Agricultural Credit: Institutions and Issues

Jim Monke
Specialist in Agricultural Policy

July 14, 2010

Congressional Research Service
7-5700
www.crs.gov
RS21977

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

The federal government has long provided credit assistance to farmers, in response to insufficient lending in rural areas or a desire for targeted lending to disadvantaged groups. One federal lender is the Farm Service Agency (FSA) in the U.S. Department of Agriculture (USDA). It issues direct loans to farmers who cannot qualify for regular credit, and guarantees repayment of loans made by other lenders. Thus, FSA is called a lender of last resort. Of about $240 billion in total farm debt, FSA provides about 2% through direct loans, and guarantees about another 4% of loans. Another federally related lender is the Farm Credit System (FCS), a cooperatively owned, federally chartered lender with a statutory mandate to serve agriculture-related borrowers. FCS makes loans to creditworthy farmers, and is not a lender of last resort. FCS accounts for about 39% of farm debt. Commercial banks are the largest farm lender and hold 44% of total farm debt.

While the global financial crisis that escalated in 2008 was slower to affect agricultural balance sheets than the housing market, it has begun to take its toll. Net farm income fell by 35% in 2009, reducing some farmers' ability to repay loans—particularly among dairy, hog, and poultry farms. Delinquency rates (loans that are more than 30 days past due) on residential mortgages began to rise in 2005, but delinquency rates for agricultural loans did not begin to rise until mid-2008 and have not risen as quickly. The delinquency rate on residential mortgages was 11.3% in March 2010; it reached 3.1% for agricultural loans in December 2009, and was 2.89% in March 2010.

Because of the financial turmoil, the USDA farm loan program has seen significantly higher demand. In FY2009, FSA had its highest loan authority since 1985, issuing $4.5 billion of loans and guarantees. Two supplemental appropriations added more than $1.1 billion to $3.4 billion of regularly appropriated loan authority. The regular FY2010 appropriation provided even more, $5.1 billion. A pending FY2010 supplemental appropriation (H.R. 4899) would add $950 million of additional loan authority, for a possible total loan authority of $6 billion.

Term limits have been part of the USDA farm loan program since the financial crisis of the 1980s. They encourage farmers to graduate to commercial loans by placing a maximum number of years that farmers are eligible. However, Congress has suspended application of the guaranteed operating loan term limit to prevent some farmers from being denied credit. USDA says that 3,800 current borrowers have reached the limit and would not qualify if the term limit was not suspended. The 2008 farm bill renewed the suspension of this term limit, but only through 2010. In the Senate, S. 3221 would extend the suspension of term limits for two more years, until December 31, 2012. This would allow the issue to wait to be addressed in the next farm bill.

Also because of the financial crisis and debt repayment problems, farmers' use of mediation services has increased. USDA has a grant program that provides matching funds through the states to mediators. The $4 million program is authorized through FY2010. House-passed H.R. 3509 would reauthorize the program through FY2015, as would Senate-introduced S. 1375.

Finally, FCS is seeking to expand its authority through a broader list of permissible investments. The 2008 farm bill did not expand FCS's lending authority, but a proposed rule would allow FCS to "invest" through bonds or other assets to finance certain rural infrastructure, housing facilities, and rural business investment companies. Under statute, FCS cannot be a lender to these non-farm entities. Disposition of the proposed rule awaits action by the Farm Credit Administration (FCA), the federal regulator. FCA's 2010 regulatory agenda listed the rule as "undetermined" and did not anticipate a decision. Congress does not have a role in this regulatory approval process.

Contents

Current Situation ... 1
Major Players and Market Shares ... 1
The Farm Balance Sheet ... 3
Agricultural Lending in the Global Financial Crisis ... 5
Delinquencies and Nonperforming Loans ... 5
Challenges Facing Agricultural Lenders ... 7
Review of Farm Loan Restructuring ... 8
Description of Government-Related Farm Lenders ... 9
USDA's Farm Service Agency (FSA) ... 9
Farm Credit System (FCS) ... 9
Farmer Mac ... 10
2008 Farm Bill Provisions ... 10
Farm Service Agency ... 10
Farm Credit System ... 11
Issues for Congress ... 11
Supplemental Appropriations for USDA Farm Loans ... 11
Term Limits on USDA Farm Loans ... 13
Farm Operating Loans ... 13
Farm Ownership Loans ... 14
Agricultural Mediation Grants ... 14
Farm Credit Administration Proposed Rule on Investments ... 14
Background on FCS Proposals for Expansion ... 15
Mission-Related Investments ... 15

Figures

Figure 1. Market Shares by Lender of Total Farm Debt, 1960-2008 ... 2
Figure 2. Market Shares of Real Estate Farm Debt, 1960-2008 ... 2
Figure 3. Market Shares of Non-Real Estate Farm Debt, 1960-2008 ... 2
Figure 4. Farm Assets, 1960-2010 ... 4
Figure 5. Farm Debt, 1960-2010 ... 4
Figure 6. Debt-to-Asset Ratio, 1960-2010 ... 4
Figure 7. Net Farm Income, 1960-2010 ... 4
Figure 8. Net Farm Income and Government Payments, 1960-2010 ... 4
Figure 9. Debt-to-Net Farm Income Ratio, 1960-2010 ... 4
Figure 10. Delinquency Rates on Loans at Commercial Banks, 1990-2010 ... 6
Figure 11. Nonperforming Farm Loans, 1990-2010 ... 6

Tables

Table 1. USDA Farm Loans in Enacted FY2009-FY2010 Appropriations and Proposed FY2010 Supplemental Appropriations 12

Contacts

Author Contact Information 17

Current Situation

Major Players and Market Shares

The federal government has a long history of providing credit assistance to farmers. This intervention has been justified at one time or another by many factors, including the presence of asymmetric information among lenders, asymmetric information between lenders and farmers, lack of competition in some rural lending markets, insufficient lending resources in rural areas compared to more populated areas, and the desire for targeted lending to disadvantaged groups (such as small farms or socially disadvantaged farmers).[1]

The lender with the greatest connection to the federal government is the Farm Service Agency (FSA), in the U.S. Department of Agriculture (USDA). It 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. Because FSA also has targets or funds reserved for disadvantaged groups, it sometimes also is called a lender of first opportunity.

The lender with the next-largest amount of government intervention is the Farm Credit System (FCS). It is a cooperatively owned, but federally chartered, private lender with a statutory mandate to serve agriculture-related borrowers only. FCS makes loans to creditworthy farmers, and is *not* a lender of last resort, but is a government-sponsored enterprise (GSE). Third is Farmer Mac, another GSE that is privately held, and provides a secondary market for agricultural loans. FSA, FCS, and Farmer Mac are described in more detail later in this report.

Other lenders do not have a government connection. These include commercial banks, life insurance companies, and individuals, merchants, and dealers.

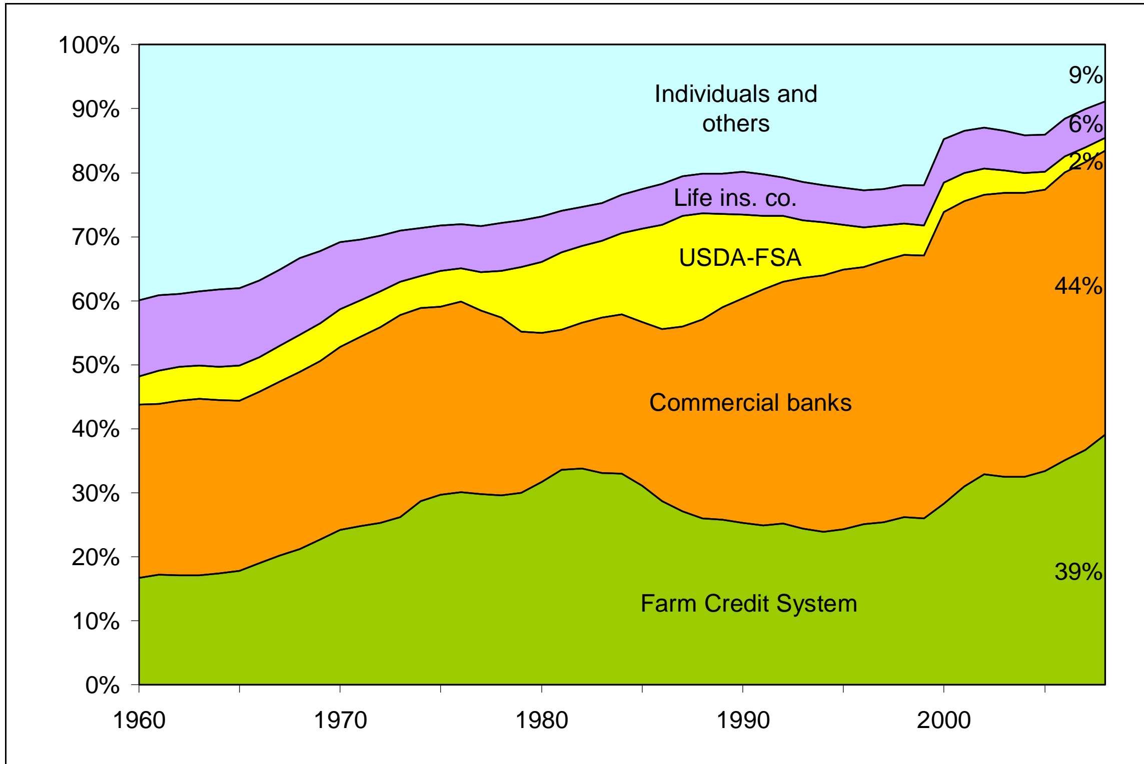
Figure 1 shows that commercial banks lend most of the farm sector's total debt (44%), followed by FCS (39%), individuals and others (9%), and life insurance companies (6%). FSA provides about just over 2% of the debt through direct loans. FSA also guarantees about another 4% of the market through loans that are made by commercial bank and the FCS.

Total farm debt is split nearly evenly between real estate debt (54%) and non-real estate debt (46%). FCS is the largest lender for real estate loans, although commercial banks' share is growing, and as of recently they hold nearly as much farm real estate debt as FCS (**Figure 2**). Commercial banks are the largest lender for non-real estate loans, and have been for nearly five decades (**Figure 3**).

As the three figures show, market shares among these lenders have changed over time, with commercial banks holding relatively little farm real estate debt through 1985, but nearly as much as the FCS in 2008 (**Figure 2**). The share of real estate loans from "individuals and others" has steadily decreased over time, primarily from declining use of private contract for deed arrangements between farmland sellers and buyers. FSA held a much larger share of both the real estate and particularly non-real estate debt during the farm financial crisis of the 1980s; that ratio declined as the farm economy improved after the early 1990s (**Figure 3**).

[1] USDA-FSA, *Evaluating the Relative Cost Effectiveness of the Farm Service Agency's Farm Loan Programs*, report to Congress, August 2006, pp. 11-17, at http://www.fsa.usda.gov/Internet/FSA_File/farm_loan_study_august_06.pdf.

Figure 1. Market Shares by Lender of Total Farm Debt, 1960-2008

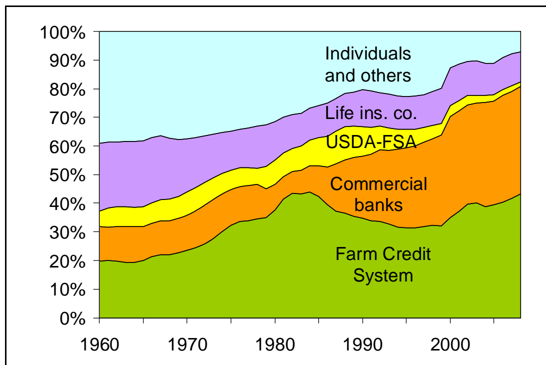


Source: CRS using USDA-ERS data at http://www.ers.usda.gov/Data/FarmBalanceSheet/fbsdmu.htm.

Notes: In the graph, amounts for USDA-FSA are for direct loans only. FSA also issues loan guarantees covering about 4% of the market on debt issued by commercial banks and the Farm Credit System.

Figure 2. Market Shares of Real Estate Farm Debt, 1960-2008

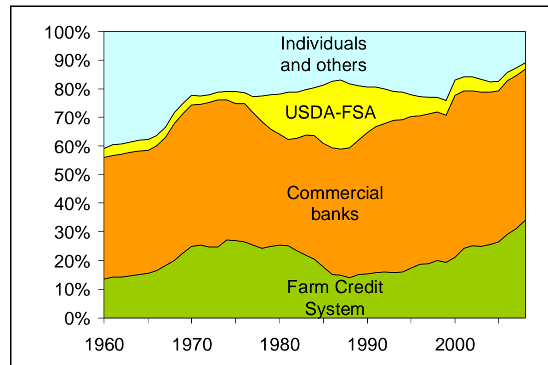
(54% of total farm debt in 2008)



Source: CRS using USDA-ERS data at http://www.ers.usda.gov/Data/FarmBalanceSheet/fbsdmu.htm.

Figure 3. Market Shares of Non-Real Estate Farm Debt, 1960-2008

(46% of total farm debt in 2008)



Source: CRS using USDA-ERS data at http://www.ers.usda.gov/Data/FarmBalanceSheet/fbsdmu.htm.

The Farm Balance Sheet

As a whole, the farm sector recorded a historically high level of farm assets in 2007, a total of $2.05 trillion. In the two years from then to the end of 2009, farm asset levels fell 5.4%, totaling $1.94 trillion at the end of 2009 (**Figure 4**). In 2010, USDA expects farm assets to fall another 3.5% to $1.88 trillion. Real estate is about 84% of the total amount of farm assets; machinery and vehicles are the next-largest category at about 6% of the total.[2]

Farm debt reached a historic high of $249 billion at the end of 2009, up 4.4% from $239 billion in 2008 (**Figure 5**). In inflation-adjusted terms, however, this level of debt is still well below the levels at the peak of the 1980s. In 2010, USDA expects farm debt to fall 6.8% to $233 billion.

Debts and assets can be compared in a single measure by dividing debts by assets—the debt-to-asset ratio. A lower debt-to-asset ratio generally implies less financial risk to the sector than a higher ratio. Farm debt-to-asset ratio levels have declined fairly steadily since the late 1980's after the farm financial crisis, and reached a historic low of 10.4% in 2007. However, as farm assets began to fall and debt continued to rise in recent years, the debt-to-asset ratio also began to rise, albeit to still comparatively low levels of 12%-13% (**Figure 6**). This indicates that farms, as a whole, are not as highly leveraged as they were going into the farm financial crisis of the 1980s.

Net farm income has become more variable, especially since 2000. After reaching historic highs in 2004, net farm income fell by a third in two years, through 2006 (**Figure 7**). After peaking again in 2008 at $87 billion, net farm income fell by 35% in one year to $56 billion in 2009. USDA expects net farm income to rise by almost 12% in 2010 to $63 billion.[3] Despite the severe declines in farm income in 2006 and 2009, the low net farm income years in the past decade are still higher than the inflation-adjusted lows experienced during the farm financial crisis of the 1980s.

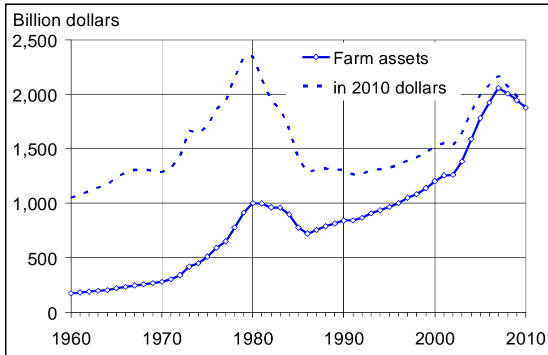
Government payments to farmers also have risen, but do not always offset the variability in net farm income (**Figure 8**). Fixed direct payments that are not tied to prices or revenue are a large component of government payments; these payments support farm income but do not necessarily help farmers manage risks. **Figure 8** shows that more of net farm income is coming from the market rather than the government, compared to the 1980s.

Another indicator of farmers' leverage compares debt to net farm income. A lower debt-to-income ratio (with the ratio expressing the number of years of current income that debt represents) implies less financial leverage and risk. The farm debt-to-net farm income ratio is more variable than the debt-to-asset ratio because of the variability of net farm income. It reached a 35-year low of 2.1 in 2004 and rose to 4.4 in 2009 (**Figure 9**). The forecast for 2010 suggests it will fall to 3.7. These levels, while more variable than in the 1990s, are roughly within historical levels, and certainly less than from 1976 to1986.

[2] USDA, Economic Research Service. "Farm Sector Income Forecast," February 11, 2010, at http://www.ers.usda.gov/Briefing/FarmIncome/Data/Bs_t5.htm.

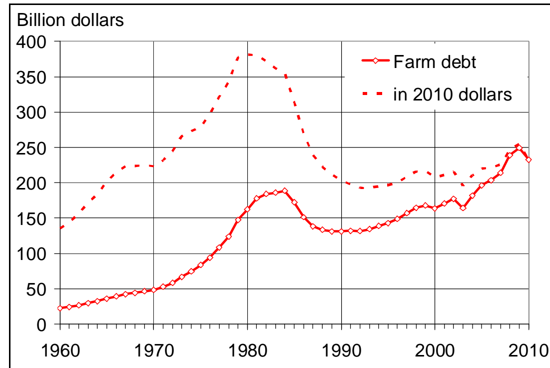
[3] For more information on farm income expectations, see CRS Report R40152, *U.S. Farm Income*, by Randy Schnepf.

Figure 4. Farm Assets, 1960-2010



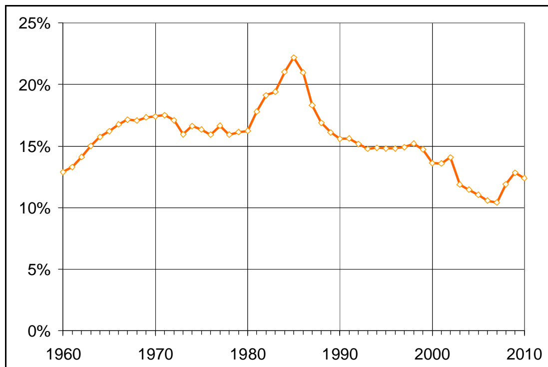
Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/Briefing/FarmIncome/Data/Constant-dollar-table.xls. 2009 prelim.; 2010 forecast..

Figure 5. Farm Debt, 1960-2010



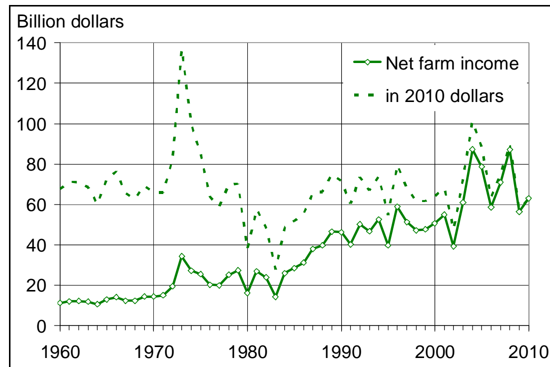
Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/Briefing/FarmIncome/Data/Constant-dollar-table.xls. 2009 prelim.; 2010 forecast..

Figure 6. Debt-to-Asset Ratio, 1960-2010



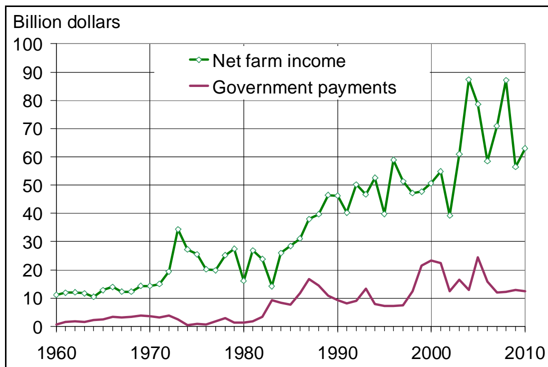
Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/Briefing/FarmIncome/Data/Constant-dollar-table.xls. 2009 prelim.; 2010 forecast..

Figure 7. Net Farm Income, 1960-2010



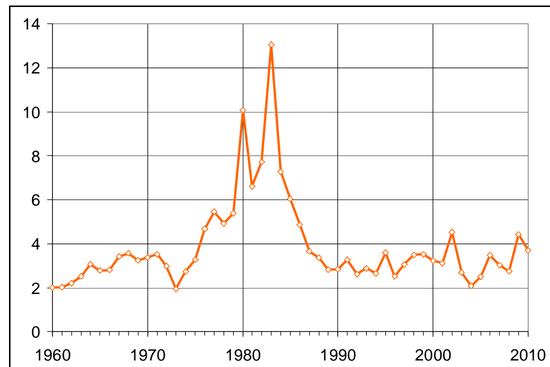
Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/Briefing/FarmIncome/Data/Constant-dollar-table.xls. 2009 prelim.; 2010 forecast..

Figure 8. Net Farm Income and Government Payments, 1960-2010



Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/Briefing/FarmIncome/Data/Constant-dollar-table.xls. 2009 prelim.; 2010 forecast..

Figure 9. Debt-to-Net Farm Income Ratio, 1960-2010



Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/Briefing/FarmIncome/Data/Constant-dollar-table.xls. 2009 prelim.; 2010 forecast..

Agricultural Lending in the Global Financial Crisis

While the global financial crisis was slower to affect the balance sheets of farmers and agricultural lenders than the housing market, it has begun to take its toll.

In 2007 and 2008, farm commodity prices were particularly high, supporting farm income at above-average levels. But since the historic high prices in the summer of 2008, farm commodity prices have fallen and reduced farm income in 2009 and 2010. Net farm income fell by 35% in 2009 to $56 billion, reducing some farmers' ability to repay loans, particularly in some farm sectors such as dairy, hogs, and poultry. But USDA expects net farm income to rebound by almost 12% in 2010 to $63 billion (**Figure 7**).

Delinquencies and Nonperforming Loans

Delinquency rates on residential mortgages began to rise in 2005, and for all loans particularly in 2007. Delinquencies include loans that are 30 days or more past due and still accruing interest, as well as those in nonaccrual status. The delinquency rate on residential mortgages and all loans has continued to rise without yet reaching a peak (11.3% for residential mortgages and 7.4% for all commercial bank loans as of March 31, 2010, **Figure 10**). But the delinquency rates for agricultural loans did not begin to rise until mid-2008, after continuing to fall to historic lows while delinquencies were rising in residential mortgages and other loans. Moreover, the rate of increase in delinquencies on farm production loans at commercial banks has not been as sharp as in non-farm sectors, reaching a peak of 3.1% in December 2009, before falling to 2.89% in March 2010.[4]

A more severe measure of loan performance is nonperforming loans. Nonperforming loans include nonaccrual loans and accruing loans 90 days or more past due. These loans are more in jeopardy than delinquent loans, and represent a smaller subset of loans. Within the agricultural loan portfolio, FCS nonperforming loans rose from 0.43% at the beginning of 2008 to a near-term peak of 2.78% on September 30, 2009, before moderating to 2.44% as of March 31, 2010 (**Figure 11**). The FCS nonperforming loan rate is at a level not seen since the mid-1990s, when the system had finally recovered from the farm financial crisis of the 1980s.[5]

Nonperforming farm loans at commercial banks also have risen. Nonperforming farm real estate loans at commercial banks rose from a low of 0.66% in December 2006 to 2.6% in March 2010. Nonperforming farm production loans rose from a low of 0.64% in December 2006 to 2.37% in March 2010 (**Figure 11**).[6]

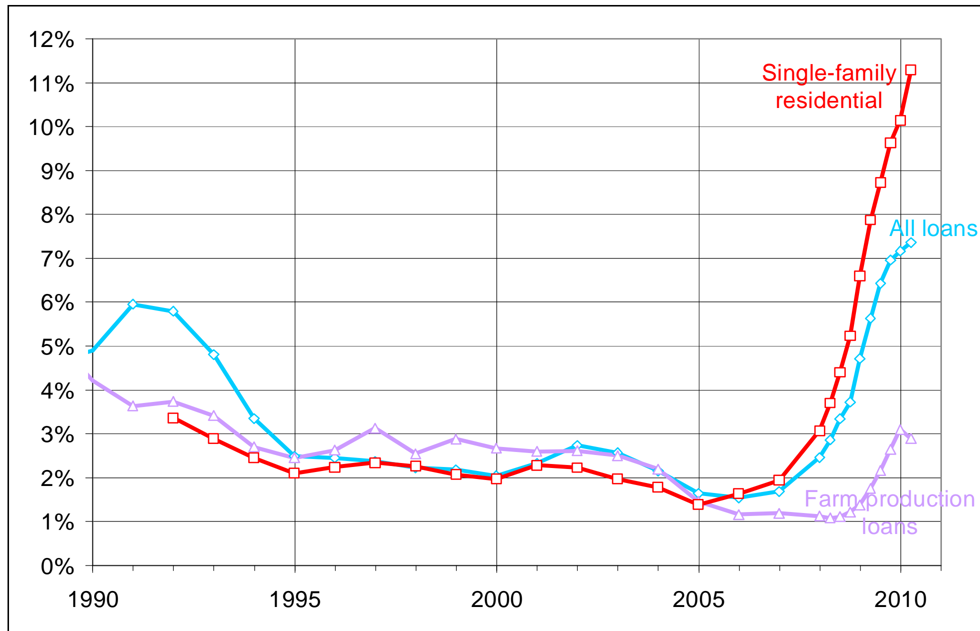
---

[4] Federal Reserve Bank, "Delinquency Rates on Loans at Commercial Banks" (seasonally adjusted), at http://www.federalreserve.gov/releases/chargeoff.

[5] Federal Farm Credit Banks Funding Corporation, "First Quarter 2010 Quarterly Information Statement of the Farm Credit System," p. 9, May 10, 2010, at http://www.farmcredit-ffcb.com/farmcredit/serve/public/finin/quarin/report.pdf?assetId=155241.

[6] Federal Reserve Bank, *Agricultural Finance Data Book*, Tables B.2 and B.4, at http://www.federalreserve.gov/releases/e15/default.htm.

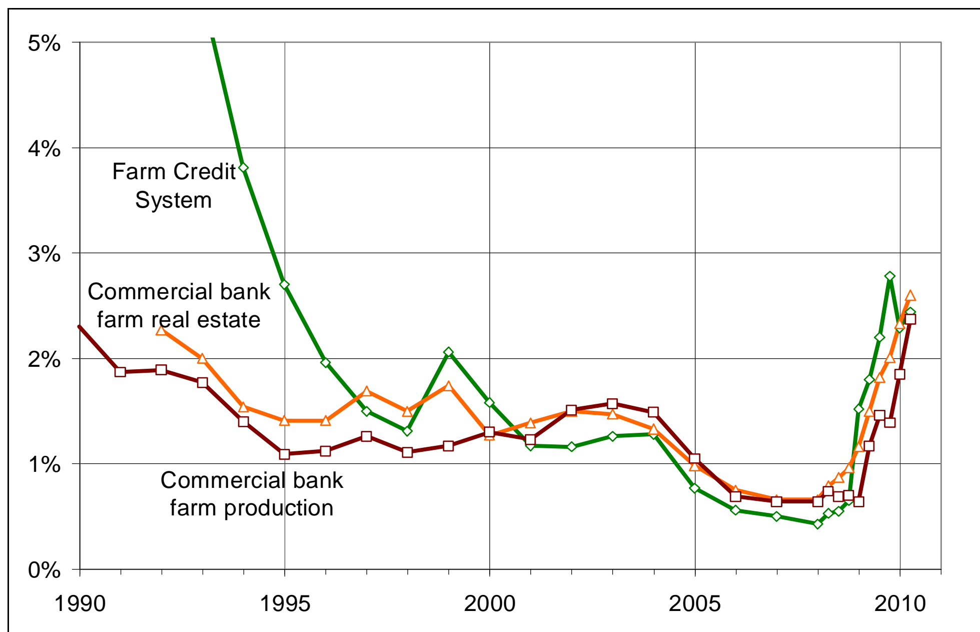
Figure 10. Delinquency Rates on Loans at Commercial Banks, 1990-2010



Source: Compiled by CRS. Data are through March 31, 2010,using Federal Reserve Bank, "Delinquency Rates on Loans at Commercial Banks" (seasonally adjusted), at http://www.federalreserve.gov/releases/chargeoff.

Notes: Delinquencies include loans that are 30 days or more past due and still accruing interest, as well as those in nonaccrual status. The amounts are percentages of end-of-period loans.

Figure 11. Nonperforming Farm Loans, 1990-2010



Source: Compiled by CRS. Data are through March 31, 2010. FCS data from Federal Farm Credit Banks Funding Corp. at http://www.farmcredit-ffcb.com. Commercial bank data from Federal Reserve Bank, *Agricultural Finance Data Book*, Tables B.2 and B.4, at http://www.federalreserve.gov/releases/e15/default.htm.

Notes: Nonperforming loans include nonaccrual loans and accruing loans 90 days or more past due. The amounts are percentages of total loans.

Challenges Facing Agricultural Lenders

Agricultural lenders face challenges like other banks in accessing capital. While some independent rural banks may be less affected than urban money center banks, the rural banks are not immune to the crisis. For example, the Farm Credit System—a private entity but still a government-sponsored enterprise—is very dependent on the bond market and has felt the shock of the financial crisis in its ability to sell bonds to fund its loans. Although its bonds are still creditworthy and able to be sold, the terms of FCS's bond sales reflect the change and turmoil in the financial markets. Rural community banks, most of which are not directly involved with the failing entities and investments of the money-center banks, can end up with less funding available for loans when regulators increase capital holding requirements as a result of macro-level risks.

The financial crisis and stock market losses have affected agricultural lenders in unexpected ways, as illustrated by two examples. In the fall of 2008, Farmer Mac—the secondary market for agricultural loans and another GSE—lost $106 million on investments in Fannie Mae stock and Lehman Brothers securities. These losses reduced Farmer Mac's capital and jeopardized its ability to meet statutory capital requirements. Farmer Mac raised $124 million in capital in 2008 by issuing the same amounts of preferred stock. Management issues also were addressed by replacing the chief executive officer. In 2009, Farmer Mac successfully rebuilt its capital position.

In April 2009, the 11th-largest farm lender among commercial banks[7]—New Frontier Bank in Greeley, Colorado, with a $780 million agricultural loan portfolio—failed, leaving many farmers in northeastern Colorado scrambling to find new lenders for their operating loans. While this has not been the only bank failure, it was particularly noteworthy given the concentration and size of the bank's agricultural loans, and its impact on other lenders such as FCS and FSA that were solicited to take over some of the loans.

As a consequence of the global financial crisis, agricultural lenders tightened credit standards in 2009 and 2010—at a minimum requiring more documentation and oversight of loans, and possibly making or having less credit available to producers.

Thus, because of this turmoil and as the lender of last resort, the USDA Farm Service Agency has experienced significantly higher demand for its direct loans and guarantees. By May 2009, the demand for direct farm operating loans (the loans farmers use to buy seed, fertilizer, and fuel to plant a crop) was up 81% over a year earlier, demand for direct ownership loans (loans for real estate) was up 132%, and demand for guaranteed operating loans was up 31%.[8] Two supplemental appropriations during FY2009 added more than $1.1 billion of loan authority to $3.4 billion of loan authority in the regular appropriation (**Table 1**), making a total of $4.5 billion of FSA loans or guarantees available in FY2009—the highest since 1985. The regular FY2010 agriculture appropriation provided even more, $5.1 billion of loan authority and guarantees. Additional loan authority for FY2010 is contemplated in a pending supplemental appropriation (H.R. 4899, discussed later) that could add $950 million for a possible total loan authority in FY2010 of $6 billion.

---

[7] American Bankers Association, "Top 100 Farm Bank Lenders by Dollar Volume in 2008," at http://www.aba.com/NR/rdonlyres/05858407-284E-46CD-9443-38EB9601A25A/58849/Top100FarmBanksbyDollarVolumein2009.pdf.

[8] Doug Caruso, FSA Administrator, in testimony before the House Agriculture Subcommittee on Conservation, Credit, Energy, and Research, June 11, 2009, at http://agriculture.house.gov/testimony/111/h061109sc/Caruso.doc.

Review of Farm Loan Restructuring

Section 501 of the Helping Families Save Their Homes Act (P.L. 111-22) required the Congressional Oversight Panel (COP) to write a report that analyzed the extent to which commercial banks receiving Troubled Asset Relief Program (TARP) funds could or should be required to use loan restructuring rather than foreclosure to address problem farm loans. The analysis was to include comparisons to FSA's direct loan restructuring program (7 U.S.C. 2001), FCS's loan restructuring options, and the Treasury's Making Home Affordable Program.

The impetus to write the report came from an amendment (S.Amdt. 1032) by Senators Feingold and Gillibrand that, as initially proposed, would have compelled TARP recipients to offer farm loan borrowers "a restructuring program comparable to the terms and conditions of the program established … [for the USDA farm loan program] (7 U.S.C. 2001)."[9] The original amendment also had provisions for the terms of shared appreciation agreements, future borrower eligibility, and protections for the farmer's principal residence. However, the amendment was revised and the adopted version did not compel farm loan restructuring, but instead required only the COP report mentioned above.

The Congressional Oversight Panel report[10] found that the effects of a restructuring mandate for TARP recipient banks would have limited reach and impact for the farm sector. The report found that TARP-recipient banks hold only about 10% of total farm real estate debt. The COP suggested that Congress could help struggling farmers by creating a more encompassing, voluntary restructuring program funded through TARP, or creating a TARP-funded loan guarantee program for restructured farm loans, since the demand for FSA loan guarantees nearly always exceeds the supply. The report also noted that farm credit data—especially for farm foreclosures—are inadequate compared to other parts of the banking sector, and that the existing data (e.g., on delinquencies and nonperforming loans, as in **Figure 10** and **Figure 11**) should be monitored closely to track the direction of trends in problem farm loans.

The benchmark in the Feingold/Gillibrand amendment was the USDA loan restructuring program that is required in statute. The farm loan restructuring provisions for the USDA farm loan program are largely a result of the farm loan crisis of the 1980s, and are designed to provide borrower rights and keep family farmers on their farms if at all financially possible. As a government lender, USDA generally does not want to foreclose on farms, especially considering the visibility of the government being the entity to take away a sometimes generations-old family farm and homestead. Applying government-lending provisions directly to commercial lenders may not necessarily be appropriate, given the differing business goals of their respective lending programs.

[9] *Congressional Record*, p. S5028, May 1, 2009.

[10] Congressional Oversight Panel, *Special Report on Farm Loan Restructuring*, July 21, 2009, at http://cop.senate.gov/documents/cop-072109-report.pdf.

Description of Government-Related Farm Lenders

USDA's Farm Service Agency (FSA)

USDA's Farm Service Agency 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 FCS. Permanent authority exists in the Consolidated Farm and Rural Development Act (CONACT, 7 U.S.C. 1921 *et seq.*). FSA usually makes and guarantees about $3.5 billion of farm loans annually. However, because of the heavier demand for FSA loans during the financial crisis, FSA has received supplemental appropriations and a higher regular FY2010 appropriation. Its regular FY2010 appropriation is $141 million to support $5.1 billion of loans. FSA also received $321 million in salaries and expenses to administer the loan program.

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 funding for farm ownership loans and 50% of 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 by race, gender, and ethnicity (7 U.S.C. 2003). Because of these provisions, FSA also is known as lender of first opportunity for borrowers who are not yet creditworthy for regular commercial business loans.

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 neither a government agency nor guaranteed by the U.S. government, but is a network of borrower-owned lending institutions operating as a government-sponsored enterprise (GSE). 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. FCS is unique among the GSEs because it is a retail lender making loans directly to farmers, and thus is in direct competition with commercial banks.

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). For more background, see CRS Report RS21278, *Farm Credit System*, by Jim Monke.

Farmer Mac

Farmer Mac is a separate GSE that is a secondary market for agricultural loans. It is related to the FCS in that FCA is its regulator and it was created by the same legislation, but it is a financially separate entity. 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.*).

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. The most recent farm bill adjustments are summarized below, and a more detailed side-by-side comparison of provisions is available in CRS Report RL34696, *The 2008 Farm Bill: Major Provisions and Legislative Action*, coordinated by Renée Johnson.

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 2008 farm bill makes several changes:

- It 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.
- It further prioritizes lending for beginning and socially disadvantaged farmers by increasing the amounts reserved for these groups (see earlier description of FSA).
- It extends the term of the beginning farmer down-payment loan program, raises the lending limit, and lowers the interest rate. It adds eligibility for socially disadvantaged farmers.
- It makes permanent and nationwide the guarantee program for seller-financed land loans to beginning and socially disadvantaged farmers.
- It extends eligibility for emergency loans to equine farmers; conferees noted that horses for racing, showing, and recreation should not be eligible.
- It creates a beginning farmer "Individual Development Account" pilot program. Farmers receive up to a 2:1 match, up to $6,000/year.
- It creates direct loans and loan guarantees for conservation projects.
- It extends the right of first refusal to reacquire a homestead property to the family of a socially disadvantaged borrower-owner.
- It adds socially disadvantaged farmers to beginning farmers as preferred groups when the USDA sells or leases property.
- It suspends until December 31, 2010, the enforcement of the 15-year "term limit" on guaranteed operating loans that requires farmers to graduate to commercial lenders. A further extension is discussed in the section on "Issues for Congress."

Farm Credit System

The enacted 2008 farm bill does *not* allow any expansion of FCS 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 (H.Amdt. 702).

For the FCS, the enacted 2008 farm bill makes the following provisions:

- It allows rural utility (electric or telephone facility) loans to qualify for the agricultural mortgage secondary market (Farmer Mac). It provides for separate consideration of rural utility loans when determining credit risk.
- It makes technical changes in the payment of insurance premiums by FCS banks to the FCS Insurance Corporation.
- It makes more borrowers able to own Bank for Cooperatives voting stock.
- It 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. It requires board and shareholder votes. These provisions are effective as of January 1, 2010.

Issues for Congress

Supplemental Appropriations for USDA Farm Loans

An FY2010 supplemental appropriation is proposed for farm loans to respond to the continued heavy demand for loans and a projected shortage of appropriated loan authority. Both the House- and Senate-passed versions of H.R. 4899 (a war and disaster supplemental appropriations bill) would provide identical funding for USDA's Farm Service Agency to issue an additional $950 million in loans and guarantees (on top of a nearly exhausted FY2010 base of $5.1 billion, **Table 1**). This additional loan authority would cost $32 million in budget authority ($31 million for loan subsidy plus $1 million for administrative expenses, on the FY2010 loan subsidy base of $141 million). The House and Senate are trading amendments on the bill to resolve differences on other provisions (rather than using a conference committee).[11]

As the lender of last resort, FSA experienced significantly higher demand for its loans beginning in FY2009 during the banking crisis. In 2009, an unusually high number of direct operating loan applications were from new customers: 45% in 2009, compared with about 20% usually.[12]

---

[11] For more information on the supplemental appropriation, see CRS Report R41255, *FY2010 Supplemental Appropriations for Agriculture*, by Jim Monke. Other agricultural programs also would receive supplemental appropriations in the bills.

[12] Doug Caruso, FSA Administrator, in testimony before the House Agriculture Subcommittee on Conservation, Credit, Energy and Research, June 11, 2009, at http://agriculture.house.gov/testimony/111/h061109sc/Caruso.doc.

Table 1. USDA Farm Loans in Enacted FY2009-FY2010 Appropriations and Proposed FY2010 Supplemental Appropriations

(dollars in millions)

	FY2009				FY2010				Change	
	Regular (P.L. 111-8)		Supplemental (P.L. 111-5, and P.L. 111-32) and USDA internal transfer		Regular (P.L. 111-80)		Supplemental (House-passed and Senate-passed bill H.R. 4899)		FY2010 Total minus FY2009 Total	
FSA Farm Loan Program	**Budget Authority**	**Loan Authority**	**Budget Authority**	**Loan Authority**	**Budget Authority**	**Loan Authority**	**Budget Authority**	**Loan Authority**	**Budget Authority**	**Loan Authority**
Farm ownership loans										
Direct	13	222	23	360	27	650			-9	68
Guaranteed	4	1,239			6	1,500	1	300	3	561
Farm operating loans										
Direct	68	575	81	683	47	1,000	17	350	-84	92
Guaranteed (unsubsidized)	25	1,017	5	193	35	1,500	6	250	11	539
Guaranteed (interest assistance)	37	270	-17	-120	24	170	7	50	10	70
Indian tribe land acquisition	0.2	4			0	4			0	0
Indian highly fractured land loans					0.8	10			0.8	10
Boll weevil eradication loans	0	100			0	100			0	0
Conservation loans										
Direct					1.1	75			1.1	75
Guaranteed					0.3	75			0.3	75
Subtotal, FSA Farm Loan Program	**147**	**3,428**	**92**	**1,117**	**141**	**5,084**	**31**	**950**	**-68**	**1,490**
Salaries and expenses	309	—			313	—			4	—
Administrative expenses	8	—			8	—	1	—	1	—
Total, FSA Farm Loan Program	**465**	**3,428**	**92**	**1,117**	**462**	**5,084**	**32**	**950**	**-63.2**	**1,490**

Source: Compiled by CRS from P.L. 111-5; P.L. 111-8; P.L. 111-32; P.L. 111-80; H.R. 4899; H.Res. 1500; and USDA Farm Service Agency, "Funding," at http://www.fsa.usda.gov/FSA/webapp?area=home&subject=fmlp&topic=fun. Does not include $75 million of budget authority proposed for emergency loans for poultry producers in H.R. 4213.

Notes: *Budget authority* reflects the cost of making loans, such as interest subsidies and default. *Loan authority* reflects the amount of loans that FSA may make or guarantee.

In FY2010, USDA continues to experience higher loan demand, since some commercial lenders continue to constrain their own lending practices and some farmer families are losing off-farm jobs. Some USDA farm loan offices in the states have begun to deplete their FY2010 allocation to make loans. Nationally, some loan programs have used over 90% of the their fiscal year allocation in eight months.[13]

Regular appropriated loan authority for USDA increased 48% from FY2009 to FY2010, and supplemental appropriations are increasing these amounts each year. The regular FY2009 level for farm loans included $3.4 billion of loan authority (direct loans and guarantees), typical of recent years. Two supplemental appropriations in FY2009 added over $1.1 billion in loan authority, for a total of $4.5 billion of loans in FY2009 (**Table 1**).

Term Limits on USDA Farm Loans

Following the farm credit crisis of the 1980s, Congress added "term limits" to the USDA farm loan program to restrict eligibility for government farm loans and encourage farmers to "graduate" to commercial loans. The term limits place a maximum number of years that farmers are eligible for certain types of FSA loans or guarantees. However, Congress has suspended application of one of the term limits to prevent some farmers from being denied credit.

Farm Operating Loans

- Direct operating loans are limited to a seven-year period. In certain cases, borrowers may qualify for a one-time, two-year extension (7 U.S.C. 1941(c)(1)(C) and (c)(4)). In June 2009, USDA said that about 4,800 FSA borrowers are limited to one more year of direct operating loans, and another 7,800 borrowers are limited to two more years. USDA does not expect many of these borrowers to graduate to commercial credit in the current financial environment.[14]
- Guaranteed operating loans are limited to a 15-year period (7 U.S.C. 1949(b)(1)), but that limit is suspended until December 31, 2010, by Section 5103 of the 2008 farm bill (P.L. 110-246). Receiving direct operating loans counts toward the guaranteed loan term limit. That is, when either the first direct or guaranteed operating loan is issued, the clock starts on the 15-year eligibility for guaranteed operating loans. USDA said in June 2009 that 3,800 current borrowers have reached the guaranteed term limit and would not qualify for additional loan guarantees if the term limits were not suspended.[15]

Suspension of term limits on guaranteed operating loans is not new. The 2002 farm bill made a similar suspension of term limits for nearly the life of the 2002 farm bill. However, because the current suspension does not last for the entire life of the 2008 farm bill, it may receive congressional attention by the end of the 111th Congress, and a bill is proposed in to extend it.

[13] USDA posts updated data on available funds remaining in the farm loan program at http://www.fsa.usda.gov/FSA/webapp?area=home&subject=fmlp&topic=fun.

[14] Doug Caruso, FSA Administrator, in testimony before the House Agriculture Subcommittee on Conservation, Credit, Energy and Research, June 11, 2009, at http://agriculture.house.gov/testimony/111/h061109sc/Caruso.doc.

[15] Ibid.

In the Senate, S. 3221 would extend the suspension of term limits on guaranteed operating loans for two more year until December 31, 2012. This would allow the issue to wait to be addressed again until the next farm bill. The bill has not received committee or floor action. A similar bill in 2006 passed the Senate by unanimous consent and the House by voice vote (P.L. 109-467).

Farm Ownership Loans

- A borrower is eligible for direct farm ownership (real estate) loans for a maximum of 10 years after the first loan is made (7 U.S.C. 1922(b)(1)(C)).
- There is no time limit on eligibility for guaranteed farm ownership loans.[16]

Agricultural Mediation Grants

Farmers' use of mediation services has increased because of the financial crisis and debt repayment problems. The USDA Farm Service Agency has a state mediation grant program that provides matching grants to organizations in the states (for example, cooperative extension services). The program provides mediation services not only for credit disputes (between farmers and USDA or other lenders), but also for other farm- and conservation-related disputes. Mediation through an impartial third party is a voluntary alternative to litigation, arbitration, or formal appeals. The program was begun in 1988 as one response to the 1980s farm financial crisis. FSA has approved 32 participating states[17] for the Certified State Agricultural Mediation Program.[18]

The program has received funds annually through the Agriculture appropriations bill. In FY2010, it received $4.4 million. It is authorized through the end of FY2010, and has been reauthorized on a five-year cycle since its inception. To reauthorize the program, the House passed H.R. 3509 on March 18, 2010. The bill would reauthorize the program for five years through FY2015. An identical bill, S. 1375, was introduced in the Senate in June 2009, but has not received action.

Farm Credit Administration Proposed Rule on Investments

Although the 2008 farm bill did not change FCS's scope of lending authority, the FCS is seeking through regulatory action to expand its list of permissible investments (currently a proposed rule, but not yet finalized). The expansion of investment opportunities would allow FCS to assist rural communities to expand infrastructure and housing facilities, as well as allowing other rural activities such as with rural business investment companies.

[16] USDA-FSA, *Evaluating the Relative Cost Effectiveness of the Farm Service Agency's Farm Loan Programs*, Report to Congress, August 2006, p. 76, at http://www.fsa.usda.gov/Internet/FSA_File/farm_loan_study_august_06.pdf.

[17] Alabama, Arizona, Arkansas, California, Colorado, Florida, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nebraska, Nevada, New Jersey, New Mexico, New York, North Dakota, Oklahoma, South Dakota, Texas, Utah, Virginia, Washington, Wisconsin, and Wyoming.

[18] For more information, see http://www.fsa.usda.gov/FSA/webapp?area=home&subject=oued&topic=ops-am.

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*[19] highlighted perceived needs for greater lending authority, including rural housing in towns with up to 50,000 population (the population limit is 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.[20] They say that federal tax benefits for FCS are no longer necessary.[21]

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. Unlike the housing GSEs (Fannie Mae, Freddie Mac) that do not lend directly to homeowners, FCS is a retail lender that competes for farm loans against commercial banks. FCS asserts its statutory mandate to serve agriculture (and by extension, rural areas) through good 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*.[22] The Bush Administration opposed FCS expansion,[23] and a past chairman of the FCA, Michael Reyna, also voiced opposition.[24] In the end, the 2008 farm bill did not change FCS's scope of lending authority.

Mission-Related Investments

On June 16, 2008, the FCA published a proposed rule to allow "mission related investments" (73 *Federal Register* 33931-33940).[25] 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. As

---

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

[20] 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.

[21] 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.

[22] Letter on House-Senate Farm Bill Conference, January 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.

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

[24] *Congressional Record*, July 26, 2007, p. H8728.

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

discussed below, a final rule as not yet been adopted and FCA's projected date for a decision remains "undetermined."[26]

FCA promoted 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."

The scope of mission-related investments and the statutory restrictions governing to whom FCS may lend cause some to raise the following question: Do investments in bonds and venture capital effectively result in loans by another name to borrowers who otherwise are ineligible for FCS loans? Like banks, FCS institutions may use their assets to make loans or buy investments. Investments offer an alternative form of diversification to loans, and some types of investments can be appropriate for capital reserves. However, 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.

Since 2004, an FCA pilot program has been allowing similar investments in what sometimes are called "Rural America Bonds."[27] 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.[28] Among the comment letters are two bipartisan letters from the House Financial Services Committee[29] and the Senate Banking Committee[30] 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,[31] which somewhat contradicts the Administration's opposition to FCS expansion in the farm bill in 2007 (see footnote 23).

---

[26] FCA, "Spring 2010 Regulatory Performance Plan," February 19, 2010, at http://www.fca.gov/law/perf_plan.html.

[27] FCA, Informational Memorandum on "Investments in Rural America," January 11, 2005.

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

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

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

[31] 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.

The disposition of the proposed rule now awaits action by the FCA. FCA's 2010 regulatory agenda does not project a date for a final rule, but rather categorizes the rule as "undetermined" (see footnote 26). 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, which could include disapproving the rule under the Congressional Review Act.

Author Contact Information

Jim Monke
Specialist in Agricultural Policy
jmonke@crs.loc.gov, 7-9664