

CRS Report for Congress

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Farm Credit System

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Summary

The Farm Credit System (FCS) is a nationwide financial cooperative that lends to agricultural producers, rural homeowners, certain agriculture-related businesses, and agricultural, aquatic, and public utility cooperatives. Established by the Federal Farm Loan Act in 1916 as a government-sponsored enterprise (GSE), it has a statutory mandate to serve agriculture and related enterprises. The System's lending associations are governed by directors elected from System borrowers. Funds are raised through the sale of System bonds and notes. Federal oversight is designed to provide for the safety and soundness of System institutions. This report will be updated.

What Is the Farm Credit System?

Rural Lender. The Farm Credit System (FCS or System) was created to provide a permanent, reliable source of credit to American agriculture. When Congress enacted the Federal Farm Loan Act in 1916, credit was frequently unavailable or unaffordable in rural areas. Many lenders avoided such loans due to the inherent risks of agriculture. Current statutory authority is in the Farm Credit Act of 1971, as amended. The most comprehensive recent changes were enacted in the Agricultural Credit Act of 1987.

The System is authorized to lend to farmers, ranchers, and harvesters of aquatic products. Loans may also be made to finance the processing and marketing activities of these borrowers, for home ownership in rural areas, certain farm- or ranch-related businesses, and agricultural, aquatic and public utility cooperatives.

As of September 30, 2005, the System had \$103 billion in loans outstanding, 51% of which was in long-term agricultural real estate loans, 28% in short- and intermediate-term agricultural loans, 16% in loans to cooperatives, 2% in export financing, and 3% in rural home loans. The System holds about 31% of the farm sector's total debt (second to the 40% share of commercial banks) and has the largest share of farm real estate loans (38%).

Government-Sponsored Enterprise (GSE). As a GSE, FCS is a privately owned, federally chartered corporation designed to provide credit nationwide, and limited to serving agriculture. Each GSE is given certain benefits such as implicit federal

guarantees or tax exemptions, presumably to overcome barriers faced by purely private markets.¹ FCS is a direct lender, unlike the housing GSEs, which are secondary markets.

System of Banks and Associations. FCS is composed of 5 regional banks that provide funds and support services to 96 smaller Agricultural Credit Associations (ACA), Federal Land Credit Associations (FLCA), and Production Credit Associations (PCA). These associations in turn, provide loans to eligible borrowers. The most common operating structure (due to favorable tax and regulatory rules) is a “parent ACA” with FLCA and PCA subsidiaries. FLCA subsidiaries are exempt from federal income taxes. As of September 30, 2005, there were 85 ACAs and 11 stand-alone FLCAs.

One of the regional banks, CoBank, has a nationwide charter to finance farmer-owned cooperatives and rural utilities. It finances agricultural exports and provides international services for farmer-owned cooperatives through three international offices.

Cooperative Organization. As a nationwide financial cooperative, all System banks and associations are governed by boards of directors elected by the stockholder-borrowers of each institution. Each has one vote, regardless of the size of his/her loan. Directors are member-borrowers, but federal law requires that at least one be elected from outside the System. Association directors elect the directors for their affiliated bank.

FCS Is Not a Government Agency

FCS is not a government agency and the System’s debt instruments and loans are not explicitly guaranteed by the U.S. government.² FCS is not a depository institution; funds for loans come from selling bonds to investors. FCS is not a lender of last resort; FCS is a commercial, for-profit lender with a statutory mandate to serve agriculture and related enterprises. Borrowers must meet creditworthiness requirements similar to those of a commercial lender. (The USDA Farm Service Agency (FSA) is a lender of last resort. FSA borrowers must be unable to get a loan from another lender, such as the FCS.)

Loans and Eligibility

FCS provides three types of loans: (1) operating loans for the short-term financing of consumables such as feed, seed, fertilizer, or fuel; (2) installment loans for intermediate-term financing of durables such as equipment or breeding livestock; and (3) real estate loans for long-term financing (up to 40 years) of land, buildings, and homes.

Since FCS has a statutory mandate to serve agriculture and rural America, borrowers must meet certain eligibility requirements in addition to creditworthiness. Eligible borrowers and their scope of their financing can be grouped into four categories.

¹ For more on GSEs, see CRS Report RL30533, *The Quasi Government: Hybrid Organizations with Government and Private Characteristics*, by Ronald C. Moe and Kevin R. Kosar. There are five GSEs: Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), Federal Agricultural Mortgage Corporation (Farmer Mac), Federal Home Loan Bank System, and FCS.

² Because of the significant role of GSEs in the U.S. economy, most investors feel the federal government will not allow a GSE to fail. Thus, an implicit, albeit not statutory, guarantee exists.

Full-Time Farmers. For individuals with over 50% of their assets and income from agriculture, FCS can lend for all agricultural, family, and non-agricultural needs (including vehicles, education, home improvements, and vacation expenses).

Part-Time Farmers. For individuals who own farmland or produce agricultural products but whose income from agriculture is less than 50% of their total income, FCS can lend for all agricultural and family needs. However, non-agricultural lending is limited relative to the agricultural income. For example, if 20% of income comes from agriculture, a person may borrow up to 20% of his/her non-agriculture related expenses.

Businesses. FCS can lend to businesses that process and/or market farm, ranch or aquatic products, provided that more than 50% of the business is owned by farmers who provide at least some of the “throughput.” FCS also can lend to businesses that provide services to farmers and ranchers, such as crop spraying and cotton ginning. The extent of financing is based on the amount of the business’ farm-related income.

Rural Homeowners. FCS can lend for the purchase, construction, improvement, or refinancing of single family dwellings in rural areas with populations of 2,500 or less. Loans also can be made for the purchase or refinancing of unimproved residential lots.

Source of System Funds

With the exception of seed money that was repaid by the 1950s and a temporary Treasury line of credit in the 1980s,³ FCS operates without any direct federal money. Moreover, System banks and associations do not take deposits like commercial banks.

Instead, a separate System entity, the Federal Farm Credit Banks Funding Corporation, raises funds in capital markets through the sale of Systemwide bonds and notes. These debt securities become the joint and several liability of all System banks. The banks act as financial intermediaries providing wholesale funds to their member associations which, in turn, act as retail lenders to the farmer customers.

FCS also raises some funds through two other methods. When a borrower acquires a loan from FCS, the borrower is required to pay the lesser of \$1,000 or 2% of the loan amount and become a System stockholder. Additionally, FCS also generates funds through profits that are not returned as patronage to borrowers (see below).

Patronage Refunds

As a cooperative, System associations are owned by the member-borrowers who purchase stock, typically as part of their loan. If an association is profitable, the directors may choose to retain the profits to increase lending capital, or distribute some of the net income to members by declaring a dividend or patronage refund. Distributing patronage refunds to members effectively reduces the cost of borrowing. A member’s refund is proportional to the size of the loan. Some associations tend to regularly pay a higher level

³ The Financial Assistance Corporation (FAC) borrowed \$1.26 billion from Treasury following the farm financial crisis of the 1980s. On June 10, 2005, the last of these bonds was repaid on schedule, and interest was repaid to the U.S. Treasury. The FAC will discontinue existence soon.

of patronage while others prefer to retain their earnings or charge lower interest rates initially. Patronage may be paid in cash, allocated surplus,⁴ or stock.

Consolidation

The number of banks and associations has been declining for decades through mergers and reorganizations. This consolidation accelerated, however, in 1999 when the Farm Credit Administration (FCA), the System's regulator, approved the "parent ACA" structure and the Internal Revenue Service declared FLCA subsidiaries tax-exempt. In the mid-1940s, there were over 2,000 lending associations, nearly 900 in 1983, fewer than 400 by 1987, 200 in 1998, and only 96 in 2005. The system operated with 12 districts into the 1980s, 8 districts in 1998, and 5 regional banks (districts) since 2004.

Twenty years ago, the typical FCS association covered several counties and specialized either in land or farm production loans. Today, the typical FCS association covers a much larger region, delivers a wide range of farm and rural credit programs and services, and has an extensive loan portfolio. The System and associations benefit when consolidation creates more diversified portfolios. Customers may benefit if greater institutional efficiency is passed along through lower interest rates. However, consolidation may weaken the original cooperative concept of local borrower control and close many local offices at which farmers had established relationships.

Charter Territories

Each association within FCS has a specific "charter territory." If an association wants to lend outside its charter territory, it first must obtain approval from the other territory's association. For example, associations within U.S. AgBank's region can compete for loans, but associations in the AgFirst region cannot. Charter territories help ensure that borrowers are served locally and maintain local control of the association. Charter territories and any changes must be approved by FCA. In 2001, FCA proposed allowing national charters so that associations would not be restricted by geographical boundaries. The FCA board later dropped the idea after opponents raised concerns that national charters would weaken the System's mission by pitting associations against each other for prime loans and reducing commitments to local areas.

Federal Regulation

Congressional Oversight. Congressional oversight of FCS is provided by the House and Senate Agriculture Committees. The House held hearings on Farmer Mac on June 2, 2004, and over the proposed sale of an FCS association on September 29, 2004. The latter hearing arose following the controversial decision by directors of Farm Credit Services of America to leave the FCS and be purchased by a private bank. After much public criticism, the board voted in October 2004 to terminate that agreement. For more information, see CRS Report RS21919, *Farm Credit Services of America Ends Attempt to Leave the Farm Credit System*, by Jim Monke.

⁴ Allocated surplus is the retained portion of a member's patronage and is recorded on the books of the association, or allocated to the member's equity account.

Farm Credit Administration (FCA). The FCA (<http://www.fca.gov>) is an independent agency and the federal regulator responsible for examining and ensuring the safety and soundness of all System institutions. FCA's operating expenses are paid through assessments on System institutions. Even though FCA does not receive an appropriation from Congress, the annual agriculture appropriations act in recent years has put a limit on FCA's administrative expenses (\$44.25 million in FY2006).

FCA is directed by a three-member board nominated by the President and confirmed by the Senate. Board members serve a six-year term and may not be reappointed after serving a full term or more than three years of a previous member's term. The President designates one member as Chairman, who serves until the end of that member's term.⁵

Other System Entities

Federal Agricultural Mortgage Company (Farmer Mac). Farmer Mac (<http://www.farmermac.com>) was established in the Agricultural Credit Act of 1987 to serve as a secondary market for agricultural loans — purchasing and pooling qualified loans, then selling them as securities to investors.⁶ Farmer Mac increases the capacity for agricultural lenders to make more loans; for example, if a lender makes a 30-year loan and sells it to Farmer Mac, the proceeds can be used to make another loan. Although part of FCS and regulated by FCA, Farmer Mac has no liability for the debt of any other System institution, and the other System institutions have no liability for Farmer Mac debt. Farmer Mac is organized as an investor-owned corporation, not a member-owned cooperative. Voting stock may be owned by commercial banks, insurance companies, other financial organizations, and FCS institutions. Nonvoting stock may be owned by any investor. The Board of Directors has 15 members — five elected from the System, five elected from commercial banks, and five appointed from the public at-large.

Farmer Mac operates two programs: Farmer Mac I (loans not guaranteed by USDA) and Farmer Mac II (USDA-guaranteed loans). A majority of Farmer Mac I volume comes from the sale of long-term standby purchase agreements (LTSPC). Under an LTSPC, Farmer Mac promises to purchase specific agricultural mortgages under specified circumstances, essentially guaranteeing the loans against default risk while the participating lender retains interest rate risk. Under Farmer Mac II, the company purchases the portion of individual loans that are guaranteed by USDA. On these purchases, Farmer Mac accepts the interest rate risk but carries no default risk.

In 2003, the Government Accountability Office recommended that Congress establish clearer goals for Farmer Mac (GAO-04-116). GAO was concerned with risk management practices (including geographic concentration), lack of secondary market development, and corporate governance. On June 2, 2004, the House Agriculture Committee held a hearing. Questions have also arisen whether a certain type of swaps are reducing insurance premiums paid to the System without any reduction in risk exposure.

⁵ FCA board members are Nancy C. Pellett (chairman since May 22, 2004), appointed in 2002 for a term that ends in May 2008; Douglas L. Flory, appointed in 2002 for a term that ends in October 2006; and Dallas Tonsager, appointed in 2004 for a term that ends in May 2010.

⁶ However, Farmer Mac continues to hold most of the loans it purchases, a potentially more profitable activity for the company, but also more risky.

Federal Farm Credit Banks Funding Corporation. The Funding Corporation ([\[http://www.farmcredit-ffcb.com\]](http://www.farmcredit-ffcb.com)) is based in Jersey City, NJ, and manages the sale of Systemwide bonds and notes in capital markets. The Funding Corporation also provides financial advice to System banks. It is governed by a 10-member board.

Farm Credit System Insurance Corporation. The Insurance Corporation ([\[http://www.fcsic.gov\]](http://www.fcsic.gov)) was established in 1988 to ensure timely payment of principal and interest on Systemwide debt securities. The FCA Board comprises its board of directors. Annual premiums are paid by each bank through an assessment based on loan volume until the secure base amount of 2% of total outstanding System loans is reached.

Farm Credit Council (FCC). FCC ([\[http://www.fccouncil.com\]](http://www.fccouncil.com)) is the national trade association of FCS. FCC has offices in Washington, DC, and Denver, CO, and lobbies on behalf of System banks and associations. FCC also provides support services.

Farm Credit System Banks (as of September 30, 2005)⁷

AgFirst FCB (Columbia, SC) has 23 parent ACAs in Delaware, Maryland, Pennsylvania, Virginia, West Virginia, North and South Carolina, Georgia, Mississippi, Alabama, Florida, Puerto Rico, and parts of Ohio, Kentucky, Tennessee, and Louisiana.

Agribank FCB (St. Paul, MN) has 18 parent ACAs serving Arkansas, Missouri, Illinois, Indiana, Iowa, Michigan, Minnesota, Nebraska, North Dakota, South Dakota, Wisconsin, Wyoming, and part of Ohio, Tennessee, and Kentucky.

FCB of Texas (Austin, TX) has 13 parent ACAs and 8 FLCAs serving Texas, Alabama, Louisiana, Mississippi, and part of New Mexico.

U.S. AgBank FCB (Wichita, KS) has 26 parent ACAs and 3 FLCAs serving Kansas, Oklahoma, Colorado, Arizona, Nevada, Utah, California, Hawaii, and part of New Mexico, eastern Idaho, and the western edge of Wyoming.

CoBank, ACB (Denver, CO) has a national charter to provide financial services to farmer-owned cooperatives and rural utilities. International banking services are provided through its headquarters in Denver and field offices in Mexico City, Singapore, and Buenos Aires. CoBank has specific authority to lend to 5 parent ACAs in its chartered territory of Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont, and Montana, Washington, Oregon, Alaska, and western Idaho.

⁷ For a directory of institutions in the Farm Credit System, and a map of the five regional banks, see the Farm Credit Administration website at [\[http://www.fca.gov/apps/instit.nsf\]](http://www.fca.gov/apps/instit.nsf).