

CRS Report for Congress

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Agricultural Credit: Institutions and Issues

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Summary

The federal government has a long history of providing credit assistance to farmers by issuing direct loans and guarantees, and creating rural lending institutions. These institutions include the Farm Credit System (FCS), which is a network of borrower-owned lending institutions operating as a government-sponsored enterprise, and the Farm Service Agency (FSA) of the U.S. Department of Agriculture (USDA), which makes or guarantees loans to farmers who cannot qualify at other lenders. When loans cannot be repaid, special bankruptcy provisions help family farmers reorganize debts and continue farming (P.L. 109-8 made Chapter 12 permanent and expanded eligibility).

S. 238 and H.R. 399 (the Rural Economic Investment Act) would exempt commercial banks from paying taxes on profits from farm real estate loans, thus providing similar benefits as to the Farm Credit System. This report will be updated.

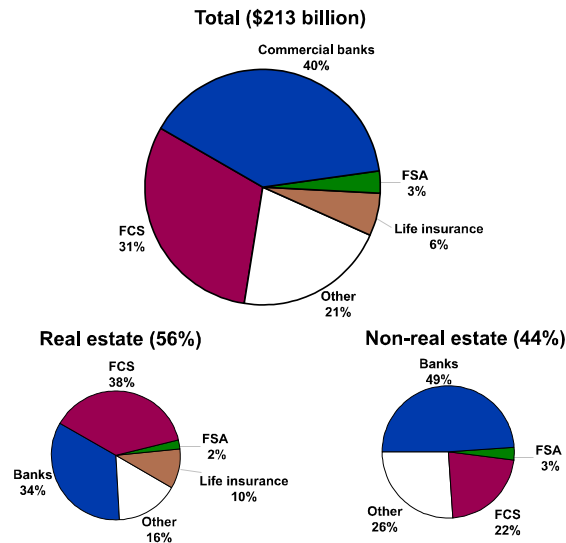
Lending Institutions

Five types of lenders make credit available to agriculture, the first two of which are more or less affiliated with the federal government: the Farm Credit System (FCS), USDA Farm Service Agency (FSA), commercial banks, life insurance companies, and individuals and others. Creditworthy farmers generally have adequate access to loans, mostly from the largest suppliers — commercial banks, FCS, and merchants and dealers.

Figure 1 shows that commercial banks lend the largest portion of the farm sector's total debt (40%), followed by the Farm Credit System (31%), individuals and others (21%), life insurance companies (6%), and the Farm Service Agency (3%). Ranked by type of loan, the FCS has the largest share of real estate loans (38%), and commercial banks have the largest share of non-real estate loans (49%). Although FSA has a 3% share of the market through its direct lending program, it guarantees loans made by other (commercial) lenders accounting for approximately another 4%-5% of the market.

Farm Credit System (FCS).¹ Operating as a government-sponsored enterprise, FCS is a network of borrower-owned lending institutions. It is not a government agency or guaranteed by the U.S. government. However, Congress established the system in 1916 to provide a dependable and affordable source of credit to rural areas at a time when many lenders avoided farm loans. Statute and oversight determine the scope of FCS activity, and provide benefits such as tax incentives. Five large banks provide funds to 96 credit associations that, in turn, make loans to eligible creditworthy borrowers. FCS funds its loans with bonds sold in capital markets. For more about FCS, see CRS Report RS21278, *Farm Credit System*, by Jim Monke.

Figure 1. Market Shares of Farm Debt, by Lender, 2005



Source: CRS, using USDA Economic Research Service data at [http://www.ers.usda.gov/Briefing/FarmIncome/Data/Bs_t6.htm].

USDA's Farm Service Agency (FSA)² As a government agency, FSA is referred to as a lender of last resort because it makes direct loans to family farms unable to obtain credit from other lenders. FSA also guarantees timely payment of principal and interest on some loans made by commercial lenders. FSA loans finance farm land purchases, annual operating expenses, and recovery from emergencies or natural disasters. Some loans are made at a subsidized interest rate. To qualify for an FSA guaranteed or direct loan, farmers must have enough cash flow to make payments.

FSA Loan Changes in the 2002 Farm Bill. FSA loan programs have permanent authority under the Consolidated Farm and Rural Development Act (7 U.S.C. 1921 et seq.). Title V of the 2002 farm bill (P.L. 107-171) authorized amounts for the programs through 2007, subject to annual appropriations. Changes allow FSA to lend more to beginning farmers for down payments. A new pilot program guarantees seller-financed land contracts, available to five contracts per state per year in Indiana, Iowa,

¹ Farm Credit System institutions are described at [<http://www.fca.gov/FCS-Institutions.htm>].

² USDA Farm Service Agency loan programs are described at [<http://www.fsa.usda.gov/dafl>].

North Dakota, Oregon, Pennsylvania, and Wisconsin. Losses due to USDA-imposed quarantines qualify for emergency loans. Shared appreciation agreements — contracts under which USDA forgave part of a loan in return for sharing any price appreciation over a future period — that have become delinquent may be reamortized for up to 25 years.³

FSA Appropriation for Farm Loans. FSA receives an annual appropriation (loan subsidy) to cover interest rate discounts and anticipated loan defaults. The amount of loans that can be made (loan authority) is larger. The enacted FY2006 loan subsidy is \$151.3 million to support loans totaling \$3.785 billion (see **Table 1**). The loan subsidy is 3.4% below FY2005, while the loan authority rises by 1.8%. Loan authority can rise while the loan subsidy falls because (1) guaranteed loans grow more than direct loans, and (2) the multiplier (loan authority divided by loan subsidy) rises for most programs as a result of USDA factoring in low interest rates and a history of fewer defaults.

Most of the growth in loan authority over FY2005 levels is a \$59 million (5.4%) increase in unsubsidized guaranteed farm operating loans. Changes in unsubsidized guaranteed loans can be made with smaller changes in appropriations compared to subsidized or direct loans. In recent years, the subsidized guaranteed operating loan program has not been able to meet demand, and qualified farmers have been placed on waiting lists when funds are depleted. In FY2006, the subsidized guaranteed operating loan program will be 3% smaller than in FY2005. In both FY2005 and FY2006, the Administration requested new funds for emergency loans, but Congressional committee reports said carryover funding should be sufficient.

³ For a side-by-side of credit provisions in the 2002 farm bill, see the Economic Research Service, [<http://www.ers.usda.gov/Features/FarmBill/Titles/TitleVCredit.htm#Service>]. For guaranteed seller-financed contracts, see FSA at [<http://www.fsa.usda.gov/dafl/pilot%20program.htm>]. For shared appreciation agreements, see CRS Report RS21145, *Shared Appreciation Agreements on USDA Loans*, by Jerry Heykoop.

Table 1. FSA Loan Appropriations, FY2006

FSA loan program	Loan subsidy (million \$)	Loan authority (million \$)	Implicit multiplier
Farm Ownership Loans (FO)			
Direct	10.7	208	20
Guaranteed	6.7	1,400	208
Farm Operating Loans (OL)			
Direct	64.7	650	10
Unsubsidized Guaranteed	34.8	1,150	33
Subsidized Guaranteed	34.3	275	8
Indian Tribe Land Acquisition	0.1	2	25
Emergency Loans (EM)	0	0	—
Boll Weevil Eradication	0	100	—
Total	151.3	3,785	25
Subtotal: Direct FO+OL	75.3	858	11
Subtotal: Guaranteed FO+OL	75.9	2,825	37

Source: CRS, based on H.Rept. 109-255 to accompany H.R. 2744 (P.L. 109-97).

Commercial and Other Nongovernmental Lenders. Commercial banks lend to farmers through both small community banks and large multi-bank institutions.⁴ Another category of lenders is “individuals and others.” This category consists of seller-financed and personal loans from private individuals, and the growing business segment of captive financing by equipment dealers and input suppliers (e.g., John Deere Credit and Pioneer Hi-Bred Financial Services). Life insurance companies historically also have looked to farm real estate mortgages for diversification.

Farmers’ Balance Sheets

Debt levels vary greatly among farmers. Only 66% of farmers have any debt (farm or nonfarm), and only 38% have farm debt. USDA expects total farm debt to rise by 2.9% in 2005, reaching a record \$213 billion.⁵ Total farm assets are expected to rise by 6.1% in 2005, reaching \$1.6 trillion and resulting in a 13.3% debt-to-asset ratio. Debt-to-asset ratios for the sector have been stable to falling for the past decade. Thus, farm equity has been rising because increases in debt have been offset by larger gains in farm land. Economists attribute much of the continued growth in land values to government payments, although land prices near urban areas also rise from development potential.

Recent strength in farm income generally has given farmers more capacity to repay their loans or borrow new funds. USDA economists estimate that the farm sector is using

⁴ Commercial bank issues are summarized by the American Bankers Association at [http://www.aba.com/Industry+Issues/issues_ag_menu.htm] and the Independent Community Bankers of America at [<http://www.ibaa.org>].

⁵ Economic Research Service, at [<http://www.ers.usda.gov/Briefing/FarmIncome/wealth.htm>].

about 48% of its debt repayment capacity (measured as the actual debt relative to the maximum feasible debt) in 2005, down from a 53% average over 1995-2004. Debt capacity usage over 60% indicates potential widespread problems, as was the case from 1977-1986. Although credit conditions are good overall, some farmers may experience financial stress due to individual circumstances (10%-20% of commercial- and intermediate-sized farms).

Farm Bankruptcy: Chapter 12

In response to the farm financial downturn of the early 1980s, Congress added Chapter 12 to the Bankruptcy Code in 1986 (P.L. 99-554). It has special provisions for farmers compared with other bankruptcy chapters, strengthening farmers' bargaining position with creditors. Chapter 12 is more about reorganization of debt than bankruptcy because it allows secured debts to be written down to the fair-market value of the collateral and repaid at lower interest rates over extended periods. Chapter 12 is seen by many as a policy response to the social stigma attached to family farm failures during the Great Depression. It gives struggling farmers another chance to reorganize and repay their debts, rather than forcing them into liquidation and off the farm.

Chapter 12 has succeeded in keeping some farmers in business and has encouraged informal lender-farmer settlements out of court. But it has increased costs to society by encouraging inefficient farmers who would otherwise liquidate to remain in business, and allowing efficient farmers who could otherwise continue to farm to charge off part of their debts. Bankruptcy costs include legal fees and the efficiency costs from continuing to use labor and capital in otherwise inefficient enterprises.⁶

Chapter 12 was enacted with an initial sunset provision of October 1, 1993. Congress renewed the law 11 times with temporary extensions, and in 2005, made it permanent under Title X of the Bankruptcy Abuse Prevention and Consumer Protection Act, P.L. 109-8 (April 20, 2005). The act also expands eligibility by raising the debt limit and lowering the percentage of debt that must come from farming. It also extends Chapter 12 benefits to family fisherman.

For these purposes, a "family farmer" includes an individual and spouse, or a family-owned partnership or corporation, with debts of less than \$3,237,000, 50% of which arises from the farming operation. The debtor must derive at least 50% of gross annual income from farming. A "family fisherman" is an individual and spouse, or a family-owned partnership or corporation, engaged in a commercial fishing operation whose debts are less than \$1,500,000, 80% of which arises from the fishing operation. The debtor must derive at least 50% of gross annual income from fishing.

Policy Issues for Congress

Exempting Taxes on Agricultural Loans for Commercial Banks. In the 109th Congress, S. 238 and H.R. 399 (the Rural Economic Investment Act) would exempt

⁶ For more background and analysis on farm bankruptcies, see the USDA Economic Research Service at [<http://www.ers.usda.gov/Briefing/Bankruptcies>] and CRS Report RS20742, *Chapter 12 of the U.S. Bankruptcy Code*, by Robin Jeweler.

commercial banks from paying taxes on profits from agricultural real estate loans. The definition of agricultural real estate would include residential loans in rural areas with fewer than 2,500 people.

Proponents, including the American Bankers Association, say the bill would boost rural development and give commercial banks equal treatment for tax exemptions long available to the Farm Credit System (12 U.S.C. 2098). Critics say such exemptions are not warranted since agriculture no longer faces a credit constraint and other industries do not receive such preferential treatment.

Farm Credit System. In recent years, the FCS has sought to expand its lending authorities beyond traditional farm loans and into rural housing and business loans. FCS also generally desires to update the Farm Credit Act of 1971, which last was amended comprehensively in 1987. Commercial banks, which are FCS's primary competitors, oppose expanding FCS lending authority. Bankers say that commercial credit in rural areas is not constrained, and that FCS's government-sponsored enterprise (GSE) status provides an unfair competitive advantage vis-a-vis commercial banks. FCS responds to debates over its GSE status by asserting its statutory mandate to serve agriculture through good times and bad, unlike commercial lenders without such a mandate.

This controversy was highlighted in 2004 when a private bank, Netherlands-based Rabobank, tried to purchase an FCS association. The board of directors of the FCS association (Omaha-based Farm Credit Services of America) initially voted for the sale, indicating to some observers that FCS may no longer need government sponsorship. Although Congress had no direct statutory role in the approval process, the House held hearings on the implications of the deal,⁷ and Senators Daschle and Johnson introduced S. 2851 in the 108th Congress to require public hearings and a longer approval process.

In 2004, FCS asked Congress to eliminate provisions of the law (12 U.S.C. 2279d) allowing institutions to leave the System. Commercial bankers say that institutions should be allowed to leave FCS if they want more lending authorities than allowed under the current Farm Credit Act. It is not clear whether Congress, in 1987, intended the provision to be used by outside companies to purchase parts of the System. Although the buyout attempt was aborted, the initial agreement has affected the agricultural and banking industry's view of FCS. For more information, see CRS Report RS21919, *Farm Credit Services of America Ends Attempt to Leave the Farm Credit System*, by Jim Monke.

⁷ The hearing transcript is available at [<http://agriculture.house.gov/hearings/108/10838.pdf>].