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Agricultural Credit: Institutions and Issues

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SUMMARY

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Agricultural Credit: Institutions and Issues

A variety of lenders from the federal government to commercial banks make loans to farmers. The federal government provides credit assistance to farmers who cannot obtain loans elsewhere, and helps assure credit availability across rural areas. At Congress's direction, federal farm loan programs target beginning farmers and socially disadvantaged groups based on race, ethnicity, or gender.

Description of Lenders

The U.S. Department of Agriculture (USDA) Farm Service Agency (FSA) is a small but important lender for family-sized farms that do not qualify for credit elsewhere. FSA also guarantees payments on some loans made by other lenders. At the end of FY2019, FSA had a portfolio of $12 billion of direct loans to 87,000 borrowers and loan guarantees of $16 billion for 39,000 borrowers. Thus, out of the $423 billion market for farm debt, FSA had a direct market share of 3% of loans and loan guarantees that covered about another 5% of the market. For FY2021, annual appropriations support $9.9 billion of new FSA direct loans and guarantees.

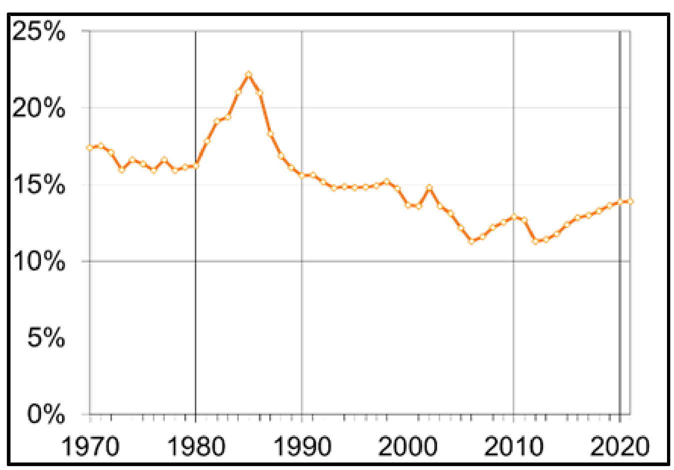
The Farm Credit System (FCS) has the next-largest amount of government intervention. FCS is a private lender with a federal charter and a statutory mandate to serve creditworthy farmers, certain agribusinesses, cooperatives, and rural homeowners in towns with less than 2,500 population. At the end of 2020, FCS had a total loan portfolio of $315 billion, including over $190 billion of farm loans (43% of farm debt). As a government-sponsored enterprise (GSE), FCS has tax advantages and lower costs of funds. Capital is raised through the sale of bonds on Wall Street. Four large banks allocate funds to 67 regional credit associations that, in turn, make loans to eligible creditworthy borrowers.

Another GSE for farm loans is Farmer Mac, a privately held secondary market. Farmer Mac purchases agricultural mortgages and issues guarantees on mortgage-backed securities that are bought by investors. Other agricultural lenders without government support or mandates include commercial banks (40% market share of farm debt); individuals, merchants, and dealers (8%); and life insurance companies (4%). Commercial banks' and FCS's shares of farm debt have grown in recent years as others' shares have decreased.

Farm Sector Balance Sheet

The farm sector's balance sheet has remained strong in recent years. Inflation-adjusted debt levels and debt-to-asset ratios (debts divided by assets) are below peak stress levels during the 1980s (figure). The delinquency rates on FSA direct and guaranteed loans have remained fairly steady in recent years through the trade disruption and the COVID-19 pandemic. About 30% of all U.S. farms have farm debt.

Farm Debt-to-Asset Ratio



Source: CRS, using USDA Economic Research Service data.

Notes: 2021 is the USDA forecast.

Since 2018, more of net farm income has come from the government in the form of trade aid payments and COVID-19 assistance. During the pandemic, USDA has suspended new foreclosures on farm loans. FSA borrowers may use a Disaster Set-Aside (DSA) provision to move a loan payment to the end of the loan or extend an annual operating loan by a year.

Issues in Agricultural Credit

A 2019 Government Accountability Office report found that socially disadvantaged farmers had proportionately fewer FSA direct and guaranteed loans than other farmers, and that socially disadvantaged farmers continued to face difficulties because of historic, systemic discrimination. The American Rescue Plan Act of 2021 (P.L. 117-2) contains a provision to pay socially disadvantaged farmers 120% of their balances on FSA direct loans, FSA guaranteed loans, and Farm Storage Facility Loans as of

January 1, 2021. The payment is intended to retire loan balances and cover tax liabilities and fees, since debt forgiveness is subject to income taxes. The provision uses a definition of *socially disadvantaged farmer* that includes only racial and ethnic minorities, which is narrower than the definition used to make farm loans that also includes gender. The Congressional Budget Office estimates the debt forgiveness provision will cost $4 billion.

Competition between FCS and commercial banks remains an issue in agricultural lending. 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. Because of this direct competition for creditworthy borrowers, FCS and commercial banks often have an adversarial relationship in the policy realm. Commercial banks assert unfair competition from FCS for borrowers because of tax advantages that can lower the relative cost of funds for FCS. FCS counters by citing its statutory mandate to serve only agricultural borrowers and despite economic conditions. Commercial banks and FCS both support the FSA loan guarantee program and do not see FSA as a competitor because FSA allows them to make and service loans that otherwise might not be possible at acceptable risk levels.

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Description of Government-Related Farm Lenders

The federal government has a long history of assisting farmers with obtaining loans for farming. This intervention has been justified at one time or another by many factors, including the presence of asymmetric information among lenders or between lenders and farmers,[1] the lack of competition in some rural areas, insufficient lending resources, and the desire for targeted lending to disadvantaged groups (such as small farms or farmers who are socially disadvantaged based on race, ethnicity, or gender).[2]

Several types of lenders make loans to farmers. Some are government entities or have a statutory mandate to serve agriculture. The one most closely controlled by the federal government is the Farm Service Agency (FSA) in the U.S. Department of Agriculture (USDA). FSA receives federal appropriations to make direct loans to farmers and to issue guarantees on loans made by other lenders to farmers who are unable to obtain credit elsewhere.

The lender with the next-largest amount of government intervention is Farm Credit System (FCS). It is a private, government-sponsored enterprise (GSE) with a federal charter and a statutory mandate to serve only agriculture-related borrowers.[3] FCS makes loans to creditworthy farmers and is not a lender of last resort. Third is Farmer Mac, another privately held GSE, which provides a secondary market for agricultural loans by reselling these loans to private investors.[4]

Other lenders do not have direct government involvement in their funding or existence. These lenders include commercial banks, life insurance companies, individuals, merchants, and dealers.

USDA Farm Service Agency

FSA is considered 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 banks and FCS. Farm bills modify the permanent authority for FSA's lending activities in 7 U.S.C. 1921 et seq. At the end of FY2019, FSA had a portfolio of $12 billion of direct loans to 87,000 borrowers and loan guarantees of $16 billion for 39,000 borrowers.[5] FSA direct loans were about 3% of the market for farm debt and FSA loan guarantees covered about another 5% of the market.

During FY2021, an appropriation of $68 million in budget authority (plus $307 million for salaries and expenses) is supporting $9.9 billion of new direct loans and guarantees.[6] Direct farm

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[1] Asymmetric information is a type of market failure that arises when parties have different insights about a transaction.

[2] Charles Moss, *Agricultural Finance* (New York: Routledge, 2013).

[3] A government-sponsored enterprise (GSE) is a federally chartered, nongovernment entity with certain benefits (such as tax exemption, implicit federal guarantees, or risk management tools) that overcome barriers to private markets in achieving a stated goal. For the Farm Credit System (FCS), its charter is limited to serving agriculture-related businesses and rural homeowners. Other examples of GSEs include the Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), Federal Home Loan Bank System, and Federal Agricultural Mortgage Corporation (Farmer Mac).

[4] A secondary market purchases qualified loans from originating lenders, pools them, and may sell them to investors as securities or hold them in its own portfolio. This provides a risk management option that lets lenders make more loans and satisfy regulatory requirements.

[5] U.S. Department of Agriculture (USDA), Farm Service Agency (FSA), "Farm Loan Programs Loan Servicing Data," at https://www.fsa.usda.gov/programs-and-services/farm-loan-programs/program-data.

[6] CRS Report R46437, *Agriculture and Related Agencies: FY2021 Appropriations*.

ownership loans (real estate) are limited to $600,000 per borrower, direct operating loans are limited to $400,000, and microloans are limited to $50,000 for both ownership and operating loans. Guaranteed loans may be up to $1.776 million (adjusted for inflation). Direct emergency loans up to $500,000 are available for disasters if the farm suffers a 30% loss in a designated or contiguous county.[7]

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 farm ownership and operating loans for the first half of the fiscal year. Funds also are targeted to farmers who are "socially disadvantaged" by race, gender, and ethnicity (7 U.S.C. 2003). Using these provisions, FSA is known as a *lender of first opportunity* for many borrowers.[8]

Farm Credit System

Congress established FCS 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 is it guaranteed by the U.S. government; it is a network of borrower-owned lending institutions operating as a GSE. It is not a lender of last resort but a for-profit lender with a statutory mandate to serve agriculture. Funds are raised through the sale of bonds on Wall Street. Four large banks allocate these funds to 67 credit associations that, in turn, make loans to eligible creditworthy borrowers.

Statutes and oversight by the House and Senate Agriculture Committees determine the scope of FCS activity (Farm Credit Act of 1971, as amended; 12 U.S.C. 2001 et seq.). Benefits such as tax exemptions for FCS lenders and bondholders also are provided. Loan eligibility is limited to farmers, certain farm-related agribusinesses, rural homeowners in towns with a population of fewer than 2,500, and cooperatives.[9] The federal regulator is the Farm Credit Administration (FCA).[10]

At the end of FY2020, FCS had a total portfolio of $315 billion of loans, including over $190 billion of farm loans.[11] FCS holds about 43% of the share of farm debt.

Farmer Mac

Farmer Mac is a GSE that is a secondary market for agricultural loans. Some consider Farmer Mac to be related to FCS because FCA regulates both Farmer Mac and FCS, and both were created by the same legislation; however, Farmer Mac is financially and organizationally a separate entity from FCS. Farmer Mac purchases mortgages from lenders and guarantees mortgage-backed securities that are bought by investors.[12]

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[7] FSA, "Farm Loan Program," at http://www.fsa.usda.gov/dafl.

[8] CRS In Focus IF10641, *Farm Bill Primer: Federal Programs Supporting New Farmers*.

[9] CRS Report RS21278, *Farm Credit System*.

[10] CRS In Focus IF10767, *Farm Credit Administration and Its Board Members*.

[11] Federal Farm Credit Banks Funding Corporation, *2020 Annual Information Statement of the Farm Credit System*, March 2021.

[12] CRS In Focus IF11595, *Farmer Mac and Its Board Members*.

Current Situation

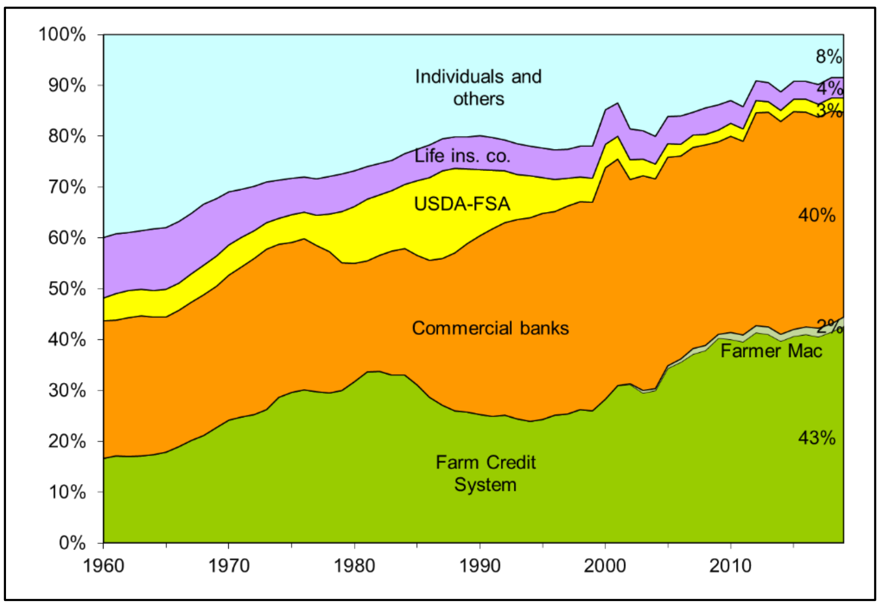
Market Shares of Farm Debt

Figure 1 shows that, based on USDA data for 2019, FCS and commercial banks provide most of the farm credit (43% and 40%, respectively) followed by individuals and others (8%) and by life insurance companies (4%).[13] FSA provides about 3% of farm debt through direct loans. FSA also guarantees about another 5% of the market through loans that are made by commercial banks and FCS.

The total amount of farm debt ($432 billion at the end of 2020) is concentrated relatively more in real estate debt (64%) than in non-real estate debt (36%). FCS is the largest lender for real estate (47%). Commercial banks are the largest lender for non-real estate loans (46%).

As **Figure 1** shows, both commercial banks' and FCS's shares have grown since the 1980s as other lenders' shares have decreased. Commercial banks held relatively little farm real estate debt through 1985 but now hold a sizeable amount, which has increased their share of total farm debt. The share of loans from "individuals and others" has steadily decreased over time, following fewer private contracts for farm real estate and despite an increasing mix of dealer financing. FSA holds a much smaller share of farm debt today than it held during the 1980s farm financial crisis.

Figure 1. Market Shares by Lender of Total Farm Debt, 1960-2019



Source: Congressional Research Service (CRS), using year-end data from the U.S. Department of Agriculture (USDA) Economic Research Service (ERS), as of February 5, 2021.

Notes: Percentages on the right are for 2019. FSA = Farm Service Agency. Shares in the graph are for direct loans. Guarantees are not shown (FSA guarantees about 5% of farm loans that are included in the shares of commercial banks and the Farm Credit System).

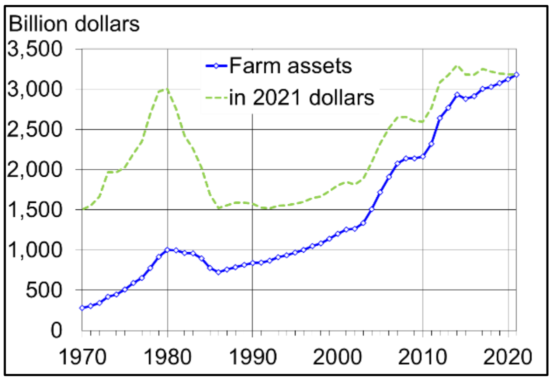
[13] USDA, Economic Research Service (ERS), "Farm Income and Wealth Statistics," at http://www.ers.usda.gov/data-products/farm-income-and-wealth-statistics.aspx. Hereinafter, ERS, "Farm Income and Wealth Statistics."

The Farm Balance Sheet

As a whole, farm assets have remained strong and grown steadily since the end of the 1980s, though inflation-adjusted growth has slowed since 2014. At the end of 2020, farm sector assets totaled $3.1 trillion, according to USDA (**Figure 2**), which was 4% below their 2014 peak in inflation-adjusted terms. Real estate accounted for about 82% of total farm assets in 2020; machinery and vehicles were the next-largest category, at about 9% of the total.[14] USDA forecasts that farm assets will increase by 1.8% in 2021.

Farm debt reached a historic high of $432 billion at the end of 2020 (**Figure 3**). About 30% of U.S. farms have farm debt.[15] USDA forecasts that debt will increase by 2.2% in 2021. In inflation-adjusted terms, this forecast debt is approaching, but remains below, the peak level of farm debt in the 1980s.

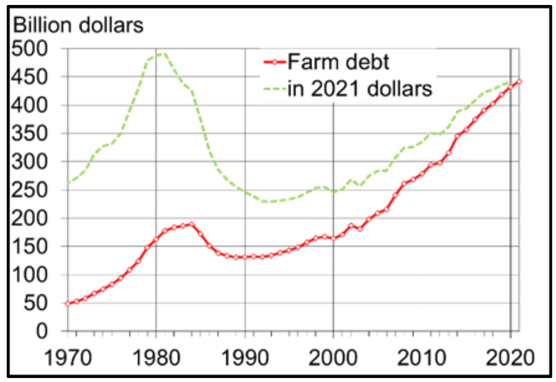
Figure 2. Farm Assets



Source: CRS, using ERS data.

Notes: 2021 is forecast, as of February 5, 2021.

Figure 3. Farm Debt



Source: CRS, using ERS data.

Notes: 2021 is forecast, as of February 5, 2021.

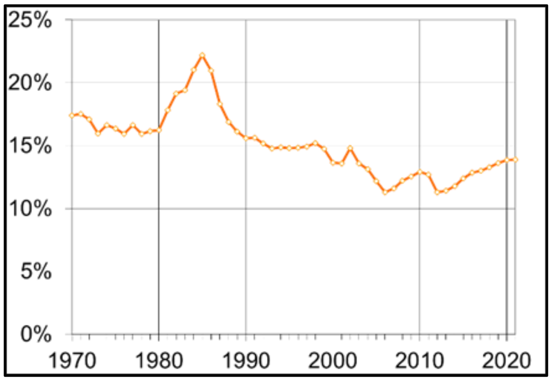
Financial risk to a sector is indicated when the debt-to-asset ratio (debts divided by assets) is high. Farm debt-to-asset ratio levels have declined fairly steadily since the farm crisis of the 1980s (**Figure 4**). When farm asset growth paused in 2009-2010, the debt-to-asset ratio rose before returning to a historic low in 2012. The debt-to-asset ratio has been slowly rising due to lower farm incomes, trade disruption, and the COVID-19 pandemic, although the farm sector is not as highly leveraged as it was in the 1980s.

Another indicator of leverage is the debt-to-income ratio (debt divided by net income, or the number of years of current income to cover debt; **Figure 5**). The farm debt-to-income ratio is more variable than the debt-to-asset ratio. The decline in net farm income from 2013 to 2016 caused the ratio to rise to levels not seen since the 1980s, until high income from government payments in 2020 returned the ratio to near its 10-year average.

[14] ERS, "Farm Income and Wealth Statistics."

[15] ERS, "Debt Use By U.S Farm Businesses, 1992-2011," EIB-122, April 2014, p. 3. Updated by ERS in special tabulations for the author, March 5, 2021.

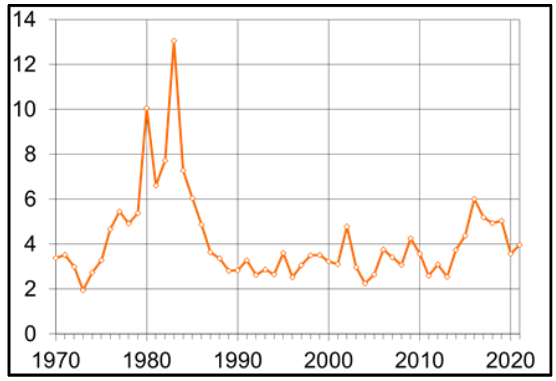
Figure 4. Farm Debt-to-Asset Ratio



Source: CRS, using ERS data.

Notes: 2021 is forecast, as of February 5, 2021.

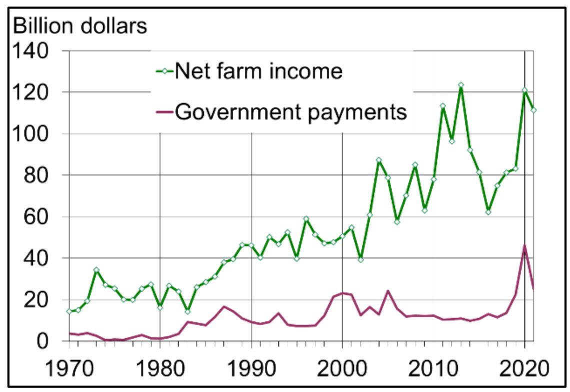
Figure 5. Farm Debt-to-Income Ratio



Source: CRS, using ERS data.

Notes: 2021 is forecast, as of February 5, 2021.

Figure 6. Net Farm Income and Government Payments



Source: CRS, using ERS data.

Notes: 2021 is forecast, as of February 5, 2021.

Net farm income has become more variable, especially since 2000 (**Figure 6**). Net farm income reached highs in 2011 and 2013 but fell below the 10-year average for the next six years, through 2019. Large government payments in 2020 raised farm income to a near high absolute level and improved farmers' debt-repayment capacity during the pandemic. Although government payments to farmers have risen from decades ago, however, these payments do not always offset income variability when net farm income falls. Since 2018, an increasing portion of net farm income has come from the government in the form of trade aid payments and COVID-19 assistance.[16] A forecast decline in government payments in 2021 may reduce net farm income.

Delinquency Rates on Farm Loans

During the COVID-19 pandemic, USDA has suspended loan accelerations (i.e., the requirement for immediate repayment) and new foreclosures on farm loans. FSA also temporarily expanded the Disaster Set-Aside (DSA) provision to allow more payment flexibility. The DSA provision allows a borrower to move a loan payment to the end of the loan or, in the case of an annual operating loan, to extend the payment by a year. Interest continues to accrue on the deferred

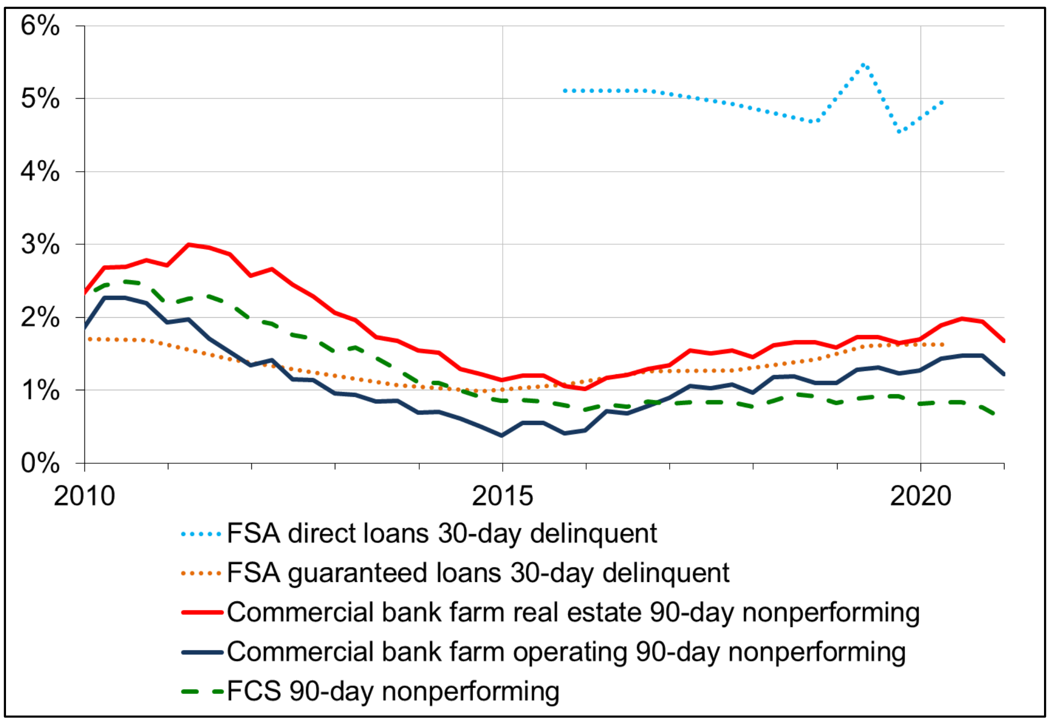
[16] CRS In Focus IF11770, *U.S. Farm Income Outlook: February 2021 Forecast*.

principal; neither the interest nor the principal is forgiven.[17] About 4,000 borrowers used the DSA provision in 2020.[18]

Delinquency rates include loans that are 30 days or more past due and are still accruing interest. The delinquency rate on FSA direct loans is about 5% (of loan portfolio value) and has remained fairly steady through the trade disruption and the pandemic, despite FSA being a lender of last resort. The delinquency rate on FSA guaranteed loans is lower, at about 1.6%, arguably reflecting the comparatively higher quality of these loans made by other lenders (**Figure 7**).

A more severe measure of loan performance problems is nonperforming loans: nonaccrual loans and interest-accruing loans 90 days or more past due. These loans are more in jeopardy than delinquent loans and represent a smaller subset of loans. The nonperforming rate on farm loans at commercial banks rose after the financial crisis in 2009 but recovered through 2016. Lower farm incomes in recent years, along with trade disruption and the pandemic, have again increased the rate of nonperforming loans, but not to the levels of a decade ago. At FCS, nonperforming loans recovered after the 2007-2009 financial crisis and have remained steady through the period of lower farm income after 2013, owing in part to trade disruption and the pandemic.

Figure 7. Delinquent and Nonperforming Agricultural Loans



Sources: Compiled by CRS, using USDA, FSA, "Farm Loan Programs Loan Servicing Data," at https://www.fsa.usda.gov/programs-and-services/farm-loan-programs/program-data/index; Federal Reserve Bank of Kansas City, Commercial Bank Call Report Data, "Delinquent Farm Loans"; and Federal Farm Credit Banks Funding Corporation, "Information Statements: Nonperforming Assets."

Notes: FCS = Farm Credit System; FSA = USDA Farm Service Agency. Delinquencies include nonaccrual loans and accruing loans that are 30 days or more past due. Nonperforming loans include nonaccrual loans and accruing loans 90 days or more past due. Percentages are of dollar amounts of loans.

[17] CRS Insight IN11415, *COVID-19 and USDA Farm Loan Flexibilities*.

[18] Based on CRS communication with the deputy administrator for Farm Loans Programs, USDA FSA, March 26, 2021.

Issues in Agricultural Credit

Debt Forgiveness for Socially Disadvantaged Farmers

The American Rescue Plan Act of 2021 (P.L. 117-2) contains a provision (§1005) to pay socially disadvantaged farmers 120% of their outstanding FSA direct loans, FSA guaranteed loans, and Farm Storage Facility Loans (made by the Commodity Credit Corporation) as of January 1, 2021. The payment is intended to retire loan balances and cover tax liabilities and fees, since debt forgiveness is subject to income taxes. The provision uses a definition of *socially disadvantaged farmer* that includes racial and ethnic minorities (7 U.S.C. §2279(a)); this definition is narrower than the one used for targeting socially disadvantaged farmers in the farm loan programs, which also includes gender (7 U.S.C. §2003).

The Congressional Budget Office estimates the debt forgiveness provision will cost $4 billion.

A 2019 Government Accountability Office (GAO) report, which was mandated by the 2018 farm bill (P.L. 115-334, §5416), observed that despite specific preferences, socially disadvantaged farmers and ranchers had proportionately fewer FSA direct and guaranteed loans than non-socially disadvantaged producers. GAO found that socially disadvantaged farmers and ranchers face difficulties in obtaining farm loans and highlighted the historic, systemic discrimination against such farmers.[19]

Data that describe annual FSA lending to socially disadvantaged borrowers do not reflect the impact of the debt relief provision for racial minorities, since gender is included in the loan program data.[20] Agricultural Census data indicate that White women comprise a majority of this socially disadvantaged category.[21]

Competition Between Farm Credit System and Commercial Banks

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. Because of this direct competition for creditworthy borrowers, FCS and commercial banks often have an adversarial relationship in the policy realm. Commercial banks assert unfair competition from FCS for borrowers because of tax advantages that can lower the relative cost of funds for FCS.[22] Commercial banks often call for increased congressional oversight. FCS counters by citing its statutory mandate (and limitations) to serve agricultural borrowers in good times and in bad times.[23]

In contrast, FSA's loan programs are supported by both FCS and commercial banks. FSA is not regarded as a competitor, since it serves farmers who otherwise may not be able to obtain credit. Commercial banks and FCS particularly support the FSA loan guarantee program, because it

[19] Government Accountability Office (GAO), *Agricultural Lending: Information on Credit and Outreach to Socially Disadvantaged Farmers and Ranchers Is Limited,* GAO-19-539, July 11, 2019. Hereinafter, GAO-19-539.

[20] FSA, "Program Data," at https://www.fsa.usda.gov/programs-and-services/farm-loan-programs/program-data.

[21] "Table 1. Producers Identified as Socially Disadvantaged Farmers and Ranchers (SDFR), 2017," in GAO-19-539, p. 6.

[22] For example, letter from the American Bankers Association to the House and Senate Agriculture Committees, February 2, 2015.

[23] For example, letter from the Farm Credit Council to the House and Senate Agriculture Committees, February 5, 2015.

allows them to make and service loans that otherwise might not be possible (or to do so at a reduced level of risk).

Term Limits on USDA Farm Loans

Congress added term limits to the USDA farm loan program in 1992 and 1996 to restrict eligibility for government farm loans and to 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, until the end of 2010, Congress had suspended enforcement of term limits on guaranteed operating loans to prevent some farmers from being denied credit. The 2014 farm bill (P.L. 113-79) eliminated the term limit on guaranteed operating loans (**Table 1**).

Table 1. Term Limits on Farm Service Agency (FSA) Loans

(maximum number of years that farmers are eligible for loans)

Type of FSA Loan	Direct Loans Term Limits	Guaranteed Loans Term Limits
Farm Operating Loans	6 years, plus possible 2-year extension[a]	No term limit[b]
Farm Ownership Loans	10 years[c]	No term limit

Source: CRS, based on statute and unpublished USDA data.

Notes: Term limits are different from the maximum maturity or duration of an individual loan, which may be as long as 40 years for a farm ownership loan or as short as 1 year for a farm operating loan.

a. Direct operating loans are limited to a six-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)).

b. The 2014 farm bill (P.L. 113-79) permanently removed this term limit. Guaranteed operating loans had been limited to a 15-year period, though enforcement was suspended by statute through 2010.

c. A borrower is eligible to receive new 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)). The repayment term may exceed the term limit.

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