

SPECIAL REPORT

WILL THE FARM CREDIT SYSTEM BE INCLUDED IN THE FARM BILL?

By Jeana Hultquist

The last major revision to the Farm Credit System's lending authorities occurred in 1971. Yes, there have been other legislative changes since that time relating to structure, capital, etc., but no new look at how agriculture has changed over the years and the changing needs of financial services for agriculture and rural America. That was the genesis of Farm Credit's Horizons Project; a forward-looking planning initiative. Horizons research showed how globalization and technological advances are driving change in agriculture, the food system and rural communities. Horizons also identified the potential for a bright future with greater rural economic activity driven by agriculture's response to our nation's growing energy needs, more opportunities for value-added production and the potential of rural entrepreneurship.

The project moved forward in identifying the following incremental changes to current law for the Farm Credit System:

- Providing more financing options for farm-related businesses
- Increasing the current population level for home mortgage homes; and
- Modernizing Farm Credit Directors' authority to set cooperative stock requirements

American AgCredit, along with the entire Farm Credit System held several forums in which these issues were discussed and yes, even debated internally. Many of you reading this article responded to several surveys and questionnaires along the way to ensure that what we were asking for were changes that meet the needs and wants of people we already have a relationship and commitment to, but can't further our service to them because of outdated laws that don't reflect what is needed in today's environment.

For example, current law permits Farm Credit associations to lend to certain farm-related businesses, but the Farm Credit Act places strict eligibility and purpose limits on this lending. Associations may lend to farmers (eligibility limit) who own businesses that are engaged in the basic processing or marketing of commodities (purpose limit). The Farm Credit Act requires that to be eligible the marketing and processing business must be "directly related to the operations of the borrower and those of other eligible farmers (or ranchers or producer or harvester of aquatic products)..." (a further limit on purpose). Therefore, to be eligible to borrow from Farm Credit today a marketing or processing business must 1) be majority owned or controlled by farmers, AND 2) be marketing and/or processing commodities grown by the farmer-owners of the entity. An example of an eligible entity under this authority would be a farmer-owned vegetable processing facility that processes vegetables grown by the farmer owner. The facility also may process vegetables of other farmers. If the farmer owner of this business stops processing his own vegetables, the business would no longer be

eligible for Farm Credit financing.

Associations also currently may lend to certain non-farmer owned, farm-related service businesses (eligibility limit) that are primarily engaged in providing "farm-related services" to farmers and ranchers (purpose limit). The services provided by these businesses must be related directly to the on-farm operating needs of farmers and ranchers (additional purpose requirement). An example of this is a business that provides spraying services or lime application on the farm or an equipment repair service that services equipment on the farm. The System may not finance the business activities of these entities that are not provided on the farm unless they are incidental in nature. So if the sprayer service also sells a substantial amount of chemicals to farmers through a retail outlet for the farmers to apply on their own or if the equipment repair service also has a service facility to which farm equipment is brought, the System is limited in its ability to finance these other activities.

The Farm Credit System's legislative proposal would eliminate the requirement for both farm-ownership and throughput for marketing and processing businesses and the "on farm" and service only requirements for input and service

providers. Importantly, however, the proposal would impose requirements that these businesses be primarily engaged in serving the needs of farmers, ranchers or the producers or harvesters of aquatic products.

We knew all along that we would face opposition from the

commercial banking industry. The American Bankers Association sent its members to Capitol Hill carrying an inflammatory brochure that unfairly characterized Farm Credit as "lending anywhere but the farm," and the Independent Community Bankers of America issued a letter and news release attacking Horizons for seeking to "take the Farm" out of the Farm Credit System.

The truth of the matter is that commercial banks don't like competition, whether it's from the credit unions, Wal-Mart, insurance companies or the Farm Credit System. In verbal testimony before a congressional subcommittee hearing, two witnesses testified on behalf of the bankers, Frank Pinto, President of the Pennsylvania Association of Community Bankers, and Jeff Greenlee, President of Oklahoma-based NBanc. Not surprisingly, the bankers' testimony reflected the groups' knee-jerk opposition to HORIZONS, insisting that agriculture and rural communities are already well-served by commercial banks and that "expansion" of the Farm Credit System would put banks out of business. Testifying on behalf of Farm Credit were Armin Apple, a member of the Farm Credit Council Board and the board of AgriBank, FCB, headquartered in St. Paul, MN and Doug Stark, President and CEO of FCS of America, headquartered in Omaha,

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NE. Under questioning by members of the Subcommittee, Messrs. Apple and Stark expanded upon their testimonies, in particular making note that under the rural housing proposal Farm Credit would remain bound by the requirement that rural home mortgage lending cannot exceed more than 15 percent of a Farm Credit association's loan portfolio (currently American AgCredit holds a mere \$1,274MM or 0.04%, not what many would consider a real competitor), as well as challenging bankers' repeated assertions that Farm Credit holds unfair competitive advantages over commercial banks.

An example of the bankers' outlandish arguments is that they insist that rural credit availability is more than adequate – citing as proof a survey of bankers themselves. The ICBA survey asked “over 1,000 randomly selected rural bankers” whether there was a lack of credit available in their marketplace. Naturally, one hundred percent of respondents answered “no.” Further example of their eccentric arguments, when asked by Agriculture Committee Ranking Member Bob Goodlatte (R-VA) to specify a population figure that bankers would find acceptable for allowing Farm Credit to offer home mortgages, Pinto replied “zero.”

The modest proposals requested by the Farm Credit System was fully supported by the House Agriculture Committee only to find its demise on July 26th at about 10:00 p.m. EST on the House Floor when Financial Services Chairman Barney Frank (D-MA) introduced a “motion to strike” the Farm Credit provisions from the Farm Bill. The debate was limited to ten minutes after which the Speaker called for a voice vote. This maneuver was well orchestrated and Congresswoman Tauscher (presiding over the House at the time) slammed the gavel down so quick that any “nay” voices were well drowned-out. A quote I recently read of a Roman philosopher, “Where fear is present, wisdom cannot be.” This vote had absolutely nothing to do with the merits of the proposal or in responding to constituents' interest, but promoted by an entirely self-interested banking lobby. In addition to the thousands of letters and phone calls, over 550 organizations with a stake in the future success of U.S. agriculture and rural America has expressed their support for modernizing Farm Credit's authorities. “Ironically, this vote came on the very evening the stock market dropped more than 300 points, largely on the news that home mortgage financing and credit for new business ventures are rapidly drying up. Rural America always is hurt first by these types of changes. The Farm Bill provisions killed by the Frank/Bachus amendment would have provided rural areas with some modest help to address this downturn in credit availability,” says Ken Auer, President and CEO, Farm Credit Council.

As the Farm Bill was making its way through the House of Representatives, so was the GSE Reform Bill (H.R. 1427 - which has passed the House and is currently in the Senate) which provides unlimited access to GSE funding for nearly every community bank in America. The bill expands substantially the number of community banks eligible for direct access to additional GSE funding for a wide range of purposes – including agriculture. Yet, community banks claim they are competing on an “un-level playing field” against the Farm Credit System. Community banks have similar GSE access as the Farm Credit System – with none of the constraints on lending authority that restrict Farm Credit's service to agriculture, farm-related businesses and rural homeowners. According to the American

Banker's Association 2006 Farm Bank Performance report (“farm banks” are defined by the ABA as banks with assets less than \$1 billion whose ratio of domestic farm loans to total domestic loans is greater than 13.94 percent for 2006): “At the end of 2006, approximately 54 percent of all farm banks had borrowings from the Federal Home Loan Bank System; and advances from the FHLBs at farm banks grew from \$6.5 billion in 2001 to \$10.5 billion in 2006.”

In addition, in recently approved supplemental legislation (H.R. 2206), community banks were provided substantial additional tax relief by Congress. These tax relief measures benefit existing Subchapter S community banks and will allow additional banks to more easily elect conversion to Subchapter S status and avoid paying all Federal income tax.

The combination of tax relief and expanded GSE access will allow community banks to expand profits and returns to investors. Congress is giving community banks what they want to increase profits, which will benefit no one except the banks' well-heeled investors, while Farm Credit passes its benefits on to the farmers and ranchers who borrow from it. American AgCredit is your dedicated farmer-cooperative committed to the future financial needs of California agriculture and rural America. Congress should give farm-related businesses and rural homeowners what they need by greater access to American AgCredit and the Farm Credit System. ❖

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WHAT ARE GOVERNMENT SPONSORED ENTERPRISES (GSEs)?

The government sponsored enterprises (GSEs) are a group of financial services corporations created by the United States Congress. Their function is to enhance the flow of credit to targeted sectors of the economy and to make those segments of the capital market more efficient and transparent. The desired effect of the GSEs is to enhance the availability and reduce the cost of credit to the targeted borrowing sectors: agriculture, home finance; and education. Congress created the first GSE in 1916 with the creation of the Farm Credit System; it initiated GSEs in the home finance segment of the economy with the creation of the Federal Home Loan Banks; and later Fannie Mae and Freddie Mac. It targeted education when it chartered Sallie Mae in 1972 (although Congress allowed Sallie Mae to relinquish its government sponsorship and become a fully private institution via legislation in 1995).

FARM CREDIT FACTS:

- Farm Credit was established as a permanent source of credit for U.S. agriculture and rural America – mission focused to serve their needs in good times and bad.
- As a GSE, Farm Credit has access to reliable and cost-effective sources of funds to lend to agriculture and rural America – supporting Farm Credit's mission.
- The Farm Credit System's “GSE status” does not mean it is subsidized by the Federal Government. It raises funds for loans by selling debt securities on the open market and, as a cooperative, it is privately-owned by its customer-borrowers.
- Farm Credit is also the only GSE that funds its own insurance fund, which protects bondholders and, ultimately, taxpayers.
- Commercial banks have access to GSE funds through Farm Credit, as well as GSE funding for agricultural loans through Farmer Mac and the Federal Home Loan Banks and for housing through Freddie Mac and Fannie Mae in addition to the Federal Home Loan Banks.