HEARING TO REVIEW CREDIT CONDITIONS IN RURAL AMERICA

HEARING

BEFORE THE

SUBCOMMITTEE ON DEPARTMENT OPERATIONS, OVERSIGHT, AND CREDIT

OF THE

COMMITTEE ON AGRICULTURE
HOUSE OF REPRESENTATIVES

ONE HUNDRED TWELFTH CONGRESS

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HEARING TO REVIEW CREDIT CONDITIONS IN RURAL AMERICA

THURSDAY, APRIL 14, 2011

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON DEPARTMENT OPERATIONS,
OVERSIGHT, AND CREDIT,
COMMITTEE ON AGRICULTURE,
Washington, D.C.

The Subcommittee met, pursuant to call, at 10:00 a.m., in Room 1301 of the Longworth House Office Building, Hon. Jeff Fortenberry [Chairman of the Subcommittee] presiding.

Members present: Representatives Fortenberry, Johnson, Crawford, Fudge, and McGovern.

Staff present: Patricia Barr, Tamara Hinton, John Konya, Brandon Lipps, Josh Maxwell, Debbie Smith, Nona Darrell, Liz Friedlander, Lisa Shelton, Anne Simmons, and Jamie Mitchell.

OPENING STATEMENT OF HON. JEFF FORTENBERRY, A REPRESENTATIVE IN CONGRESS FROM NEBRASKA

The CHAIRMAN. The hearing of the Subcommittee on Department Operations, Oversight, and Credit to review credit conditions in rural America, will come to order. Thank you all for joining us today. Before I give my opening statement, I would also like to recognize the Ranking Member, Ms. Fudge, from Cleveland, Ohio. It is a pleasure to begin working with you. This is our first hearing of the 112th Congress of the Subcommittee. And thank you to our witnesses for coming today. We appreciate your willingness to testify.

When this Committee last reviewed rural credit conditions in June of 2009, crop prices were down. The Department of Agriculture was predicting the average farm income would decrease by 20 percent. Non-performing loans were on the rise and credit conditions were generally tight that year. A short year and a half later, the Federal Reserve Bank of Kansas City reported that rural America was at the forefront of our nation's economic recovery. Now, credit conditions in rural America are generally good. Various factors include strong demand, tight supplies, and low interest rates. These have resulted in high prices and increased net farm income. The Farm Credit Administration reports that the Farm Credit System remains fundamentally sound, is well capitalized, and continues to generate strong earnings.

However, the FCA reports that a few sectors of the ag economy are experiencing problems that may result in portfolio stress. The Farm Service Agency reported that its direct and guaranteed loans have increased in 2009, 2010, and are projected to increase in 2011. Both the FDIC and the Federal Reserve Bank of Kansas City have expressed concern over rising farmland values, and the FCA reports that it is closely monitoring this trend.

While the current agriculture economy and high farm prices are resulting in overall good credit conditions, we must be cautious moving forward. As we know, the agricultural economy is highly cyclical. History teaches us that interest rates will eventually go up and record-high prices will eventually come down. We must ensure that good farm and agricultural credit policies are in place to sustain an abundant supply of both food and fiber.

I hope to hear more from you, our witnesses, on the current credit conditions and how we can ensure the availability of credit for America's farmers now, as well as into the future.

[The prepared statement of Mr. Fortenberry follows:]

PREPARED STATEMENT OF HON. JEFF FORTENBERRY, A REPRESENTATIVE IN CONGRESS FROM NEBRASKA

I would like to welcome our witnesses and guests to today's hearing.

When this Committee last reviewed rural credit conditions in June of 2009, crop prices were down, the Department of Agriculture was predicting that average farm income would decrease by 20 percent, non-performing loans were on the rise and credit conditions were generally tight. A short year and a half later the Federal Reserve Bank of Kansas City reported that rural America was at the forefront of our nation's economic recovery.

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I hope to hear more from our witnesses on current credit conditions and how we can ensure availability of credit for America's farmers now and in the future.

The CHAIRMAN. So with that I will turn to the Ranking Member for her opening comments.

OPENING STATEMENT OF HON. MARCIA L. FUDGE, A REPRESENTATIVE IN CONGRESS FROM OHIO

Ms. FUDGE. Thank you so much, Mr. Chairman. I certainly look forward to working with you. Having had the opportunity to get to know you a little bit over the last few months, I could not have asked for a better Chairman. So I thank you. And I thank you for holding this hearing to review the status of credit in rural America.

As a new Member of the Committee, I am pleased to have the opportunity to both listen and to ask questions of today's expert witnesses. I understand that the purpose of this hearing is to look at the credit conditions in rural America. As our nation's economy continues to recover, now is an important time for this Subcommittee to assess rural ag credit.

I represent the Cleveland area so there are not a lot of farmers in my district. So my focus will be on the soundness of the credit extended to farmers and how that credit affects the larger economy and the food American's serve their families. I am also interested in learning how ag lenders are keeping up with some of the developments I see in our cities and suburban areas.

There has been an increasing demand for locally produced food and growth in neighborhood farmers' markets along with other innovative ways to improve access to healthy and fresh foods especially in food deserts.

Finally, I will have some questions about how lenders are reaching out to small, beginning, and minority farmers. It seems to me with initiatives like USDA's "Know Your Farmer, Know Your Food," there are opportunities for young and ambitious entrepreneurs who have a good, wholesome product and a good idea and a willingness to work hard. Are they being served by lenders who have an understanding of these smaller enterprises? Adequate credit is the lynchpin for successful farming and ranching for operations of all sizes in all states and all locales.

So again, welcome to our witnesses. I look forward to hearing your testimony. Mr. Chairman, I yield back.

The CHAIRMAN. Thank you, Congresswoman. I would like to, first of all, welcome Mr. Crawford to the Subcommittee, and any opening statement you have will be submitted for the record.

I would also like to welcome our first panel of witnesses to the table. Mr. Dolcini, who is the Acting Administrator of the Farm Service Agency of the Department of Agriculture here in Washington, he is accompanied by Mr. Chris Beyerhelm, the Deputy Administrator for Farm Loan Programs, Farm Service Agency of the Department of Agriculture here in D.C. I would like to also recognize Mr. Leland Strom, the Chairman and CEO of the Farm Credit Administration in McLean, Virginia; as well as Dr. Jason Henderson, Vice President of the Federal Reserve Bank of Kansas City. Welcome, gentlemen.

Mr. Dolcini, you may proceed.

STATEMENT OF VAL DOLCINI, ACTING ADMINISTRATOR, FARM SERVICE AGENCY, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, D.C.; ACCOMPANIED BY CHRIS BEYERHELM, DEPUTY ADMINISTRATOR FOR FARM LOAN PROGRAMS, FSA, USDA

Mr. DOLCINI. Thank you, Mr. Chairman, Ranking Member Fudge, Mr. Crawford. And thanks for the opportunity to discuss credit conditions in rural America.

My name is Val Dolcini. I am the Acting Administrator of the Farm Service Agency, and I am joined today by Chris Beyerhelm, my Deputy Administrator for Farm Loan Programs. And today, we will focus our remarks on the current state of farm loan programs at FSA.

Let me begin with a brief overview of our farm loan programs. Farmers and ranchers who were denied commercial credit can turn to loan programs administered by FSA. And while we have been known as the lender of last resort by some, I think we have really become the lender of first opportunity to many in rural America.

The Agency assists farmers through both direct and guaranteed loans. Direct loans are made and serviced by FSA employees who provide supervision to direct loan borrowers. Direct loans are not intended to be a permanent source of credit. Rather, they are intended to help borrowers transition to commercial credit.

Guaranteed loans, on the other hand, are made and funded by a commercial lender, and FSA guarantees up to 95 percent of the loan principal and interest. Guaranteed lenders are then accountable for loan servicing under this guarantee.

All FSA farm loan programs are discretionary programs funded through annual appropriations and because the vast majority of the loans are repaid, FSA loans carry a low cost for the taxpayer. Last year, for example, $155 million in appropriations supported over $5.2 billion in loans to about 36,000 borrowers. And as of March 31 of this year, $70.7 million in Fiscal Year 2011 appropriations had supported more than $2.4 billion in lending.

As in recent years, demand for loans has remained quite high, as the Chairman pointed out. While higher commodity prices have been beneficial for some producers, input costs such as fuel and fertilizer have remained high. And higher feed costs for livestock and dairy producers have helped sustain the demand for operating credit. As land prices continue to rise, commercial lenders in many regions are continuing to maintain relatively tight credit standards overall.

Term limits on our loans are also having an added effect on loan availability. Federal statute presently limits borrowers with guaranteed operating loans to 15 years of total eligibility. This has been suspended in the past, but the latest suspension expired on December 31 of last year, making about 4,500 guaranteed loan borrowers ineligible for further guaranteed loans as a result.

Given this high demand, we at FSA are always working to improve the way we administer and service our loan portfolio. And in Fiscal Year 2010, I am proud to report that the loss rate in our Direct Loan Program fell to 1.2 percent, which was the second-lowest level since 1986. The direct loan delinquency rate stood at 5.6 percent in Fiscal Year 2010, its lowest point in 2 decades, and the foreclosure rate in the FSA direct loan portfolio overall stood at just 1⁄10 of a percent last year.

While hoping to keep troubled loan numbers low, we were also able to graduate more than 2,000 direct loan borrowers to a guaranteed loan last year. And I am particularly proud of that statistic because helping farmers build those relationships with their local community banks is a key step in establishing their future success in agriculture.

As I explained in greater detail in my written statement, we are processing loans more quickly now than ever before. And this improvement is largely due to modernized IT systems which help our field office staff to deliver these programs more efficiently. For example, business plans are now processed through a web-based system which allows real-time access to loan data, and these modernized systems allow us to manage loan applications more quickly.

I would note that support in Congress for this critical infrastructure improvement has made these great strides in service possible, and I am grateful for your continued support.

Finally, Members, I would like speak briefly on the issue of equal access to our loans. As you know, Secretary Vilsack has been extremely clear that improper and inequitable treatment of those that USDA and the Farm Service Agency serve will not be tolerated. We have worked diligently to improve the processing of civil rights complaints, requesting an external analysis of program delivery by USDA service center agencies where appropriate. And I would reiterate that I, along with all the members of the FSA management team both here and across the country—and we do have 2,248 service centers in all 50 states—remain fully committed to equal access and opportunity for all the customers that FSA serves.

Mr. Chairman, Members of the Subcommittee, thank you for allowing me to share this snapshot of FSA loan activities with you. I am available and happy to answer any of your questions now or in the future. Thank you.

[The prepared statement of Mr. Dolcini follows:]

PREPARED STATEMENT OF VAL DOLCINI, ACTING ADMINISTRATOR, FARM SERVICE AGENCY, U.S. DEPARTMENT OF AGRICULTURE, WASHINGTON, D.C.

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear before you to discuss credit conditions in rural America, focusing on the current status and operations of the farm loan programs at the Farm Service Agency (FSA).

Credit Conditions

The farm economy strengthened in 2010. However, farm income, especially net farm income, is very unevenly distributed. Much of the improvement in farm economic conditions is driven by higher commodity prices. While higher prices have been beneficial for some crop producers, they have also resulted in higher feed costs which are squeezing profits among livestock and dairy producers.

A combination of higher commodity and energy prices is significantly increasing the amount of capital required to finance agricultural production. Crop-related expenses grew 77 percent between 2002 and 2008, and are expected to rise by 9.5 percent in 2011. Livestock expenses increased by 64.4 percent between 2002 and 2008, and are forecast to increase by 6.8 percent in 2011. These higher production costs increase the demand for operating credit, increase financial leverage, and strain liquidity.

Recent Federal Reserve Surveys indicate commercial lenders in most regions are continuing to maintain stringent credit standards. Concerned that a combination of factors may be pushing farmland values quite high, the Federal Deposit Insurance Corporation has issued guidance to its examiners to scrutinize farm loans more rigorously, particularly in financial institutions with a concentration of farm lending. The combination of high feed and other input costs, increased operating capital needs, and a continued high level of loan scrutiny by lenders means some farmers are still being denied commercial credit.

FSA Farm Loan Programs

Family farmers who are denied commercial credit due to lender standards, but are otherwise creditworthy, can turn to the farm loan programs administered by FSA. The Agency assists farmers through direct and guaranteed farm loans. Direct loans are made and serviced by FSA; agency employees provide supervision and technical assistance to direct loan borrowers. Direct loans are not intended to be a permanent source of credit and borrowers agree to obtain commercial credit and refinance their FSA debts when they are able to do so.

Guaranteed loans are made, funded and serviced by a commercial lender. FSA guarantees up to 90 percent of the loan principal and interest. FSA employees must evaluate and make a credit decision on all guaranteed loans. Guaranteed lenders must retain at least the non-guaranteed portion of the loan in their portfolio and are accountable for loan servicing under the FSA guarantee.

Funding. FSA farm loan programs are discretionary programs funded through annual appropriations. In accordance with the Federal Credit Reform Act of 1991, appropriations for FSA farm loans are based on the projected total cost of loans when they are made. Because the vast majority of these loans are repaid, the programs operate at a relatively low cost; Federal budget resources are significantly leveraged through the loan programs. In Fiscal Year (FY) 2010, for example, $155.3 million in appropriations supported $5.29 billion in direct and guaranteed FSA loans.

Loan Demand. Activity in FSA's farm loan programs indicates that a significant number of farmers continue to be unable to obtain commercial credit under current conditions. Farm loan program demand is usually a reflection of financial conditions in the farm economy: when the over-all farm economy is strong, farm loan activity declines; during times of financial stress in the farm economy, demand for FSA's loans rises. This makes sense, since a basic requirement to qualify for the loan programs is to be unable to meet the criteria for commercial credit.

In early FY 2009, loan demand surged to levels that had not been seen since the early 1980s. Demand for farm loan program assistance in FY 2009 and FY 2010 reached its highest levels since FY 1985. Demand has continued at, and in some programs increased above, those near-record FY 2009 levels (*Chart 1*). Use of the guaranteed farm ownership program in FY 2010 reached an all-time high. FY 2010 direct operating and farm ownership obligations nearly doubled compared to FY 2008 levels. Application activity in FY 2011 reflects demand levels similar to the higher levels of FY 2009 and FY 2010.

Over the past 2½ years, an unusually high number of direct operating loan applications have been received from new customers. Normally, about 20 percent of direct operating loan applications are from farmers who do not have FSA loans. Since 2009, over 40 percent of direct operating loan applications have been from farmers who are not FSA borrowers. As of April 4, 2011, 43 percent of the direct operating loans made in FY 2011 were to customers who did not have existing FSA operating loans.

Performance and Portfolio Condition

Farm loan programs continue to emphasize the importance of processing applications in a timely manner. Between FY 2001 and FY 2011, farm loan programs reduced its direct loan application processing timeframes by 11.5 days (31 percent), and reduced guaranteed loan processing timeframes by 2 days (10 percent). As of March 30, 2011, the average time from application receipt to final decision for direct loans was 25.9 days, and for guaranteed loans, 7.8 days. It is remarkable that even though loan demand has surged, there has been no deterioration in application processing time. This is a testament to the dedication of FSA field staff and the effectiveness of the Information Technology (IT) solutions farm loan programs has deployed.

The quality of our portfolio has also continued to improve, with foreclosure and loss rates falling alongside an increase in borrower "graduation" to commercial loans.

Loss Rates. In FY 2010, losses in the direct loan program fell to their second lowest level since 1986—just 1.2 percent (*Chart 2*). Losses for FY 2010 in the guaranteed loan program were 0.6 percent, (*Chart 2*).

Delinquency Rates. As with losses, the direct loan delinquency rates have been at historic lows for the past 2 decades at 5.9 percent for FY 2010 (*Chart 3*). This is the result of steady and dramatic decreases, from a 23.8 percent delinquency rate in FY 1995. The decrease was facilitated by expanded authority, since 1996, to offset loan obligations with Federal payments, salaries and income tax refunds to delinquent borrowers. In the guaranteed program, the FY 2011 delinquency rate was 1.69 percent, the second lowest since 1995 (*Chart 3*).

Foreclosures. Foreclosure rates continue to be very low in the direct loan program. In 2010, FSA completed 64 foreclosures. This represents less than 1⁄10 of 1 percent of the agency's direct loan caseload. The extremely low foreclosure rate is the result of use of all available servicing tools and a structured review process to ensure that all options to assist the borrower have been exhausted before a foreclosure action is started.

Inventory Properties. Inventory farm properties—those that have come into government ownership through voluntary conveyance or foreclosure—are also at historic lows, with just 86 farms totaling 10,900 acres in FY 2010 (*Chart 4*). In 1995, FSA held nearly 1,800 farms totaling 598,000 acres. Many of those inventory properties were sold to established and beginning farmers, providing those individuals with prime opportunities to expand or create new operations.

Graduation Rates. Federal law requires FSA to "graduate" its borrowers to commercial credit when they have made sufficient progress to be able to qualify for loans from other lenders. They are assisted by the agency in refinancing their direct loans with FSA guaranteed loans from commercial lenders. Some 2,221 direct loan borrowers were able to graduate in FY 2010.

Equitable Treatment and Participation

Secretary Vilsack has been extremely clear that improper and inequitable treatment of individuals the United States Department of Agriculture (USDA) and FSA serve will not be tolerated. On April 21, 2009, the Secretary announced several actions in a comprehensive approach to ensure fair and equitable treatment of USDA employees and constituents. These actions included an initiation of several improvements in processing civil rights complaints, requesting an external analysis of program delivery by USDA service center agencies, and 90 day suspension of FSA farm foreclosures, which has provided us time to ensure that all producers have received their statutory protections. I, and all the members of the FSA management team, remain fully committed to equal access and opportunity for all those FSA serves. I will closely monitor the operations of farm loan programs and all other FSA programs to assure that our producers, program applicants, and employees receive fair and equitable treatment. I want to update you on a few key activities dealing with these important issues.

Program participation. An examination of the composition of FSA's loan portfolio indicates that FSA finances socially disadvantaged farmers at a much higher rate than that groups' proportion of the farm population (*Chart 5*). FSA has significantly increased the amount of loan funds provided to socially disadvantaged applicants. Between 1995 and 2010, the FSA direct socially and disadvantaged caseload increased from 3,260 to 14,840 borrowers. Between 1997 and 2010, the FSA guaranteed socially disadvantaged caseload increased from 1,730 to 2,998 borrowers.

In the 2008 Farm Bill, Congress re-affirmed the focus for FSA programs on beginning farmers and ranchers. FSA continues to strive to reach more beginning farmers and ranchers and has increased the amount of loan funds provided to beginning farmers and ranchers. The FSA direct loan beginning farmer caseload increased from 3,474 in 1995 to 27,111 borrowers in 2010. Guaranteed caseloads for beginning farmers and ranchers were first reported in 1997. The FSA guaranteed beginning farmer caseload increased from 3,617 in 1997 to 9,477 borrowers in 2010.

IT Modernization

FSA has made significant strides in modernizing the IT systems used in farm loan programs delivery and management. Performance in delivery and operations this year illustrates the high level of performance and functionality of farm loan programs IT systems. So far, in FY 2011, FSA has processed nine percent more loan requests than in FY 2010. There has been a steady increase in loan requests since FY 2009 when the demand jumped 41 percent over the previous year; however, service levels have not declined. Average processing times for direct and guaranteed loan applications have been fairly steady. This is a tribute to the dedication and diligence of farm loan programs field staff, but without the modern IT systems they could not have maintained an acceptable level of service. For example, business plans for FSA borrowers are now processed through a web-based state of the art system. This off-the-shelf IT solution provides access to "real time" data on our portfolio while sharing data among our automated systems. This system also provides a reporting option. This system has allowed our loan officers to conduct more extensive and meaningful financial analysis of our borrower's farm businesses, reducing risk to the government while enhancing the opportunities of our borrowers for success and graduation to commercial lending. FSA loan officers now order applicant credit reports from the three major reporting companies through this system as well, which also expedites loan processing.

Farm loan programs has also implemented modern, web-based systems to manage the loan application, approval and funding process. This system provides real-time management data on application activity and allows the Agency to better cope with funding problems and act quickly when necessary. For example, when the Agency received supplemental funding in the American Revitalization and Recovery Act, over 2,000 farmers were waiting for desperately needed direct operating loans to pay 2009 planting and other farming expenses. When funds were made available to FSA, the agency was able to process obligations overnight, and funds began flowing into farmers' bank accounts only 3 days later. I am proud to say that FSA was one of the first agencies in the government to get stimulus funding flowing to those who desperately needed it. The modern, web-based IT systems in place for farm loan programs, such as the Direct Loan System (DLS) and the Program Funds Control System (PFCS), were a key factor in our ability to provide such timely service.

This past year we have completed the final phase of moving all automated farm loan systems to the Web. With the completion of this project, duplicate data collection is eliminated and farm loan services are being delivered even more efficiently. Our employees are able to conduct USDA business from any location where there is broadband, WiFi or dial-up Internet access. This allows us to conduct business with producers at locations and times convenient to them. Additionally, this information is stored on a centralized server allowing employees to quickly access portfolio information and provide real time management reports. FLP no longer relies on antiquated operating systems for program delivery.

In addition to the business plan and loan accounting systems, other IT systems have been developed and implemented which also enhance the efficiency of FSA employees. Agency appraisers have recently been provided state of the art agricultural software that allows collateral valuations to be done more expeditiously, which facilitates faster access to capital for loan applicants. Automated Web-based systems have been developed for program oversight, including Farm Loan Programs Risk Assessment (FLPRA) & the District Director Oversight System (DDORS), which help to ensure the integrity of FSA's farm loan programs.

Ongoing Challenges

FSA will continue to face challenges in the years to come. Some of the most prominent are staffing constraints, term limits, and maintaining program performance and success rates through these difficult times.

Staffing Challenges. We project that approximately 35 percent of FSA's current loan officers will be eligible to retire by the year 2012 and 45 percent can retire by 2014. This potential loss of experienced, seasoned credit experts comes at exactly the wrong time considering the increased workload from this year's influx of new borrowers; and creates the potential for major staffing challenges in the next few years.

FSA farm loan programs have an excellent employee recruitment and training program which will be critical to maintaining our staffing needs. On average, it requires about 2 years to fully train a loan officer. The 2 year training window for new loan officers complicates a somewhat cloudy staffing forecast.

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

Term Limits. The statute presently limits a borrower to direct operating loans in each of 7 years, with an additional one-time, 2 year waiver on an individual case basis:

- There are more than 4,200 FSA borrowers who can only receive direct operating loan assistance one more year from the agency; and
- There are more than 6,900 FSA borrowers who can only receive direct operating loan assistance 2 more years from the agency.

Without FSA direct loan assistance, they may not have access to the capital necessary for them to conduct their farming operations. Under the current credit environment, it is unlikely that many of these borrowers reaching their term limits will be able to obtain conventional financing.

The statute presently limits borrowers with guaranteed operating loans to 15 years of eligibility, with receipt of a direct operating loan also counting as a year of eligibility for guaranteed operating loans. This provision has been suspended on several occasions. Most recently, the 2008 Farm Bill extended the suspension through December 31, 2010. As of April 5, 2011, over 4,500 guaranteed loan borrowers do not qualify for additional loan guarantees. At the end of FY 2010, an additional 1,447 borrowers are projected to become ineligible for guaranteed loans; at the end of 2012, 1,896 borrowers would become ineligible under term limits.

These limits have come at a difficult time for many borrowers who have been affected by the unpredictable, cyclical nature of agriculture and its influence on farmers' businesses. There is a critical need to maintain a strong agricultural credit safety net for our hardworking farmers and ranchers. With thousands of family farmers across rural America facing the tightest agricultural credit markets in 20 years, USDA loan programs can mean the difference between surviving a tough year and losing the family business.

Conclusions

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

However, we continue to face challenges. Government resources are increasingly limited and the agriculture production landscape is changing. We are experiencing a unique set of conditions in the credit and banking sectors, and to a large extent, in agriculture. These changes pose significant barriers and challenges to the groups that FSA farm loan programs are intended to assist. These issues create major challenges for the agency as well, since the success of the program depends on those whom the programs are intended to serve. To keep pace with these changes, we will continue efforts to modernize our delivery systems, and to refine and adjust program requirements and operations to maximize the opportunities for our nation's small, beginning, and socially disadvantaged farmers and ranchers.

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

Thank you for allowing me to share our Department of Agriculture perspective as you address this important issue. I am available to answer your questions now or at any time in the future.

Chart 1
Total All Loans
Comparison of Obligations
(in Billion Dollars)

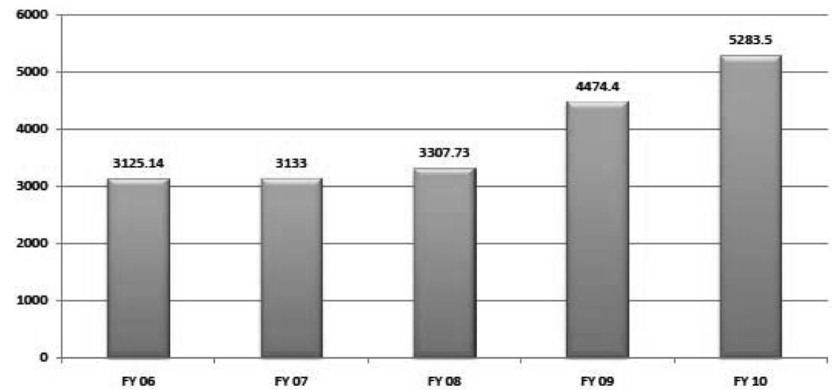


Chart 2
Farm Loan Programs Loss Rates
10 Year Trend

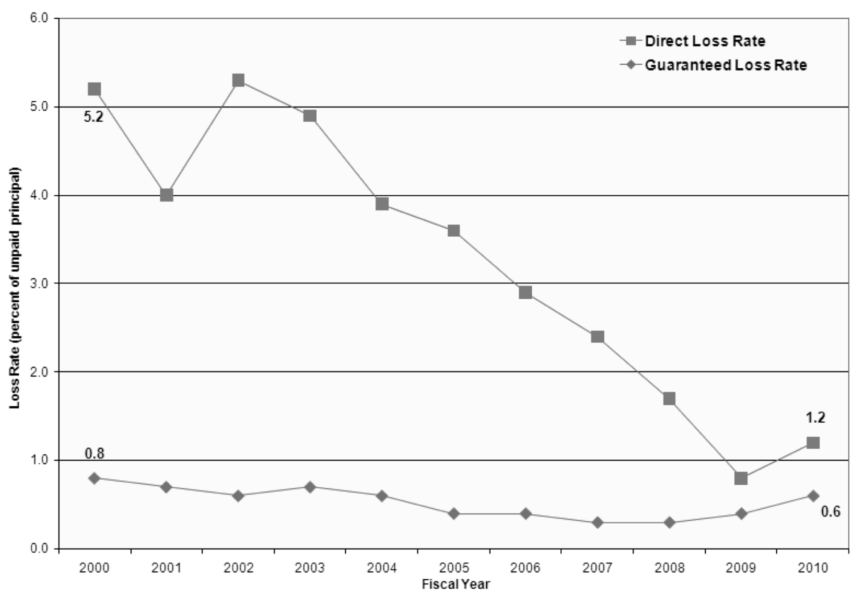


Chart 3
Farm Loan Programs Dollar Delinquency Rate
10 Year Trend

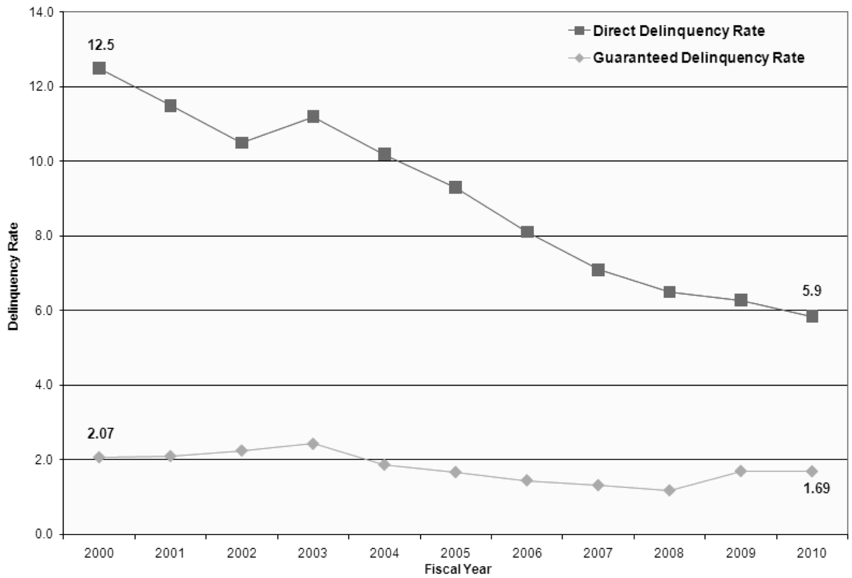


Chart 4
Farm Loan Programs Inventory Property

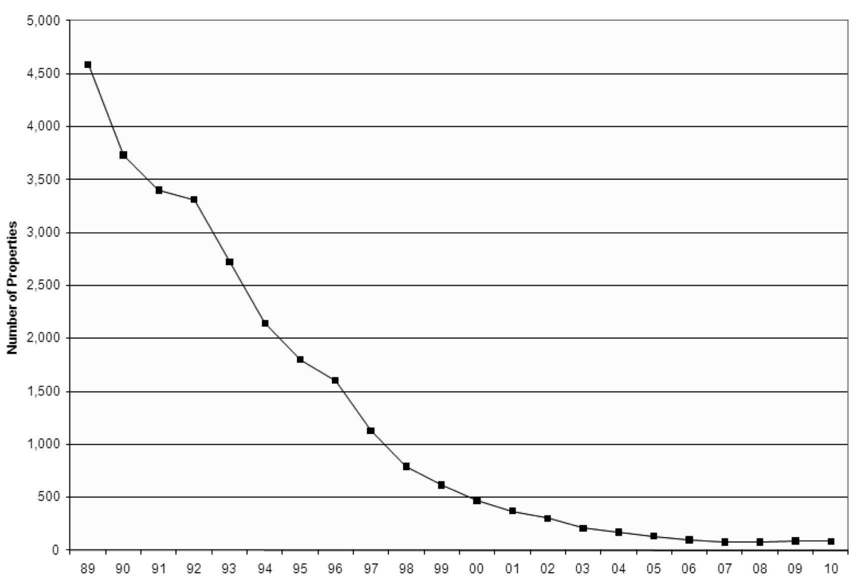


Chart 5
FY 2010 Borrower Caseload by Race
(As Compared to 2007 Ag Census Data)

	Percent of 2007 Ag Census Population	Percentage of FY 2010 Direct Caseload	Percent of Population being served by FSA Direct Farm Loans	Percentage of FY 2010 Guaranteed Caseload	Percent of Population being served by FSA Guaranteed Farm Loans
White	96.45	89.15	2.99	95.53	1.56
Black	1.40	3.10	7.18	0.53	0.60
Asian/Hawaiin	0.57	0.89	5.00	2.21	6.05
Amer Ind/Al Nat	1.58	3.46	7.07	1.58	1.57
* Hispanic	N/A	3.31	N/A	0.11	N/A
Other	N/A	0.10	N/A	0.04	N/A

* Hispanic Americans are not a separate category within the 2007 Census of Agriculture; therefore, no reliable comparison can be established.

The CHAIRMAN. Thank you, Mr. Dolcini. Mr. Strom, please proceed.

STATEMENT OF HON. LELAND A. STROM, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FARM CREDIT ADMINISTRATION, MCLEAN, VA

Mr. STROM. Thank you, Mr. Chairman. Chairman Fortenberry, Ranking Member Fudge, Members of the Subcommittee, I am Leland Strom, Chairman and Chief Executive Officer of the Farm Credit Administration. On behalf of my colleagues on the FCA Board, Kenneth Spearman and Jill Long Thompson and the dedicated men and women at FCA, I am pleased to participate in this important hearing today.

FCA is an independent arms-length agency responsible for examining and regulating the banks, associations, and related entities in the Farm Credit System, including the Federal Agricultural Mortgage Corporation, or Farmer Mac.

I am pleased to report that the overall condition and performance of the System remains safe and sound and continues to meet its Congressionally-directed mission. The System continues to have acceptable credit quality and is well capitalized. We have increased supervisory oversight and dedicated additional resources at a number of institutions that are experiencing stress. These institutions represent less than four percent of the System assets, and while they may not pose a systemic risk, they are important to the farmers and ranchers they serve and the fabric of the System.

Farmer Mac has made strides in rebuilding its capital position since 2008 when it experienced difficulties with non-program investment losses. It continues to provide an important outlet for financial institutions to better manage their risk and increase liquidity and funding to rural America through several business solutions.

During the economic downturn, the Farm Credit System maintained its presence in the agricultural marketplace by providing competitively-priced loan products to creditworthy farmers, ranchers, and agricultural cooperatives. In fact, the System did much during the past year to help producers and rural America. For example, recently in the 7 days following the March 31 crop report, a System institution loaned almost $2 billion to farmers and grain elevators to meet their financing needs, primarily to cover the margin calls due to the crop reports' bullish impact on corn prices.

Farm income is expected to remain strong in 2011. Grains, soybeans, and cotton largely account for the increase. High grain prices, however, will present challenges for the livestock sector and potentially the ethanol industry. Although grain producers are doing well at this time, their input costs are rising rapidly. Consequently, crop farmers could face declining profit margins if grain prices retreat from current levels. Therefore, we must remain vigilant and respond quickly to changes in the risk environment.

High grain prices combined with extremely low interest rates are also propelling farmland values to record highs in parts of the Midwest. The associations of the Farm Credit System are the largest source of farm mortgages in the U.S. with a market share estimated by USDA at about 43 percent. The average Farm Credit association has over 55 percent of its loan portfolio in farmland mortgages.

We at the agency have been taking a proactive approach to addressing the rising farmland values issue. Recently, we hosted a regulator roundtable that was attended by FDIC, the Comptroller of the Currency, the Federal Reserve Board, and Federal Reserve banks. We plan to continue to work together to identify risks we see for the future and what further actions may be needed regarding our regulated entities.

At FCA we have emphasized appropriate and sound agricultural real estate underwriting standards in our policy guidance and examination activity in these volatile times.

The System focuses on lending to young, beginning, and small farmers and ranchers by offering them specially-designed programs and services. In 2010, the System's loans to YBS producers continue to show solid gains, indicating Farm Credit System institutions are staying focused on this very special mission responsibility.

The Farm Credit Act established specific consumer protections for System borrowers. For example, the Act requires Farm Credit System institutions to review and consider restructuring a distressed agricultural loan before initiating foreclosure. These borrower rights requirements have served the System and its borrower-owners well for the past 25 years.

In closing, as agriculture and rural America contend with the challenges of these uncertain times, we are mindful that the System was designed to be a dependable lender to agricultural and rural communities in both good times and bad. FCA remains committed to ensuring that the System can fulfill its mandate to both current and future generations of farmers and ranchers and the rural areas in which they live.

Mr. Chairman, this concludes my statement and I will happy to answer any questions you may have.

[The prepared statement of Mr. Strom follows:]

PREPARED STATEMENT OF HON. LELAND A. STROM, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, FARM CREDIT ADMINISTRATION, MCLEAN, VA

Introduction

Chairman Fortenberry, Ranking Member Fudge, Members of the Subcommittee, I am Leland A. Strom, Chairman and Chief Executive Officer of the Farm Credit Administration (FCA or Agency). On behalf of my colleagues on the FCA Board, Kenneth Spearman of Florida, Jill Long Thompson of Indiana, and all the dedicated men and women of the Agency, I am pleased to participate in this important hearing today.

FCA is an independent agency responsible for examining and regulating the banks, associations, and related entities in the Farm Credit System (FCS or System), including the Federal Agricultural Mortgage Corporation (Farmer Mac). The FCS is a nationwide network of borrower-owned financial institutions that provide credit to farmers, ranchers, residents of rural communities, agricultural and rural utility cooperatives, and other eligible borrowers.

FCA Mission

As directed by Congress, FCA's mission is to ensure a safe, sound, and dependable source of credit and related services for agriculture and rural America. The Agency accomplishes its mission in two important ways. First, FCA protects the safety and soundness of the FCS by examining and supervising all FCS institutions, including Farmer Mac, and ensures that the institutions comply with applicable laws and regulations. Our examinations and oversight strategies focus on an institution's financial condition and any material existing or potential risk, as well as on the ability of its board and management to direct its operations. We also evaluate each institution's compliance with laws and regulations to ensure that it serves all eligible borrowers, including young, beginning, and small farmers and ranchers. If a System institution violates a law or regulation or operates in an unsafe or unsound manner, we use our supervisory and enforcement authorities to take appropriate corrective action.

Second, FCA develops policies and regulations that govern how System institutions conduct their business and interact with customers. FCA's policy and regulation development focuses on protecting System safety and soundness; implementing the Farm Credit Act; providing minimum requirements for lending, related services, investments, capital, and mission; and ensuring adequate financial disclosure and governance. The policy development program includes approval of corporate charter changes, System debt issuance, and other financial and operational matters.

Through the oversight and leadership of the House and Senate Agriculture Committees, many important reforms were made to the Farm Credit Administration and the FCS as a result of the agricultural credit crisis of the 1980s. This included restructuring FCA as an independent arm's length regulator with formal enforcement powers, providing borrower rights to System borrowers with distressed loans, and establishing the Farm Credit Insurance Fund (Insurance Fund) to protect System investors.

Over the ensuing 2 decades, the Farm Credit System, which FCA regulates, has restored its financial health and the trust of its borrowers. With its authority as an arm's length regulator, FCA has been able to ensure that System institutions adhered to safety and soundness standards. The Insurance Fund also helped by restoring investor confidence.

Both the System and FCA learned much during the crisis of the 1980s, and those lessons helped build a much stronger Farm Credit System, as well as a stronger regulator. As the arm's length regulator of the FCS, the Agency will continue to focus on ensuring that the System remains safe and sound by promulgating regulations, providing appropriate guidance, and maintaining strong and proactive examination and supervisory programs. With the dynamics and risks in the agricultural and financial sectors today, FCA recognizes that FCS institutions must have the appropriate culture, governance, policies, procedures, and management controls to effectively identify and manage risks. Today the System is a dependable provider of credit to agriculture and rural America as intended by Congress.

Farm Credit System Mission

The FCS is a government-sponsored enterprise (GSE) created by Congress in 1916 to provide American agriculture with a dependable source of credit. It is a nationwide network of cooperatively organized banks and associations that are owned and controlled by their borrowers, serving all 50 states and the Commonwealth of Puerto Rico. The System provides credit and other services to agricultural producers and farmer-owned agricultural and aquatic cooperatives. It also makes loans for agricultural processing and marketing activities, rural housing, farm-related businesses, rural utilities, and foreign and domestic companies involved in international agricultural trade. In addition, the System provides funding and discounting service to certain "other financing institutions" and forms partnerships with commercial banks to provide credit to agriculture and rural America through participations and syndications.

As required by law, System borrowers own stock or participation certificates in System institutions. The FCS had nearly 880,000 loans and approximately 488,000 stockholders in 2010. Approximately 85 percent of the stockholders were farmers or cooperatives with voting stock. The remaining 15 percent were nonvoting stockholders, including rural homeowners and other financing institutions that borrow from the System. The U.S. Department of Agriculture's latest data show that the System's market share of farm debt was 40 percent, second only to the 44 percent share held by commercial banks.

One of FCA's oversight roles is to ensure that the System, with its mission devoted to agriculture and rural America, maintains its presence in the agricultural marketplace to provide competitive and dependable credit for all eligible and creditworthy farmers, ranchers, and agricultural cooperatives. In fact, the System has maintained its mission service during the difficult markets of the past 3 years to help producers and rural America. When commodity prices soared in early 2008, System institutions stepped forward to meet the critical financing needs of the grain elevator industry. They met increased demands for financing machinery and higher input costs for producers. The FCS also helped Midwest borrowers affected by floods and worked with livestock producers, especially dairy and hog producers, as they made difficult decisions during stressful market conditions. The System also provided funding for critical infrastructure projects in rural America through innovative bond financing, such as a critical-care facility in St. James, Minnesota, and similar needed community facilities in the Midwest, Southeast, and Northwest. Overall the System continued to have access to funds and was able to increase its lending to agriculture and rural America during a financial crisis and severe recession.

Condition of the FCS

Farm income is expected to be very strong in 2011. The U.S. Department of Agriculture forecasts $98.6 billion in farm net cash income—the highest since 1974, after adjusting for inflation. The high prices that grain, soybean, and cotton farmers will receive for their products will largely account for this increase. High feed costs, however, will present challenges for livestock producers. Already tight supplies of corn and soybeans in the United States could lead to significantly higher feed costs in 2011 and 2012 if growing conditions are unfavorable. High grain prices combined with extremely low interest rates are also propelling farmland values to record highs in parts of the Midwest.

We are carefully watching factors such as higher interest rates that could cause a reversal in the factors that have contributed to a strong farm economy and land values. We are also watching carefully how higher oil prices may influence the global economy and undermine the demand for farm products. Although grain producers are doing well at this time, their input costs are rising rapidly. For example, fuel and fertilizer prices, which account for about ⅓ of the non-land costs of a Central Illinois corn farm, have increased 22 percent and 31 percent, respectively, since August 2010. Consequently, crop farmers could face declining profit margins if grain prices retreat from current levels.

The System remained fundamentally safe and sound in 2010 and is well positioned to withstand the continuing challenges affecting the general economy and agriculture. Total capital increased to $33.3 billion at December 31, 2010, up from $30.0 billion a year earlier. In addition, more than 81 percent of total capital is in the form of earned surplus, the most stable form of capital. The ratio of total capital to total assets increased to 14.5 percent at year-end 2010, compared with 13.9 percent the year before, as strong earnings allowed the System to continue to grow its capital base.

Loan growth picked up in 2010, especially in the second half of the year when commodity prices increased sharply. In total, loans grew by 6.4 percent in 2010 compared with 2.1 percent in 2009. The greatest contributors to the System's loan growth last year were loans to cooperatives and real estate mortgage loans, as they increased $5.7 billion and $2.7 billion, respectively. Credit has been available to eligible creditworthy borrowers. Outstanding loans to producers of most major commodities increased in 2010 compared with the prior year. However, loans outstanding did decline in 2010 for forestry, poultry and eggs, hogs, and biofuels industries that have struggled recently.

Nonperforming loans decreased modestly to $3.4 billion as of December 31, 2010, and represented 10.2 percent of total capital at the end of 2010, down from 11.8 percent at the end of 2009. Two of the most troubled industries in 2009, hogs and ethanol, experienced a substantial improvement in 2010 because of much stronger prices for their products. Other sectors that have had difficulties over the past few years, such as cattle, dairy, and forestry, recorded relatively small changes in their nonaccrual rates in 2010. Dairy improved slightly, while cattle and forestry registered somewhat higher nonaccrual rates. Although credit quality is satisfactory overall, the volatility in commodity prices and weaknesses in the general economy have increased risks to some agricultural operators, creating the potential for future declines in asset quality.

The System reported significantly higher earnings in 2010, with a combined net income of $3.5 billion, up 22.6 percent from 2009. Return on assets remained favorable at 1.60 percent. System institutions, as cooperatives, distributed 29 percent of their earnings in patronage to their borrower-owners in 2010.

Further strengthening the System's financial condition is the Insurance Fund, which holds more than $3.2 billion. Administered by the Farm Credit System Insurance Corporation (Insurance Corporation), this fund protects investors in Systemwide consolidated debt obligations.

The System's access to capital markets returned to normal during 2010, which helped the System further augment its solid overall financial strength, serve its mission, and maintain the Insurance Fund. As a GSE with solid financial performance, the System benefited from monetary policy actions that helped to foster historically low domestic interest rate levels. Tepid investor demand for longer-term Systemwide debt securities in 2009 improved appreciably in 2010, particularly for those with maturities of more than 5 years. While the System expects to have continued reliable access to the debt capital markets to support its credit mission in 2011, it has also taken steps to enhance the liquidity of its investment portfolio to provide flexibility in the event of restricted market access. The System's overall liquidity position equaled 173 days at December 31, 2010, well in excess of the 90 day regulatory minimum.

Rising Farmland Values

We are in an optimistic period for U.S. agriculture, as rising world and domestic demand for commodities has been coupled with very low interest rates. Not surprisingly, profitability and expectations for further growth in returns are being bid into the value of U.S. farmland. Farmland values rose in 2010, especially in the latter half of the year, with much of the Midwest showing strong double-digit annual gains. While data for this past winter are incomplete, anecdotal evidence suggests that farmland values continued to rise this past winter, especially in the major corn and soybean producing regions. The importance of farmland values to the agricultural economy and to agricultural credit markets cannot be overstated, as farmland accounts for the overwhelming majority of the $2 trillion in farm equity that USDA is projecting for the end of this year.

History has shown that substantial downward adjustments to the value of farmland can occur. The severe correction in the 1980s reshaped farming and agricultural lending alike. We studied the land markets of both periods, and while there are some similarities, there are also some important differences. The most significant difference is that the level of debt or leverage used to purchase farmland today is much less than it was in the 1980s. Nonetheless, FCA is closely monitoring the situation because FCS associations are the largest supplier of farm mortgages in the United States, with a market share estimated by USDA of about 43 percent.

Although the current economy generally supports today's average land prices, some factors, such as higher interest rates, geopolitical developments that could undermine global demand for farm products, and an unexpected decline in grain prices because of a global supply response, could lead to a sharp drop in the value of farm real estate. Indeed, farm commodity markets have become more volatile in the past 5 years. The volatility is no more evident than in corn, the single biggest U.S. crop. Just since last summer the spot price of corn has more than doubled in value, helping to drive the latest surge in cropland prices.

To address the risks associated with rising farmland values, FCA has issued guidance on collateral risks to FCS lenders through a series of Informational Memoranda. FCS institutions are improving underwriting standards, implementing appraisal guidelines, and capping the amount per acre they will lend on the basis of sustainable agricultural value analysis. They are also improving efforts to identify portfolio risk through land value studies and the stress testing of land value changes.

To further address the issue of rising farmland values, FCA recently organized a meeting with the other Federal financial regulators to discuss concerns and observations regarding agricultural land values and associated risks to loan collateral. Our intent also was to foster a broad-based interchange on the appropriate regulator response to these risks and to develop a productive working relationship among banking regulators. We plan to hold additional meetings to continue our focus on topics important to agriculture.

Examination Programs for FCS Banks and Associations

The Agency's highest priority is to maintain appropriate risk-based oversight and examination programs to ensure the safety and soundness of FCS institutions. Given the increasing complexity and risk in the System and human capital challenges at FCA, we have undertaken a number of initiatives to improve operations, increase examination effectiveness, and enhance staff expertise in key examination areas. The Agency bases its examination and supervision strategies on institution size, existing and prospective risk exposure, and the scope and nature of each institution's business model. FCA also performs nationally focused examinations of specific issues and operational areas to monitor the condition and operations of the System as a whole. On a national level, we actively monitor risks that may affect groups of System institutions or the entire System, including risks from the agricultural, financial, and economic environment. There are several key risk areas on which the Agency is focusing in 2011. They include loan portfolio management; large, complex, and shared assets; collateral risk management; and compensation programs and corporate governance.

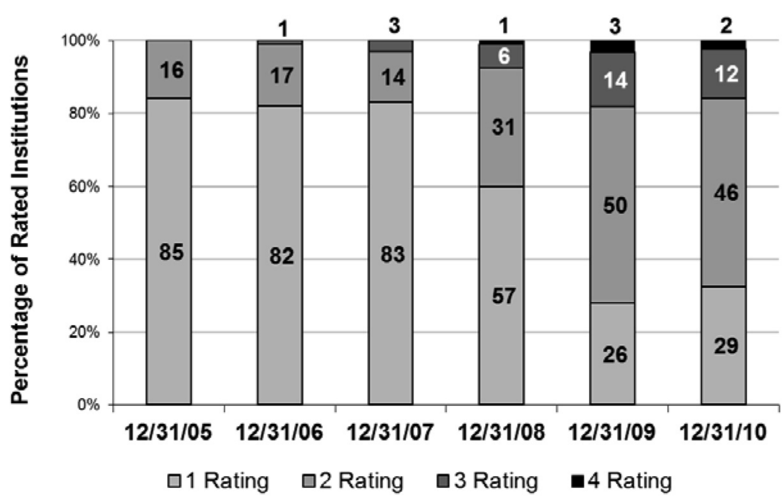
The frequency and depth of examination activities vary based on risk, but each institution receives a summary of examination activities and a report on its overall condition at least every 18 months. FCS institutions are required to have effective loan underwriting and loan administration processes to maintain adequate asset-liability management capabilities, and to establish high standards for governance and transparent disclosures for shareholder oversight. Because of the recent increased volatility in the agricultural and credit sectors, FCA has increased its on-site examination presence. Also, FCA is closely watching rapidly rising real estate values in certain sections of the country to ensure that FCS lending practices remain prudent.

In certain cases, FCA will use its enforcement powers to effect changes in the institution's policies and practices to correct unsafe or unsound conditions or violations of law or regulations. The Agency uses the Financial Institution Rating System (FIRS) as a key method to assess the safety and soundness of each FCS institution (see chart). The FIRS provides a general framework for evaluating significant financial, asset quality, and management factors to assign component and composite ratings. FIRS ratings range from one for a sound institution to five for an institution that is likely to fail. Overall, the System remains financially strong and adequately capitalized. The FCS does not pose material risk to investors in FCS debt, the Insurance Corporation, or to FCS institution stockholders.

Although the System's condition and performance remain satisfactory overall, a number of FCS institutions are experiencing stress and now require special supervision and enforcement actions. These actions reflect the weaknesses in the nation's economy and credit markets, a rapidly changing risk environment in certain agricultural segments, and, in certain cases, management's ineffectiveness in responding to these risks. We have increased supervisory oversight at a number of institutions and dedicated additional resources in particular to those 14 institutions rated three or worse. Although these 14 institutions represent less than four percent of System assets and do not meaningfully impact the System's consolidated performance, they require significantly greater Agency resources to oversee. Currently, seven FCS institutions are under formal enforcement action, but no FCS institutions are in conservatorship or receivership.

The chart below includes only the five System banks and their affiliated direct-lender associations. The figures in the bars reflect the number of institutions by FIRS rating.

Farm Credit System FIRS Composite Ratings



Source: FCA's FIRS Ratings Database.

Regulatory Activities

Congress has given the FCA Board statutory authority to establish policy, prescribe regulations, and issue other guidance to ensure that FCS institutions comply with the law and operate in a safe and sound manner. The Agency is committed to developing balanced, flexible, and legally sound regulations.

Some of the Agency's current regulatory and policy projects include the following:

- Revising regulations to implement the requirements of the Dodd-Frank Act with respect to imposing margin requirements on non-cleared derivatives transactions and removing references to credit ratings.
- Revising regulations to ensure that FCS funding and liquidity requirements are appropriate and to ensure that the discounts applied to investments reflect their marketability.
- Revising regulations to require that each FCS institution's business plan includes strategies and actions to serve all creditworthy and eligible persons in the institution's territory. In addition, the regulation will encourage serving nontraditional customers, such as women and minorities, who often operate within local food systems by producing organic or specialty crops on small farms. The regulation will also seek to achieve diversity and inclusion in the workforce of System institutions.
- Enhancing our risk-based capital adequacy framework to more closely align it with that of other Federal banking agencies and the Basel Accord. We published an advance notice of proposed rulemaking to solicit comments on amending FCA's regulations to replace the current core and total surplus capital standards with a "Tier 1/Tier 2" capital framework.
- Revising lending- and leasing-limit regulations to ensure that FCS institutions maintain effective policies to measure and manage exposure to single counterparties, industries, and market segments, and to large complex loans.
- Revising regulations to allow System institutions to purchase eligible agricultural loans from the Federal Deposit Insurance Corporation.
- Revising regulations to enhance System disclosures of senior officer compensation and supplemental benefit programs. We published an advance notice of proposed rulemaking to solicit comments on ways to clarify and enhance rules related to the disclosure of senior officer compensation, and the responsibilities and authorities of System institution compensation and audit committees.
- Strengthening investment-management regulations to ensure that prudent practices are in place for the safe and sound management of FCS investment portfolios.

Corporate Activities

While the number of FCS institutions has declined over the years as a result of mergers, their complexity has increased, which has placed greater demands on both examination staff resources and expertise. Generally, these mergers have resulted in larger, more cost-efficient, and better-capitalized institutions with a broad, diversified asset base, both by geography and commodity. Thus far in FY 2011, two mergers of associations have become effective. In addition, two banks, U.S. AgBank, FCB, and CoBank, ACB, have submitted a plan of merger for FCA Board consideration. As of January 1, 2011, the System had 84 direct-lender associations, five banks, five service corporations, and two special-purpose entities.

Federal Agricultural Mortgage Corporation

Congress established Farmer Mac in 1988 to provide secondary market arrangements for agricultural mortgage and rural home loans. Farmer Mac creates and guarantees securities and other secondary market products that are backed by mortgages on farms and rural homes, including certain USDA guaranteed loans. The 2008 Farm Bill expanded Farmer Mac's program authorities by allowing it to purchase and guarantee securities backed by eligible rural utility loans made by cooperative lenders. Through a separate office required by statute (Office of Secondary Market Oversight), the Agency examines, regulates, and monitors Farmer Mac's operations.

Farmer Mac is a separate GSE devoted to agriculture and rural America. By statute, in extraordinary circumstances Farmer Mac may issue obligations to the U.S. Treasury Department, not to exceed $1.5 billion, to fulfill the guarantee obligations of Farmer Mac Guaranteed Securities. The Insurance Fund does not back Farmer Mac's securities, and the System is not liable for any Farmer Mac obligations.

From Farmer Mac's creation, Congress included strong statutory underwriting, security appraisal, and repayment standards for qualified loans, with Farmer Mac's activities regulated and supervised by FCA. In addition to its statutory minimum requirements, Farmer Mac was required to develop sound underwriting standards for loans to qualify for its programs. To date, these standards and regulations have prevented any investor credit losses in Farmer Mac securities. However, Farmer Mac was impacted by the spillover of the economic stress and recession stemming from the 2008 financial crisis. Losses on certain investments required Farmer Mac to raise additional capital during the fall of 2008, and management changes were made by its board of directors. Farmer Mac continues to restructure its balance sheet and further strengthen its operations and risk-bearing capacity to focus on fulfilling its mission.

Notably, in January 2010, Farmer Mac raised $250 million in capital from a private offering of shares of noncumulative perpetual preferred stock of Farmer Mac II LLC, an operating subsidiary in which Farmer Mac owns all of the common equity. The new preferred stock has a lower net effective cost than the retired capital and has increased its capacity to purchase and guarantee qualified loans and to provide liquidity to rural markets. As of December 31, 2010, Farmer Mac's core capital totaled $460.6 million, which exceeded its statutory requirement of $301.0. As a result, capital surplus grew to $159.6 million, up from $120.2 million as of December 31, 2009. The total portfolio of loans, guarantees, and commitments grew 14 percent to $12.2 billion.

Farmer Mac's program-business portfolio shows continued stress in certain subsectors but remains manageable. Stress in the ethanol industry, as well as certain crop and permanent planting segments, contributed to an increase in the nonperforming loan rate to 1.90 percent at December 31, 2010, compared with 1.41 percent at December 31, 2009. Loans more than 90 days delinquent increased from 1.13 percent at December 31, 2009, to 1.63 percent at December 31, 2010.

Farmer Mac continues to enjoy reliable access to the debt capital markets to support its mission of providing financing and liquidity to agriculture and rural markets. Over the past 2 years, Farmer Mac has taken significant measures to increase the quality and liquidity of its $1.76 billion investment portfolio in order to improve its financial flexibility in the event of a financial or market disruption.

Working With Young, Beginning, and Small Borrowers

System institutions are required to develop programs and make special efforts to serve young, beginning, and small (YBS) farmers and ranchers. In 2010, lending by the System to YBS producers continued to show gains in loan dollars outstanding. Nevertheless, YBS results as a percentage of total loans have either dipped or remained relatively flat over the past several years. However, the System's YBS dollar results are noteworthy because institutions have managed to expand loan volume in spite of generally downward demographic trends for these groups of farmers.

FCS institutions may use a variety of tools to fulfill their commitment to YBS lending, including lower rates or fees for YBS borrowers, differential underwriting standards, USDA guarantees, and special training programs and other financial services. Many associations have revised their YBS policies and procedures in the past 3 years. The changes are in response to guidance issued in our August 2007 FCA Bookletter, which allowed for more flexibility in lending to YBS borrowers and encouraged use of credit enhancements so YBS borrowers could qualify for credit. The changes are an indication that FCA's oversight activities are accomplishing the goal of helping institutions' management and boards stay focused on this important mission area.

Working With Financially Stressed Borrowers

Agriculture involves significant inherent risks and volatility because of many factors, including adverse weather, changes in government programs, international trade issues, fluctuations in commodity prices, and crop and livestock diseases. The significant risks in agriculture can sometimes make it difficult for borrowers to repay loans. The System, under provisions of the Farm Credit Act of 1971, as amended (Act), provides borrowers certain rights when they apply for loans and when they have difficulty repaying loans. For example, the Act requires FCS institutions to consider restructuring a distressed agricultural loan before initiating foreclosure. It also provides borrowers an opportunity to seek review of certain credit and restructuring decisions. If a borrower's loan goes through foreclosure, the Act and implementing regulations provide qualifying borrowers the opportunity to buy back their property at the appraised fair market value or to make an offer to buy the property back at less than this value. These rights are unique when compared with other financial institutions that operate under Federal law.

FCA enforces the borrower rights provisions of the Farm Credit Act and examines institutions to make sure that they are complying with these provisions. It also receives and reviews complaints from borrowers regarding their rights as borrowers. Through these efforts, FCA ensures compliance with the law and helps FCS institutions continue to provide sound and constructive credit and related services to eligible farmers and ranchers. In 2009 and 2011, FCA issued Frequently Asked Questions (FAQs) to clarify its borrower rights regulations. These FAQs help guide System institutions and their borrowers through many of the situations encountered.

Conclusion

We at FCA remain vigilant in our efforts to ensure that the Farm Credit System and Farmer Mac remain financially sound and focused on serving agriculture and rural America. While we are proud of our record and accomplishments, I assure you that the Agency will continue its commitment to excellence, effectiveness, and cost efficiency and will remain focused on our mission of ensuring a safe, sound, and dependable source of credit for agriculture and rural America. This concludes my statement. On behalf of my colleagues on the FCA Board and at the Agency, I thank you for the opportunity to share this information.

The CHAIRMAN. Thank you, Mr. Strom. Dr. Henderson?

STATEMENT OF JASON R. HENDERSON, PH.D., VICE PRESIDENT AND OMAHA BRANCH EXECUTIVE, FEDERAL RESERVE BANK OF KANSAS CITY, OMAHA, NE

Dr. HENDERSON. Thank you, Mr. Chairman and Members of the Subcommittee. My name is Jason Henderson. I am Vice President and economist with the Federal Reserve Bank of Kansas City. In this capacity, I lead several Federal Reserve initiatives that track economic conditions in the farm economy, including the *Agricultural Finance Databook,* which summarizes trends in national farm lending and the Agricultural Credit Survey for our seven states in the 10th Federal Reserve District. I appreciate the opportunity to discuss some of our findings regarding national agricultural credit conditions and farmland values.

In 2009, the recession and fragile financial markets cut farm incomes and raised concerns about credit availability for agricultural borrowers. Since then, a stronger global economy has spurred booming farm incomes. Surging crop prices are boosting profits for crop producers, and many livestock operations are still able to maintain some level of profitability even in the face of high feed costs. With a resurgent farm economy, agricultural loan demand is shifting.

The most dramatic shift has emerged from the decline in farm operating loans. With strong cash flows at the end of last year, farmers paid off operating loans and many prepaid a large portion of their input costs. Commercial bankers across the nation reported higher loan repayment rates with operating loan volumes falling sharply in the first quarter of 2011.

In contrast, commercial banks increased lending to livestock producers. With higher costs straining livestock profits, loan demand from livestock enterprises increased. And even in the face of tighter credit standards and rising delinquency rates, commercial banks expanded loan volumes for livestock last year.

In addition, loan volumes for farm machinery and equipment have risen sharply. Larger profits prompted many producers to expand their capital investments and business contacts reported brisk farm machinery sales. In the first quarter of 2011, farm loans for machinery and equipment surged 72 percent above year-ago levels at commercial banks.

Finally, farm real estate loan volumes rose solidly with booming cropland values. According to Federal Reserve and university surveys, cropland values in many midwestern states have soared more than 20 percent over the past year. The Northern and Southern Plains also enjoyed stronger farmland value gains as robust energy markets lifted land lease revenues for oil exploration. By the end of 2010, farm real estate loan volumes at commercial banks and Farm Credit associations rose solidly, and our industry contacts noted that life insurance companies, vendor creditors, and non-farm investors remained active in agricultural markets.

Going forward, lenders appear to be in position to meet the credit needs of farmers. Agricultural bankers report having ample funds for farm loans and continue to lend at historically low interest rates. Bankers are beginning to ease collateral requirements on farm loans after stronger repayment rates trimmed delinquencies on farm loans. And with healthier loan portfolios, agricultural banks are enjoying stronger earnings than their peers, which should underpin lending activity.

Still, questions surrounding the availability of credit and collateral requirements persist. The most pressing concerns and stringent requirements have likely emerged for livestock producers struggling with profitability, and for smaller farm operations owned by young and beginning farmers with less equity. Our research at the Federal Reserve Bank of Kansas City indicates that these operations are more likely to struggle with debt repayment and be denied credit.

As a result, the sustainability of farm profits and land values pose the greatest risk to agricultural credit conditions. Agriculture is a boom-and-bust industry. While another year of hearty profits are expected, these profits could be fleeting. For example, USDA projects average annual corn prices to fall below $4.25 per bushel by 2013 and remain below these levels through 2020, cutting net returns above variable costs by 30 percent. In addition, profit margins for other major field crops are projected to decline. Shrinking returns could threaten booming cropland values, and if capitalization rates rise to their historical averages, land values could fall by as much as ⅓, eroding the financial health of the farm sector.

In the face of volatile markets and uncertain profits, low leverage ratios and larger levels of working capital are often the best risk management strategies for farmers. Most measures of financial leverage remain at historical lows, but it is still an open question whether farmers have learned these lessons from past farm crises and will resist the temptation of excessive borrowing at low interest rates.

In sum, near-term prospects for U.S. agriculture remain bright. Delinquency rates have eased and, while tight, credit standards for agricultural loans are beginning to loosen. With lofty incomes, many farmers invested in machinery, equipment, and farm real estate, while others paid down debts to weather any unexpected storms building on the horizon. While volatile commodity markets and rising production costs are threats to future farm profits, credit is still available.

Mr. Chairman and Members of the Subcommittee, thank you for inviting me here today, and I will be happy to respond to any questions at the appropriate time or in the future. Thank you.

[The prepared statement of Dr. Henderson follows:]

PREPARED STATEMENT OF JASON R. HENDERSON, PH.D., VICE PRESIDENT AND OMAHA BRANCH EXECUTIVE, FEDERAL RESERVE BANK OF KANSAS CITY, OMAHA, NE

Thank you, Mr. Chairman and Members of the Subcommittee. My name is Jason Henderson. I am Vice President and Economist with the Federal Reserve Bank of Kansas City. In this capacity, I lead several Federal Reserve initiatives that track economic conditions in the farm economy, including the *Agricultural Finance Databook,* which summarizes trends in national farm lending and the Survey of Agricultural Credit Conditions for our seven states in the Tenth Federal Reserve District. I appreciate the opportunity to discuss some of our findings regarding national agricultural credit conditions and farmland values.

Agricultural Credit Conditions

In 2009, the recession and fragile financial markets cut farm incomes and raised concerns about credit availability for agricultural borrowers. Since then, a stronger global economy has spurred booming farm incomes. Surging crop prices are boosting profits for crop producers and many livestock operations are still able to maintain some level of profitability even in the face of high feed costs. With a resurgent farm economy, agricultural loan demand is shifting.

The most dramatic shift has emerged from the decline in farm operating loans. With strong cash flows at the end of 2010, farmers, especially crop producers, paid off operating loans. In addition, many pre-paid a large portion of their input costs at the end of last year, curtailing loan demand. Based on Federal Reserve surveys, commercial bankers across the nation reported higher loan repayment rates and fewer extensions and renewals for operating loans, with loan volumes falling more than 22 percent below year ago levels in the first quarter of 2011.

In contrast, commercial banks expanded lending to livestock producers. With higher costs for feed and feeder cattle straining livestock profits, loan demand from livestock enterprises increased. Even in the face of tighter credit standards and rising delinquency rates, commercial banks expanded loan volumes for livestock approximately 15 percent last year. In the first quarter of 2011, commercial bank lending for livestock held near last year's elevated levels.

In addition, loan volumes for farm machinery and equipment have risen sharply. Larger profits prompted many crop producers to expand their capital investments and business contacts reported brisk sales of tractors, combines, trucks, pivot-irrigation systems, grain bins, and other farm equipment. For example, according to the Association of Equipment Manufacturers, four-wheel drive tractor sales jumped roughly 30 percent in 2010. In the first quarter of 2011, commercial bankers reported that loan volumes for farm machinery and equipment surged 72 percent above year ago levels.

Finally, farm real estate loan volumes rose solidly with booming cropland values. According to Federal Reserve and university surveys, cropland values in many Midwestern states have soared more than 20 percent over the past year. The northern and southern Plains also enjoyed stronger farmland value gains as robust energy markets lifted land lease revenues for oil exploration. By the end of 2010, farm real estate loan volumes at commercial banks and Farm Credit associations rose solidly, and industry contacts noted that life insurance companies, vendor creditors, and non-farm investors remained active in agricultural markets.

The Outlook for Agricultural Lending

Going forward, agricultural lenders appear to be in position to meet the credit needs of farmers. Agricultural bankers report having ample funds for farm loans and continue to lend to farmers at historically low interest rates. Bankers are beginning to ease collateral requirements on farm loans after stronger repayment rates trimmed delinquencies on farm loans. With healthier loan portfolios, agricultural banks are enjoying stronger earnings than their banking peers, which should further underpin future lending activity.

Still, questions surrounding the availability of credit and collateral requirements persist. The most pressing concerns and stringent requirements have likely emerged for livestock producers struggling with profitability and for smaller farm operations owned by young and beginning farmers with less equity. Our research at the Federal Reserve Bank of Kansas City indicates that these operations are more likely to struggle with debt repayment and be denied credit.

As a result, the sustainability of farm profits and agricultural land values pose the greatest risk to agricultural credit conditions. Agriculture is a boom and bust industry. While many crop producers expect another year of hearty profits, these profits could be fleeting. For example, according to the U.S. Department of Agriculture's long-term projections, average annual corn prices could fall to $4.10 per bushel by 2013 and remain less than $4.25 per bushel through 2020, cutting net returns above variable costs by 30 percent. Profit margins for other major field crops are also projected to decline. Shrinking returns could threaten booming cropland values, and if capitalization rates return to their historical averages, cropland values could fall by as much as a third, eroding the financial health of the farm sector.

In the face of volatile markets and uncertain profits, low leverage ratios and larger levels of working capital are often the best risk management strategies for farmers. Most measures of financial leverage remain at historical lows, but it is still an open question whether farmers have learned these lessons from past farm crises and will resist the temptation of borrowing at low interest rates.

In sum, near-term prospects for U.S. agriculture remain bright. Delinquency rates have eased and, while tight, credit standards for agricultural loans are beginning to loosen. With lofty incomes, many farmers invested in machinery, equipment and farm real estate, while others paid down debts to weather any unexpected storms building on the horizon. While volatile commodity markets and rising production costs are threats to future farm profits, credit is still available.

Mr. Chairman, thank you for inviting me today, and I will be happy to respond to any questions at the appropriate time.

ATTACHMENT

Agricultural Finance Databook

Cropland Values Climb and Agricultural Finances Strengthen

By Jason Henderson and Maria Akers

April 2011

Agricultural finance conditions strengthened amid soaring farmland values, booming farm incomes and rising commodity prices. Strong farm incomes, especially in grain producing regions, drove cropland values as much as 20 percent above year-ago levels. Robust farm and non-farm investor demand and skyrocketing land prices enticed some landowners to list farms for sale. Robust energy markets also placed upward pressure on farmland values in the northern Plains where land lease revenues for oil exploration surged. Farmland value gains, however, were more modest in the southern Plains as drought conditions intensified. Rising farmland values and brisk sales raised farm real estate loan volumes at commercial banks moderately at year-end.

With stronger loan portfolios, agricultural banks ended the year with their best performance since the start of the financial crisis. Farm loan delinquencies fell as more farmers paid off loans at the end of 2010. Bankers also reported fewer loan renewals or extensions, potentially foreshadowing future declines in noncurrent loan volumes. The return on assets and equity at agricultural banks marched higher during the year, while the returns at other small banks held steady. Moreover, in a year when over 150 commercial banks failed, fewer than ten were agricultural banks.

Strong farm incomes transformed non-real estate loan portfolios at commercial banks. Rising incomes curbed demand for short-term production loans but fueled capital investment that lifted intermediate-term loan volumes for machinery and equipment. The volume of loans for operating expenses waned at the first of the year as both crop and livestock producers used current incomes to pay for operating expenses. In contrast, farm machinery and equipment loan volumes rose sharply with a rebound in capital spending. With softer non-real estate loan demand, more bankers reported a rise in funds available for farm loans. Collateral requirements generally held steady and interest rates continued to trend down.

Section A

Resurgent capital spending on farm machinery and equipment shifted lending activity toward intermediate-term loans. With rising incomes, farmers sharply increased their capital spending levels, in turn boosting intermediate-term loan volumes on farm machinery and equipment (*Chart 1*). In fact, farm machinery and equipment loan volumes jumped 73 percent above year ago levels in the first quarter of 2011. These loans were extended for slightly shorter terms compared to last year but at much lower effective interest rates that averaged 4.4 percent (*Chart 2)*.

In contrast, rising farm incomes trimmed operating loan demand as farmers used cash to pay for operating expenses. The volume of operating loans plunged 22 percent below year ago levels in the first quarter. Bankers reported weak loan demand and strong pre-payment of operating expenses. Strong winter storms during the February survey period and the atypical timing of the survey may have exacerbated the declines in loan originations in first quarter 2011. Operating loan maturities were about 2 months longer than average at 11 months, and the average effective interest rate edged up to 5.3 from a fourth quarter low.

After rising substantially the last half of 2010, the volume of feeder and other livestock loans at commercial banks posted modest declines. In the first quarter, the volume of feeder livestock loans fell nine percent below year-ago levels, even though rising feeder cattle prices pushed average loan amounts higher. The average maturity for feeder livestock loans fell to just under 8 months, and the average effective interest rate held around five percent.

Small and mid-size commercial banks were more affected by shrinking non-real estate loan volumes than large commercial banks. The size of farm loan portfolios at banks with $25 million or less in farm loans contracted 12 percent year-over-year, while the size of farm loan portfolios at banks with more than $25 million in farm loans held steady. At the same time, the composition of farm loan portfolios shifted away from smaller loans towards larger loans over $100,000.

Section B

Agricultural banks closed 2010 with their strongest financial performance in 2 years. The average rate of return on equity at agricultural banks jumped to 8.4 percent in the fourth quarter, compared to 1.1 percent at other small banks (*Chart 3*). Moreover, the rate of return on assets at agricultural banks strengthened in the fourth quarter to 0.9 percent, in contrast to 0.1 percent at other small banks. In addition, the percentage of agricultural banks with negative income as a share of average equity fell by more than a third. After rising during most of 2010, average capital ratios at both agricultural banks and other small banks edged down in the fourth quarter but remained near year-ago levels.

Non-real estate loan performance strengthened in the fourth quarter. The volume of outstanding non-real estate farm loans at all commercial banks ended the year slightly below 2009 levels. Delinquent non-real estate loans have trended down since early 2010, comprising just 2.0 percent of outstanding farm production loans in the fourth quarter (*Chart 4*). Also, the volume of non-real estate loans 30 to 90 days past due dropped to its lowest level since 2008. With declining delinquency rates, fourth quarter net charge-offs fell more than 25 percent below year-ago levels.

Loan performance measures for real estate loans improved at year-end. Farm real estate loan volumes at all commercial banks settled 2.0 percent above year-ago levels. After rising steadily during the past 3 years, the share of nonperforming farm real estate loans eased slightly in the fourth quarter to 2.7 percent. In addition, the volume of real estate loans 30 to 90 days past due leveled off, which could signal further declines in delinquency rates. Net charge-off amounts grew in the fourth quarter but they accounted for about the same percentage of outstanding farm real estate loans as last year.

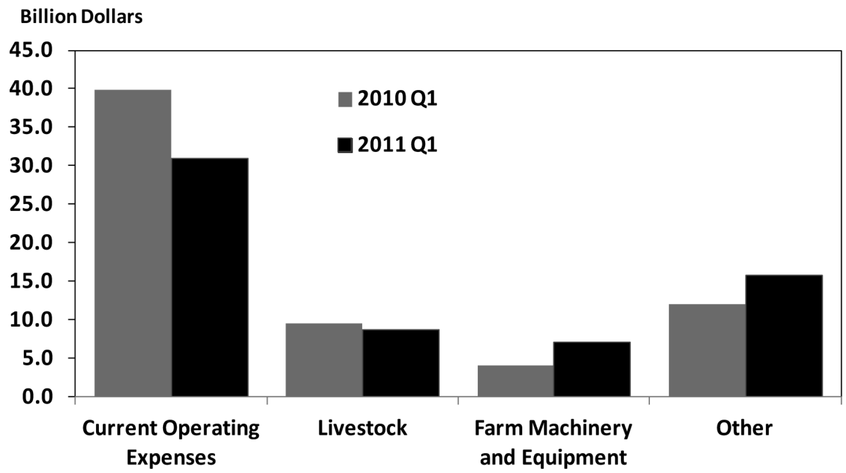
Section C

Rising farm incomes propelled farmland values higher at the end of 2010. Large year-over-year farmland value gains were seen across the Corn Belt and into the northern Plains where energy production is booming. In fact, North Dakota enjoyed the strongest annual increase in farmland values largely due to land lease revenues from expanded oil production (*Map 1*). Crop producing states such as Indiana, Illinois, Iowa, Nebraska, and Kansas reported another round of robust farmland price increases in the fourth quarter. Cropland values, however, increased more modestly in the southern Plains as drought conditions threatened crop yields and limited cattle grazing. Even with slightly more farms for sale at the end of the year, strong demand from farmers and nonfarm investors kept bidding brisk and values elevated. Bankers in the Chicago District expected growth in farm real estate loan volumes relative to last year. Many Federal Reserve survey respondents anticipated that farm incomes and farmland values would rise further in the coming months.

Overall demand for farm loans stalled in the fourth quarter with less borrowing for production expenses and an upswing in loans for capital purchases. Several districts noted a decline in operating loan demand as many farmers used income to pre-pay for crop inputs. In addition, bankers in the Chicago, Dallas, and Richmond Districts reported fewer feeder cattle and dairy loans in the fourth quarter. Still, a majority of bankers expected operating loan volumes would rebound prior to spring planting. Federal Reserve surveys also noted a rush of machinery and equipment loans at the close of 2010 as farmers upgraded equipment and took advantage of new tax depreciation rules.

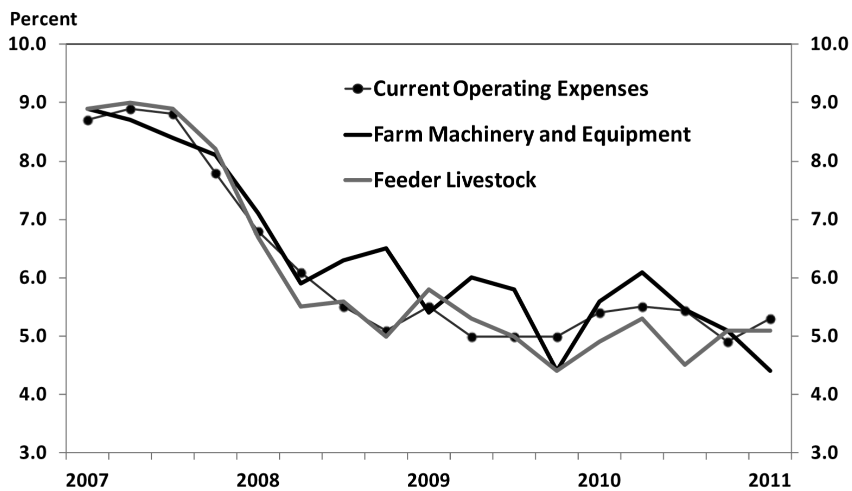
Farm credit conditions strengthened further as farmers paid off loans in earnest at year-end. According to Federal Reserve surveys, loan repayment rates at agricultural banks continued to climb and were markedly higher in the Chicago, Minneapolis, and Kansas City Districts. Moreover, loan renewals and extensions fell in all districts but Richmond. Most bankers, but particularly those in the Chicago and Kansas City Districts, noted ample funds were available for loans, and very few loans were referred to non-bank credit agencies. Collateral requirements generally held steady or eased slightly. Interest rates trended down for both real estate and non-real estate loans.

Chart 1: Loan Volume by Purpose of Loan



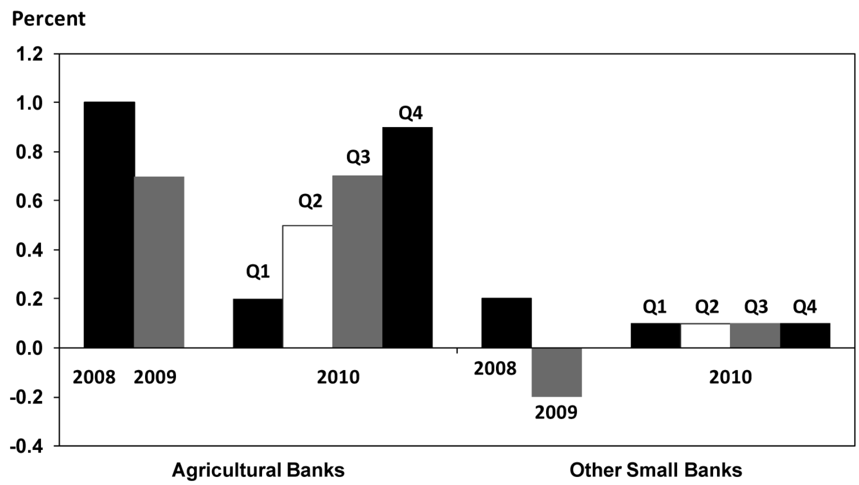
Source: Agricultural Finance Databook, Section A.

Chart 2: Average Effective Interest Rates on Farm Loans



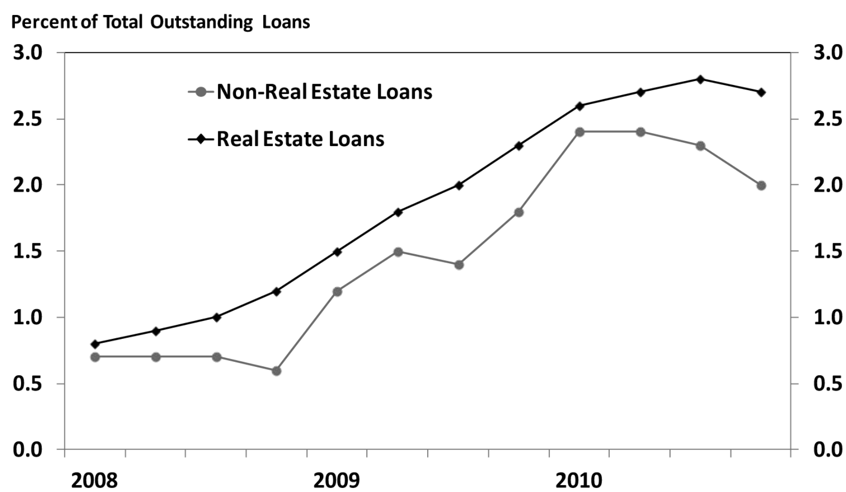
Source: Agricultural Finance Databook, Section A.

Chart 3: Rate of Return on Assets



Source: Agricultural Finance Databook, Section B.

Chart 4: Nonperforming Loan Volumes



Source: Agricultural Finance Databook, Section B.

Map 1: Good-Quality (Non-irrigated) Cropland Values
(Percent change Fourth Quarter 2009 to Fourth Quarter 2010)

Source: Federal Reserve District Surveys (Chicago, Minneapolis, Kansas City, Dallas).

The CHAIRMAN. Thank you, Dr. Henderson and gentlemen, for your testimony. I will begin questioning. Each Member will have approximately 5 minutes.

Mr. Dolcini, you had stated that loans have increased in 2010 over 2009 and are expecting a further increase this year. We have heard testimony today that the farm sector is in generally good condition and credit is readily available. So can you explain these increases, as well as the fact are they limited to certain credit sectors that are under stress now?

Mr. DOLCINI. Thanks for the question, Mr. Chairman. I think that what we have seen at FSA, and I consider our farm loan programs to be as an important part of the safety net as our Farm Programs, sort of the other side of the house, but there are still haves and have-nots in American agriculture. And while there are certainly some sectors of the overall ag economy that are doing quite well, and I think they have been cited in the testimony you have heard this morning. There are others that are not: poultry, hogs, dairy certainly. I come from California where the dairy industry has been hit really hard over the last couple of years.

What we also have really tried to do in light of direction from the 2008 Farm Bill, and this Secretary and President Obama for that matter, is to bring more beginning farmers into our overall portfolio. And we have seen dramatic increases in the numbers of those folks in the last couple of years, too. So that accounts for a part of the growth that we have seen. And they have, in our experience, a tough time getting loans commercially. I think you will hear from a beginning farmer later this morning. But that has been an important part of where we have seen our portfolio grow.

The CHAIRMAN. So what percent of the growth is due to these livestock sectors that are under certain stress as well as beginning farmers?

Mr. DOLCINI. Chris, can you address that?

Mr. BEYERHELM. Yes, I wouldn't be able to give you an exact percentage, but I know that currently in 2011 and in 2010, 40 percent of our loans made during those years were for new customers we hadn't done business with before. When you analyze those, at least half of those are from cattle producers. So just intuitively, what our takeaway from that is is that people are needing credit from the livestock industry and then also, as Mr. Dolcini said, beginning farmers that have not had access to credit previously.

The CHAIRMAN. Thank you.

Mr. DOLCINI. We would be happy to provide you a breakdown of that.

The CHAIRMAN. I think that would be helpful. Thank you very much.

One further question. There have been a few requests to Members of this Committee to either suspend or extend term limits on guaranteed loans. Can you give us some insight from the Agency's perspective on why producers are not graduating from the program at 15 years?

Mr. BEYERHELM. Thank you for that question. What our analysis is is that most of the farmers we work with—and ranchers—are in business for 40 to 50 years. And during that 40 or 50 year period, the odds that some sort of weather condition or financial condition or personal condition that changes their ability to obtain credit from the commercial lending sector is most likely to happen. And you would think that 15 years would be enough, but if you live in certain parts of the country, farmers and ranchers have experienced numerous disasters, numerous setbacks, made some financial progress and then they are set back. So in some cases, 15 years is not enough in order to prepare them to get commercial credit without the assistance of a guaranteed loan.

The CHAIRMAN. But the point of the program is to move people off of it after 15 years?

Mr. BEYERHELM. Yes, and that is correct. I think the data is good as far as the number of people that are moving off of the System.

The CHAIRMAN. That would actually be a helpful statistic as well if you could provide that. Thank you very much.

I will turn to Mr. Strom now. In your written testimony, Mr. Strom, you discussed that the System is financing infrastructure projects through innovative bond financing, I assume that is part of the rural community investment pilot program. You have actually proposed expanding this Pilot Program in 2008. Can you comment on the status of this potential new rule?

Mr. STROM. Thank you for the question, Mr. Chairman.

The status of that rule is is that this Pilot Program began in 2005. In spring of 2008 we put out a proposed rule on this. We received numerous comment letters on that rule. We continue to look at and investigate the status of this program. Obviously, we are looking at how it can benefit areas of rural America with these targeted types of investments. It is currently on our regulatory agenda to go to a final rule, with yet an undetermined date. But we, again, continue to look at this very closely, again, trying to determine exactly the benefit that this can serve for rural America.

The CHAIRMAN. Do you have just your perspective on why this particular mission change of the organization is under consideration?

Mr. STROM. Well, the Farm Credit Act of 1971 gives this type of investment authority to the System. I think, initially, it was viewed that this would be good for farmers and ranchers and the communities that they live in. Investments held under these Pilot Program authorities are segregated in five categories. There is rural housing mortgage securities, rural development, debt securities—which include community facilities, rural business, rural lenders. There is credit link to agricultural notes, agribusiness investments and equity investments.

I think in the overall look at this, again, with looking at how the authority of this can apply to these types of investments and, again, we received over 10,000 comment letters on this so there was a lot of comment regarding these. We just want to ensure that if this goes forward that it is done in a way that is targeted toward helping rural communities through infrastructure process, through either investments in the community facilities like critical care units or assisted living facilities. But again, the 1971 Act does give authority for these investment types. And I would be happy to provide you further information on that authority.

The CHAIRMAN. That would be helpful. Thank you, Mr. Strom.

Mr. STROM. Thank you.

The CHAIRMAN. I will turn now to our Ranking Member, Ms. Fudge.

Ms. FUDGE. I thank you, Mr. Chairman.

As you know, there are many conflicting events and meetings going on at this time, so I would like to yield to my colleague Mr. McGovern to ask his questions first.

Mr. MCGOVERN. I appreciate that and apologize that I have to leave early.

But Mr. Dolcini, I am from New England and farmers in New England are typically smaller family-owned farms and tend to produce specialty crops or dairy. And I guess can you discuss some of the credit issues specific to smaller farmers and the ways that your Agency reaches out to them and can provide assistance? And what are you doing to continue to extend farm credit to dairy farmers that held on during the 2009 crisis?

Mr. DOLCINI. Sure. I will take that one first.

The Dairy Industry Advisory Commission, which the Secretary convened last year, recently came up with its report. I think it listed 17 different recommendations. We are looking at that at USDA to determine how we can best fit those recommendations into the loan programs that we provide currently, or may want to provide in the future to the dairy industry. I think that we are working with Congress on that issue.

The beginning farmer statistics, Mr. McGovern, are particularly impressive when you look back to 1995 when we only had about 3,500 folks who we consider beginning farmers in our portfolio. That number is now about 27,000. And that has come as a result of a lot of aggressive outreach in all of the 50 states, including New England, to identify small farmers in particular, SDA borrowers, African Americans, women, Hispanic, Asian farmers, and really focus on new and different types of agriculture.

As I mentioned earlier, I come from a state that grows 400 different crops and has a very diverse farmer base. And we have worked with Hmong farmers, for example, in the Central Valley who might farm on an acre or less and still grow 20 or 30 crops. And there are plenty of examples like that scattered around New England and the rest of the country, too. So, what we are doing in the states and what we are doing here in D.C. to push initiatives like that out are really making a big difference and a positive one.

Mr. MCGOVERN. I appreciate that. One final question.

In your written testimony you begin by saying that farm economy strengthened in 2010. However, farm income, especially net farm income is very unevenly distributed. Can you expand on that a little bit and who are the winners and who are the losers?

Mr. DOLCINI. Well, as I mentioned in my remarks and I will defer to Mr. Beyerhelm for a deeper drill-down on the stats, but you know, there are haves and have-nots. And what we have seen in the dairy industry, as you mentioned——

Mr. MCGOVERN. Right.

Mr. DOLCINI.—poultry, hogs, some beginning farmers who have had trouble accessing commercial credit and are now coming into our programs are folks who are on the have-not side of the ledger. Large commodity program crops, the grain crops of the Midwest, are the folks who are enjoying historically higher prices. Rice is included in that as well. So it is kind of a regional breakdown depending on where you are. People who have accessed USDA programs historically and successfully are those that I think are enjoying the benefits of these high prices nowadays.

Mr. MCGOVERN. Thank you. Do you have anything to add?

Mr. BEYERHELM. I think Mr. Dolcini covered it.

Mr. MCGOVERN. Okay. I appreciate it very much. Thank you.

The CHAIRMAN. Do you want to use the balance of your time?

Ms. FUDGE. No, actually, after you I will go.

Mr. CRAWFORD [presiding.] Okay. I am pinch-hitting for the Chairman. I am Congressman Crawford from Arkansas and I have just a couple of quick questions for you, Mr. Dolcini.

My district in Arkansas is home to large-scale rice production. Some of my constituents have come to me with complaints about the FSA Facility Loan Program. Beginning rice farmers and those having to replace their equipment have been asked to put up more collateral in order to secure loans for grain bins. The FSA is asking these farmers to leverage their land instead of their equipment when loans exceed a specific amount. Has credit become tighter for these types of loans as a result of insufficient resources and overall market conditions? Or has there been an increased amount of risk associated with lending to grain farmers?

Mr. DOLCINI. That is a good question, Mr. Crawford, and I appreciate the opportunity to get back with you with something I might leave out. But I would say that the Facility Storage Loan Program is a relatively new one. We are still trying to figure out, in some cases, the best ways to make it accessible to rice farmers like your constituents or others around the country. Cold storage is another area of application for that loan program. Obviously, we want good collateral for the loans that we make and whether it is land or machinery, or other things, I would like the opportunity to work with your staff to drill down a little further on that.

Your Congressional district has about 26 USDA service centers, so I know we play an important part of the local economies in your CD and would like to come and visit with you and your staff to talk about these things in greater detail.

Mr. CRAWFORD. That sounds great. I would welcome that. Let me move on to something else.

Are all the loans set aside for beginning and socially disadvantaged producers being used? Is the demand for these funds consistent with those set aside or are we preventing funds from getting to producers who could use the funds?

Mr. DOLCINI. They are not all being used. You know, we have expanded that portfolio—as I mentioned to Mr. McGovern—quite dramatically, but there are still funds for socially disadvantaged and beginning farmers that go unused.

Chris, can you add to that?

Mr. BEYERHELM. We maximize the use of those targets, but at certain times in the year, the targets do come off. So by the end of the year we are able to then move money to perhaps areas where loans are unfunded so at the end of the year we are able to make sure that we have utilized all of the funds that have been allotted.

Mr. DOLCINI. Our authorities are somewhat flexible in that regard so it is helpful to us.

Mr. CRAWFORD. Okay. Finally, after going through the CR that we will be voting on later today, I learned the FSA Ag Credit Insurance Fund will be cut by $433 million and the Farm Assistance Fund by $44 million. Is the FSA capitalized enough to absorb this kind of funding reduction and would it cause the FSA to change lending standards or create a backlog for potential borrowers?

Mr. DOLCINI. Well, sir, we have had a backlog for some months now as we have gone from one CR to another, as you probably know. We have been pretty aggressive in trying to focus funds that do come up in the CRs towards the operating loans. It is obviously spring-planting season and we want to be able to get those monies out into the countryside. We are still evaluating the continuing resolution that you will be considering later today, and we will have a more concrete answer early next week when we see those numbers. I think that we will be able to sustain our current activities around the nation.

Mr. CRAWFORD. Thank you. I want to thank the members of the panel. And unfortunately, due to a scheduling conflict, we are going to have to stand in recess briefly. And as soon as we can resume, we will get back with you. So we will stand in recess. Thank you.

[Recess].

Mr. JOHNSON [presiding.] I will now recall the Committee to order. This meeting of the Subcommittee will reconvene. I am Congressman Johnson and I am here in Mr. Fortenberry's required absence. And again, I welcome the first panel and I would call on Congresswoman Fudge for questions for this panel.

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

Let me begin with Mr. Strom. You mentioned in your testimony that the biggest loan growth in 2010 was to cooperatives and real estate mortgage loans. Is it possible to find out if this growth was in concentrated geographic areas? For example, did most of this growth happen in the West or the South or North? Could you respond, please?

Mr. STROM. Ranking Member Fudge, the System's loan growth in 2010 would have equated to about $10 billion in loan growth. And, as you look at and analyze that, there are a couple of strong contributing factors: one, the rising values of land in the upper Midwest, especially where grain prices and the concentration of grain production or corn, soybeans, wheat, and because there has been strong income returns for farmers and ranchers in those areas last year and with higher prices now, that is obviously a contributing factor. So you saw increased loan growth somewhat in real estate mortgages there.

I would say another strong contributing factor, though, to loan growth or that $10 billion in the System was probably driven by the rise in commodity prices because, again, the Farm Credit System in financing those cooperatives, many of those cooperatives are local grain elevators that are located across, again, the Midwest predominantly who enter into contractual arrangements with farmers and producers to contract grain prices. They lay off their risk by the use of hedging tools, which the Commodity Futures Trading Commission regulates. But as those farmers establish those positions and those prices move up, there is many times margin call requirements that have to be fulfilled. And as I mentioned in my opening statement, we saw just in the 7 days after the last Planting Intentions report and stocks report, demand for almost $2 billion. So if you look at last year when you had rising prices in the last half of last year, I am sure a good portion of that went to those types of margining requirements also.

Ms. FUDGE. Thank you very much.

Dr. Henderson, you mentioned that bankers are beginning to ease collateral requirements. Is that only for lending institutions "best customers," or are you seeing it for smaller producers as well where commodity prices are going up or going down?

Dr. HENDERSON. Well, what we are hearing in terms of collateral requirements starting to ease is across the board as long as the borrower has a projected out income stream on returns and will be able to repay the loans. So we are seeing across the board for small, medium, and large, but it really depends upon what is their repayment capacity and their ability to repay that loan.

Ms. FUDGE. And when you say repayment capacity, tell me exactly what you are talking about.

Dr. HENDERSON. In terms of incomes and expectations, your business plan, what is your projected profitability for your institution?

Ms. FUDGE. Is there a standard you have or do you just look at every instance separately?

Dr. HENDERSON. Every borrower is on an individual basis because a lot of it depends upon an income, the projections in there, but it also depends upon the management capabilities of the borrower in themselves and how they run their business. A lot of times if you look at community banks, they do some relationship-based lending. And so a lot of times that might not be done on strict hard core numbers, but at the same point in time, they understand that there is a relationship there, they are building a business for future growth as well and so they do make some loans on that basis.

Ms. FUDGE. Okay. Thank you. And this is to any member of the panel. Any of you, if you could just respond if you are aware of any individual banks in the System that may be doing things to facilitate direct marketing of foods, like encouraging producers to establish infrastructure like farmers' markets. Obviously, that is a big thing where I come from. So any member of the panel is welcome or more than one.

Mr. STROM. Let me just first respond. The Farm Credit System and its Young Beginning Small Farmer Program emphasizes it. It is a mission of the System to serve all eligible borrowers, creditworthy farmers and ranchers, even those that are producing on small plots for local food systems. We are currently under a project looking closely at that issue to make sure that those emerging markets and local food systems are being adequately served.

Mr. DOLCINI. I will take a crack at that, too, Congresswoman. You know, you didn't ask it directly but we do make loans in urban areas actually if there is a tie to agriculture. So for example, some of the loans that the California operation has made while I was out there involved small apiaries, for example, or rooftop gardens or things. If there is a nexus between agriculture, we are not confined, unlike some other USDA agencies, to simply rural areas. We can make those loans. And in many cases it starts out with youth loans and then they graduate into our Direct or Guaranteed Program. There was a couple of sisters in Fresno County that were raising pigs and they started out with a $5,000 youth loan and today they are borrowers at a much higher level. So we have really tried to develop those relationships.

On the farmers' market side, you mentioned, "Know Your Farmer, Know Your Food." We are really seeing around the country a much greater emphasis on locally grown, and customers and consumers who want to have relationships with their farmers and ranchers, who want to know where their food was produced.

In my state again—I keep going back to my regional bias—we have 300 active farmers' markets there. USDA has provided support to a number of them through various grant programs. And we have provided support to a number of participants through our loan program. So we are active on that front.

Ms. FUDGE. Thank you very much.

Mr. JOHNSON. Well, if there are no other questions and there is just Congresswoman Fudge and I at this point, we will dismiss the first panel and we appreciate your testimony and appreciate your time.

And if I could ask the second panel to come to the table. Briefly introduce yourselves and we will be more than happy to hear fairly brief comments. Thank you again.

As the gentlemen are assembling, let me take the liberty, then, of introducing each of them. We have Mr. Michael Gerber, President and Chief Executive Officer, Federal Agricultural Mortgage Corporation here in D.C.; and Doug Stark, President and Chief Executive Office, Farm Credit Services of America on behalf of the Farm Credit System; Matthew Williams, Chairman and President, Gothenburg State Bank on behalf of the ABA in Gothenburg, Nebraska; and Matt Starline, Starline Organics, Athens, Ohio.

So if you want to proceed in the order I introduced you, we would be more than happy to hear from you. Thanks.

STATEMENT OF MICHAEL A. GERBER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL AGRICULTURAL MORTGAGE CORPORATION (FARMER MAC), WASHINGTON, D.C.

Mr. GERBER. Good morning, Mr. Chairman, Ranking Member Fudge, and Members of the Subcommittee. My name is Michael Gerber and I am the President and CEO of the Federal Agricultural Mortgage Corporation, also known as Farmer Mac. I greatly appreciate the opportunity to testify here today before you. Let me tell you a little bit about Farmer Mac and then give you a snapshot of credit conditions as we see them today in rural America.

Farmer Mac provides a secondary market for agricultural real estate loans, rural utilities loans, and certain loans guaranteed by the U.S. Department of Agriculture. We support primary lenders represented by those seated next to me, as well as others by purchasing or guaranteeing the farm loans they originate. In doing so, we help ensure lending capacity and liquidity for those rural lenders and provide a source of funding for long-term credit at stable interest rates to rural America's communities, including farmers, ranchers, and other rural electric cooperatives.

Since 1996, Farmer Mac has provided over $26 billion in credit to rural America. Currently, our portfolio stands at $12.2 billion of loans, guarantees, and commitments with loans in all 50 states. You may be interested to know that 65 percent of our portfolio of loans comes from family farms and 61 percent of the loans by number meet the USDA definition of *small farms.*

In 2008, Congress expanded our charter to purchase and guarantee loans made by cooperative lenders to the nation's rural utility cooperatives. We took that authorization very seriously and are proud to say that we have provided over $5 billion of funding to that industry.

Since our creation in 1988, we have maintained rigorous underwriting standards. Our commitment to these standards has enabled us to maintain a low delinquency rate and minimal charge-offs. In addition, as you know, we are regulated for safety and soundness by the Farm Credit Administration and also subject to regulation by the Securities and Exchange Commission. We cannot consider as qualified for our program a loan with a loan-to-value ratio in excess of 80 percent, and today our actual weighted average loan-to-value ratio for our farm mortgage portfolio is 55 percent.

The financial crisis of 2008 was a challenging time for financial institutions and Farmer Mac was not immune. Yet we continued to provide lending programs to rural lenders even during those challenging times. Farmer Mac's losses during that period were not in our lending portfolio but rather our liquidity investments, which are required under regulation. When the difficulties arose, it was our partners, the Farm Credit System, the National Rural Utilities Cooperative Finance Corporation, and the commercial banks which provided the necessary capital to allow us time to resolve our issues. We took no taxpayer dollars or government support during that time and—with an additional capital raise in January of 2010—paid our partners back in full, including interest. Since that time, we have grown our capital to well above the required minimum level and continue our efforts to grow that capital base.

Today, the ag economy is stable. While commodity prices on products such as grains and cotton have resulted in strong cash flow for those producers, commodities tied to the general economy have experienced some challenges. All ag producers, however, today face substantial increases in prices for farm inputs. Manufactured input costs such as petroleum and fertilizer are forecast to increase by almost 11 percent in 2011 while input costs such as feed are forecast to increase by about six percent. These increases will add risk to the cash flow for farm operations and may result in additional need for operating lines of credit.

Farmland has also increased in price over recent years in many parts of the country. This is largely due to generally favorable fundamental economic factors such as increasing demand for ag products, strong commodity prices, and low interest rates. Demand for farm loans remains steady. Volatile commodity prices, high input costs, and a slowly recovering economy will continue to impact the borrowing needs of producers.

As a result of these conditions, we have seen solid growth at Farmer Mac. As banks, Farm Credit institutions, and rural utility lenders all work together to meet the demands of their customers, our healthy financial position and mission focus allow us to support rural America today and in an even bigger way in the future. Thank you again for this opportunity and we look forward to working with you in the future. And I would be happy to answer any questions you may have.

[The prepared statement of Mr. Gerber follows:]

PREPARED STATEMENT OF MICHAEL A. GERBER, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FEDERAL AGRICULTURAL MORTGAGE CORPORATION (FARMER MAC), WASHINGTON, D.C.

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear today to testify on behalf of the Federal Agricultural Mortgage Corporation known as Farmer Mac. My name is Michael Gerber and I am the President and Chief Executive Officer of Farmer Mac, headquartered here in Washington, D.C.

Farmer Mac provides a secondary market for agricultural real estate and rural utilities loans and certain loans guaranteed by the U.S. Department of Agriculture. This secondary market increases the availability of long-term credit at stable interest rates to America's rural communities, including farmers, ranchers and other rural residents, and rural utilities, and provides those borrowers with the benefits of capital markets pricing and product innovation. Farmer Mac is a stockholder-owned, federally chartered instrumentality of the United States and part of the Farm Credit System.

Farmer Mac was created by Congress in the aftermath of the agricultural credit crisis of the 1980s, when land values fell as interest rates rose sharply, credit policies tightened and there was a wave of farm foreclosures. Farmer Mac interacts with all categories of rural lenders (including banks, Farm Credit System institutions, insurance companies, and cooperative rural utilities lenders) throughout the country helping to ensure liquidity and lending capacity for lenders to rural America, every day. We serve as a bridge between institutional investment pools of capital and Main Street rural America.

Farmer Mac Programs

Farmer Mac accomplishes its Congressional mission of providing liquidity and lending capacity to rural lenders by:

- purchasing eligible loans directly from lenders;
- providing advances against eligible loans;
- guaranteeing securities representing interests in, or obligations secured by, pools of eligible loans; and
- providing credit enhancements that enable lenders to meet their customers' growing credit needs, transfer risk and improve their capital position.

Farmer Mac conducts these activities through three programs—Farmer Mac I, Farmer Mac II and Rural Utilities, offering loan products designed to increase the liquidity of agricultural real estate mortgage and other eligible loans and the lending capacity of financial institutions that originate them. As of December 31, 2010, the total outstanding volume in all of Farmer Mac's programs was $12.2 billion.

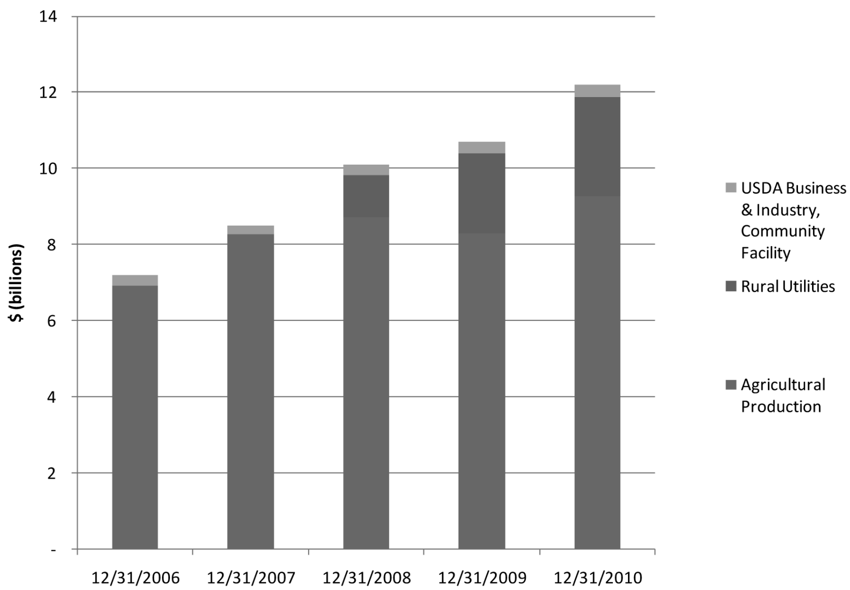
Under the Farmer Mac I program, Farmer Mac purchases or commits to purchase eligible agricultural mortgage loans or securities backed by eligible loans. Loans must meet credit underwriting, collateral valuation, documentation and other standards specified by Farmer Mac. Small farms account for 61% of Farmer Mac guarantees and commitments and the average outstanding loan balance for Farmer Mac I loans is $305,000.

Under the Farmer Mac II program, Farmer Mac's wholly-owned subsidiary purchases the portions of loans guaranteed by the U.S. Department of Agriculture under the Consolidated Farm and Rural Development Act of 1972, as amended. Eligible USDA-guaranteed loans include Farm Service Agency Guaranteed Farm Ownership and Term Operating Loans and Rural Development Business and Industry and Community Facility Guaranteed Loans.

In the Farm Bill of 2008, Congress expanded Farmer Mac's charter to authorize the Corporation to purchase, and to guarantee securities backed by, loans made by cooperative lenders to borrowers who have received or are eligible to receive loans under the Rural Electrification Act of 1936. These loans are for the financing of electrification and telecommunications systems in rural areas. This expansion has been very successful, with Farmer Mac working with eligible rural utilities lenders to provide significant funding to date, with nearly $2.6 billion outstanding as of December 31, 2010. Farmer Mac has worked diligently to develop this line of business and the consumer owners of the nation's rural electric cooperatives have benefited from it.

Figure 1

Outstanding Loans and Guarantees



After buying eligible loans, Farmer Mac can either retain them for investment or pool the loans together, securitize them, and guarantee the timely payment of interest and principal on the resultant securities. Securities that Farmer Mac guarantees are sold to investors in the capital markets, exchanged for the loans and retained by the lender or held by Farmer Mac.

Farmer Mac funds its purchases of Farmer Mac Guaranteed Securities and eligible loans primarily by issuing debt obligations of various maturities in the capital markets. Farmer Mac's regular debt issuance and non-program investment assets support its access to the capital markets. As lenders seek Farmer Mac's products and services, favorable loan terms ultimately depend on Farmer Mac's access to the capital markets. Ultimately, this access to the capital market at favorable rates means that rural borrowers can borrow at better rates which reduces their costs and improves the chances of their success.

Strong Statute and Oversight

When Congress created Farmer Mac in response to the needs arising from problems in the agricultural credit delivery system in the 1980s, the legislators added requirements for a strong and independent regulator. Unlike the other existing secondary market GSEs at the time, under the initial 1987 legislation (Title VIII of the Farm Credit Act of 1971 as amended), Farmer Mac was to be regulated by an independent regulator, the Farm Credit Administration, for safety and soundness. In 1991, Congress required Farmer Mac to be regulated by a separate office (Office of Secondary Market Oversight) within the Farm Credit Administration. The statute creating Farmer Mac expressly required that qualified loans meet minimum credit and appraisal standards that are representative of sound loans to profitable farm businesses. Farmer Mac's statutory charter requires offerings of Farmer Mac Guaranteed Securities to be registered under the Securities Act of 1933 unless an exemption for an offering is available. This provision leads to the requirement that Farmer Mac comply with the periodic reporting requirements of the Securities Exchange Act of 1934, including quarterly reports on the financial status of the Corporation and more frequent reports when there are significant developments. These registration and reporting requirements also put Farmer Mac under the regulatory authority of the Securities and Exchange Commission.

As required by its statutory charter, Farmer Mac has established underwriting, appraisal, and repayment standards for eligible loans taking into account the nature, risk profile, and other differences between different categories of qualified loans. These standards for agricultural real estate mortgage loans under the Farmer Mac I program at a minimum are intended to:

- provide that no loan with a loan to value ratio ("LTV") in excess of 80 percent be eligible (as of December 31, 2010 the weighted average original LTV for Farmer Mac I loans was 55%);
- require each borrower to demonstrate sufficient cash-flow to provide adequate debt service on the loan; and
- protect the integrity of the appraisal process with respect to any loan.

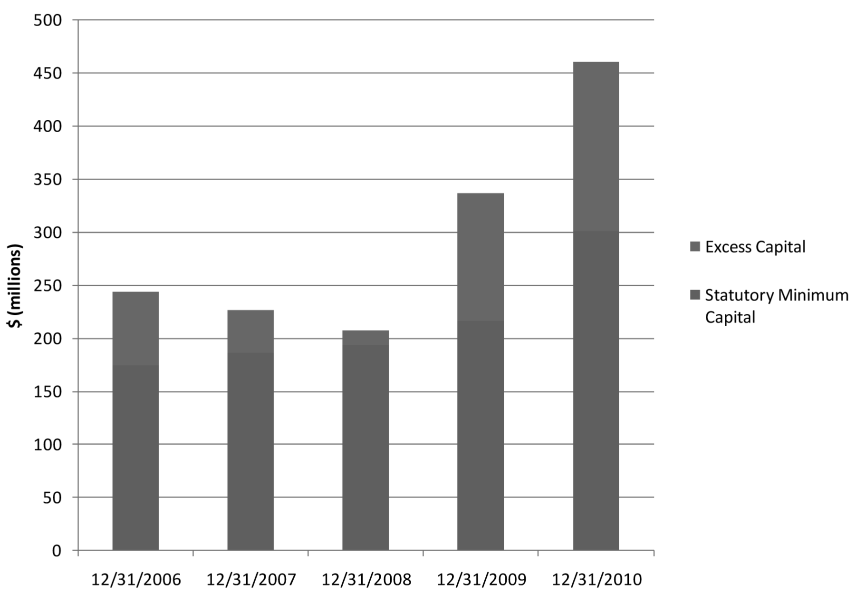
Farmer Mac is required to set aside in a segregated account a portion of the fees it receives from its guarantee activities. This segregated account must be exhausted before Farmer Mac may issue debt obligations to the U.S. Treasury against the $1.5 billion that it is statutorily authorized to borrow in order to fulfill its guarantee obligations. That borrowing authority is not intended to be a routine funding source and has never been used.

Maintenance of Regulatory Capital Levels

The Farm Credit Act established capital requirements for Farmer Mac. Farmer Mac must comply with the higher of the minimum capital and the risk-based capital requirement. Over the past 2 years, Farmer Mac substantially improved its capital position to support the additional business demands in the agricultural production and rural utilities sectors. The chart below illustrates the growth in the level of excess capital, from $13.5 million at year end 2008 to $159.6 million at year end 2010.

Figure 2

Capital Levels



The Farm Credit Act directs the Farm Credit Administration to classify Farmer Mac within one of four enforcement levels for purposes of determining compliance with capital standards. Farmer Mac is currently classified as within level I—the highest compliance level.

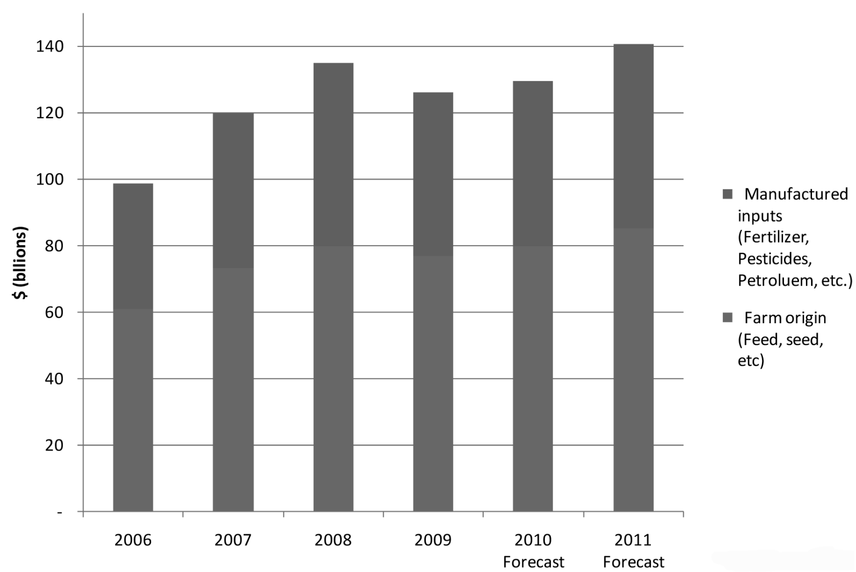
Current Credit Conditions

The current economic environment is a generally stable one for the agricultural sector as a whole. The grains sector, for example, has seen commodity prices approach all-time highs, which has resulted in strong cash flows for these producers. Commodities such as timber and nursery/greenhouses have experienced some challenges tied to the general economy and most notably the dairy and meat complex have seen volatile prices for their commodities and cash flow challenges as a result of higher feed costs.

All agricultural producers are facing substantial increases in the prices for farm inputs, as illustrated in the chart below. These increases will add risk to the cash flow for operations and may result in additional credit needs for operating lines. Manufactured inputs costs (such as petroleum and fertilizer) are forecast to increase by almost 11% in 2011, while farm origin input costs (such as feed) are forecast by about 6%. These cost increases for agricultural producers are significantly higher than overall inflation in the economy, as consensus forecasts for CPI inflation during 2011 are currently around 2.7%.

Figure 3

Agricultural Input Costs

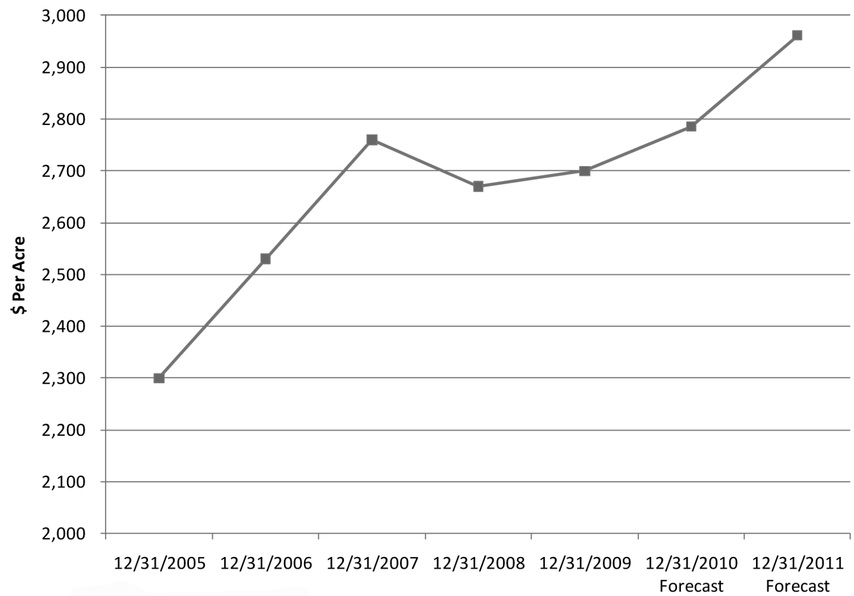


Source: USDA ERS.

Farmland has also experienced substantial increases in price over recent years. The chart below shows the average value per acre for U.S. cropland, which has been remarkably resilient despite the impacts of the recent recession. This is largely due to generally favorable fundamental economic factors such as increasing demand for agricultural products, strong prices for agricultural commodities, low leverage in the agricultural sector, and low interest rates.

Figure 4

U.S. Average Cropland Value

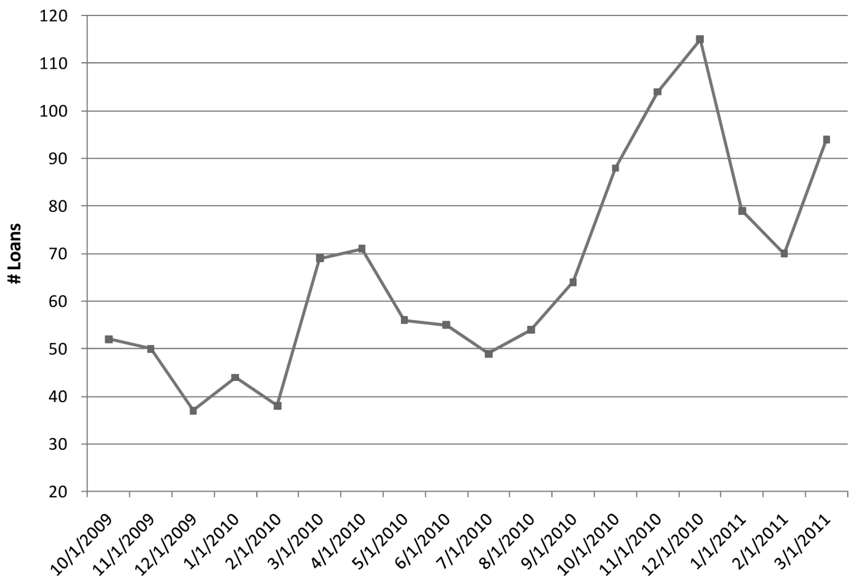


Source: USDA NASS, USDA ERS.

The combination of the above mentioned factors combined with many financial institutions desiring to improve their balance sheets has resulted in an increase in demand for Farmer Mac products. Lenders continue to seek to offer their customers long-term interest rates at historically low levels, fund larger real estate loans, and manage borrower exposure levels. Farmer Mac has seen its outstanding loans and guarantees expand, and the numbers of new financial institutions, most of which are small rural lenders, applying to become approved Farmer Mac participants grew by 217 from 2008 to 2010. This has resulted in significant growth in our cash window products as new loan submissions have increased substantially over the past 2 years. Net volume of loans, guarantees and commitments grew in excess of 14% in 2010. The chart below shows producer-level loan submissions to Farmer Mac, and does not include portfolios securing Farmer Mac advances to lenders or portfolios credit enhancements to lenders.

Figure 5

Famer Mac Agricultural Production Loan Purchase Submissions



Mirroring the agricultural economy as a whole, Farmer Mac's portfolio of loans and guarantees has generally performed well in recent years. As of December 31, 2010, Farmer Mac's 90 day delinquencies stood at $70.2 million, all of which were in the Farmer Mac I program. These delinquencies represent 1.63% of outstanding Farmer Mac I loans, or 0.57% of Farmer Mac's total amount of outstanding loans and guarantees. Farmer Mac believes that delinquency rates will remain at manageable levels over the foreseeable future.

Commodity/Geographic Diversity

It is Farmer Mac's policy to diversify its portfolio of loans held and loans underlying Farmer Mac I products, both geographically and by agricultural commodity/product. Farmer Mac directs its marketing efforts toward agricultural lenders throughout the nation to achieve commodity/product and geographic diversification in its exposure to credit risk. Farmer Mac evaluates its credit exposure in particular geographic regions and commodities/products, adjusted for the credit quality of the loans in those particular geographic regions or commodity/product groups relative to the total principal amount of all outstanding loans held and loans underlying Farmer Mac I products.

Figure 6
Agricultural Production Commodity Distribution

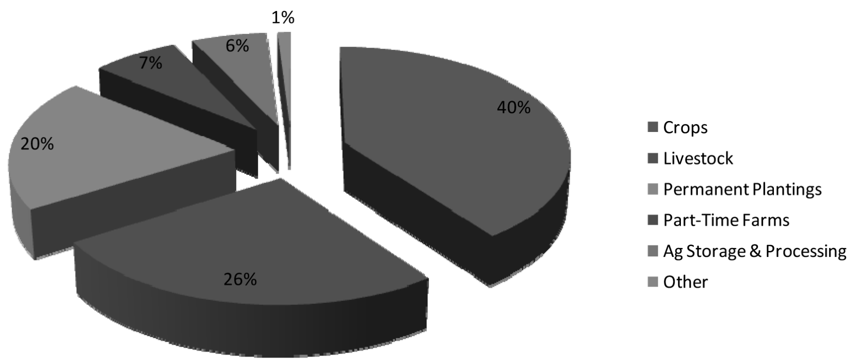
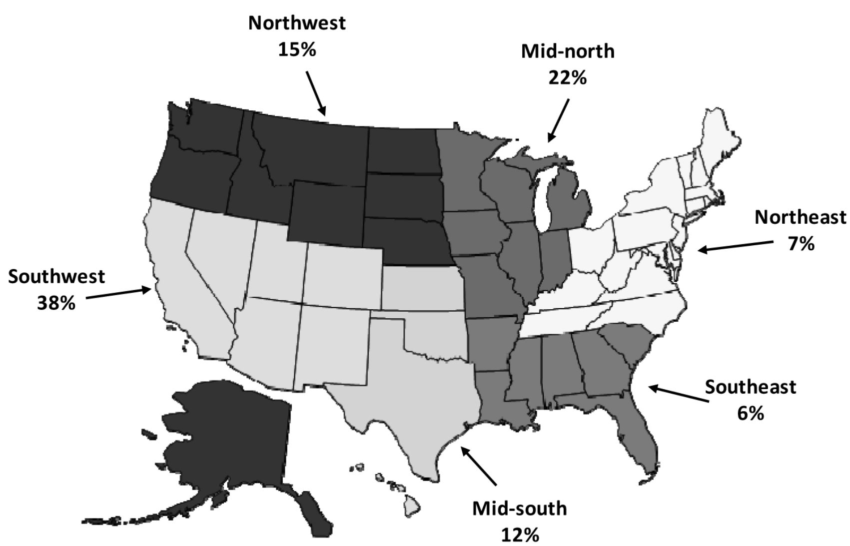


Figure 7
Agricultural Production Geographic Distribution



Conclusion

In summary, agriculture lending has slowed but is stable. Volatile commodity prices, high input costs and a slow general economy will continue to impact the borrowing needs of producers. As a result of that and the pressure on the lending industry to strengthen their financial position, we have seen solid growth at Farmer Mac. Since late 2008, our focus has been on assuring the strength of our business, mitigating the risk on our balance sheet and enhancing our capital position so that we may further serve Rural America. We have made significant progress. That progress has resulted in a renewed interest in products that help rural lenders meet the needs of America's farmers, ranchers and rural communities. As community banks, rural utilities lenders, Farm Credit Institutions and other rural lenders work to meet the demands of their customers, this healthy financial position and mission focus positions us to support Rural America in an even bigger way in the future.

We thank you for the opportunity to present Farmer Mac to you today. We look forward to working with Members of Congress and our partners to do even more to fulfill our mission of bringing liquidity and the benefits of the secondary market to rural America.

The CHAIRMAN [presiding.] Thank you, Mr. Gerber. First, let me apologize and thank you all for your patience, especially the Ranking Member. I do not have the supernatural gift of bi-location and absolutely had to be at another hearing where my own bill was considered by the Committee, which got a little bit entangled, but good news, it did pass. So we will proceed on now with Mr. Doug Stark. Go ahead, Mr. Stark.

STATEMENT OF DOUG STARK, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FARM CREDIT SERVICES OF AMERICA, OMAHA, NE; ON BEHALF OF FARM CREDIT SYSTEM

Mr. STARK. Thank you, Mr. Chairman, Ranking Member Fudge. I appreciate the opportunity today to testify before the Committee on behalf of the Farm Credit System. I am Doug Stark, President and CEO of Farm Credit Services of America out of Omaha, Nebraska.

As Mr. Strom reported earlier, the Farm Credit System remains financially strong. We ended the year 2010 with $175 billion loan portfolio with a growth rate of about 6.4 percent overall for the System. As mentioned as well, the System's capital position has increased as well to almost 15 percent of total assets, or more than double the regulatory minimum.

The institution I lead, Farm Credit Services of America is owned by more than 85,000 farmers that borrow from us in the States of Iowa, Nebraska, South Dakota, and Wyoming. Our customers appreciate being part of a cooperatively owned financial institution. Last year, we distributed $110 million in cash patronage to them and over the last several years, since 2004, have distributed $425 million of our earnings back to our customer-owners. Overall, the Farm Credit System distributed $733 million of cash patronage back to its customers last year.

The cash grain industry represents almost half of our portfolio at 46 percent. While the industry is experiencing record commodity prices and strong profitability, we are seeing increasing risk in this segment. Volatility is at record levels. Commodity prices alone are double what they were 1 year ago.

Farm inputs, as you heard already today, have increased considerably as well. Landlords are demanding more cash rent. The cost of seed, fertilizer, and fuel have all increased, and this drives the need for more capital to operate these farms.

Complicating matters further, grain producers in and of themselves are finding the need to capitalize almost 3 years of production. First of all, they have to finance the carryover of their inventory from last year while they market it. They also are financing the ongoing investment in the crop being planted, and not too far down the road here, they will be asked to step up and make commitments and prepay such things as fertilizer, seed, and chemicals for the coming year. We estimate that the capital requirements for a typical Midwest corn producer are nearly four times what they were just a mere few years ago in 2005.

As these credit needs for farmers have increased, lenders have also had to continue to build capital so they can keep up with the increased loan demand and maintain capital levels necessary for a safe and sound financial institution. At Farm Credit Services of

America, last year our loan volume increased 13 percent, approximately $2 billion. This required us to build nearly $300 million in retained earnings to capitalize our institution so that we could safely meet the increasing needs of our farmers and ranchers in our local area.

As you have heard, of great interest at local coffee shops and increasingly from the media as well are the recent price increases in agricultural real estate. The most notable increases have been in the upper Midwest, the major grain-producing areas of the country. The System continues to finance land transaction in these volatile times by remaining focused on sound underwriting and by making credit decisions based on the repayment capacity of the individual borrower. Because we hold all our loans on our own balance sheet, we have a strong interest in seeing that our customers are successful.

Given the volatility and risk present in agricultural real estate values, we have also implemented various adjustments to underwriting processes to reduce the risk on new real estate loans. These actions include such things as setting lower loan-to-value limits, establishing maximum per-acre limits, stress-testing a borrower's repayment capacity, shortening loan terms, or cross-collateralizing loans with property that has limited debt encumbrance. The most important thing we continue to do, though, is making our credit decisions based on the repayment capacity of the borrower, not just on collateral values.

Another aspect that I wanted to make sure that we talked about was the programs we have in place for three special categories of borrowers: those that are young, those that are just beginning in farming, and those that are small farmers. Last year, the Farm Credit System made $7.3 billion in loans to young farmers and $10.3 billion to beginning farmers. Our loan officers work hard in understanding agricultural operation that these new farmers engage in, whether they are traditional farms or they are sustainable local food-related operations that involve value-added processing. We recognize that we must reach out to those who are innovators in farm enterprise as they move from being niche operators to tomorrow's Main Street businesses.

In conclusion, the Farm Credit System is financially strong. It is economically vital and serving its mission for agriculture and rural America well. We make credit available to all segments of agriculture, including commercial producers, as well as young, beginning, and small farmers. We pay insurance premiums to protect our investors, pay the full cost of our regulator, and have no taxpayer backstop.

Mr. Chairman, thanks for the opportunity to testify today on behalf of the System. I look forward to any questions that you or the Committee Members may have.

[The prepared statement of Mr. Stark follows:]

PREPARED STATEMENT OF DOUG STARK, PRESIDENT AND CHIEF EXECUTIVE OFFICER, FARM CREDIT SERVICES OF AMERICA, OMAHA, NE; ON BEHALF OF FARM CREDIT SYSTEM

Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to testify today on behalf of the Farm Credit System. My name is Doug Stark, and I am President and CEO of Farm Credit Services of America. Farm Credit Services of America is a part of the nationwide Farm Credit System. My remarks today will provide some background on the Farm Credit System, comments on current credit conditions, discuss our response to increasing land values, and summarize what Farm Credit is doing to meet the credit needs of agriculture in the geographic area served by my institution.

Background on the Farm Credit System

Established in 1916, the Farm Credit System is a unique set of 89 private institutions, including five funding banks (four Farm Credit Banks and one Agricultural Credit Bank) and direct-lending associations, all of which are cooperatively owned by the farmers, ranchers, agricultural cooperatives, rural utilities and others in rural America that borrow from them. Farm Credit institutions are chartered by the Federal Government to provide credit and other related financial services to our owners and others consistent with the eligibility criteria set out in the Farm Credit Act.

Farm Credit Services of America is one of these 89 Farm Credit cooperatives. We are owned by more than 85,000 farmers that borrow from us in the states of Iowa, Nebraska, South Dakota, and Wyoming. As President and CEO, I report to a 16 member Board of Directors that consists of thirteen farmers elected by the members of the cooperative and three appointed directors. Two appointed directors are selected for their financial experience and the board has selected a third to ensure we had a young farmer represented on the board. In Farm Credit, employees are not allowed to serve as directors of our lending institutions.

There are 84 independently operated Farm Credit associations like Farm Credit Services of America serving agriculture throughout the United States and Puerto Rico. Every Farm Credit association is organized as a cooperative that is owned and governed by its farmer-members. The Board of Directors of each institution is responsible for establishing the institution's capitalization plan consistent with Federal regulations and for ensuring that management makes available loan products and financially related services appropriate to the unique needs of agriculture in the area that the institution serves.

Each Farm Credit association obtains funds for their lending programs from one of the five wholesale Farm Credit banks. At Farm Credit Services of America, we get our funding from AgriBank Farm Credit Bank (headquartered in St. Paul, MN), which is cooperatively owned by 17 local associations. The five System banks own the Federal Farm Credit Banks Funding Corporation (located in Jersey City, NJ), which, as agent for the banks, markets to the investing public the System-wide debt securities that are used to fund the operations of all Farm Credit System institutions. Unlike commercial banks, Farm Credit institutions do not have access to insured deposits that are guaranteed by the FDIC and backed by the U.S. Treasury as a source of funding for our operations.

Regulatory Oversight by the Farm Credit Administration

All Farm Credit institutions are regulated by the Farm Credit Administration (FCA), which was created by Congress and is subject to oversight by both House and Senate Agriculture Committees. The Farm Credit Administration is an arm's-length, independent safety and soundness regulator. FCA's three board members are nominated by the President and confirmed by the Senate. The FCA has all of the oversight and enforcement powers that every other Federal financial regulatory institution has to ensure that Farm Credit institutions operate in a safe and sound manner.

The Farm Credit System's mission, ownership structure and authorizing legislation is unique among financial institutions. For farmers, ranchers and the cooperatives that they rely on, it is critically important that Farm Credit's safety and soundness regulator understands our unique mission and what it takes to be successful in accomplishing that mission. Changing our regulatory oversight would threaten our ability to accomplish the mission set out for us by this Committee in the Farm Credit Act.

Fulfilling Farm Credit's Mission of Serving Agriculture and Rural America

All Farm Credit System institutions are focused on accomplishing the mission established for us by Congress: to serve agriculture and rural America. We take our Congressional charge seriously, and continuously review our performance to ensure that we are doing so efficiently and effectively. Our cooperative structure and governance is designed specifically to ensure that our lending and financially related service activities are driven by the needs of our farmer-members and to ensure that there is a reliable and competitive credit source available to agriculture that farmers own and control. Our practice is to engage our customers in a consultative lending relationship, using our accumulated expertise and knowledge of agriculture and finance to craft long term lending relationships that are often delivered across the farmer's kitchen table.

We understand that farming isn't a short-term investment for our member-borrowers. Our cooperative structure allows us to work with our farmer-owners with an approach that is not focused on achieving quarterly returns to impress investing stockholders. We know that when we work with our customer-owners to help them achieve success in their business, our business will succeed as well. Farm Credit's lending relationship with our member-borrowers is based on constructive credit over the long haul—we make loans, retain loans, and service loans. We do not enter and exit agricultural lending as farm profitability waxes and wanes. Our lending philosophy is to be conservative in good times so that we can be courageous in tough times.

Distributing Profits to Farmers Through Patronage

Our commitment to our farmer-members' business success is demonstrated further by the fact that we share our profits directly through patronage dividends with the farmers that borrow from us. Each year, the Farm Credit Services of America board of directors makes a determination based on our profitability and financial strength as to what portion of our net earnings will be returned directly to the farmer-members that own our institution.

Since 2004, Farm Credit Services of America has distributed over $425 million dollars in earnings as patronage dividends to the member-borrowers of our cooperative. This "rural stimulus" has allowed our customer-owners to re-invest in their own operations and to support their rural communities through local spending. We are proud to be able to directly and indirectly support all of these communities, regardless of size. In the past 5 years, the Farm Credit System in total has returned some $3.3 billion in cash and allocated an additional $1.2 billion in equities to our customer-owners. That is money that stays in agriculture and rural America and helps Farm Credit's customers be successful.

Farm Credit's Financial Strength

The Farm Credit System remains very strong financially. The System's combined net income was $3.5 billion for 2010, 23% higher than 2009. Nationwide, Farm Credit ended 2010 with a loan portfolio of about $175 billion which was 6.4% larger than where we had ended 2009. Farm Credit's financial performance has allowed growth in combined capital to $33.3 billion as of year-end 2010. This represents the reserves available in the event of losses.

The Farm Credit System's debt securities are insured by the Farm Credit System Insurance Corporation (FCSIC). Farm Credit institutions pay annual premiums of up to 20 basis points to assure that the FCSIC Insurance Fund is maintained at the secure base amount of 2% of outstanding System debt. The Insurance Fund held $3.031 billion as of year-end 2010. There is no Federal backstop for the Insurance Fund.

Current Conditions in Agriculture

As you are well aware, starting in 2008 financial and credit markets were disrupted severely due to failures in the home mortgage sector. Despite this disruption, the Farm Credit System successfully continued to meet the credit demands of our customers. At Farm Credit Services of America, we continued to see increased demand for credit and I am pleased how we have been able to respond. With the strength of current commodity prices it is very important that we continue our prudent approach to making credit available. Our experience tells us that the extraordinary period of farm profitability we now enjoy will inevitably be replaced by a period of thinner margins.

Let me give you some highlights regarding what we are seeing in Farm Credit Services of America's territory when it comes to the local farm economy, credit conditions, and how Farm Credit Services of America is responding to these unique circumstances.

The cash grain industry represents 46 percent of our portfolio. While the industry is experiencing record commodity prices and strong profitability, we are seeing the risk increasing in this segment. Volatility is at record levels—commodity prices alone are double what they were 1 year ago. Not everyone benefits from these increases, particularly livestock producers.

Farm input costs have continued to increase. Landlords are demanding more for cash rent, while seed, fertilizer and, of course, fuel also have increased notably. This has driven a considerable increase in the need for capital to operate these farms. In many situations, grain producers are finding that they need to capitalize and fund portions of 3 years of production: they must finance their investment in the carryover of last year's crop while it is being marketed; they have the ongoing investment in the present crop being planted and grown; and even before this year's crop has matured or been harvested, they are expected to make commitments and prepay such things as seed, fertilizer, and chemicals for the coming year. To effectively market their crops, many farmers also set up marketing loans to fund margin calls to cover their marketing program positions. We have estimated that the capital requirements for a typical Midwest corn producer to be nearly four times what it was in 2005.

To be successful in these volatile times farmers need profitability so that they can increase their equity stake in their own operations. But as the credit needs of these farmers has continued to increase, lenders have had to continue to build capital so that they can keep up with increased loan demand while maintaining appropriate capital levels. At Farm Credit Services of America, our 2010 loan volume increased by 13 percent, or approximately $2 billion. This increase required us to build nearly $300 million in retained earnings to capitalize our institution so that we could safely meet the increased borrowing needs of farmers and ranchers. We have seen that some local financial institutions had neither the financial capacity nor the experienced personnel to deal with this rapidly changing and volatile environment. This becomes apparent when we see an increase in loan requests from producers whose need for credit has outgrown their local lender's financial capacity, or who are in need of an immediate loan because volatile prices lead to calls for immediate increased margins in their hedge accounts.

Of great interest at local coffee shops, increasingly from the media, and from financial regulators are the recent price increases in agricultural real estate. The most notable increases have been in the upper Midwest—the major grain producing areas of the country. While there are many reasons for increased farmland values including low interest rates and higher commodity prices, the volatility in agricultural commodity prices and in land values has heightened the caution with which Farm Credit System institutions approach the marketplace. The System continues to finance land transactions in these volatile times by remaining focused on sound underwriting and making credit decisions based on the repayment capacity of the individual borrower. Because we hold virtually all of our loans on our own balance sheet, we have a strong interest in seeing that our customers are successful and prudent in their own risk-taking, including the purchase and financing of farm real estate.

Given the volatility and risk in the present agricultural real estate values, most Farm Credit System institutions have implemented adjustments to their underwriting processes to reduce the risk on new real estate loans. Some of these actions have included setting lower loan to value limits, establishing maximum loan per acre limits, strengthening loan analysis by stress testing a borrower's repayment capacity, shortening loan terms, or cross-collateralizing loans with property that has limited debt encumbrance. Appraisals are also completed by certified and licensed appraisers who are totally independent of the credit decision process. These adjustments result in terms that are significantly more conservative than allowed by law and regulation, designed to maintain safety and soundness.

Another way Farm Credit Services of America was able to extend to our customers our institutional sense of prudent risk-taking was through our Loan Conversion program. Most people don't expect their lender to contact them about reducing the rate of interest on their loan. This past year, more than 15,000 of our farm and ranch customers have benefited from the lowering of their long term fixed interest rate. These actions resulted in savings to customers of $44 million in the first year alone. The conversion of longer term, fixed rate loans to lower cost, fixed rates resulted not just in immediate savings to the borrower, but continued interest savings for the life of the converted loans. We know that our long-standing focus on what's best for our customers has improved the financial strength of both the borrowers and our Farm Credit cooperative.

The balance of our portfolio is to various segments in the livestock industry, most notably cattle, followed by swine, and then dairy. These industries have, for the most part, been adversely impacted by an increase in feed prices since 2008. For a good share of 2008 and 2009, we saw losses to producers in these segments, especially swine and dairy. Because of our focus on agriculture, we have in place a skilled lending staff that is backed by our strong capital position. This dual strength allowed us to restructure loan terms and repayment plans for a significant portion of the producers in these agricultural operations that feed grains.

A Commitment to Serving Young, Beginning and Small Farmers

Every Farm Credit association has programs in place targeted specifically at meeting the needs of three special categories of borrowers—those that are young, those that are just beginning in farming, and those that are small farmers. Our mission to serve the needs of young, beginning, and small farmers leads us to identify, understand, and finance the farm operations that these new agriculturalists engage in, including such operations as organic, sustainable, local food-related, direct-to-retail, or other emerging business models in addition to traditional agricultural operations. We recognize that we must reach out to those who are innovators in farm enterprises in order to follow today's niche operation as it becomes tomorrow's mainstream business.

Farm Credit Services of America has an exceptional commitment to our Young, Beginning, and Small farmer program that starts in our board room. Several years ago, our board took the unusual step of creating an appointed board member position to be filled by an outstanding young farmer so that we would include the voice of the next generation in all of the board's deliberations.

Farm Credit Services of America's Young, Beginning, and Small farmer program has many facets to serve the unique needs of borrowers in our area. Our program offers lower interest rates, while maintaining our credit standards. In fact, as of year-end, 2010, nearly 17% of our loan portfolio consists of loans to young and beginning borrowers in our territory. In addition, we are dedicated to training and education programs for young, beginning, and small farmers in our territory through our own classes, seminars, and institutes as well as supporting such programs provided by others. This is part of our commitment to training future farmers the good credit habits and skills that will help make them successful business people in the future.

Nationwide, the Farm Credit System's dedication to our mission is demonstrated by the aggregate amount of new loans made in the year 2010 to Young, Beginning, and Small farmers by all Farm Credit associations. New loans in 2010 to young farmers totaled $7.3 billion, in the same period new loans to beginning farmers added up to $10.3 billion, and to small farmers was $13.1 billion. It is important to note that farmers may be included in multiple categories since they are included in each category for which they meet the defined characteristic; Young—35 or younger; Beginning—10 years or fewer of farming experience; Small—less than $250,000 in annual gross farm sales.

When it comes to serving the needs of small farmers, the Farm Credit System stands out. Recently, the American Bankers Association released its report on "farm bank" performance in 2010. They indicated that the 1,552 banks that met their definition of a "farm bank" had some $33.9 billion in credit outstanding in small farm loans (those with an original loan size of less than or equal to $500,000). In comparison, the 84 associations of the Farm Credit System had slightly more than $143.7 billion of similar sized loans outstanding at the end of 2010.

USDA Programs Help Farm Credit Serve Agriculture

Additionally, at Farm Credit Services of America we often make use of USDA's Farm Service Agency (FSA) loan guarantees to support our lending, particularly to young and beginning farmers and ranchers. We are pleased that our experience and excellent credit management practices have allowed us to be recognized as an FSA preferred lender.

The guarantees available through FSA are an important tool that allows us to serve higher risk credits that might not otherwise meet our underwriting standards. The Farm Credit Act requires that we focus our resources on meeting the needs of credit worthy borrowers. These FSA guarantees, along with our Board's acute focus on serving young and beginning farmers and ranchers has allowed to create a special program we call AgStart, which assists young producers who cannot meet normal underwriting standards. In this special program we are now serving 1,340 young producers that fit into this category.

Another very important USDA program which benefits our farmer-members is the Risk Management Agency's (RMA) crop insurance program. Producers need protection against weather related disasters and price volatility and today's crop insurance represents a terrific risk mitigation tool for them. As a lender we believe strongly that crop insurance is essential for producers but also is essential for lenders to help protect our investments in loans. At Farm Credit Services of America we are an active participant in the crop insurance program. Last year, we paid out over $124 million in claims. I can't emphasize enough how important crop insurance is as the primary risk management tool that allows our member-borrowers to make the huge investments required to plant and grow annual crops.

Serving the Vital Needs of Rural Communities and Global Markets

Lending to companies that serve the needs of rural communities in the energy, communications, and water industries is a growing part of Farm Credit's overall business. Customers in these industries include rural electric generation and transmission cooperatives, electric distribution cooperatives, independent power producers, rural local exchange carriers, wireless provides, cable television system, and water and waste water companies. Farm Credit loans to these customers increased to $15 billion at the end of 2010 from $14.6 billion at the end of 2009.

Much of the loan growth to these customers came as the broader debt capital markets contracted as part of the overall financial market crisis. The Farm Credit System, primarily through CoBank (the one Farm Credit bank that operates as an Agricultural Credit Bank) has increased its lending to these customers ensuring that a continued flow of competitively priced credit is available to them. The System's ability to expand financing to these customers has been critical as many of them, electric co-ops especially, have been forced to modernize facilities and expand operations as demand for electricity has boomed across rural areas.

Similarly, as global credit markets contracted, demand for credit around the world to purchase U.S. agricultural export products increased. Loans made by CoBank to facilitate the export of U.S. farm products increased from $2.1 billion at the end of 2007 to $4 billion at year end 2010.

Impact of Financial Market Disruptions

Because the Farm Credit System relies on our access to the financial markets for the funds we need to make credit available to our borrowers, a disruption in the efficient operation of those markets can adversely impact agriculture. We witnessed firsthand how disruptions in the nation's financial markets can directly impact not only our cost of funds but also the term of the funds that are available.

During the recent crisis, commercial banks were extended a direct Federal guarantee on their debt issuance and access to Federal capital support. The housing GSEs gained enhanced support from the Treasury to facilitate their access to the debt markets. In the case of Farm Credit, we have no such guarantee, we were provided no access to capital support, we have no explicit borrowing line with the Treasury, and no Federal backstop for the Farm Credit System Insurance Fund.

Despite the fact that we have had no assistance from the government throughout these times of extreme stress in the financial markets, we are very proud to report to you that we have not had to deny a single farmer, cooperative or other eligible borrower access to credit because we could not access the nation's money markets. This is testament to the financial strength that the System has carefully built up during good times through cautious lending and the accumulation of appropriate capital reserves.

Trust has been built with our investors, who know that the Farm Credit System has never failed to meet its obligations. They are secure in the knowledge that System management and directors are intent on preserving this fine organization to ensure that farmers will continue to own and govern their credit source through their cooperative in the future. However, Farm Credit's operational prudence notwithstanding, the financial market turmoil demonstrated to us that our ability to access the necessary funding to meet our mission to agriculture and rural America may be at risk if circumstances beyond our control disrupt our market access.

Conclusion

The Farm Credit System is financially stable, economically vital, and serving its mission for agriculture and rural America well. We continue to make credit available to all segments of agriculture including commercial producers as well as young, beginning and small farmers. There are no Federal dollars invested in the Farm Credit System. We even pay for the expense of being regulated by the Federal Government through an assessment on all Farm Credit System institutions.

As a network of agricultural and rural lending cooperatives owned by the farmers, cooperatives, and rural utilities that borrow from us, we have the built in oversight mechanism that our farmer-owners hold our feet to the fire to keep service quality high. We understand that Farm Credit's success depends on our customers' success. To continue serving our mission, we must have continued, effective access across all terms to the national debt markets and an independent, arm's-length regulator that comprehends the unique requirements of agriculture.

I am testifying to you as a leader of a nationwide lending institution in a climate of high farm profitability and increasing farmland values. But it should not surprise you that I am reporting on our prudence in lending practices, credit management, and service to our mission. The Agriculture Committee understands why the Farm Credit System exists, and our continued success is due in part to the fact that this Committee had the foresight to change our structure more than 20 years ago while strengthening our regulatory oversight to ensure our safety and soundness.

We are proud of our commitment to rural America. We have maintained our focus and continually work to meet our mission. We are aware that all of agriculture will inevitably face challenging economic times that may test the resolve of many. We urge that you assure adequate guaranteed loan programs through USDA FSA and Rural Development, along with the funding resources and flexibility for a strong crop insurance program.

Mr. Chairman, thank you again for the opportunity to testify today on behalf of Farm Credit Services of America Farm Credit and the Farm Credit System. I will be pleased to respond to your questions.

The CHAIRMAN. Thank you, Mr. Stark, for your testimony. Mr. Williams?

STATEMENT OF MATTHEW H. WILLIAMS, CHAIRMAN AND PRESIDENT, GOTHENBURG STATE BANK; VICE CHAIRMAN, AMERICAN BANKERS ASSOCIATION, GOTHENBURG, NE

Mr. WILLIAMS. Chairman Fortenberry, Ranking Member Fudge, and Members of the Subcommittee, I am Matt Williams, President of the Gothenburg State Bank in Gothenburg, Nebraska, a family-owned bank, and I am a fourth-generation banker. I also serve as the Vice Chairman of the American Bankers Association.

More farmers and ranchers borrow money from banks than any other source. Over 5,700 banks, nearly 75 percent of all the banks in the United States, reported ag loans on their books at the end of 2010 with a total outstanding portfolio of $127 billion. Since the financial crisis, the banking industry has stepped up and increased farm and ranch lending from year end 2007 to year end 2010 by over $13 billion.

In the past 6 months, we have heard a great deal about the increase in farmland prices. Is this the next asset bubble? Recently, I was invited to speak on behalf of bankers at an FDIC symposium on this issue. In most of Nebraska, ag land prices have increased. Agriculture has done well with farmers responding to market conditions by increasing their land holdings. As a result, land that has gone on the market has generated significant interest and prices have risen accordingly. Demand for credit, though, to finance these purchases has been relatively flat. In fact, many of the sales are paid for with cash.

For over 40 years, the banking industry and the USDA have worked together to provide access to credit to more than 55,000 farmers and ranchers who borrow money from banks through the Guaranteed Farm Programs offered through the USDA's Farm Service Agency. As you have heard today, Congress inserted term limits into these programs that prohibit farmers and ranchers after a period of years. While the goal of term limits is understandable, term limits hurt those farmers and ranchers who can least afford a financial setback. For this reason, the American Bankers Association has endorsed H.R. 1422, introduced by Representative Leonard Boswell. We urge you to pass H.R. 1422.

Credit is certainly available to agriculture. In fact, the lending market is very competitive. I compete with many financial service providers for loans. Over the years, farm credit is one of our major competitors. I face this taxpayer-backed tax-advantaged Federal Farm Credit System on a daily basis. Today, farm credit is a large and complex financial service business with $229 billion in assets. It earned $3.495 billion in 2010 and it enjoyed a combined local, state, and Federal tax rate in 2010 of just 5.9 percent. Farm Credit is a GSE and it presents the same kind of potential liability to the

American taxpayer as Fannie Mae and Freddie Mac. Congress will soon reform the housing GSEs. I urge this Committee to take a look at the Farm Credit System also when you are reviewing GSEs.

I would also like to bring to your attention the Investment Bond Pilot Program, a program offered and created by the Farm Credit Administration, the regulator of the Farm Credit System. To finance a project under this program, an FCS lender helps a borrower issue a bond and Farm Credit purchases this bond as an investment. In this way, Farm Credit is able to characterize otherwise prohibited commercial lending activity as an investment instead of a loan. This pilot program has been running nationwide since 2005. A nationwide program that allows entities to access Farm Credit funding that are prohibited from borrowing is a regulatory overreach and should be stopped.

In conclusion, let me emphasize two things. We know our farmers and banks have an adequate supply of credit available for these farmers. Based on how we finance ag land and how Farm Credit, by the way, finances ag land, a decrease in farmland values will not cause a significant decrease in loan quality.

We would ask you to please not allow excess regulation such as Dodd-Frank, unfair competition, reduce our ability to continue serving the agriculture needs of our communities and our country. Thank you for this opportunity to address the Subcommittee.

[The prepared statement of Mr. Williams follows:]

PREPARED STATEMENT OF MATTHEW H. WILLIAMS, CHAIRMAN AND PRESIDENT, GOTHENBURG STATE BANK; VICE CHAIRMAN, AMERICAN BANKERS ASSOCIATION, GOTHENBURG, NE

Chairman Fortenberry, Ranking Member Fudge, and Members of the Subcommittee, my name is Matt Williams, and I am the Chairman and President of Gothenburg State Bank in Gothenburg, Nebraska. My great grandfather founded the bank in 1902 and our family has operated it since then. My grandfather served as President of the bank and my father followed him in the job. Since it was founded, Gothenburg State Bank and my family have survived many economic catastrophes including the farm crisis of the 1920s, the Great Depression, the farm crisis of the 1980s, and the Great Recession of 2008/2009. We plan to continue to serve the citizens of central Nebraska for the next 100 years or more. Our bank's tag line is "Still Pioneering" and it is a core value of our company. Today, Gothenburg State Bank has two office locations, assets of $115 million, and employs 27 people. Our loans total nearly $80 million with about 75% of our portfolio connected to agriculture in a direct or indirect way.

I also serve as the Vice Chairman of the American Bankers Association (ABA), and I appreciate the opportunity to present the views of the ABA on credit conditions in rural America. The ABA represents banks of all sizes and charters and is the voice of the nation's $13 trillion banking industry and its two million employees. ABA is uniquely qualified to comment on agricultural credit issues as banks have provided credit to agriculture since the founding of our country. Over 5,700 banks—nearly 75% of all banks—reported agricultural loans on their books at year end 2010 with a total outstanding portfolio of over $127 billion. More farmers and ranchers receive credit from the banking industry than from any other source. In addition to our commitment to farmers and ranchers, thousands of farm dependent businesses—food processors, retailers, transportation companies, storage facilities, manufacturers, *etc.*—receive financing from the banking industry as well.

The topic of today's hearing is extremely important and timely. Our nation is facing difficult economic conditions which are affecting all businesses, including banks. The core business of banking is lending. That is what banks do. Banks will continue to be the source of financial strength in their communities by meeting the financial needs of farms, businesses and individuals. Banks in every state in the country are actively looking for good farm and ranch loans. Since the financial crisis, the banking industry stepped up and ***increased*** their share of farm and ranch lending from year end 2007 to year end 2010 by over $13 billion. During the same period farmers and ranchers have ***reduced*** their total indebtedness by nearly $6 billion.

The Impact of Dodd-Frank on the Banking Industry

Our communities and our country cannot reach their full potential without the presence of a local bank—a bank that understands the financial and credit needs of its citizens, farmers, businesses, and government. I am concerned that this model may be in jeopardy given the massive weight of new rules and regulations that will result from the *Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010* (Dodd-Frank). The vast majority of banks in our country had nothing to do with the events that led to the financial crisis and are as much victims of the devastation as the rest of the economy. While most banks are far removed from Wall Street and banks on Main Street are the ones that are paying the price for the mess that others created.

Banks work every day to make credit and financial services available to their customers. Those efforts, however, are made more difficult by regulatory costs and second-guessing by bank examiners. Combined with hundreds of new regulations expected from the Dodd-Frank Act, these pressures are slowly but surely strangling our traditional community banks, handicapping our ability to meet the credit needs of our communities.

Managing this mountain of regulation will be a significant challenge for a bank of any size. The median-sized bank has only 37 employees—for them, and for banks like mine that have even fewer employees, this burden will be overwhelming. Historically, the cost of regulatory compliance as a share of operating expenses is 2½ times greater for small banks than for large banks. Moreover, it creates more pressure to hire additional compliance staff, not front line customer service staff. It means more money spent on outside lawyers to manage the risk of compliance errors and greater risk of litigation. It means more money to hire consulting firms to assist with the implementation of all of the changes, and more money hiring outside auditors to make sure there are no compliance errors. It means more risk of regulatory scrutiny, which can include penalties and fines. All of these expenditures take away precious resources that could be better used serving the bank's community.

The consequences of these new burdens from the government are real. New regulatory pressures will have a negative impact on the number of banks that survive in our country. Costs are rising, access to additional capital is limited, and revenue sources have been severely cut. It means that fewer loans will get made. It means a weaker economy. It means slower job growth. With regulatory over-reaction, new laws, and uncertainty about government's role in the day-to-day business of banking, meeting the financial needs of our local community seems to have become secondary, and yet our success in Gothenburg demands that we focus on our customers and our community.

The Impact of Dodd-Frank on Agricultural Credit

The increased regulatory burden brought about by the passage of Dodd-Frank that I have spoken about will impact agricultural credit. Dodd-Frank will require that we supply the regulators with additional data about our lending activities to farmers and ranchers. Dodd-Frank may require us to justify the "suitability" of the credit products we make available to our farm and ranch customers.

Of particular concern is the additional regulatory and compliance burden expected once the Bureau of Consumer Financial Protection (CFPB) becomes fully operational. This new bureaucracy—expected to hire over 1,200 new staff—will certainly impose new obligations on community banks—banks that had nothing to do with the financial crisis and already have a long history of serving farmers, ranchers and all consumers fairly in a competitive environment.

Small banks like mine are *not* exempt from the CFPB. All banks—large and small—will be required to comply with rules and regulations set by the CFPB, including rules that identify what the CFPB considers to be "unfair, deceptive, or abusive." Moreover, the CFPB can require community banks to submit whatever information it decides it "needs." There are also many other new regulatory burdens flowing from the Dodd-Frank Act empowerment of the CFPB which will add considerable compliance costs to every bank's bottom line. Increased compliance costs increase the cost of borrowing money for our customers; this will not help us revive our local and national economy.

In response to what we know lies ahead, ABA and our members have been telling farmers and ranchers that they have to improve their business practices including their marketing plans, their capital expenditure planning, and their risk management practices to name a few. Overall, many producers have responded positively to these messages, and they have stepped up their game to meet the challenges of this period. Proven cash flow, and being able to demonstrate the ability to repay a loan, continues to be a bedrock principle of agricultural lending by banks. If a producer cannot show adequate repayment ability, it will be hard to obtain credit. Again, the regulators have made it very clear to the bankers that they expect bankers to stick to the basics and that demand is being followed by the bankers I know.

Agricultural Real Estate Values Have Increased Due to Farm Prosperity, Not Leveraged Speculation

In the past 6 months we have all heard and read a great deal about the increase in farmland prices. The question most asked by the press, and increasingly the banking regulators is, "Are we looking at another bubble?" A little more than a month ago the FDIC held a symposium on this issue. In early December the FDIC issued guidance (the Office of the Comptroller of the Currency issued similar guidance to all western banks) to all FDIC insured banks warning them about the dangers of asset bubbles and also warning agricultural banks—those banks with a concentration in agricultural lending—like mine, to consider the dangers of credit concentration. We appreciate the guidance of the regulatory community.

I was the only banker invited to share my views at the FDIC Symposium. While it is clear in some areas of the country—including most of Nebraska—farmland prices have escalated, there is no evidence that this is being fueled by credit. Farmers are responding to market signals, and those signals are extremely positive. Farmers and ranchers have accumulated cash thanks to a healthy agricultural economy, and they have a positive outlook. As a result of these factors, what land that has gone on the market (in my area, very few parcels have come up for sale) has generated intense interest, and as a result, prices have risen. At the same time, demand for credit to finance these new land acquisitions has been relatively flat. A recent survey of bankers in three Federal Reserve Districts supports this point. In all three districts, the overwhelming majority of bankers reported that farm and ranch loan demand in the third quarter of 2010 was essentially the same as it was in the third quarter of 2009. In the districts that reported an increase in demand, the increase was very modest. This data strengthens my belief that the increase in farmland sales values that we have seen over the past few years has largely been the result of farmer prosperity, not excessive lending.

I made it clear to the participants at the FDIC Symposium last month that managing agricultural loan risk is what we do at Gothenburg State Bank, and what bankers at banks all over the country do. To give you a sense of our posture towards farm real estate lending, please consider some of the standards at our bank:

- We have very conservative underwriting standards for real estate lending and these have not changed for a decade or more.
- Repayment-ability is the primary driver of our underwriting—if the request does not cash flow, we do not do it—regardless of the collateral position of the customer.
- We only lend a maximum of 60% of the appraised value of the land (loan-to-value).
- In our current farmland loan portfolio, our average loan-to-value is about 40%
- Even though land values have increased to $5,000 per acre in our service area, we use $3,500 per acre for credit analysis purposes when calculating net worth position, debt to assets, and other key ratios.
- Technology is available that allows us to stress test our farm loan portfolio to see what would happen if real estate values dropped by as much as 40%.
- I cannot overstate the value of the technology that my bank and that most banks have invested in that allows us to do credit analysis and run "what if" scenarios almost instantaneously. In our bank exercise, a 40% drop in real estate values did reduce the balance sheet net worth of our customers, but it had very little or no effect on the quality of our loan portfolio. Our bank's risk to the FDIC insurance fund would not change.

I believe the concerns about what is happening in farmland values are overstated at this time. Our farm and ranch customers, and the farm and ranch customers of many other banks, have enormous skin in the game in their operations. Many are paying cash for real estate. Leverage levels are at or near a historic low—a recent paper published by the Kansas City Federal Reserve indicates that only 30% of all farmers and ranchers had ***any*** debt in 2008 (the most recent data available). Prosperity is driving the demand for farmland and retained earnings are providing the cash to purchase it.

Recommendation to Congress to Help Farmers and Ranchers Access Credit from Banks and Other Private Sector Lenders

I have spoken at length about the prosperity that many farmers and ranchers have enjoyed over the past 10 years. However, for many reasons, that prosperity has not benefited all sectors of the agricultural economy. For over forty years the banking industry and the USDA have worked cooperatively to provide access to credit to those farmers and ranchers who have some deficiency in their operation that makes them ineligible for bank credit. Many of these farmers and ranchers who borrow are young and are still acquiring the asset base they need to be able to qualify for bank loans. Most of these farmers operate small farms because the average loan is $187,000 which is not a large farm loan given the capital that modern agriculture demands. Despite the challenges these young and small farmers and ranchers face, they are conscientious customers who handle their credit obligations very well.

I am referring to the farmers and ranchers who borrow money from banks through the guaranteed farm loan programs offered by the USDA's Farm Service Agency (FSA). Since it is a credit guaranty, banks like mine underwrite and fund the loan and the USDA provides the bank with a guaranty against loss on the loan. At the end of FY10, over 55,000 farmers and ranchers accessed credit through this program. Banks are not the only participants as Farm Credit System lenders, credit unions, state agricultural credit programs, and others have worked with USDA to provide credit to these farmers and ranchers.

The program has been a resounding success. Each year a limited appropriation is leveraged into a significant program that, in many cases, is the only way these farmers and ranchers can access credit. At the end of FY10, the portfolio of guaranteed farm and ranch loans exceeded $10 billion, or about 4% of the total agricultural credit market. Even though these customers have some financial statement or operating deficiency, they are very conscientious borrowers. FY10 year-end loan delinquencies were 1.69% and losses in the program in FY10 were .581% of outstanding loans. From a delinquency and loan loss perspective, this is a very sound portfolio of loans.

In the early 1990s, Congress inserted "term limits" into the program that only allowed farmers and ranchers a limited period of eligibility for the program. While the goal of term limits was understandable, it has created uncertainty for many farmers and ranchers. I should also note that I do not know of any comparable eligibility limitation in other Federal loan guaranty programs. Given the volatile nature of the agricultural economy, the practical application of FSA term limits has caused hardship to those farmers and ranchers who can least weather a financial setback.

For this reason, the American Bankers Association (and many farm organizations) has endorsed H.R. 1422 introduced by Representative Leonard Boswell, and cosponsored by Representative Bruce Braley, Representative G.K. Butterfield, Representative Tom Latham, and Representative David Loebsack. Congressman Boswell's bill would extend the deadline on FSA guaranteed loan term limits to December 2013. We urge this Committee to support and pass H.R. 1422.

The Banking Industry is Concerned About the Risk a Government Sponsored Enterprise Creates in the Rural Economy

I mentioned earlier in my testimony that the market for agricultural credit is very competitive. I compete with several other banks in my service area, finance companies from all of the major farm equipment manufacturers, several international banks, credit unions, life insurance companies, and finance companies owned by seed and other supply companies to name a few. However, the most troublesome competitor I face is the taxpayer-backed and tax-advantaged Federal Farm Credit System (FCS). The FCS was chartered by Congress in 1916 as a borrower-owned cooperative farm lender at a time when banks did not have the legal authority to make farm real estate loans. Over the ensuing 95 years the FCS has received numerous charter enhancements, and it continues to pursue increased authorities from Congress and from its regulator.

Today the FCS is a large and complex financial services business with $229 billion in assets. It is profitable—it earned $3.495 billion in net income in 2010. It is tax-advantaged and enjoyed a combined local, state, and Federal tax rate in 2010 of 5.9%. In spite of their size, profitability, and tax advantages the Farm Credit System presents the same kind of potential liability to the American taxpayer as Fannie Mae and Freddie Mac. As a Government Sponsored Enterprise (GSE) like Fannie Mae and Freddie Mac, the American taxpayer is the ultimate back stop should the Farm Credit System develop financial problems. The potential liability that GSEs pose to taxpayers became very real in 2008 when the Federal Government seized Fannie Mae and Freddie Mac. An earlier near collapse of the Federal Farm Credit System in the late 1980s as a result of their irresponsible farm lending foreshadowed what taxpayers would confront more than twenty years later with the housing GSEs. Congress will take up the question about what to do with the housing GSEs in an effort to restructure home mortgage finance in the United States. I urge this Committee to include the Federal Farm Credit System in those discussions as there is no difference between the risk the housing GSEs pose to our economy and the risk the Farm Credit System poses to our rural economy.

As an example of the risk the Farm Credit System poses to the rural economy, I would like to bring to your attention the **investment bond pilot program,** a program created by the Farm Credit Administration (FCA), the regulator of the Farm Credit System. Under the "pilot" program FCS institutions are authorized to finance almost any kind of commercial and municipal activity in rural America. Often called "mission-related investments", "Rural Investment Bonds", or "Agriculture and Rural Community (ARC) bonds", this program allows FCS to finance "independent or assisted living facilities, waste water or water treatment facilities, rural business facilities, rural drainage district projects, fire station facilities or major equipment purchases, municipal, township or county facilities, health care facilities such as outpatient surgery centers, physician and dental facilities, multi-family housing, community buildings, processing or manufacturing facilities, hotel/convention facilities, industrial development parks, agribusiness facilities or major equipment purchases" (Source: Badgerland Financial website March, 2011. Badgerland Financial is an FCS lender based in Wisconsin).

To finance a project under this program, an FCS lender helps the borrower issue a "bond" which is then purchased by FCS as an "investment". In this way, FCS is able to characterize otherwise prohibited commercial lending activity as an investment instead of a loan. The pilot program has been running since 2005. The Farm Credit Administration has been considering a proposed rule to expand and permanently authorize the program for several years. Thousands of bankers and others wrote comment letters opposing the program, and yet the FCA continues to allow the pilot project to operate, and to continue to acquire assets.

The pilot program and proposed rule allows unrestricted commercial financing that redirects the FCS away from its mission to serve family farmers and ranchers. Hotels, dental clinics, and other financing projects already undertaken have moved the FCS directly into commercial finance. The FCS was specifically chartered by Congress to leverage its special GSE privileges in support of farmers, ranchers, and farmer-owned cooperatives, not commercial businesses. The diversion of the capital owned by farmers and ranchers into commercial projects that have no direct connection to the farmer-owners of the FCS puts farmer-owned capital in jeopardy. Interestingly, since these are "investments" the bond issuers (the borrowers) are not eligible to participate in the benefits of cooperative ownership so they do not receive patronage dividends. Congress should be additionally concerned that the FCS is quickly devolving into a two tiered system of "owners" who share the benefits of cooperative ownership, and those who do not receive any benefits.

If Congress intended the FCS to finance hotels, dental clinics, and general manufacturing, it would have provided that authority to the FCS. The FCA's attempt to broadly reinterpret the investment portion of the statute as a way to expand lending oversteps its authority and undermines the express intent of Congress. It is a gross example of regulatory over-reach. A pilot project by definition is conducted in a limited area for a limited time. FCA has allowed the "Investments in Rural America" pilot program to operate since 2005. A nationwide program operating indefinitely is clearly not a pilot program and should be terminated.

We urge this Committee to stop the Farm Credit System's investment bond pilot project.

The Banking Industry is Well Positioned to Meet Their Customer's Needs

For the past decade, U.S. agriculture has enjoyed one of the longest periods of financial prosperity in history. Financially, American agriculture has never been stronger. In 2010, many American farmers and ranchers enjoyed their most profitable year ever, and USDA projects that 2011 will exceed 2010. The balance sheet for U.S. agriculture at the end of 2010 (according to USDA) is the strongest it has ever been with a debt to asset ratio of less than ten percent. USDA projected that at year end 2010 farm and ranch net worth was in excess of $2 trillion. This unprecedented high net worth is due in part to a robust increase in farm asset values (mainly farm real estate), but is equally due to solid *earned* net worth as farmers used their excess cash profits to retire debt and to acquire additional equipment and additional land. As a result, farmers and ranchers today have the capacity to tap their equity should there be a significant decline in farm profitability resulting in diminished cash flows. While no farmer or rancher wants to take on additional debt, the strength of the U.S. farm and ranch balance sheet gives producers options to do so if the need arises.

When the agricultural economy collapsed in the middle 1980s, the banking industry worked with farmers and ranchers to restructure their businesses and to rebuild the agricultural economy. Since that time banks have provided the majority of agricultural credit to farmers and ranchers. While other lenders shrank their portfolios of agricultural loans or exited the business altogether, banks expanded agricultural lending, just as they did following the economic crisis of 2008/2009. Bankers saw opportunity where others did not.

In 1902 my great grandfather saw great possibilities in Gothenburg, Nebraska. We are still pioneering in Gothenburg. Do not allow the opportunities for banks like mine working with our farm, ranch and rural customers to become overshadowed by excessive regulation and unfair competition from government backed entities.

Thank you for the opportunity to express the views of the American Bankers Association. I would be happy to answer any questions that you may have.

The CHAIRMAN. Thank you, Mr. Williams. We appreciate your testimony. Mr. Starline?

STATEMENT OF MATTHEW STARLINE, OWNER, STARLINE ORGANICS, LLC; MEMBER, OHIO ECOLOGICAL FOOD AND FARM ASSOCIATION, ATHENS, OH

Mr. STARLINE. First, I would like to thank the Subcommittee for giving me the opportunity to testify this morning. My name is Matthew Starline, and I am a beginning farmer from Athens, Ohio. My farm is a 50 acre diversified farm located in the foothills of Appalachia. We grow a variety of vegetables, fruits, mushrooms, herbs, and grains, also employing the full circle of farming with lamb, pork, and beef. I am a member of the Ohio Ecological Food and Farming Association. I am a 100 percent full-time farmer, roughly half the age of the average farmer.

All of our products are consumed 20 miles from our farm. The local residents of the community are enthusiastic about eating our fresh, local, and organic produce. Our products are available at many locally-minded restaurants and food stores, as well as the Athens Farmers' Market and onsite sales. We make every attempt that we can to provide food for anyone, regardless of economic status. We participate in the Farmers' Market Electronic Benefits Transfer assistance program, and we also accept WIC and Senior Farmers' Market Nutritional Program.

I think my story is a model for the opportunities in today's agriculture. Farming as a career choice is one of the most difficult occupations to enter. Limited access to land and markets, high input costs, and a lack of sufficient support networks are major barriers for entry into agriculture. Despite these hurdles, people want to farm and see great opportunities in agriculture. The local movement and the growth in organics are a few of the trends that have more and more individuals and families interested in farming.

Access to credit is crucial in all types of new and beginning farmers, including small-scale and more locally-oriented farms like mine. Finding credit is difficult for beginning farmers as a whole, and particularly difficult for farmers like me because most lenders are learning on a curve on both sides. For the farmer, we must learn how to present a business plan that makes sense to the lender, and the lender to quickly merge with the local food sector.

I am currently about $300,000 in debt, primarily from buying land, even though land and equipment—even though land is relatively cheap in my area, my expenses are relatively low when compared to someone who starts out with more of the average size as a conventional farm. Mortgage payments have opened my eyes for the need of year-round sales. My energy is now focused through season extension programs through NRCS, as well as my own needs.

We have plans to add a certified kitchen, as well as cold storage unit for our products. I am pleased to say that all my bills are being paid on time. The greatest hill to climb for a new beginning farmer is the initial start-up cost. It is hard for someone with very few assets to secure a loan for agricultural land. It is crucial to retain the Farm Service Agency Direct Loan Programs as a lender for those who cannot find credit elsewhere.

FSA lending creates new farming opportunities and helps regenerate American agriculture. I believe Congress was correct in the last four farm bills directing a majority of direct real estate loans to beginning farmers as well as a substantial amount of direct operating loans. These loans help slow down the aging of American agriculture. I hope Congress will continue to ensure a strong target for beginner farmers and the robust funding overall for direct and guaranteed loans. The future of the next generation of farmers depends on it.

I had to move fast on my loan. Land on the market does not wait for a loan to become available. Many beginning farmers have lost out on farmland because FSA was temporarily out of funds and delays in the Congressional appropriations process. Currently, I am working with FSA on the cold storage unit for storing my vegetable products. My local FSA agent was very concerned about funding issues on whether or not it would be budgeted and I would be able to obtain my loan.

I plea for this Committee to remember that beginning farmers do not have the luxury of waiting for the budget process to close on a deal to buy land. Either loans are available or they are not. If we are serious about growing a new generation of farmers and reversing the aging of American agriculture, we need to be serious about ensuring a healthy FSA loan budget. Thank you for the time and I would be happy to answer any questions.

[The prepared statement of Mr. Starline follows:]

PREPARED STATEMENT OF MATTHEW STARLINE, OWNER, STARLINE ORGANICS, LLC; MEMBER, OHIO ECOLOGICAL FOOD AND FARM ASSOCIATION, ATHENS, OH

Thank you for the opportunity to testify this morning. I am Matt Starline, a beginning farmer from the Athens, Ohio area. Starline Organics is a 50 acre diversified farm located in the Appalachian foothills of southeast Ohio. We grow a variety of vegetables, mushrooms, herbs, and grains, plus lamb, pork and beef.

I am also here today as a member of the Ohio Ecological Food and Farming Association (OEFFA). Formed in 1979, OEFFA is a grassroots coalition of nearly 3,000 farmers, backyard gardeners, consumers, retailers, educators, researchers, and others who share a desire to build a healthy food system that brings prosperity to family farmers, helps preserve farmland, offers food security for all Ohioans, and creates economic opportunities for our rural communities. OEFFA developed and began operating an organic certification program in 1981, and is currently one of the largest USDA-accredited certifying agents, last year certifying over 600 organic farms and processors. OEFFA provides education, advocacy, and grassroots organizing to promote local and organic food systems, helping farmers and consumers reconnect and together build a sustainable food system, one meal at a time.

I farm the foothills of Appalachia. That means that you are lucky if you have flat land. My plateau is rich in history reminding me of how we are merely stewards of the land. My land was host to many generations of farmers including American Indians. When I first started my small business, vegetables were my main focus. Now with more diverse land base, I have ventured into livestock as well as grains.

Our farming practices are centered on sustainability. We utilize a natural gas well to heat our greenhouses as well as our home. Spring water provides the largest input for our water system. We look at our soil as our largest investment as well as our most important living ecosystem. We are always looking at innovative ways of how to turn our waste into a usable positive product, such as plant excess being fed to pigs rather than turning it into compost. Our animals are rotationally grazed. We are moving towards a multi-species grazing method to decrease the use of chemical dewormers for sheep. Currently we have three separate Environmental Quality Incentive Program contracts: construction of a high tunnel, an irrigation system connecting springs and wells to supply the garden, and the Organic Initiative with an emphasis on Integrated Pest Management (IPM) for organic systems. We are also applying for an agriculture easement as a long term insurance policy for moneys we receive. This is a state program placing permanent agricultural easement on the land.

I am a child of Appalachia. I grow food to feed the Athens, Ohio community 20 minutes from my farm. My farm is certified organic in an impoverished region of Ohio. I find the local residents in my community are enthusiastic about eating our fresh, local, and organic produce. Our products are available at many locally-minded restaurants and food stores, as well as at the Athens Farmers' Market and on-site.

We attempt to make our farm products available to everyone regardless of economic status. Our business took in 1⁄60 of the Ohio statewide Farmers' Market Electronic Benefits Transfer (EBT) assistance program, in conjunction with the Athens Farmers' Market taking in $34,000 for the year. We also accept Woman, Infants and Children (WIC) and Senior Farmers' Market Nutritional Program (SFMNP) coupons. A local nonprofit, Community Food Initiatives (CFI), has a "Donation Station" where farmers can donate excess product to be distributed to over 40 different places of need. Being a beginning small business, I understand that donating has no instant monetary gain. However in the long run I feel I am trading for promotional advertising.

I am the son of a farmer who signed all of his farmland into the Conservation Reserve Program (CRP). My earliest memories are riding with my dad in his old Gleaner combine, hypnotized by the crops until I would fall asleep only to be awoken by the jolt of hitting a hole. I am a 100% full-time farmer, which means I am part-time mechanic, educator, scientist, researcher, advocate, plumber, carpenter, gas well operator, landowner, delivery driver, record keeper, veterinarian, sales representative, and community member. I am roughly half the age of the average farmer. I moved from a conventional background to growing organic. My wife came from a non-farming background and is now an operating owner. Most of my equipment is significantly older than I am, but it works as hard as I do.

I think my story is indicative of the opportunities in today's agriculture. Farming as a career choice is one of the most difficult occupations to enter. Limited access to land and markets, high input costs, and a lack of sufficient support networks are major barriers to entry into agriculture. Yet, despite these hurdles people want to farm or ranch and see great opportunities in agriculture. The burgeoning local food movement and the growth in organics are just a couple of the trends that have more and more individuals and families interested in farming.

If more institutions sourced locally there would be a large spike in the demand for fruits and vegetables. For instance, Ohio University takes up much of Athens. The demand is there, and from a public health perspective the need is there, but we desperately need more farmers to supply local foods and meet rising demand. I understand that every town does not have an institution like OU, but there are elementary schools and high schools where volume can be created. In Ohio, farm to school programs are breaking ground. We have an excellent model in Granville High School in Granville, Ohio that is now being applied elsewhere.

Access to credit is obviously critical for all types of new and beginning farmers, including smaller-scale and more locally-oriented farms like mine. Finding credit is difficult for beginning farmers as a whole, and particularly difficult for farmers like me because most lenders are not as familiar with what we do, how we market, and what our price structures are. There is a learning curve on both sides—for the farmer to learn how to present a business plan that makes sense to the lender, and for the lender to learn what this quickly emerging local food sector is all about. I am pleased to say that my local FSA agent views vegetable farming as the best opportunity for beginning farmers in my area and has been willing to work with me. From what I hear at farmer meetings, others have not been so lucky.

I am $300,000 in debt, primarily from buying land, even though land is relatively cheap in my area and my expenses are relatively low when compared with someone who would start out the average size more conventional farm. Mortgage payments opened my eyes to the need for year round sales. Now my energy is focused on season extension structures for produce. We have plans to add a certified kitchen for value added products, storage bins for grains, and a grain processing facility. I am pleased to say that all our bills are being paid on time.

The greatest hill to climb for a new beginning farmer is the initial start-up cost. It is hard for someone with few assets to secure a loan for agricultural land. It is critical therefore to retain the Farm Service Agency direct loan programs. As the lender for those who cannot find credit elsewhere other than resorting to credit cards, FSA creates new farming opportunities and helps regenerate American agriculture. I believe Congress was correct in the last four farm bills to target a majority of FSA direct real estate loans to beginning farmers as well as a substantial amount of direct operating loans. These loans in a very real sense help slow down the aging of American agriculture, and it is my hope that Congress will continue to ensure strong targeting to beginners and robust funding overall for both direct and guaranteed loans. The future for the next generation of farmers, like the ones before it, depends on it.

My father-in-law was the first to show me a print out for the FSA loans for beginning farmers. I qualified for the FSA beginning farmer loans, however, like many others, I had to move fast to secure my farm. Land on the market does not sit around waiting for loan funds to become available. Many beginning farmers have lost out on farmland because FSA was temporarily out of funds due in part to delays in the Congressional appropriations process. It would be great if Congress and the Administration could find a way to allow FSA to make loans in these situations. The loan programs need to reflect the reality of the land market if new and beginning farmers are going to have a realistic chance of competing.

Currently, I am working with FSA on a loan for construction of a cold storage unit for our products. We are also looking to build a certified kitchen above the cold storage unit, although that is not a part of the loan. This will enable me to prolong the storage life of our vegetables and herbs after harvest and further improve our profitability. This will also allow for more time to harvest and will allow us to harvest more overall. The kitchen will also pave the way to selling more value-added products, meeting strong consumer demand while again improving our profitability. These are the kind of activities that I hope FSA, Farm Credit, and commercial lenders will look at more seriously in the future. The market for local food is real and expanding, and the new farmers who are serving this market need to know that credit will be available to help us respond to the demand for farm fresh food.

We need a national strategy and commitment to support beginning farmer and ranchers entering agriculture. With an aging farm population, the time is now to nurture new agriculture start-ups. A new farms policy, especially in the local food sector, is a jobs creator, a sound investment that can provide long-term societal benefits and contribute to the revitalization of our rural as well as urban communities.

In that light, I was disappointed to hear that the continuing resolution for the rest of Fiscal Year 2011 contains a very substantial 27 percent cut in direct farm ownership loan funding. This is like throwing away the seed corn for the future of our farming system. Thankfully the reduction in direct operating loans was a more modest five percent. I would urge this Subcommittee to work diligently with your colleagues on the Agriculture Appropriations Subcommittee to secure adequate loan program levels for Fiscal Year 2012.

The 2008 Farm Bill targets 75 percent of direct ownership loans and 50 percent of direct operating loans to beginning farmers. In FY 2009, the FSA made or guaranteed about $4.5 billion in loans to 34,210 farmers, including over 20,000 farmers receiving direct operating loans. From this total, about 14,500 beginning farmers received loans totaling $1.5 billion. Nearly half of all direct operating loans and over 70 percent of direct ownership loans went to beginning farmers, just shy of the farm bill targets of 50 and 75 percent, respectively.

Reflecting credit difficulties during the recession, FSA lending in FY 2010 increased to $5.3 billion servicing 36,440 borrowers. Perhaps as a result of the additional influx of more established farmers requiring FSA assistance during the downturn, the agency's performance on beginning farmer lending declined a bit. Total loans to beginners dipped under 14,000 though loan volume remained constant at about $1.5 billion. The percentage of beginning farmer loans to total loans dropped, however, to 60 percent for direct ownership and 45 percent for direct operating.

For the first half of Fiscal Year 2011, FSA has needed to concentrate on funding the direct operating loan program to help get farmers into the field for this growing season. As a result, direct farm ownership lending has suffered. Total direct farm ownership loan volume is down considerably, and the beginning farmer participation rate remains stuck at 60 percent of the total, the same as for Fiscal Year 2010. Both of these situations will hopefully turn around in the last half of the fiscal year as the full year's funding is made available, though obviously the 27 percent cut in funding will have a very real and negative impact.

Despite the pain it causes beginning farmers who were not able to secure farmland in the absence of loan availability, FSA is to be commended for concentrating on operating loans in the past months given how close we are to planting time. These are the very unfortunate but necessary trade-offs that have to be made when Congress is so late in appropriating funds. Compounding the problem is the Administration's decision that during repeated short-term Continuing Resolutions FSA can only spend a pro rata share of total loan funds under the pretense that lending remains constant week to week over the course of a year. Of course, as we all know, operating credit in particular is front loaded into the first half of the fiscal year to correspond with the planting season. I would encourage this Subcommittee to help relieve this nonsensical situation by working for a policy that keeps lending rates consistent with normal lending volumes for a given portion of the year during these unfortunate long delays in appropriations.

While performance on meeting the beginning farmer targets for direct loans has been admirable, the picture on guaranteed loans is less positive. Congress has targeted 40 percent of guaranteed ownership and operating loans to beginning farmers, but the actual rates in recent years have been less than 20 percent. The relative lack of responsiveness of the commercial sector to concentrating more resources on beginning farmers through the guaranteed program would be a worthwhile subject for this oversight panel to pursue.

The Down Payment Loan program for first-time land acquisition by beginning and minority farmers took a big upturn since passage of the 2008 Farm Bill. The farm bill lowered the interest rate and the beginning farmer down payment amount and also increased the value of land which could be financed, all of which combined to get the program more fully utilized. This creates a win-win-win situation, with the agency able to stretch its limited resources further, the commercial lender starting off with a beginning farmer customer earlier in the process, and the beginning farmer having greater equity in the operation.

The 2008 Farm Bill improvements paid off immediately. The Down Payment program financed 1,100 beginning farmers with a total of $147 million in real estate loans in 2008 and 2009, compared to the nearly 3,000 beginning farmers assisted with $131 million in loans in the previous 14 years of the program's existence combined. An additional 1,225 down payment loans were made in Fiscal Year 2010 on a loan volume of $170 million, bringing the total for the first 3 years under the new farm bill to 2,325 farms and a loan volume of over $300 million. I am glad to say that Ohio is in the top ten states using the program. Congress did the right thing in improving the program in 2008 and should continue on the same path in the new farm bill.

I will close my remarks with a note of alarm about the existing levels of backlog for FSA loans. According to FSA, as of last Friday there was a backlog of 503 approved applications from non-beginning farmers worth $91.5 million and 590 approved applications from beginning farmers worth $115 million waiting for direct farm ownership funding. Applications waiting for direct farm ownership funding from socially disadvantaged or minority farmers totaled 195 worth $34 million. The backlog for direct operating loans was also substantial. Nearly 850 beginning farmers were waiting on loans approved for $56 million and an additional 486 farmers were waiting on loans approved for $34 million. Hopefully many of these loans will move forward quickly after the final Fiscal Year 2011 appropriations bill is signed into law.

I leave you with a plea to remember that beginning farmers do not have the luxury of waiting on the vagaries of the budget process to close a deal to buy land. Either loan funds are available when the land is available or not. If we are serious about growing a new generation of farmers and reversing the aging of American agriculture, we need to be serious about ensuring a healthy FSA loan budget.

With respect to the farm bill, I applaud the many positive advances made in the 2008 bill for beginning farmers, including the Down Payment program, the Beginning Farmer and Rancher Development Program, and the targeting of conservation funds, among others. I encourage this Subcommittee to explore the positive outcomes generated by these farm bill gains and to redouble your efforts on beginning farmer issues in the 2012 bill.

Thank you again for the opportunity to testify. I will be happy to try to answer any questions you might have.

The CHAIRMAN. Thank you, Mr. Starline. Let me just start right there with you. I am curious if you could expound upon your background a little bit? What motivated you to enter agriculture in a time in which the average age of the farmer in Nebraska, and throughout most of the country, is approaching 58 years old, you are clearly not there? And I am curious as to how you came to enter into this entrepreneurial desire? Is this a part of your own family background? Did you study agriculture? If you could just briefly expound upon that?

Mr. STARLINE. Yes. Through different generations, my family has been farming land in Ohio. Growing up with it was the best aspect for me, when I was 17 I had an opportunity with OSU extension growing green bell peppers in order to wean farmers off tobacco basis. As I went to school, I was able to work on an organic vegetable farm and I saw how strong my community was in support of the local food system, and I felt that as a viable business for my area.

The CHAIRMAN. Well, congratulations on your decision and what you do is important for the country and we appreciate your willingness to take this risk and come before the Committee today to explain your perspectives.

Let me turn quickly to Mr. Gerber. I think it would be helpful for everyone for you to explain the substantive differences between Farmer Mac as a government-sponsored enterprise and other government-sponsored enterprises such as Fannie Mae and Freddie Mac, which have experienced deep structural difficulty and caused severe exposure to the taxpayer?

Mr. GERBER. Sure. Thank you for the question. A number of differences exist between the model at Farmer Mac and the model of the other GSEs you named. First of all, Farmer Mac reports to this Committee, the Agriculture Committee, which is focused on rural America, focused on the issues and needs there, and understanding the uniqueness of that marketplace.

Second, we have a strong regulator in the Farm Credit Administration, an independent regulator that reports to you and that is active in assuring that we are doing things on a safe-and-sound basis. I think in addition our model is a different one because these loans that we do real estate mortgage agricultural loans and rural utility loans are business loans rather than strictly consumer loans. As well, our underwriting standards are critical to the success. Our focus, because they are business loans, is not to focus as much on, or only on, the collateral and its value if there were default, but also the borrower's capacity to repay the loans and the understanding of the business behind those loans. That makes a significant difference as we think about the differences and the problems that the other GSEs experienced.

Farmer Mac did not experience similar problems even with the challenges of 2008—our portfolio remained strong. We have not seen significant losses through the cycles and the challenges of agriculture over the last 20 years.

The CHAIRMAN. Thank you. Quickly, let me turn to Mr. Stark. You had indicated in your testimony that the System continues to finance land transactions by remaining focused on sound underwriting and making credit decisions based upon the repayment capacity—and I think that is an important work—of the individual borrower. Is this true throughout the System?

Mr. STARK. Yes, it is true throughout the System. We have had several meetings over the course of the last few months focusing specifically on the actions that institutions in the Farm Credit System are taking with respect to financing real estate; and unanimously they have all made sure that they are focused clearly on sound underwriting practices and even using more longer-term averages for prices of corn, not the current price. We all know that that is going to fluctuate and will likely be lower, as we have heard in testimony this morning. So we are using conservative prices, conservative yields, and long-term projections to make those assumptions.

The CHAIRMAN. Does this Committee need to help ensure that this is the case?

Mr. STARK. I think that the System is adequately overseen by the Farm Credit Administration. They are in our association right now looking at loan underwriting and they give the reports back to the Agency on a timely basis.

The CHAIRMAN. Thank you. We may have to come back to another round. But right quick, Mr. Williams, thank you for your testimony. You stated that you support ending the term limits for FSA Lending Programs, the guaranteed operating loans that limit borrowers to assistance for 15 years. Congress has suspended this on several occasions, but that means that borrowers could potentially go up to 20 years on a guaranteed operating loan. So how does that encourage a borrower to graduate and move to commercial credit?

Mr. WILLIAMS. I think it is important that we recognize that graduation can happen, but as you have heard earlier today, there are certainly cycles. We had a board meeting at our bank yesterday and I brought this up with some of our ag lenders, and we have several customers coming through the late 1970s and the early 1980s that struggled and showed some weakness. We began using the Guaranteed Loan Program on them in the late 1980s and early 1990s and they were in that program for, in one case, 10 years, in another case, about 12 years during that period of time and then they graduated and have been out of the program. But if there was a weakness shown and it was needed to come back into the program with those two borrowers, the time clock has already ticked a major portion of their term limit. So it would be difficult to potentially bring them back in. I think that is the flaw in the program this way, that it sounds good to graduate but the reality is as cycles change over periods of time, we can't see the future. So that is why we would propose, again, suspending that.

The CHAIRMAN. Thank you very much. We will turn now to our Ranking Member for her questions.

Ms. FUDGE. Thank you, Mr. Chairman. Let me start with Mr. Stark and Mr. Williams, same question. Specifically, what are your institutions doing to facilitate the entry into ag production of diversified and direct marketing producers like Mr. Starline?

Mr. STARK. Well, I will start with that because I had the opportunity to visit with Mr. Starline before the session began and as a matter of fact, he obtains part of his financing from the Farm

Credit System, Farm Credit Services of Mid-America. So we are very actively involved in ensuring that young people can get their start in farming.

Our institution of Farm Credit Services of America has also appointed a member of the board. They went out of their way, as opposed to just having an elected stockholder, to make sure we put a young person on our board who is 29 years old to assure the voices of these young people are heard. And so they are very interested in having that voice heard and made that appointment.

Additionally, we also have a very active young farmer program. We do a number of things in that area, as well as being very focused on serving the needs of small farmers. Small farmers in our portfolio is the largest portion of our portfolio at this time.

Ms. FUDGE. Thank you. Mr. Williams?

Mr. WILLIAM. Ranking Member Fudge, thank you for that question. In our bank we are very excited to work with young people. That is the lifeblood of our community. That is where we are going. There has been a lot of talk about farmers' markets and those kinds of things. The farmers' market in Gothenburg is held on the sidewalk in front of the bank every Thursday night during the summer. Several of the producers that are there are small producers that we finance.

We also have started a program in Gothenburg of working with our local FFA chapter. We have two bank officers that do a significant portion of their training, and we help them in their preparation for state and national competitions. We have also devised a program to help them become farmers on a limited basis because they need that experience.

All said, as you heard this morning, farming is not an easy-entry occupation. But, with the added ingredients and the environment that we as banks and Farm Credit create, we do the best job we can to see that this happens. Thank you.

Ms. FUDGE. Thank you. And I would certainly hope, Mr. Starline, if you have these gentlemen sitting here with you that you would make sure that they do not get out of the room until you talk to them. Thank you.

Now, to all of you, as we prepare to write the next farm bill, what changes would you like to see in the area of Farm Credit? I would like each of you to give me just one thing, okay? What would you like to see change in the area of Farm Credit? We can start with Mr. Gerber.

Mr. GERBER. For agriculture and for rural America, one of the things that is interesting is that rural America is the only marketplace in this country that does not have a secondary market available to it other than what we do specifically in the agricultural real estate mortgage area, and in the area of the rural utilities business. As you have seen by our numbers and by the growth, there is a need and an opportunity for that secondary market and the opportunities that moving investment from Wall Street into rural America would bring; and we believe that is some thing that would help make a difference in rural America is the ability for those markets to have an opportunity to use the secondary market products.

Ms. FUDGE. Thank you. Mr. Stark?

Mr. STARK. I would mention the one thing that I believe supports the farmers and Farm Credit System, as well as the credit extension that we have, particularly in the Midwest is the Crop Insurance Program. And as you face challenges with budget issues, that is a very strong underpinning to credit extension throughout the country. I can recall the days of *ad hoc* disaster assistance, which were very challenging to know when and how that might occur. Farmers have in the Crop Insurance Program a very good risk-management tool. And I would just encourage your consideration of that in the credit sense.

Ms. FUDGE. Thank you.

Mr. WILLIAMS. Ranking Member Fudge, you mentioned what would we do in the farm bill for Farm Credit but I would assume you are also asking about credit to farmers, not just Farm Credit.

Ms. FUDGE. Absolutely correct.

Mr. WILLIAMS. I think it is terribly important that we remember the challenge that we have as a country behind the whole farm bill to maintain an abundant and safe supply of food for our country and the world. In our world we have conflict over energy and we can certainly get to a point that we have conflict over food. I think the American people demand and expect an abundant and safe supply of food.

Specifically, from the American bankers we would like to see the term limit on FSA guarantees, a suspension of that, and a continuation of a strong FSA Guaranteed Loan Program. That program works. It serves over 55,000 farmers in our country and it is necessary that that continues.

And we would also like to see an examination to be sure that the Farm Credit System itself continues to follow the original mission that it was proposed to do in 1916. Thank you.

Ms. FUDGE. Thank you very much. And Mr. Starline, I know that my time is over but the chair has been gracious enough to allow me to get the last answer. Mr. Starline?

Mr. STARLINE. In my eyes, after I graduated college I had next to nothing as far as equity was concerned. With the new beginning farmer aspect of FSA with the loans, lowering the interest rate and lowering the down payment would really help out beginning farmers and it is a step up in becoming a farmer.

Ms. FUDGE. Thank you so much. Mr. Chairman, I yield back.

The CHAIRMAN. Thank you, Ms. Fudge. Let me return to some additional questions.

Mr. Stark, you had indicated—and I am curious as to why—and if you could unpack further your testimony that the capital requirements of a typical corn farmer are now four times higher than they were just in 2005. Could you explain that further, please?

Mr. STARK. Yes, I think there were several things and in various presentations, one I gave most recently at the National Feed and Grain Association, I outlined some of those specifics. It really involved first of all, not only are the cost of inputs higher, which we are seeing, now, the cost of risk management programs are being passed on to farmers. Co-ops and grain merchandisers are no longer extending marketing programs out beyond 1 year, and in some cases it is even difficult to get that. So many cases we are setting up marketing loan programs that didn't exist 3 to 5 years ago because there were other options available in the market. And the overall cost of production we are estimating about $700 an acre for farmland. And then when you get to multiple years production on that that I mentioned earlier in my testimony, it quickly multiplies.

The CHAIRMAN. Can this also be explained by consolidation of land into fewer and fewer hands and therefore the need for larger loans?

Mr. STARK. Not necessarily. I would say our estimation is what would be on a per-acre basis. So, when you really look on it, regardless of size, the cost of——

The CHAIRMAN. It is per acre and not the individual borrower?

Mr. STARK. Yes.

The CHAIRMAN. I see. Okay. Thank you. You also stated that you loaned about $7.3 billion to beginning farmers. I would assume that would include value-added opportunities as well as organic and local food businesses. What percent of your portfolio is that?

Mr. STARK. We have at Farm Credit Services of America, 17 percent of our portfolio is to young and beginning farmers. So out of 85,000 customers, a significant portion of our portfolio will result in loans to farmers less than 35 years of age and less than 10 years in farming.

The CHAIRMAN. Since we are assuming, like Mr. Starline, that most young and beginning farmers are actually entering into new models of agriculture that are actually traditional models of agriculture *versus* what we understand as production ag, which is essential for you to be focused on as well; what percent of the young farmers that you are underwriting are involved in new enterprises such as his?

Mr. STARK. I don't have those numbers readily available, but I can tell you that a number of them are involved in various types of enterprises.

The CHAIRMAN. Well, the reason I ask is, we all know that this is a growing opportunity in agriculture in general and it actually augments our strong production ag system to create more entrepreneurial opportunity for local food systems, strengthening local economies, returning to the connection between the urban and rural and the farm to the family, and I think there are multiple benefits in doing that. So that is why I am trying to get a better sense as to whether or not this percent of your underwriting that goes to young farmers is actually targeted to these new emerging trends, small as they are, but nonetheless emerging trends in agriculture.

Mr. STARK. It would certainly be included in those numbers but it is not specifically broken out.

The CHAIRMAN. All right. I think that would be helpful to know if you could provide that.

Mr. STARK. We will provide that.

The CHAIRMAN. Mr. Williams, in your testimony you stated a concern that the Farm Credit System as a government-sponsored enterprise is a risk to the taxpayer, but does your institution also use advances from the Federal Home Loan Bank System and do you consider the Federal Home Loan Bank System a risk to the taxpayer as well?

Mr. WILLIAMS. Yes, we do use advances from Federal Home Loan Bank System on a limited basis to supply funding that is necessary for us to be able to meet the credit needs of our community. I think the health of the Federal Home Loan Banking System is vitally important, and the regulators and everyone overseeing that needs to recognize that and be certain that they stay as healthy as possible also, just like Farm Credit.

The CHAIRMAN. Let us touch briefly upon the issue of escalating land values and, of course, this posed perhaps the most—the drop in land values was part of the reason of the severe difficulties in the 1980s that we experienced. Will you explain why the situation may be different as we are seeing escalating land values today?

Mr. WILLIAMS. Yes, I think there are two specific questions that we need to ask when we are looking at that. One is, is this an asset bubble and what is the potential risk of land prices dropping significantly? That is the first question and that one can be debated on both sides and we will be able to look in the rearview mirror down the road and know whether that happens.

I think the second question is the more important question as to whether this is an asset bubble and if land values do decrease, what is the result of that decrease? And I think that is the important difference. And the way I would describe that is it is not your grandfather's farm anymore as it was in the 1980s when this happened before. And also granddad isn't running the bank. We do things significantly different both on the farm and in the bank that have tended to mitigate that potential risk.

We are in the risk-monitoring business in banking, weighing risk and analyzing those. The technology that we use today is substantially different. If you go back to the 1980s, we were primarily collateral-based lenders. So we were relying almost solely on the underlying value of that collateral to support our loans. So in our particular area in central Nebraska when land values dropped by 35 to 40 percent in the 1980s and we were relying on that, it was devastating to us. We are now cash flow lenders.

The other thing is we have not invented unusual and exotic types of instruments to finance agriculture. In our shop we use a 60 percent loan-to-value ratio, looking at the front end of an ag real estate loan. And we analyzed our whole portfolio and our outstanding portfolio of ag loans right now has a loan-to-value of about 40 to 45 percent. With that in mind, I would put it this way. If ag land were to drop, if it were a bubble and it were to drop that 40 percent or some number like that, we would see an instant decrease in the net worth of many of our borrowers but we——

The CHAIRMAN. Can I interrupt you for a moment? What was the loan-to-value in the 1980s?

Mr. WILLIAMS. Loan-to-value in the 1980s, we were using a much higher level because we were based on the collateral at that point. I would have to look back but I am thinking we were in the 85, sometimes 90 percent range that we were loaning. And we, again, at that time had a period of time where we had significant increases in land value very quickly. And we were aggressively pursuing that at that time.

The CHAIRMAN. Thank you. Ms. Fudge, do you have any further questions? I just thought of—Mr. Stark, you may want to comment on this as well because of the preliminary research I have done into the question suggests there is another factor in addition to the changing structural requirements that are in place in banks and the awareness of the industry not to repeat the past. The issue of not over-leveraging is also manifested in the fact that a lot of money is moving simply out of cash into land purchases. This is not taxing, if you will, the credit system further. Is that a fair assumption?

Mr. STARK. Yes, that is exactly right. You know, one of the biggest things we see today in land purchases is the amount of cash going into these transactions as well.

The other thing, Mr. Chairman, that I would mention that at the Farm Credit System we are doing to really help protect customers around not only falling land values but also to locking in the cost relative to land. We have the ability to go out and fix interest rates up to 15 and 20 years. And that is really protecting customers in the event that we have higher interest rates, which will impact land values as well. And so even this last year, we converted over 15,000 loans or loans to 15,000 customers to lower rates of interest and locked in their rates of interest to protect them against those kind of changes. So we are doing everything we can to protect them both with land values declines as well as interest rate increases.

The CHAIRMAN. Thank you very much. With that said, let me make some concluding remarks and then we will adjourn momentarily.

This has been a very important hearing to look overall at the credit system in America. We have a mixed financing system for agricultural credit in our society and we have done it this way for a very long time. I think, though, if we can take a step back and look at the reality that agriculture is one of the few bright spots in the American economy, and agriculture is significantly evolving from not only its primary mission to feed and provide a safe food supply not only for our own people but for people throughout the world; it has evolved also on the forefront of both energy, environmental, and national security policy.

So I want to thank you all for what you do in helping secure that so we have a sound financing system for American agriculture. You, Mr. Starline, being a new entrepreneur, we appreciate your entry into the field as well. Ms. Fudge, do you have any further commentary?

Ms. FUDGE. I would just like to thank you, Mr. Chairman, and to thank all of our witnesses for today for your excellent testimony. As a new Member, it is really important for me to get some background, some foundation as to the significance and the changes that are going on in credit in agriculture. So I just want to thank all of you for being here and hope to learn more about the whole credit issue and how it affects our farmers today. So I thank you all. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Under the rules of the Committee, the record of today's hearing will remain open for 10 calendar days to receive additional material and supplementary written requests from the witness to any question posed by a Member. This hearing of the Subcommittee on Department Operations, Oversight, and Credit is adjourned.

[Whereupon, at 11:45 a.m., the Subcommittee was adjourned.]