of the note.

A commercial loan (either farm ownership or operating) made to a borrower using the down payment loan program may be guaranteed by the FSA up to 95 percent (compared to the regular 90 percent) of any loss, unless it has been made with tax-exempt bonds through a state beginning farmer program.

Throughout the 90s this program was quite successful in creating new farming starts, though loan making activity has slowed in recent years as interest rates have remained fairly low. Since its inception, the program has made down payment loans to help 2,728 new farmers purchase their first land, for a loan volume of $124 million. In the recent years, however, low interest rates have made the Down Payment interest rate differential too small to make much difference and therefore has reduced the attractiveness of the partnership approach. As a result, the vast majority of direct loans have returned to the traditional 40-year 100 percent government financing loan approach or to 50/50 partnership loans between FSA and banks.

The 2007 Farm Bill should make several adjustments to the program, including most importantly setting the interest rate at 4 percent below the regular direct farm ownership interest rates or one percent, whichever is greater. This change will better accomplish what the Committee originally intended when it wrote the program during a period of high interest rates. We commend the Administration for addressing this issue in their farm bill proposal. In our view, however, the floating rate proposal is superior to the Administration's proposal for a flat 2 percent interest rate because it will not contract the number of loans that can be made in high interest rate years.

We also support these additional changes to the program:

- The maximum allowable sales price should be (a) changed to maximum allowable portion of sales price eligible for the down payment loan, and (b) increased from $250,000 to $500,000 to reflect the new land market realities since the law originally passed in 1992.

- The borrower down payment requirement should be reduced to not less than 5 percent, with the FSA portion increasing to 45 percent, and loan repayments should be deferred for the first year. These two changes were also recommended by the Administration.

- In order to maximize the number of borrowers who can be served and to promote graduation of borrowers from government to commercial loans, the down payment program and the 50/50 joint financing participation loans should be made the first choice option for real estate loans in all regions of the country.

**Loan Fund Reservations for Beginning Farmers**

The 1990 and 1996 Farm Bills and the 1992 Agricultural Credit Act introduced a number of loan fund set-asides and preferences for beginning farmers and ranchers. For instance, 70 percent of all direct farm ownership (DFO) loan funds appropriated by Congress each year are designated for beginning farmers and ranchers, with 60 percent of that total designated for Beginning Farmer and Rancher Down Payment loans. For direct operating loans (DOL), the set-aside is 35 percent. Guaranteed ownership (GFO) and operating loan (GOL) funds targets are 25 percent and 40 percent, respectively. Each of these loan set-asides are released for other types of borrowers at set times during the year if the demand from beginning farmers and ranchers does not fully subscribe the money. Guaranteed operating loan funds that are unused toward the end of each fiscal year are transferred to beginning farmer and rancher down payment and other real estate loans.

The existing statutory loan fund set-asides and inventory preferences should be continued in the 2007 Farm Bill, but with modifications:

- In its farm bill proposal, the Administration has recommended increasing the 70 percent DFO target to 100 percent and the 35 percent DOL target to 70 percent. While we fully endorse the focus on beginning farmers, we believe these proposals go a bit too far, potentially excluding otherwise qualified small family farms from securing loans. We propose instead that the DFO target be raised to no less than 75 percent and the DOL target to no less than 50 percent. We also propose that the GFO target be increased from 25 to 40 percent.

- FSA should be given greater flexibility to respond to fluctuating demand for different types of loans by changing the 60 percent reservation for Down Payment Loans to a two-thirds reservation for the combination of Down Payment Loans and joint financing 50/50 partnership loans. So, in our proposal, at least 75 percent of total direct farm ownership loan funds would be reserved for beginning farmers and ranchers, but at least two-thirds of that total (i.e., half of total DFO loan funds) would in turn reserved for the combination of down payment loans and joint financing loans through April 1 of each fiscal year.

**Direct Ownership and Operating Loan Limits and Loan Authorization Levels**

Loan limits determine the maximum amount of dollars that an applicant can borrow from FSA. Direct farm ownership (DFO) loans, which finance the purchase or improvement of real estate, currently have a $200,000 loan limit. Direct operating loans (DOL), which are used to finance production expenses, machinery, equipment, vehicles, and livestock, also have a limit of $200,000. These limits were most recently updated in the late 1970s and early 1980s. Land, production and capital costs have increased significantly since that time. The current loan limits are no longer meeting the needs of all family-sized and beginning farmers and ranchers who otherwise qualify under the "no credit elsewhere" test.

The 2007 Farm Bill should increase both the direct farm ownership and operating loan limitations from $200,000 to $300,000. We do not support the idea of combining the two limits into a single, higher limit. Since most borrowers are operating loan borrowers, a single, higher cap will very likely lead to moving direct lending in the direction of serving fewer, larger farm borrowers. Without a very significant increase in appropriations for direct operating loans, this would leave many borrowers on the waiting list, unable to access operating credit. We believe, on balance, a $100,000 increase in both the ownership and operating limits will help update the caps without threatening a large decrease in the number of borrowers being served.

While the farm bill does not set the actual funding levels for these programs, it is true that the current authorized loan funding levels were set with current loan limits in mind. If loan levels are updated and increased, as they should be, the loan authorization levels should also be changed at the same time. We recommend an increase the loan authorization program levels for direct ownership loans from $205 million a year to $350 million and for direct operating loans from $565 million to $850 million.

**Graduation and Term Limits**

Under current law, there are restrictions – referred to as term limits – on the number of years a borrower can be enrolled in the FSA direct and guarantee loan programs. The term limits for direct loan programs are seven for operating loans and ten years for ownership loans. There is also a 15-year term limit on guaranteed loans, though Congress has temporarily waived the provision. Once the term limit is reached, a borrower must be able to graduate to private, commercial lender at commercial rates or risk being unable to sustain their operation. Term limits do not have any exclusions or extensions for events such as natural disasters or export bans or other circumstances beyond a producer's control.

The idea behind term limits is good – that farmers will be able to graduate from direct loans to guaranteed loans to commercial loans over a period of time. Congress passed term limits in part due to past abuses in which some producers simply became lifelong government borrowers by default. However, the hard and fast limits are increasingly viewed as arbitrary and an overly rigid in light of the uncertainties of agricultural production.

The 2007 Farm Bill should re-emphasize and strengthen the borrower training program, loan supervision and regular loan assessment rules, market placement and graduation procedures, and the family-sized farm test and no credit elsewhere test. Congress should direct the agency to issue rules and performance criteria that will ensure these existing elements of the program are more fully utilized. The goal should be to maintain a system that from day one has as its objective starting successful farming operations and graduating borrowers to commercial credit in the shortest period of time possible.

On the basis of having those systems in place and fully funding loan officer staffing and staff training requirements, Congress should eliminate term limits. Properly applied, the existing training, loan assessment, market placement, and family-sized farm and no credit elsewhere limitations are effective in ensuring FSA credit is playing its proper role of providing temporary assistance. With the proper protections and directives in place, farm loan officers should be allowed to do their jobs and make sound loans to qualified borrowers on a temporary basis without the imposition of arbitrary term limits.

**FSA Pilot Projects**

In the last farm bill, Congress adopted the **Beginning Farmer and Rancher Land Contract** pilot program to allow USDA to provide loan guarantees to sellers who self-finance the sale of land to beginning farmers and ranchers. The pilot program is currently operating in PA, WI, IA, IN, ND, MN, NE, OR, and CA. The program is structured to provide the seller of the land a "prompt payment" guarantee. The guarantee would cover two amortized annual installments or an amount equaling two amortized annual installments. For a variety of reasons, including an overall reduction in land contract sales as land prices escalate and tax sheltering possibilities increase for landowners, the pilot has seen very modest interest and participation. Nonetheless, the concept seems quite sound and we recommend it become part of permanent law as a regular nationwide program option in the new farm bill, with the following changes:

- The current 2-year limit on payment guarantee created by regulation should be extended to three years.
- The land seller should be given the option of choosing either the 3-year prompt payment guarantee or a standard 90 percent guarantee of the outstanding principle.

The new farm bill should create a new pilot program to start building a USDA-run counterpart to the most urban-oriented Individual Development Account program run by the Department of Health and Human Services. A **Beginning Farmer and Rancher IDA pilot program** would use special matched savings accounts to assist those of modest means to establish a pattern of savings and to promote a new generation of farmers and ranchers. The account proceeds may be used toward capital expenditures for a farm or ranch operation, including expenses associated with purchases of land, buildings, equipment, infrastructure, or livestock, or toward acquisition of training. IDA programs specifically targeted to beginning farmers are currently underway in Michigan and California.

Each pilot project would involve an organization, agency, or partnership that would be chosen on a competitive basis to administer the IDA program. The pilots would target limited resource farmers including minority and immigrant farmers. IDA participants attend workshops on business planning, cash-flow projections, understanding credit reports, farm tax rules, and other topics throughout the program. The program would help each participant identify their asset goals related to developing their farm businesses. Many programs would also help connect beginning farmers with opportunities to lease or buy farmland.

Each pilot project would offer savings plans that match dollars saved by the participants, generally on a 3:1 matching basis. Participants would be committed to saving a certain amount each month for several years, so that by the end of the program they would have funds to put toward a down payment on a farm, or to purchase farm or processing equipment or animals. Savings may also be used to qualify the beginning farmer for public or private agricultural loan packages, for use as the borrower's down payment for the FSA Beginning Farmer and Rancher Down Payment Loan

Program. Given the IDA's connection to future lending, we propose the pilot be run by the loan making division of FSA.

The proposed Individual Development Accounts pilot project begins to address two critical issues – helping new farmers build equity and preparing them to access credit. With this recommendation, I conclude my testimony as it relates specifically to credit needs and recommended policy changes. However, as I have already suggested, more needs to be done to address the needs of beginning farmers and ranchers than just making credit available on appropriate terms. I will conclude my testimony by highlighting a few additional policy opportunities to aid beginning farmers.

**Beginning Farmer and Rancher Development Program**

In the last farm bill, Congress authorized the Beginning Farmer and Rancher Development Program (BFRDP), declaring it the first USDA program other than farm credit/debt financing programs targeted specifically to beginning farmers and ranchers. To be administered by USDA's Cooperative State Education and Extension Service (CSREES), this competitive grants program will fund education, extension, outreach and technical assistance initiatives directed at new farming opportunities. Unfortunately, the direct farm bill funding for the program was deleted in conference and no appropriated funds have been forthcoming, so the program has yet to get off the ground. <u>In our view, no single beginning farmer proposal in the new farm bill is as important as providing direct funding of at least $25 million a year for this critical new program.</u>

The BFRDP is targeted especially to collaborative local, state, and regionally based networks and partnerships to support financial and entrepreneurial training, mentoring and apprenticeship programs, "land link" programs, innovative farm transfer and transition practices, and education and outreach activities to assist beginning farmers and ranchers. Such networks and partnerships may include: cooperative extension; community-based and non-governmental organizations; relevant USDA and state agencies; universities; community colleges; and other appropriate partners. Not less than 25% of funds appropriated for this program are targeted to limited resource and socially disadvantaged beginning farmers and ranchers and to farm workers seeking to become farmers or ranchers. There is a 25% cash or in-kind matching requirement. Grant terms may not exceed three years.

The program also establishes education teams, made up of representatives of colleges and universities, cooperative extension, non-governmental organizations, and agencies, whose task is to develop curriculum and educational modules geared to different regions and farming systems for use in a variety of educational settings and available online. The curriculum and educational modules could include segments on new markets, new crops, and value-adding enterprises.

**Conservation Incentives for New Farmers and Ranchers**

The conservation title of the 2002 Farm Bill authorized the Secretary of Agriculture to provide special incentives to beginning farmers and ranchers and limited resource producers to participate in federal agricultural conservation programs. This provision has resulted in several limited offerings by NRCS through farm bill conservation programs, including a funding set-aside under the Conservation Innovation Grants program and ranking points for farm transition planning under the Farm and Ranch Land Protection Program. More far reaching special incentives were unfortunately not adopted, despite the new farm bill authority.

The 2002 Farm Bill also established a maximum cost share rate of 90 percent, a 15 percent cost-share differential or bonus relative to the regular maximum rate, for beginning farmers and ranchers and limited resource farmers in the Conservation Security Program (CSP) and the Environmental Quality Incentives Program (EQIP). This cost-share bonus was unevenly implemented from state-to-state.

The intent of these provisions is to help achieve two important public policy goals: help get new farmers and ranchers get started while encouraging them from the outset to adopt whole farm conservation plans and strong conservation systems. Adoption of sustainable systems is often far easier at the beginning of an operation's history than later on once a system is in place and then needs to be changed or retrofitted.

Setting aside conservation funding for beginning farmers and ranchers makes good sense for the nation, as it will assist the new generation of Americans farmers in establishing effective conservation systems on their farms at the beginning of their farming career. Similarly, assisting socially disadvantaged farmers in establishing and maintaining conservation systems and practices on their farms secures more effective conservation on the land and provides better access to these programs for a historically underserved community.

<u>We recommend that the new farm bill continue the cost-share differential and clarify the language to ensure even and consistent implementation. We also recommend that the special incentives authority be continued, but strengthened. We also concur with the Administration that the new farm bill should reserve conservation funding for beginning farmer and for socially disadvantaged farmers.</u> We suggest the reservation of funds be for the first four months following the date of availability, and that at least ten percent of total funding for each farm bill conservation program targeted to beginning and at least ten percent targeted to socially disadvantaged farmers and ranchers. Within that reserve, a higher maximum allowable technical assistance percentage should be provided to better address the conservation planning needs of new and socially disadvantaged farmer and ranchers.

**Beginning Farmer Research Priority**

Very little federal research funding currently is dedicated to new farming opportunities, farm transfer and succession, farm transition, and entry, or new farm-oriented production, conservation, marketing, value-added, or viability issues. In relation to the aging of American agriculture, the funding for research and extension on these issues seems paltry indeed. The emerging generation of farmers includes both people with farm backgrounds and those without. Of those without farm backgrounds, many are coming to farming as a second or third career change. They are ethnically and culturally diverse and interested in a wide-range of crop and livestock systems. There is a large need for research, development and diffusion of models for new farmer training, land transition, making rental land accessible as an entry option, accessible, lower risk production start-up options, alternative marketing strategies, and alternative financing strategies. <u>The 2007 Farm Bill should include language in the research title making beginning</u>

farmer and rancher (including socially disadvantaged and immigrant farmer and rancher), farm transfer and farm entry, new marketing alternatives, and related issues a priority research area. The new farm bill should incorporate specific language designating a new national integrated program area for these issues within the national competitive grants programs and within risk management education programs.

**Conclusion**

I appreciate the chance to provide the Committee with testimony that reflects the realities experiences of farmers we work with at the Land Stewardship Project. We hope our testimony is informative as the Committee evaluates policy options to address credit needs in rural America and how to best support new farmers and ranchers who will be integral parts of our nation's food and agriculture system. There are good opportunities in farming today: growth in local and regional markets, organics and other value-added products, and – hopefully very soon – energy crops. Because of this, there is real opportunity for beginning and transitioning farmers. We believe a beginning farmer initiative along the lines of what we have suggested within the new farm bill will address key obstacles to beginning farmers and provides smart, cost-effective start-up support and incentives for America's next generation of family farms.

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