Agricultural Credit: Institutions and Issues

Jim Monke
Specialist in Agricultural Policy

February 7, 2013

Congressional Research Service
7-5700
www.crs.gov
RS21977

CRS Report for Congress
Prepared for Members and Committees of Congress

Summary

The federal government provides credit assistance to farmers to assure adequate and reliable lending in rural areas, particularly when farmers cannot obtain loans elsewhere. Federal farm loan programs also target credit to beginning farmers and socially-disadvantaged groups.

The primary federal lender to farmers is the Farm Service Agency (FSA) in the U.S. Department of Agriculture (USDA). It issues direct loans to farmers who cannot qualify for regular credit, and guarantees repayment of loans made by other lenders. FSA thus is called a lender of last resort. Of about $250 billion in total farm debt, FSA provides about 2% through direct loans, and guarantees about another 4%-5% of loans.

Another federally related lender is the Farm Credit System (FCS), a cooperatively owned but federally chartered lender with a statutory mandate to serve agriculture-related borrowers. FCS makes loans to creditworthy farmers, and is not a lender of last resort. FCS accounts for nearly 43% of farm debt. Commercial banks are the other primary agricultural lender, holding slightly more than FCS with over 43% of total farm debt.

Generally speaking, the farm sector's balance sheet has remained strong in recent years. While delinquency rates on farm loans increased from 2008 into 2010, farmers and agricultural lenders did not face credit problems as severe as those of other economic sectors. Since 2010, loan repayment rates have improved. But appropriations for the FSA loan program—and the ability of FSA to meet demand for its loans and guarantees—have been constrained during an era of tight federal budgets.

Statutory authority for FSA and FCS is permanent, but periodic farm bills often make adjustments to eligibility criteria and the scope of operations. In the 112th Congress, both the Senate-passed farm bill (S. 3240) and the House-reported farm bill (H.R. 6083) would have made relatively small policy changes to USDA's credit programs in Title V. Term limits on the number of years that borrowers may remain eligible for loans may be an issue, as well as expanding existing loan programs to serve non-traditional farm producers, such as producers for local and regional food systems. In 2013, USDA created a microloan program to expedite small operating loans to nontraditional agricultural producers. Finally, efforts to expand Farm Credit System activities into new mission areas using regulatory powers may continue.

Contents

Figures

Tables

Contacts

Current Situation

Major Players and Market Shares

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

Several types of lenders make loans to farmers. Some are government entities or have a statutory mandate to serve agriculture. The one most controlled by the federal government is the Farm Service Agency (FSA) in the U.S. Department of Agriculture (USDA). It lends directly to farmers and also issues guarantees on loans made by commercial lenders to farmers who do not qualify for regular credit. Therefore, FSA is called a lender of last resort. Because FSA targets loans or reserves funds for disadvantaged groups, it also is called a lender of first opportunity.

The lender with the next-largest amount of government intervention is the Farm Credit System (FCS). It is a cooperatively owned, but federally chartered, private lender with a statutory mandate to serve agriculture-related borrowers only. FCS makes loans to creditworthy farmers, and is *not* a lender of last resort, but is a government-sponsored enterprise (GSE). Third is Farmer Mac, another GSE that is privately held, and provides a secondary market for agricultural loans. FSA, FCS, and Farmer Mac are described in more detail later in this report.

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

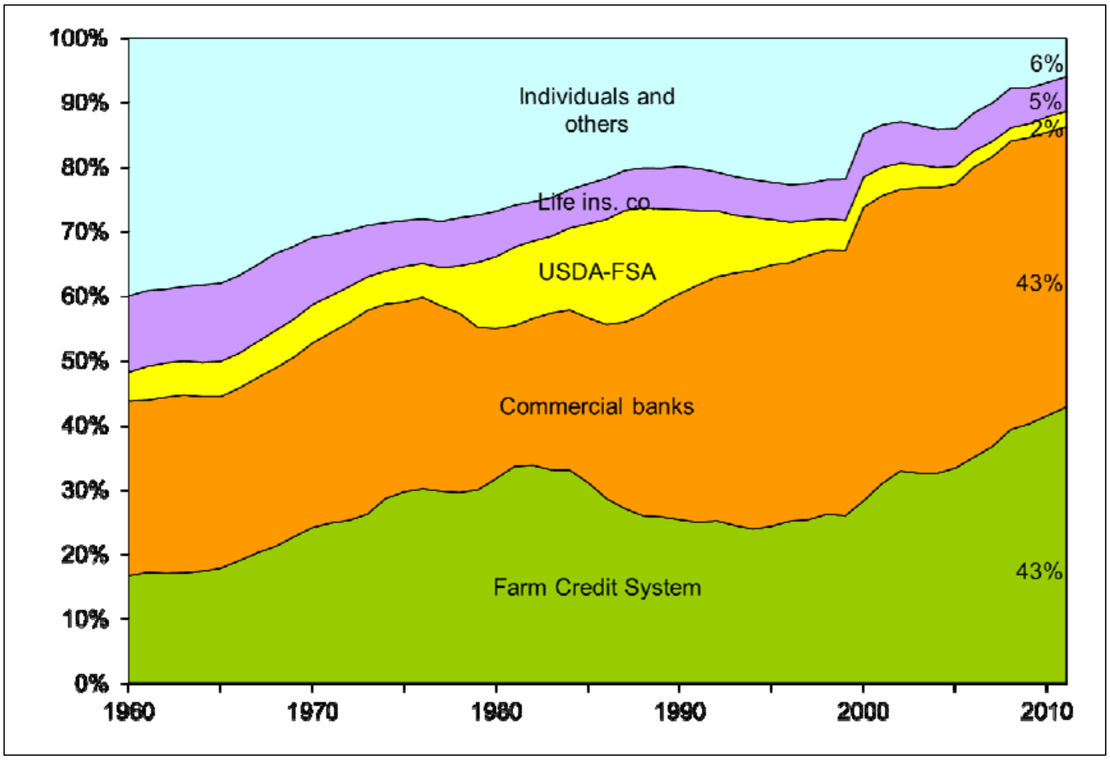
Figure 1 shows that commercial banks and the FCS provide most of the farm credit (43.4%, and 42.8%, respectively), followed by individuals and others (6.0%), and life insurance companies (5.3%). FSA provides about 2.5% of the debt through direct loans. FSA also guarantees about another 4%-5% of the market through loans that are made by commercial banks and the FCS.

The total amount of farm debt ($254 billion in 2011) is concentrated relatively more in real estate debt (57%) than in non-real estate debt (43%). FCS is the largest lender for real estate, although both commercial banks' and FCS's shares have grown as others' shares have decreased (**Figure 2**). Commercial banks are the largest lender for non-real estate loans, although FCS has gained share in recent years as the share by individuals and others has decreased (**Figure 3**).

As the figures show, market shares among these lenders have changed over time. Commercial banks held relatively little farm real estate debt through 1985, but now hold a sizeable amount (**Figure 2**). The share of loans from "individuals and others" has steadily decreased over time, with fewer private contracts for farm real estate and relatively less dealer financing in operating credits. FSA held a much larger share of farm debt during the farm financial crisis of the 1980s, but that ratio declined as the farm economy improved through the 1990s (**Figure 3**).

[1] USDA-FSA, *Evaluating the Relative Cost Effectiveness of the Farm Service Agency's Farm Loan Programs*, report to Congress, August 2006, pp. 11-17, at http://www.fsa.usda.gov/Internet/FSA_File/farm_loan_study_august_06.pdf.

Figure 1. Market Shares by Lender of Total Farm Debt, 1960-2011

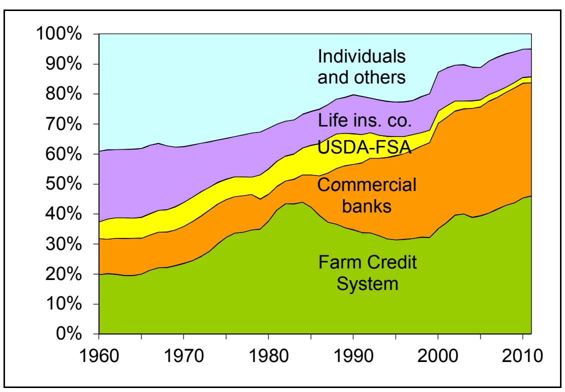


Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/data-products/farm-income-and-wealth-statistics.aspx.

Notes: FSA shares in the graph are for direct loans only. FSA-issued guarantees on about 4-5% of farm loans are not shown separately but are included in the shares of commercial banks and the Farm Credit System.

Figure 2. Market Shares of Real Estate Farm Debt, 1960-2011

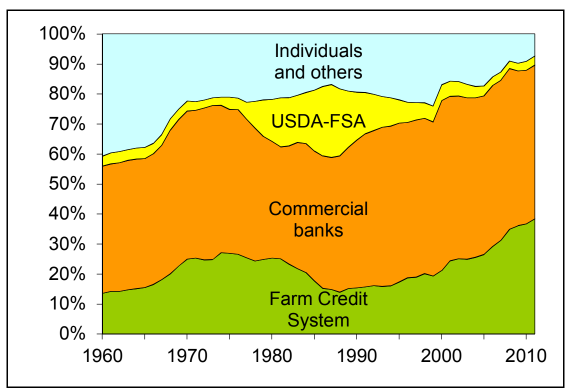
(57% of total farm debt in 2011)



Source: CRS, using USDA-ERS data.

Figure 3. Market Shares of Non-Real Estate Farm Debt, 1960-2011

(43% of total farm debt in 2011)



Source: CRS, using USDA-ERS data.

The Farm Balance Sheet

As a whole, farm sector assets have remained strong despite pressure on other real estate sectors. The value of farm assets contracted only in 2008 and has since returned positive growth. Farm assets reached a reached a new high in 2011, a total of $2.4 trillion, and were expected to rise 6.5% in 2012 (**Figure 4**). These highs in total farm assets now exceed the previous peak from 1980 in inflation-adjusted terms.[2] Real estate is about 84% of the total amount of farm assets; machinery and vehicles are the next-largest category at about 6% of the total.[3]

Farm debt reached a historic high of $254 billion at the end of 2011 (**Figure 5**). Debt was forecasted to rise 4.5% in 2012. In inflation-adjusted terms, however, this level of debt is still well below the peak debt levels of the 1980s.

Debts and assets can be compared in a single measure by dividing debts by assets—the debt-to-asset ratio. A lower debt-to-asset ratio generally implies less financial risk to the sector than a higher ratio. Farm debt-to-asset ratio levels have declined fairly steadily since the late 1980s after the farm financial crisis, and reached a historic low of 10.4% in 2007. When farm asset growth paused in 2008-2009, the debt-to-asset ratio rose to nearly 12% (**Figure 6**). However, by 2012, the debt-to-asset ratio had returned to historically low levels. As a whole, farms are not as highly leveraged as they were in the farm financial crisis of the 1980s.

Net farm income has become more variable, especially since 2000. After reaching historic highs in 2004, net farm income fell by a third in two years, through 2006 (**Figure 7**). After peaking again in 2008 at $85 billion, net farm income fell by one-quarter in one year to $63 billion in 2009. New highs were set in 2011 and 2012. Despite the severe declines in farm income in 2006 and 2009, the relative recent lows in net farm income are still higher than the inflation-adjusted lows from the farm financial crisis of the 1980s.[4]

Government payments to farmers also have risen from decades ago, but do not always offset the variability in net farm income. Fixed direct payments that are not tied to prices or revenue are the primary form of government payments in recent years; these payments support farm income but do not necessarily help farmers manage risks. **Figure 8** shows that more of net farm income is coming from the market rather than the government, compared to the 1980s.

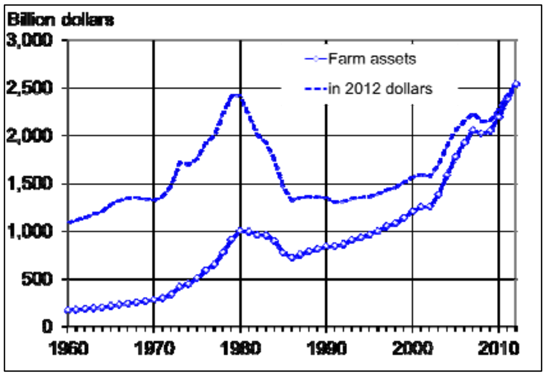
Another indicator of farmers' leverage compares debt to net farm income. A lower debt-to-income ratio (with the ratio expressing the number of years of current income that debt represents) implies less financial leverage and risk. The farm-debt-to-net-farm-income ratio is more variable than the debt-to-asset ratio because of the variability of net farm income. It reached a 35-year low of 2.1 in 2004 and rose to 3.8 in 2009 before falling again to 2.2 in 2011 (**Figure 9**). These levels, while more variable than in the 1990s, are roughly within 50-year historical levels between 2 and 4, and are certainly less than from 1976 to 1986 (a period surrounding the 1980s financial crisis).

[2] Comparisons are made to conditions in the 1980s because that was the last major financial crisis in agriculture.

[3] USDA, Economic Research Service. "Farm Sector Income Forecast," January 28, 2011, at http://www.ers.usda.gov/Briefing/FarmIncome/Data/Bs_t5.htm.

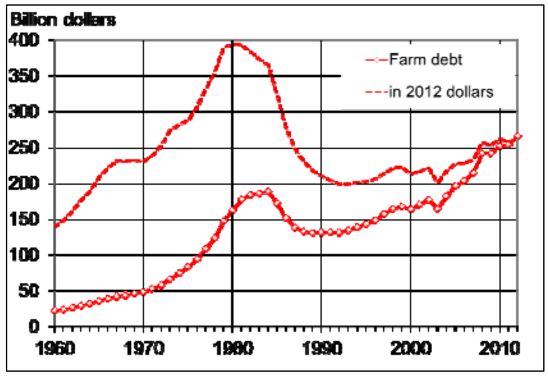
[4] For more information on farm income expectations, see CRS Report R40152, *U.S. Farm Income*, by Randy Schnepf.

Figure 4. Farm Assets, 1960-2012



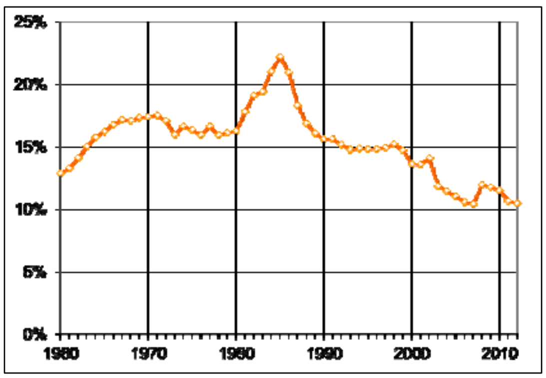
Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/data-products/farm-income-and-wealth-statistics.aspx. 2012 forecast.

Figure 5. Farm Debt, 1960-2012



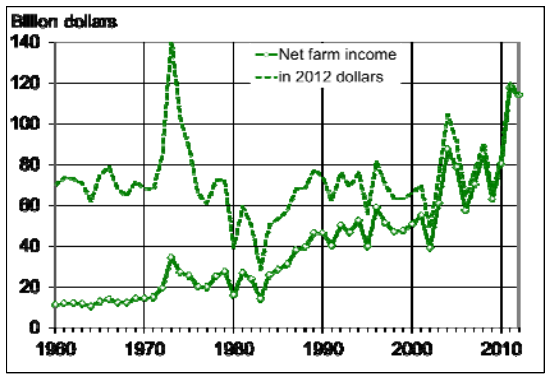
Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/data-products/farm-income-and-wealth-statistics.aspx. 2012 forecast.

Figure 6. Debt-to-Asset Ratio, 1960-2012



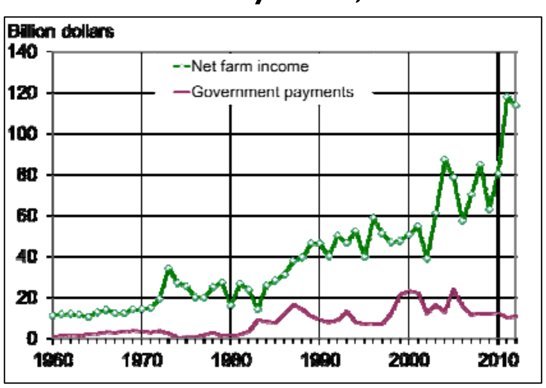
Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/data-products/farm-income-and-wealth-statistics.aspx. 2012 forecast.

Figure 7. Net Farm Income, 1960-2012



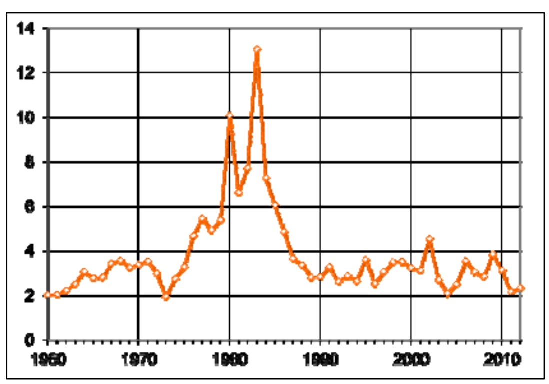
Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/data-products/farm-income-and-wealth-statistics.aspx. 2012 forecast.

Figure 8. Net Farm Income and Government Payments, 1960-2012



Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/data-products/farm-income-and-wealth-statistics.aspx. 2012 forecast.

Figure 9. Debt-to-Net Farm Income Ratio, 1960-2012



Source: CRS, using USDA-ERS data at http://www.ers.usda.gov/data-products/farm-income-and-wealth-statistics.aspx. 2012 forecast.

Agricultural Lending Situation and Challenges

While the global financial crisis was slower to affect the balance sheets of farmers and agricultural lenders than the housing market, its presence was observed in agricultural lending. Credit standards were tightened (more documentation and oversight of loans was required) and lenders sometimes made less credit available to producers. As the lender of last resort, the USDA Farm Service Agency experienced significantly higher demand for its direct loans and guarantees.

In 2007, 2008, and 2010, farm commodity prices were particularly high, supporting farm income at above-average levels. But in 2006 and 2009, net farm income fell by about one-third (**Figure 7**), reducing some farmers' ability to repay loans, particularly in some farm sectors such as dairy, hogs, and poultry. Recent strong farm income has improved most farmers' ability to repay loans.

Delinquency rates on residential mortgages began to rise in 2005, and for all loans particularly in 2007. Delinquencies include loans that are 30 days or more past due and still accruing interest, as well as those in nonaccrual status. The delinquency rates on residential mortgages and all loans appear to have reached a peak in mid-2010 (11.3% for residential mortgages and 7.3% for all commercial bank loans, **Figure 10**). The delinquency rates for agricultural loans did not begin to rise until mid-2008, after continuing to fall to historic lows while delinquencies were rising in residential mortgages and other loans. Moreover, the rate of increase in delinquencies on farm production loans at commercial banks has not been as sharp as in the non-farm sectors, and appears to have peaked in September 2010 at 3.5%. Delinquency rates on farm production loans at commercial banks have since returned to near-historic lows below 2%.[5]

A more severe measure of loan performance is nonperforming loans. Nonperforming loans include nonaccrual loans and accruing loans 90 days or more past due. These loans are more in jeopardy than delinquent loans, and represent a smaller subset of loans. Within the agricultural loan portfolio, FCS nonperforming loans rose from 0.4% at the beginning of 2008 to a near-term peak of 2.8% on September 30, 2009, before decreasing again to about 1.7% as of September 30, 2012 (**Figure 11**).[6] Nonetheless, the FCS nonperforming loan rate remains at a level not seen since the 1990s when the system had finally recovered from the farm financial crisis of the 1980s.

Nonperforming farm loans at commercial banks also have risen. Nonperforming farm real estate loans at commercial banks rose from a low of 0.7% in December 2006 to 2.9% in March 2011, before declining to 2.2% as of September 30, 2012. Nonperforming farm production loans rose from a low of 0.6% in December 2006 to 2.4% in March 2010, before declining to 1.3% as of September 30, 2012 (**Figure 11**).[7]

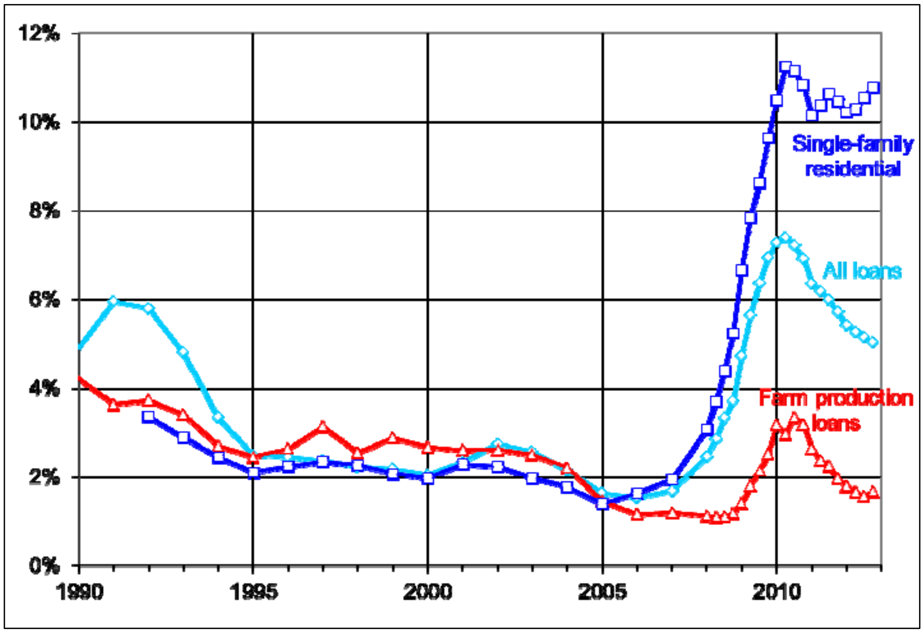
---

5 Federal Reserve Bank, "Delinquency Rates on Loans at Commercial Banks" (seasonally adjusted), at http://www.federalreserve.gov/releases/chargeoff.

6 Federal Farm Credit Banks Funding Corporation, "First Quarter 2010 Quarterly Information Statement of the Farm Credit System," p. 9, May 10, 2010, at http://www.farmcredit-ffcb.com/farmcredit/serve/public/finin/quarin/report.pdf?assetId=155241.

7 Federal Reserve Bank, *Agricultural Finance Data Book*, Tables B.2 and B.4, at http://www.kansascityfed.org/research/indicatorsdata/agfinance/index.cfm.

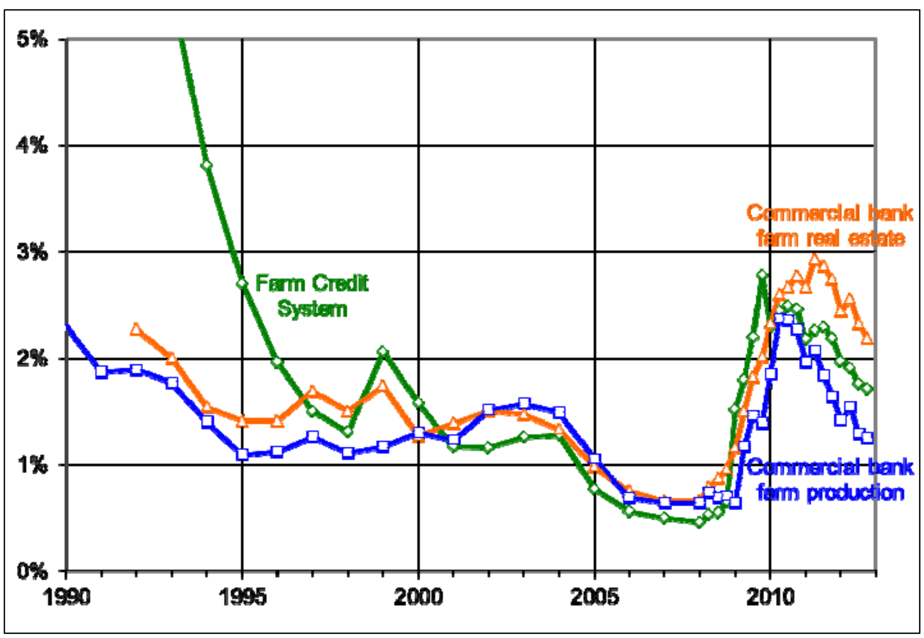
Figure 10. Delinquency Rates on Loans at Commercial Banks, 1990-2012



Source: Compiled by CRS. Data through September 30, 2012, using Federal Reserve Bank, "Delinquency Rates on Loans at Commercial Banks" (seasonally adjusted), at http://www.federalreserve.gov/releases/chargeoff.

Notes: Delinquencies include loans that are 30 days or more past due and still accruing interest, as well as those in nonaccrual status. The amounts are percentages of end-of-period loans.

Figure 11. Nonperforming Farm Loans, 1990-2012



Source: Compiled by CRS. Federal Farm Credit Banks Funding Corp. data through September 30, 2012, at http://www.farmcredit-ffcb.com. Federal Reserve Bank, *Agricultural Finance Data Book*, Tables B.2 and B.4, through September 30, 2012, at http://www.kansascityfed.org/research/indicatorsdata/agfinance/index.cfm.

Notes: Nonperforming loans include nonaccrual loans and accruing loans 90 days or more past due. The amounts are percentages of total loans.

Description of Government-Related Farm Lenders

USDA's Farm Service Agency (FSA)

USDA's Farm Service Agency is a lender of last resort because it makes direct farm ownership and operating loans to family-sized farms that are unable to obtain credit elsewhere.[8] FSA also guarantees timely payment of principal and interest on qualified loans made by commercial lenders such as commercial banks and FCS. Permanent authority exists in the Consolidated Farm and Rural Development Act (CONACT, 7 U.S.C. 1921 *et seq.*). Prior to the banking crisis in 2008, FSA usually made and guaranteed about $3.5 billion of farm loans annually. Supplemental appropriations during the financial crisis raised FSA loan activity to about $6.0 billion in FY2010. In FY2012, appropriations supported about $4.8 billion of FSA direct loans and guarantees.[9]

Direct loans are limited to $300,000 per borrower, guaranteed loans to $1,302,000 per borrower (adjusted annually for inflation). Direct emergency loans are available for disasters.

Part of the FSA loan program is reserved for beginning farmers and ranchers (7 U.S.C. 1994 (b)(2)). For direct loans, 75% of the funding for farm ownership loans and 50% of operating loans are reserved for the first 11 months of the fiscal year. For guaranteed loans, 40% is reserved for ownership loans and farm operating loans for the first half of the fiscal year. Funds are also targeted to "socially disadvantaged" farmers by race, gender, and ethnicity (7 U.S.C. 2003). Because of these provisions, FSA also is known as lender of first opportunity for borrowers who are not yet creditworthy for regular commercial business loans.

Farm Credit System (FCS)

Congress established the Farm Credit System in 1916 to provide a dependable and affordable source of credit to rural areas at a time when commercial lenders avoided farm loans. FCS is neither a government agency nor guaranteed by the U.S. government, but is a network of borrower-owned lending institutions operating as a government-sponsored enterprise (GSE). It is not a lender of last resort; it is a for-profit lender with a statutory mandate to serve agriculture. Funds are raised through the sale of bonds on Wall Street.[10] Four large banks allocate these funds to 86 credit associations[11] that, in turn, make loans to eligible creditworthy borrowers. FCS is unique among the GSEs because it is a retail lender making loans directly to farmers, and thus is in direct competition with commercial banks.

Statutes and oversight by the House and Senate Agriculture Committees determine the scope of FCS activity. Benefits such as tax exemptions also are provided. Eligibility is limited to farmers, farm input suppliers, rural homeowners in towns under 2,500 population, and cooperatives. The federal regulator is the Farm Credit Administration (FCA). For more background, see CRS Report RS21278, *Farm Credit System*.

---

[8] U.S. Department of Agriculture, Farm Service Agency, Farm Loan Program, at http://www.fsa.usda.gov/dafl.

[9] CRS Report R42596, *Agriculture and Related Agencies: FY2013 Appropriations*.

[10] Federal Farm Credit Banks Funding Corporation, "Overview," http://www.farmcreditfunding.com/ffcb_live/overview.html.

[11] Farm Credit Administration, "Number of FCS Banks and Associations," at http://www.fca.gov/info/number_of_fcs_institutions.html.

Farmer Mac

Farmer Mac is a separate GSE that is a secondary market for agricultural loans.[12] It is related to the FCS in that FCA is its regulator and it was created by the same legislation, but it is a financially separate entity. Farmer Mac purchases mortgages from lenders and guarantees mortgage-backed securities that are bought by investors. Permanent authority rests in the Farm Credit Act of 1971 (12 U.S.C. 2001 *et seq.*).

Issues for Congress

Credit Title in the Next Farm Bill

Statutory authority for FSA and FCS is permanent, but periodic farm bills often make adjustments to eligibility criteria and the scope of operations. A new farm bill is expected in 2013, and provisions may be modeled on proposals included in proposals in the House and Senate during 2012, as summarized below.[13]

In the 112th Congress, both the Senate-passed farm bill (S. 3240) and the House-reported farm bill (H.R. 6083) would have made relatively small policy changes to USDA's credit programs in Title V. Both bills would have given USDA discretion to recognize (1) alternative legal entities to qualify for farm loans and (2) alternatives to meet a three-year farming experience requirement; and both bills would have increased the maximum size of down-payment loans (from 45% of $500,000 to 45% of $667,000).

The Senate farm bill would have updated and modernized the ConAct's statutory language and organized the various programs into separate subtitles. It also would have extended the number of years that farmers could remain eligible for direct farm operating loans, and eliminated term limits on guaranteed operating loans (discussed in the next section).

The House bill's credit title would not have restructured the ConAct nor changed any term limits provisions. However, the House bill would have created a new microloan program, increased the percentage of a conservation loan that can be guaranteed, and added another lending priority for beginning farmers.

Neither H.R. 6083 nor S. 3240 made any changes to Farm Credit System statutes.

Term Limits on USDA Farm Loans

Congress added "term limits" to the USDA farm loan program in 1992 and 1996 to restrict eligibility for government farm loans and encourage farmers to "graduate" to commercial loans. The term limits place a maximum number of years that farmers are eligible for certain types of FSA loans or guarantees. However, until the end of 2010, Congress had suspended application of one of the term limits to prevent some farmers from being denied credit (**Table 1**).

---

[12] Federal Farm Credit Banks Funding Corporation, "FarmerMac," at http://www.farmcredit-ffcb.com/farmcredit/fcsystem/overview_farmer_mac.jsp

[13] For more background and comparison of proposals, see CRS Report R42552, *The 2012 Farm Bill: A Comparison of Senate-Passed S. 3240 and the House Agriculture Committee's H.R. 6083 with Current Law.*

Farm Operating Loans

- Direct operating loans are limited to a six-year period. In certain cases, borrowers may qualify for a one-time, two-year extension (7 U.S.C. 1941(c)(1)(C) and (c)(4)).[14]
- Guaranteed operating loans are limited to a 15-year period (7 U.S.C. 1949(b)(1)). Receiving direct operating loans counts toward the guaranteed loan term limit. That is, when either the first direct or guaranteed operating loan is issued, the clock starts on the 15-year eligibility for guaranteed operating loans. However, until December 31, 2010, the term limit had been suspended by the 2008 farm bill (P.L. 110-246, Section 5103). But following the expiration of the suspension, the 15-year term limit on guaranteed operating loans now applies.[15]

In the 112th Congress, the Senate-passed farm bill proposal (S. 3240) would have extended to 7 years the time that farmers could remain eligible for direct farm operating loans, and eliminated the 15-year term limit on guaranteed operating loans. The House-reported farm bill proposal (H.R. 6083) would not have changed the term limit statutes.

Farm Ownership Loans

- A borrower is eligible for direct farm ownership (real estate) loans for a maximum of 10 years after the first loan is made (7 U.S.C. 1922(b)(1)(C)).
- There is no time limit on eligibility for guaranteed farm ownership loans.[16]

Table 1. Term Limits on Farm Service Agency Loans

Maximum number of years that farmers are eligible for loans

Type of FSA Loan	Direct loans term limits	Guaranteed loans term limits
Farm Operating (OL) Loans	6 years, plus possible 2-yr. extension	15 years Was suspended (term limit not enforced) through 12/31/10. About 1,600 borrowers needed suspension to remain eligible.
Farm Ownership (FO) Loans	10 years	No term limit

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

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

---

[14] In June 2009, USDA said that about 4,800 FSA borrowers were limited to one more year of direct operating loans, and another 7,800 borrowers were limited to two more years. USDA did not expect many of these borrowers to graduate to commercial credit (Doug Caruso, FSA Administrator, in testimony before the House Agriculture Subcommittee on Conservation, Credit, Energy and Research, June 11, 2009, at http://agriculture.house.gov/testimony/111/h061109sc/Caruso.doc).

[15] In December 2010, USDA said that about 1,600 current borrowers had reached the guaranteed term limit and would not qualify for additional operating loan guarantees (personal communication with House Agriculture Committee and USDA farm loan staff, December 2010).

[16] USDA-FSA, *Evaluating the Relative Cost Effectiveness of the Farm Service Agency's Farm Loan Programs*, Report to Congress, August 2006, p. 76, at http://www.fsa.usda.gov/Internet/FSA_File/farm_loan_study_august_06.pdf.

Loans to Small and Local and Regional Food Producers

Access to sufficient credit has been raised as one factor in the growth and expansion of local and regional food production systems.[17] Because some of these farms are small and may produce in nontraditional settings, or the farmers do not have much farming experience, they may find it hard to qualify for regular production credit and may be ineligible for existing government loan programs. Several bills were introduced in the 112th Congress to expand the availability of credit for small and local and regional food producers.[18]

- H.R. 3286 and S. 1773 (the Local Farms, Food, and Jobs Act) would have explicitly recognized local and regional food producers as eligible borrowers at both USDA-Farm Service Agency and the Farm Credit System. Eligibility for FSA loans would have included local and regional food producers engaged in direct-to-consumer marketing, direct-to-institution marketing, direct-to-store marketing, and certain value-added agricultural products. Separately, the bill would have clarified that the mission of the FCS includes local and regional food production and distribution, especially by young, beginning, and small farmers.
- H.R. 3236 (the Beginning Farmer and Rancher Opportunity Act) would have created a microloan program for smaller, nontraditional, and niche-type farms, such as specialty crop producers and community-supported agriculture operations. A microloan provision was included in the House-reported farm bill proposal, H.R. 6083. (The bill also included other general agricultural credit provisions, many of which were included in the House farm bill.)
- H.R. 4351 (the Let's Grow Act) would have created a loan program for local farm businesses and garden projects, with focuses on small and socially disadvantaged farms, food deserts, sustainable agriculture, nutrition education, and community development. Private lending entities would apply for program funding and relend funds to eligible borrowers using government-guaranteed loans.

In January 2013, USDA created a microloan program within the existing direct farm operating loan program, using its regulatory prerogative.[19] A proposed rule had been issued in May 2012. The new microloan program bears many similarities to the microloan program that was proposed in H.R. 3236. FSA had found that small farm operations—including nontraditional farms, specialty crop producers, and operators of community-supported agriculture—had unique needs and limited financing options. FSA found these farms could face unintended barriers when applying for USDA operating loans, often because of experience requirements and pledging collateral. The microloan program simplifies and expedites the application process, and adds flexibility for meeting loan eligibility and security requirements. The maximum microloan size is $35,000.[20]

---

[17] CRS Report R42155, *The Role of Local Food Systems in U.S. Farm Policy*.

[18] This report discusses credit for farm producers. Credit for farmers markets and distribution systems are outside the scope of this report, but are mentioned in CRS Report R42155, *The Role of Local Food Systems in U.S. Farm Policy*.

[19] Federal Register, Vol. 78, No. 12, pp. 3828-3836, Thursday, January 17, 2013, at http://fsa.usda.gov/Internet/FSA_Federal_Notices/ml_01_17_2013.pdf.

[20] USDA Farm Service Agency, "Microloan Fact Sheet," January 2013, at http://fsa.usda.gov/Internet/FSA_File/microloans_eng_jan2013.pdf

Farm Credit Administration Proposed Rule on Investments

The Farm Credit System has proposed to expand its permissible activities through regulatory action. An expansion of investment opportunities would allow FCS to assist rural communities to expand infrastructure and housing facilities, as well as some rural business investment companies.

Background on FCS Proposals for Expansion

The Farm Credit System is authorized by statute to lend to farmers and ranchers. Loans may also be made for the processing and marketing activities of these borrowers, home loans in rural areas, certain farm-related businesses, and cooperatives. Loans to other borrowers are prohibited.

In recent years, FCS has sought to expand its lending authority beyond traditional farm loans. In 2006, an FCS report titled *Horizons* highlighted perceived needs for greater lending authority, including rural housing in towns with up to 50,000 population (the population limit is currently 2,500) and broader eligibility for agribusinesses. Commercial banks oppose any expansion of FCS lending authority, saying that credit in rural areas is not constrained given financial deregulation and integration, and that FCS's GSE status provides an unfair advantage.[21] They say that federal tax benefits for FCS are no longer necessary.[22]

The policy decision of whether to expand FCS lending authority has become less about "farm credit" and more about the ideological role of a retail GSE lender competing with private lenders. Unlike the housing GSEs (Fannie Mae, Freddie Mac) that do not lend directly to homeowners, FCS is a retail lender that competes for farm loans against commercial banks. FCS asserts its statutory mandate to serve agriculture (and by extension, rural areas) through good and bad times.

In Congress, committee jurisdiction has been questioned. During debate over the 2008 farm bill, the House Financial Services Committee and the Senate Banking Committee asserted jurisdiction for nonfarm lending and opposition to *Horizons*.[23] The Bush Administration opposed FCS expansion,[24] and a past chairman of the FCA, Michael Reyna, also voiced opposition.[25] In the end, the 2008 farm bill did not change FCS's scope of lending authority.

Mission-Related Investments

On June 16, 2008, the FCA published a proposed rule to allow "Rural Community Investments" (73 *Federal Register* 33931-33940).[26] These investments include (1) debt securities in projects that benefit rural communities and (2) equity investments in venture capital funds. The proposed

---

[21] Bert Ely, "The Farm Credit System: Lending Anywhere but on the Farm," at http://www.aba.com/Solutions/Documents/693d7e51f08c48b6a208ff59db9c0a41Horizons2006ELYFINAL.pdf.

[22] 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. For investors who buy FCS bonds to finance the system, the interest earned is exempt from state, municipal, and local taxes.

[23] Letter on House-Senate Farm Bill Conference, January 15, 2008, and letter to House Agriculture Committee, May 18, 2007.

[24] Statement of Administration Policy on H.R. 2419, July 25, 2007, p. 3.

[25] *Congressional Record*, July 26, 2007, p. H8728.

[26] FCA, proposed rule on Rural Community Investments, http://www.fca.gov/handbook.nsf/ff16b393f6bb3aa0852563ce006665bb/ea4c5c5dfb4c60058525746b0044e5b1?OpenDocument.

rule would define rural areas to include up to 50,000 residents. Targeted projects include community facilities, transportation, rural business investment companies, and venture capital funds. As discussed below, a final rule has not yet been adopted, and FCA plans to replace the 2008 proposal with a new proposed rule by March 2013.[27]

FCA promoted the program "to allow greater flexibility" and "to better serve the changing needs of agriculture and rural areas." The proposed rule states that "many rural areas are struggling to retain economic viability and vitality," and that "essential facilities, infrastructure, and services ... often lag behind those in metropolitan areas ... obstacles to rural economic development and revitalization [that] are further compounded by funding challenges." FCA designed the rule "to enable FCS to collaborate and partner in rural development ... as a financial intermediary promoting the flow of money into rural areas."

The scope of mission-related investments and the statutory restrictions governing to whom FCS may lend cause some to raise the following question: Do investments in bonds and venture capital effectively result in loans by another name to borrowers who otherwise are ineligible for FCS loans? Like banks, FCS institutions may use their assets to make loans or buy investments. Investments offer an alternative form of diversification to loans, and some types of investments can be appropriate for capital reserves. However, some question whether investments in the types of projects mentioned in the rule are safe and/or mission-related. Critics say that the rule's definition of rural as 50,000 population is at odds with the FCS statutory limit of 2,500 population for rural home loans.

Since 2004, an FCA pilot program ("Investments in Rural America") has been allowing similar investments in what sometimes are called "Rural America Bonds."[28] The proposed rule basically would make the pilot program—with revisions and the addition of the venture capital funds—a permanent part of FCS regulations and available to all FCS institutions. FCA's fall 2012 regulatory agenda anticipates that the review of the pilot program will be completed by March 2013 (see footnote 27).

The 2008 proposed rule was open for public comment until August 15, 2008, and over 10,000 comments were submitted.[29] Among the comment letters are two bipartisan letters from the House Financial Services Committee[30] and the Senate Banking Committee[31] opposing the rule. These letters note that the 2008 farm bill rejected legislation to expand FCS lending authorities, request the proposed rule be withdrawn, and ask that decisions about the scope of FCS activities be left to Congress. Three Members of the House and three Senators submitted letters from constituents who opposed the rule. The chairmen of the House and Senate agriculture committees did not take a position publicly. USDA's Rural Development Agency submitted a comment letter

[27] FCA, "Fall 2012 Regulatory Performance Plan," at http://www.fca.gov/law/perf_plan.html.

[28] FCA, Informational Memorandum on "Investments in Rural America," January 11, 2005.

[29] Comment letters are available at http://www.fca.gov/apps/regproj.nsf/e211b6dc2a9fbbba85256e5100541454/9dcc7754de2e51bb852572dd00526b3f?OpenDocument.

[30] Reps. Frank, Bachus, Maloney, and Biggert, House Financial Services Committee, letter to FCA on July 10, 2008, at http://www.fca.gov/apps/regproj.nsf/16b7ef8d45864c4685256e6100636419/b43f49f44d1c739b852574a90071f06b?OpenDocument..

[31] Senators Dodd and Shelby, Senate Banking Committee, letter to FCA on August 8, 2008, at http://www.fca.gov/apps/regproj.nsf/9646a6b403d8272d85256e5100541453/c2d1d0197290ead2852574a2004a1021?OpenDocument.

in support of the rule,[32] which somewhat contradicted the Bush Administration's opposition to FCS expansion in the farm bill in 2007 (see footnote 24).

The disposition of the proposed rule now awaits action by the FCA. FCA's fall 2012 regulatory agenda suggests that FCA plans to replace the 2008 proposal with a new proposed rule and end evaluation of the pilot program by March 2013 (see footnote 27). The FCA is authorized to implement rules that it believes are in accord with the statutes. Congress has no official role in the approval process for this proposed rule unless it exercises its legislative power, which could include disapproving the rule under the Congressional Review Act.

Author Contact Information

Jim Monke
Specialist in Agricultural Policy
jmonke@crs.loc.gov, 7-9664

---

[32] James Alsop and Joseph Ben-Israel, USDA Rural Development, letter to FCA on August 14, 2008, at http://www.fca.gov/apps/regproj.nsf/9646a6b403d8272d85256e5100541453/8fed246b2b6da162852574a500617f65?OpenDocument.