



## CRS Report for Congress

### Farm Credit System

Jim Monke  
Analyst in Agricultural Policy  
Resources, Science, and Industry Division

#### Summary

The Farm Credit System (FCS) is a nationwide financial cooperative lending to agricultural and aquatic producers, rural homeowners, and certain agriculture-related businesses and cooperatives. Established in 1916, this government-sponsored enterprise (GSE) has a statutory mandate to serve agriculture. It receives tax benefits, but no federal appropriations or guarantees. FCS is the only direct lender among the GSEs. Farmer Mac, a separate GSE but regulated under the umbrella of FCS, is a secondary market for farm loans. Federal oversight by the Farm Credit Administration (FCA) provides for the safety and soundness of FCS institutions.

Current issues and legislation affecting the FCS are discussed in CRS Report RS21977, *Agricultural Credit: Farm Bill Issues*. This report will be updated.

#### What Is the Farm Credit System?

**An Agricultural Lender.** The Farm Credit System (FCS) was created to provide a permanent, reliable source of credit to U.S. 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. Statutory authority is in the Farm Credit Act of 1971, as amended (12 U.S.C. 2001 *et seq.*). The most comprehensive recent changes were enacted in the Agricultural Credit Act of 1987.

The FCS is authorized by statute 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.

The FCS is *not* a lender of last resort.<sup>1</sup> FCS is a commercial, for-profit lender. Borrowers must meet creditworthiness requirements similar to those of a commercial

---

<sup>1</sup> The USDA Farm Service Agency (FSA) is a lender of last resort for borrowers who are unable to get a loan from another lender. For more information about other farm lenders and current issues, see CRS Report RS21977, *Agricultural Credit: Farm Bill Issues*, by Jim Monke.

lender. FCS has “young, beginning, and small” (YBS) farmer lending programs, but does not have particular targets or numerical mandates for such loans.

The FCS 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%). As of September 2006, FCS had \$115 billion in loans outstanding, of which about 47% was in long-term agricultural real estate loans, 24% in short- and intermediate-term agricultural loans, 15% in loans to agribusinesses, 5% in energy loans, 3% in rural home loans, and 6% in communications, export financing, leases, and water and waste disposal loans.

**A Government-Sponsored Enterprise (GSE).** As a GSE, FCS is a privately owned, federally chartered cooperative designed to provide credit nationwide. It is limited to serving agriculture and related businesses and homeowners in rural areas. Each GSE is given certain benefits such as implicit federal guarantees or tax exemptions, presumably to overcome barriers faced by purely private markets.<sup>2</sup> FCS is the only direct lender among the GSEs; other GSEs such as Fannie Mae are secondary markets. FCS is not a government agency and its debt instruments and loans are not explicitly guaranteed by the U.S. government.<sup>3</sup>

The tax benefits for FCS include an exemption from federal, state, municipal, and local taxation on the profits earned by the real estate side of FCS (12 U.S.C. 2098). Income earned by the non-real estate side of FCS is subject to taxation. The exemption originated in the 1916 act. Commercial bankers estimate that the annual value of these tax benefits amounted to at least \$425 million in 2004.<sup>4</sup> For investors who buy FCS bonds on Wall Street, the interest earned is exempt from state, municipal, and local taxes. This makes FCS bonds more attractive to the investing public and helps assure a plentiful supply of funds for loans. Commercial bankers say that the tax benefits let FCS offer lower interest rates to borrowers, and thus give FCS an operating advantage since they compete in the same retail lending market.

**A Cooperative Business Organization.** FCS associations are owned by the borrowers who purchase stock, required as part of their loan (the smaller of \$1,000 or 2% of the loan amount). FCS stockholders elect the boards of directors for banks and associations. Each has one vote, regardless of the loan size. Most directors are members, but federal law requires at least one from outside.

If an association is profitable, the directors may choose to retain the profits to increase lending capital, or distribute some of the net income through dividends or *patronage refunds*, which are proportional to the size of loan. Patronage refunds

---

<sup>2</sup> There are five GSEs: Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), Federal Home Loan Bank System, Federal Agricultural Mortgage Corporation (Farmer Mac), and FCS. For more on GSEs, see CRS Report RL30533, *The Quasi Government: Hybrid Organizations with Government and Private Characteristics*, Kevin R. Kosar.

<sup>3</sup> 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.

<sup>4</sup> Bert Ely, *Farm Credit Watch*, June 2005.

effectively reduce the cost of borrowing. Some associations tend to regularly pay patronage while others prefer to retain their earnings or charge lower interest rates.

**A National System of Banks and Associations.** FCS is composed of five regional banks that provide funds and support services to 95 smaller Agricultural Credit Associations (ACAs), Federal Land Credit Associations (FLCAs), and Production Credit Associations (PCAs). 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. There are 86 ACAs and nine stand-alone FLCAs.<sup>5</sup>

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.

**Capitalized with Bonds and Stock, Not the U.S. Treasury.** The Federal Farm Credit Banks Funding Corporation ([<http://www.farmcredit-ffcb.com>]) uses capital markets to sell FCS bonds and notes. These debts become the joint and several liability of all FCS banks. The funding corporation allocates capital to the banks, which provide funds to associations, which lend to borrowers. Profits from loans repay bondholders.

FCS also raises capital through two other methods. Borrowers are required to buy stock (the lesser of \$1,000 or 2% of the loan amount) and become cooperative members. FCS also retains profits that are not returned as patronage to borrowers.

With the exception of seed money that was repaid by the 1950s and a temporary U.S. Treasury line of credit in the 1980s,<sup>6</sup> FCS operates without any direct federal money. FCS banks and associations do not take deposits like commercial banks, nor do they receive federal appropriations to fund their loan program.

## Types of Loans and Borrowers

The 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.

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

---

<sup>5</sup> 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>].

<sup>6</sup> 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 was dissolved in Dec. 2006.

- **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 earn less than 50% of their income from agriculture, FCS can lend for all agricultural and family needs. However, non-agricultural lending is limited.
- **Farming-related businesses.**<sup>7</sup> FCS can lend to businesses that *process* or *market* farm, ranch, or aquatic products if 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 (but not aquatic producers), such as crop spraying and cotton ginning. The extent of financing is based on the amount of the business’s 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.

## 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 95 in 2006. 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 in either 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. FCS benefits 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

---

<sup>7</sup> A proposed rule by the Farm Credit Administration could expand the eligibility criteria for farm processing and marketing loans (71 FR 60678, October 16, 2006). For more background, see CRS Report RL33271, *Farm Commodity Programs: Direct Payments, Counter-Cyclical Payments, and Marketing Loans*, by Jim Monke.

territory's association. For example, associations within U.S. AgBank's region (the southern Plains and West) can compete for loans, but associations in the AgFirst region (the East and Southeast) 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 FCS'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 most recent hearings on FCS include one in the House on June 2, 2004, concerning Farmer Mac, and another in the House on September 29, 2004, over the proposed sale of an FCS association.

**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 FCS institutions. Regulations are published in 12 C.F.R. 600 *et seq.* FCA's operating expenses are paid through assessments on FCS banks and associations. 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.<sup>8</sup>

## Other FCS Entities

The Farm Credit System has several other entities besides those previously discussed.

**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. 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. This is similar to the much larger secondary market for housing loans, such as Fannie Mae.

---

<sup>8</sup> FCA board members are Nancy C. Pellett (chairman since May 22, 2004), appointed in 2002 for a term that ends in May 2008; Dallas Tonsager, appointed in 2004 for a term that ends in May 2010; and Leland Strom, appointed in 2006 for a term that ends in October 2012.

Although Farmer Mac is part of FCS and regulated by FCA, it has no liability for the debt of any other FCS institution, and the other FCS institutions have no liability for Farmer Mac debt. It is considered a separate GSE. 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 FCS, 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). Farmer Mac promises to purchase specific agricultural mortgages, thus 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.

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

**Farm Credit System Insurance Corporation.** The Insurance Corporation ([\[http://www.fcsic.gov\]](http://www.fcsic.gov)) was established by statute in 1988 to ensure timely payment of principal and interest on FCS 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 loans is reached.

**Farm Credit Council.** The Farm Credit Council ([\[http://www.fccouncil.com\]](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 FCS. FCC also provides support services.