Congressional Research Service

Report RS21977

Agricultural Credit: Institutions and Issues

Jim Monke, Resources, Science, and Industry Division

October 1, 2008

Abstract. The global financial crisis has taken a toll on Farmer Mac's capital. Investments in Fannie Mae and Lehman Brothers suffered about $97 million in losses, putting Farmer Mac's ability to meet capital requirements in jeopardy. It raised $65 million in a special stock issuance, and presumably will meet its quarterly capital requirement. The scope of the farm loan programs was adjusted in the 2008 farm bill, but the farm bill did not allow any expansion of FCS lending authorities. However, through the regulatory process, FCS is proposing to expand the scope of permissible investments. A proposed rule would allow FCS institutions to invest in debt securities of rural projects, as well as to make equity investments in rural venture capital funds, both in rural areas under 50,000 population. Supporters claim a need for more and innovative financing in rural areas. Opponents say FCS is overstepping its statutory authority and should focus on making loans to farmers.

Order Code RS21977
Updated October 1, 2008

CRS Report for Congress

Agricultural Credit: Institutions and Issues

Jim Monke
Specialist in Agricultural Policy
Resources, Science, and Industry Division

Summary

The U.S. Department of Agriculture's Farm Service Agency is a lender of last resort; it makes direct loans and guarantees commercial loans to farmers. The Farm Credit System (FCS) has a statutory mandate to make loans to credit-worthy farmers; it benefits from being a government sponsored enterprise (GSE). Farmer Mac, another GSE, creates a secondary market for agricultural loans.

The global financial crisis has taken a toll on Farmer Mac's capital. Investments in Fannie Mae and Lehman Brothers suffered about $97 million in losses, putting Farmer Mac's ability to meet capital requirements in jeopardy. It raised $65 million in a special stock issuance, and presumably will meet its quarterly capital requirement.

The scope of the farm loan programs was adjusted in the 2008 farm bill, but the farm bill did not allow any expansion of FCS lending authorities.

However, through the regulatory process, FCS is proposing to expand the scope of permissible investments. A proposed rule would allow FCS institutions to invest in debt securities of rural projects, as well as to make equity investments in rural venture capital funds, both in rural areas under 50,000 population. Supporters claim a need for more and innovative financing in rural areas. Opponents say FCS is overstepping its statutory authority and should focus on making loans to farmers.

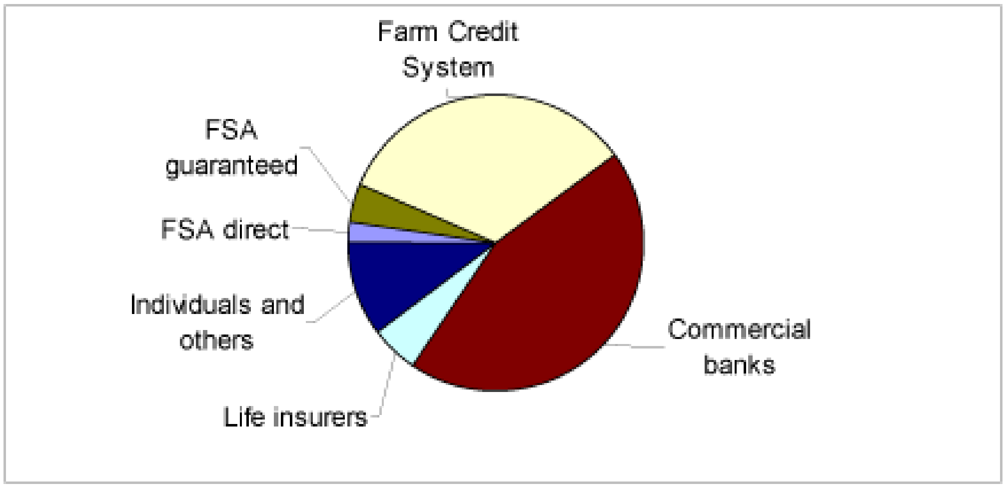
Background

The federal government has long provided credit assistance to farmers. First, USDA's Farm Service Agency (FSA) issues direct loans and guarantees on loans made by commercial lenders to farmers who do not qualify for regular credit. Therefore, FSA is called a lender of last resort. Second, the Farm Credit System (FCS) is a cooperatively owned, federally chartered private lender with a mandate to serve agriculture-related borrowers. FCS makes loans to creditworthy farmers, and is *not* a lender of last resort. Third, Farmer Mac provides a secondary market for agricultural loans.

Other lenders include commercial banks, life insurance companies, and individuals, merchants, and dealers. **Figure 1** shows that commercial banks lend most of the farm sector's total debt (45%), followed by the Farm Credit System (34%), individuals and others (10%), and life insurance companies (5%). The Farm Service Agency provides less than 3% of the debt through direct loans, and guarantees about another 4% of the market.

The farm sector had about $210 billion in debt at the end of 2007 and $2.2 trillion in assets, resulting in a debt-asset ratio of less than 10%, which is historically low and indicates that the farm sector is not overly leveraged. Credit conditions in agriculture are generally good. USDA data show declining debt-to-asset ratios, rising equity, and strength in farmers' ability to repay debts. For the most part, the farm lenders have not suffered losses like housing lenders have the past year. But the farm economy is not completely isolated. The global financial crisis is raising fears that credit availability for farmers, along with the rest of the economy, may become more constrained in the coming year.

Figure 1. Market Shares of $210 Billion of Farm Debt, 2007



Source: CRS using USDA-ERS and FSA data at [http://www.ers.usda.gov/briefing/FarmIncome/data/Bs_t5.htm].

Government-Related Farm Lending Institutions

USDA's Farm Service Agency (FSA). The USDA Farm Service Agency (FSA) is a lender of last resort because it makes direct farm ownership and operating loans to family-sized farms that are unable to obtain credit elsewhere. FSA also guarantees timely payment of principal and interest on qualified loans made by commercial lenders such as commercial banks and the FCS. Permanent authority exists in the Consolidated Farm and Rural Development Act (CONACT, 7 U.S.C. 1921 *et seq.*).

Direct loans are limited to $300,000 per borrower; guaranteed loans to $1,094,000 per borrower (adjusted annually for inflation). Direct emergency loans are available for natural or other disasters. Some guaranteed loans have a subsidized interest rate.

Part of the FSA loan program is reserved for beginning farmers and ranchers (7 U.S.C. 1994 (b)(2)). For direct loans, 75% of the annual funding for farm ownership loans and 50% of direct operating loans are reserved for the first 11 months of the fiscal year. For guaranteed loans, 40% is reserved for ownership loans and farm operating loans for the first half of the fiscal year. Funds are also targeted to "socially disadvantaged" farmers based on race, gender, and ethnicity (7 U.S.C. 2003).

Farm Credit System (FCS). Congress established the Farm Credit System in 1916 to provide a dependable and affordable source of credit to rural areas at a time when commercial lenders avoided farm loans. FCS is not a government agency nor guaranteed by the U.S. government, but is a network of borrower-owned lending institutions. It is not a lender of last resort; it is a for-profit lender with a statutory mandate to serve agriculture. Funds are raised through the sale of bonds on Wall Street. Five large banks allocate these funds to 95 credit associations that, in turn, make loans to eligible creditworthy borrowers.

Statutes and oversight by the agriculture committees determine the scope of FCS activity. Benefits such as tax exemptions are also provided. Eligibility is limited to farmers, farm input suppliers, rural homeowners in towns under 2,500 population, and cooperatives. The federal regulator is the Farm Credit Administration (FCA).

Farmer Mac is a separate GSE that is a secondary market for agricultural loans. It is part of the FCS in that FCA is its regulator, but it is financially separate. Farmer Mac purchases mortgages from lenders and guarantees mortgage-backed securities that are bought by investors. Permanent authority rests in the Farm Credit Act of 1971 (12 U.S.C. 2001 *et seq.*). For more background, see CRS Report RS21278, *Farm Credit System*.

Farmer Mac's Capital Problems in the Global Financial Crisis

The global financial crisis that began with subprime mortgage defaults in 2007 and spread throughout the U.S. and global financial sectors in 2008 has taken a toll on Farmer Mac's capital. Farmer Mac lost about $97 million in Fannie Mae stock and Lehman Brothers securities, putting in jeopardy its ability to meet statutory capital requirements for September 30, 2008. Farmer Mac had invested $52 million in Fannie Mae preferred stock; it is now valued at about $3.2 million, for a $49 million loss.[1] Its $60 million investment in Lehman Brothers debt securities fell to about $12 million, for a $48 million loss.[2] In the last quarterly report filed on June 30, 2008, its minimum statutory capital requirement was $215 million, and it had capital of $255 million, for a $40 million cushion. Based on these amounts, the investment losses would have put the capital under the required level without other action. If the capital requirement is not met, statute requires FCA to downgrade Farmer Mac's rating, something it has never needed to do. Such enforcement would involve a capital restoration plan, suspension of dividend payments, and possibly limitations on Farmer Mac's growth (12 U.S.C. 2279bb-6).

However, a formal capital restoration plan appears unnecessary because on October 1, 2008, Farmer Mac announced that it raised $65 million in capital by issuing preferred stock. The shares were bought by the five Farm Credit System banks and one commercial lender.[3] Farmer Mac's core business involving agricultural lending is performing well; all agricultural lenders, including the FCS, are having historically low default rates.

---

[1] Securities and Exchange Commission, Form 8-K, September 12, 2008, at [http://www.sec.gov/Archives/edgar/data/845877/000084587708000043/form8k.htm].

[2] Securities and Exchange Commission, Form 8-K, September 22, 2008, at [http://www.sec.gov/Archives/edgar/data/845877/000084587708000046/form8k.htm].

[3] Farmer Mac,"Farmer Mac Raises $65 Million in Capital Through the Issuance of Senior Preferred Shares," Oct. 1, 2008, [http://www.farmermac.com/news/Open_News.aspx?ID=108].

2008 Farm Bill Provisions

Statutory authority for FSA and FCS is permanent, but periodic farm bills — such as the 2008 farm bill (P.L. 110-246) — often make adjustments to eligibility criteria and the scope of operations. These adjustments are summarized below, and a more detailed side-by-side comparison of provisions is available in CRS Report RL34228, *Comparison of the 2008 Farm Bill Conference Agreement with the House and Senate Farm Bills*.

Farm Service Agency. The 2008 farm bill authorizes the FSA farm loan program at $4.226 billion for each of FY2008-FY2012, including $1.2 billion for direct loans. Actual funding is determined in annual appropriations acts. In addition, the farm bill:

- Increases lending limits per farmer to $300,000 for direct farm ownership loans and $300,000 for direct operating loans, up from $200,000 each.
- Further prioritizes lending for beginning and socially disadvantaged farmers by increasing the amounts reserved for these groups (see above).
- Extends the term of the beginning farmer down-payment loan program, raises the lending limit, and lowers the interest rate. Adds eligibility for socially disadvantaged farmers.
- Makes permanent and nationwide the guarantee program for seller-financed land loans to beginning and socially disadvantaged farmers.
- Suspends until December 31, 2010, the enforcement of "term limits" on guaranteed loans that require farmers to graduate to commercial lenders.
- Adds eligibility for emergency loans to equine farmers; conferees noted that horses for racing, showing, and recreation should not be eligible.
- Creates a beginning farmer "Individual Development Account" pilot program. Farmers receive up to a 2:1 match, up to $6,000/year.
- Creates direct loans and loan guarantees for conservation projects.
- Extends the right of first refusal to reacquire a homestead property to the family of a socially disadvantaged borrower-owner.
- Adds socially disadvantaged farmers to beginning farmers as preferred groups when the USDA sells or leases property.

Farm Credit System. The enacted 2008 farm bill does *not* allow any expansion of Farm Credit System lending authority. Although an initial House draft of the farm bill included some expanded lending authorities, those provisions were removed by a floor amendment from leaders of the House Financial Services Committee. For the Farm Credit System, the 2008 farm bill:

- Allows rural utility (electric or telephone facility) loans to qualify for the agricultural mortgage secondary market (Farmer Mac). Provides for separate consideration of rural utility loans when determining credit risk.
- Makes technical changes in the payment of insurance premiums by FCS banks to the FCS Insurance Corporation.
- Makes more borrowers able to own Bank for Cooperatives voting stock.
- Equalizes lending authorities for associations in Alabama, Mississippi, and Louisiana by allowing Federal Land Bank Associations to make shorter-term loans, and Production Credit Associations to make longer-term loans. Requires board and shareholder votes. Effective Jan. 1, 2010.

Farm Credit Administration Proposed Rule on Investments

Background on FCS Proposals for Expansion. The Farm Credit System is authorized by statute to lend to farmers and ranchers. Loans may also be made for the processing and marketing activities of these borrowers, home loans in rural areas, certain farm-related businesses, and cooperatives. Loans to other borrowers are prohibited.

In recent years, FCS has sought to expand its lending authority beyond traditional farm loans. In 2006, an FCS report titled *Horizons*[4] highlighted perceived needs for greater lending authority, including rural housing in towns with up to 50,000 population (currently 2,500) and broader eligibility for agribusinesses. Commercial banks oppose any expansion of FCS lending authority, saying that credit in rural areas is not constrained given financial deregulation and integration, and that FCS's GSE status provides an unfair advantage.[5] They say that federal tax benefits for FCS are no longer necessary.[6]

The policy decision of whether to expand FCS lending authority has become less about "farm credit," and more about the ideological role of a retail GSE lender competing with private lenders.[7] FCS asserts its statutory mandate to serve agriculture (and by extension, rural areas) through good times and bad times. In Congress, committee jurisdiction has been questioned. During debate over the 2008 farm bill, the House Financial Services Committee and the Senate Banking Committee asserted jurisdiction for nonfarm lending and opposition to *Horizons*.[8] The Administration opposed FCS expansion,[9] and a past chairman of the FCA, Michael Reyna, also voiced opposition.[10]

Mission-Related Investments. On June 16, 2008, the FCA published a proposed rule to allow "mission related investments" (73 *Federal Register* 33931-33940).[11] These investments include (1) debt securities in projects that benefit rural communities and (2) equity investments in venture capital funds. The proposed rule would define rural areas to include up to 50,000 residents. Targeted projects include community facilities, transportation, rural business investment companies, and venture capital funds.

---

[4] The *Horizons* report is available at [http://www.fchorizons.com].

[5] Bert Ely, "The Farm Credit System: Lending Anywhere but on the Farm," at [http://www.aba.com/nr/rdonlyres/e1577452-246c-11d5-ab7c-00508b95258d/45256/horizons2006elyfinal.pdf].

[6] The tax benefits for FCS include an exemption from federal, state, municipal, and local taxation on the profits earned by the real estate side of FCS. For investors who buy FCS bonds to finance the System, the interest earned is exempt from state, municipal, and local taxes.

[7] Unlike the housing GSEs (Fannie Mae, Freddie Mac) that do not lend directly to homeowners, the Farm Credit System is a retail lender that competes for farm loans against commercial banks.

[8] Letter on House-Senate Farm Bill Conference, Jan. 15, 2008 [http://www.house.gov/apps/list/press/financialsvcs_dem/press011607.shtml], and letter to House Agriculture Committee, May 18, 2007 [http://www.house.gov/apps/list/press/financialsvcs_dem/press052207.shtml].

[9] Statement of Administration Policy on H.R. 2419, July 25, 2007, p. 3 [http://www.whitehouse.gov/omb/legislative/sap/110-1/hr2419sap-r.pdf]

[10] Congressional Record, July 26, 2007, p. H8728.

[11] FCA, proposed rule on Rural Community Investments, [http://www.fca.gov/handbook.nsf/ff16b393f6bb3aa0852563ce006665bb/ea4c5c5dfb4c60058525746b0044e5b1?OpenDocument].

FCA promotes the program "to allow greater flexibility" and "to better serve the changing needs of agriculture and rural areas." The proposed rule states that "many rural areas are struggling to retain economic viability and vitality," and that "essential facilities, infrastructure, and services ... often lag behind those in metropolitan areas ... obstacles to rural economic development and revitalization [that] are further compounded by funding challenges." FCA designed the rule "to enable FCS to collaborate and partner in rural development ... as a financial intermediary promoting the flow of money into rural areas."

Like banks, FCS institutions may use their assets to make loans or buy investments. Some question whether investments in the types of projects mentioned in the rule are safe and/or mission-related. Critics say that the rule's definition of rural as 50,000 population is at odds with the FCS statutory limit of 2,500 population for rural home loans. Do investments in bonds and venture capital effectively result in loans by another name to borrowers who otherwise are ineligible for FCS loans?

Since 2004, an FCA pilot program has been allowing similar investments in what sometimes are called "Rural America Bonds."[12] The proposed rule basically would make the pilot program, with revisions and the addition of the venture capital funds, a permanent part of FCS regulations and available to all FCS institutions.

The proposed rule was open for public comment until August 15, 2008, and over 10,000 comments were submitted.[13] Among the comment letters are two bipartisan letters from the House Financial Services Committee[14] and the Senate Banking Committee[15] opposing the rule. These letters note that the 2008 farm bill rejected legislation to expand FCS lending authorities, request the proposed rule be withdrawn, and ask that decisions about the scope of FCS activities be left to Congress. Also, Representatives Herger, Buyer, and Manzullo, and Senators Byrd, Lugar, and Bingaman submitted letters from constituents who oppose the rule. The chairmen of the House and Senate agriculture committees have not taken a position publicly. USDA's Rural Development agency submitted a comment letter in support of the rule,[16] which somewhat contradicts the Administration's opposition to FCS expansion in the farm bill in 2007.

The disposition of the proposed rule now awaits action by the FCA. The FCA is authorized to implement rules that it believes are in accord with the statutes. Congress has no official role in the approval process for this proposed rule unless it exercises its legislative power, including disapproving the rule under the Congressional Review Act.

---

[12] FCA, Informational Memorandum on "Investments in Rural America," Jan. 11, 2005.

[13] Comment letters are available at [http://www.fca.gov/apps/regproj.nsf/e211b6dc2a9fbbba85256e5100541454/9dcc7754de2e51bb852572dd00526b3f?OpenDocument].

[14] Reps. Frank, Bachus, Maloney, and Biggert, House Financial Services Committee, letter to FCA on July 10, 2008 [http://www.aba.com/aba/documents/press/LettertoFCA7_10_08.pdf].

[15] Senators Dodd and Shelby, Senate Banking Committee, letter to FCA on August 8, 2008 [http://www.fca.gov/apps/regproj.nsf/9646a6b403d8272d85256e5100541453/c2d1d0197290ead2852574a2004a1021?OpenDocument].

[16] James Alsop and Joseph Ben-Israel, USDA Rural Development, letter to FCA on August 14, 2008, at [http://www.fca.gov/apps/regproj.nsf/9646a6b403d8272d85256e5100541453/8fed246b2b6da162852574a500617f65?OpenDocument]