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# Farm Credit System

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## The Farm Credit System

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 often was unavailable or unaffordable in rural areas. Many lenders avoided farm 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.*). Comprehensive 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.

FCS is a commercial for-profit lender and is *not* a lender of last resort.<sup>1</sup> Borrowers must meet creditworthiness requirements similar to those of a commercial lender. FCS has “young, beginning, and small” (YBS) farmer lending programs, but without targets or mandates.

The FCS holds nearly 41% of the farm sector’s total debt (slightly higher than the nearly 40% share of commercial banks) and has the largest share of farm real estate loans (46%). As of September 2014, FCS had \$208 billion in loans outstanding, of which about 46% was in long-term agricultural real estate loans, 22% in short- and intermediate-term agricultural loans, 14% in loans to agribusinesses, 8% in energy and water/waste water loans, 4% in export financing loans and leases, 3% in rural home loans, and 2% in communications loans.

## 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 it is 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 over \$1 billion in 2011.<sup>4</sup> For investors who buy FCS bonds on Wall Street, the interest earned is exempt

<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 general background, see CRS Report RS21977, *Agricultural Credit: Institutions and Issues*.

<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 Both Government and Private Sector Legal Characteristics*.

<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*, February 2012.

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.

## 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 or distribute some of it through dividends or *patronage refunds* that are proportional to the size of loan. Patronage refunds can effectively reduce the cost of borrowing.

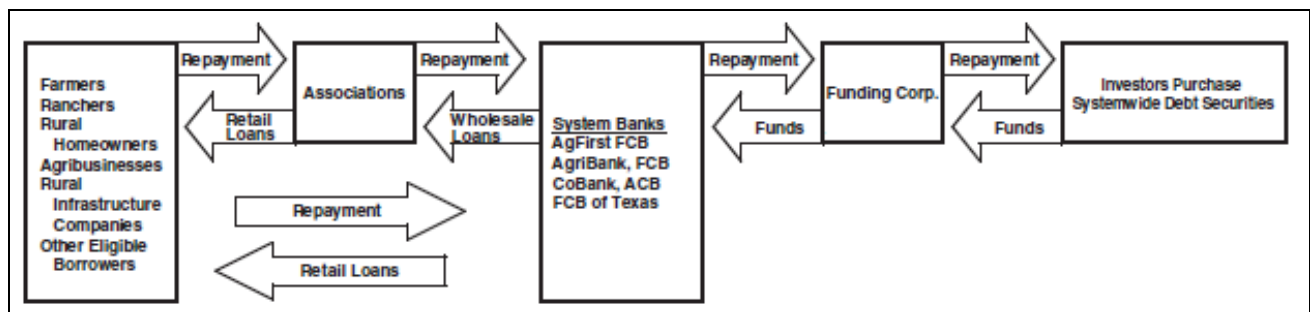
## Capitalized with Bonds and Stock

The Federal Farm Credit Banks Funding Corporation uses capital markets to sell FCS bonds and notes.<sup>5</sup> 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 (**Figure 1**).

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 appropriations. FCS banks and associations do not take deposits like commercial banks.

**Figure 1. Flow of Funds from through the FCS Between Bondholders and Borrowers**



**Source:** Farm Credit System 2014 Annual Information Statement, March 11, 2015, p. 6.

<sup>5</sup> The Funding Corporation is a central source for FCS information statements at <http://www.farmcredit-ffc.com>.

<sup>6</sup> The Financial Assistance Corporation (FAC) borrowed \$1.26 billion from Treasury during the farm financial crisis of the 1980s. In 2005, these bonds were repaid with interest to the U.S. Treasury. The FAC was dissolved in December 2006.

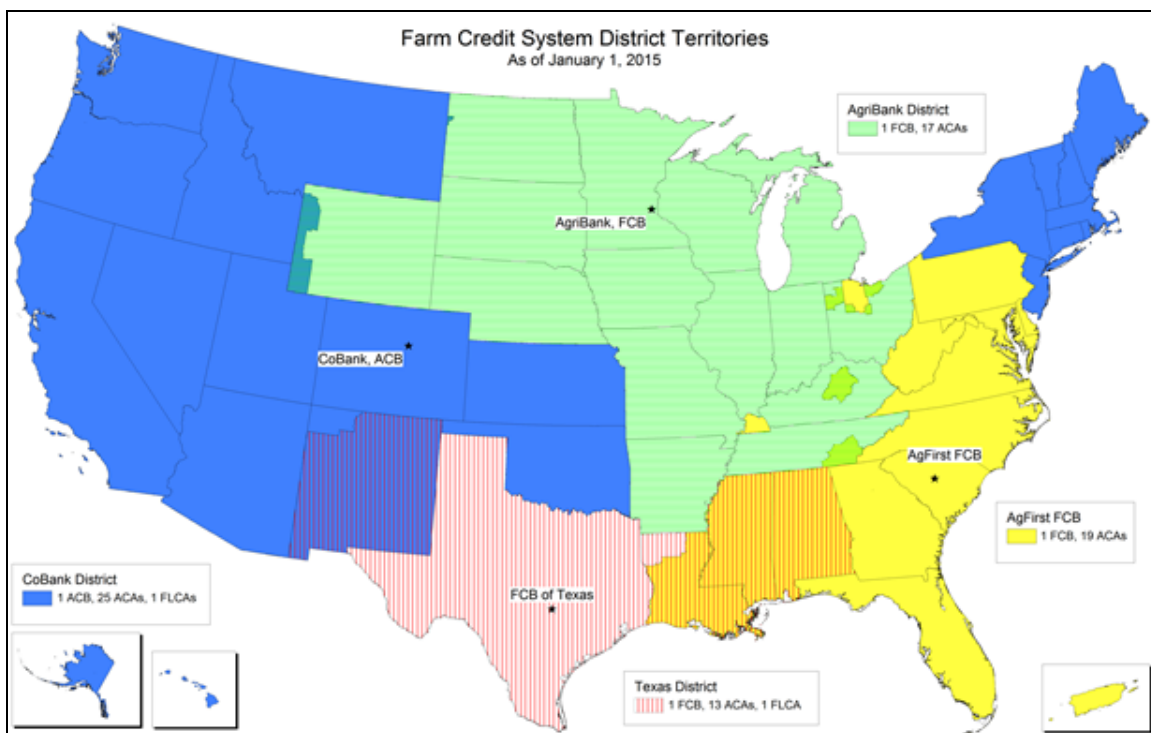
## National System of Banks and Associations

FCS is composed of four regional banks (**Figure 2**) that provide funds and support services to 76 smaller Agricultural Credit Associations (ACAs), Federal Land Credit Associations (FLCAs), and Production Credit Associations (PCAs). These associations (**Figure 3**), 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 74 ACAs and two FLCAs.<sup>7</sup>

In addition to its charter as 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.

The number of banks and associations has been declining for decades through mergers and reorganizations. This consolidation has continued in recent decades through the “parent ACA” structure. In the mid-1940s, there were over 2,000 lending associations, nearly 900 in 1983, fewer than 400 by 1987, 200 in 1998, 95 in 2006, and 80 in 2015. The system operated with 12 district banks into the 1980s, 8 districts in 1998, 5 districts in 2004, and 4 regional banks since 2012.

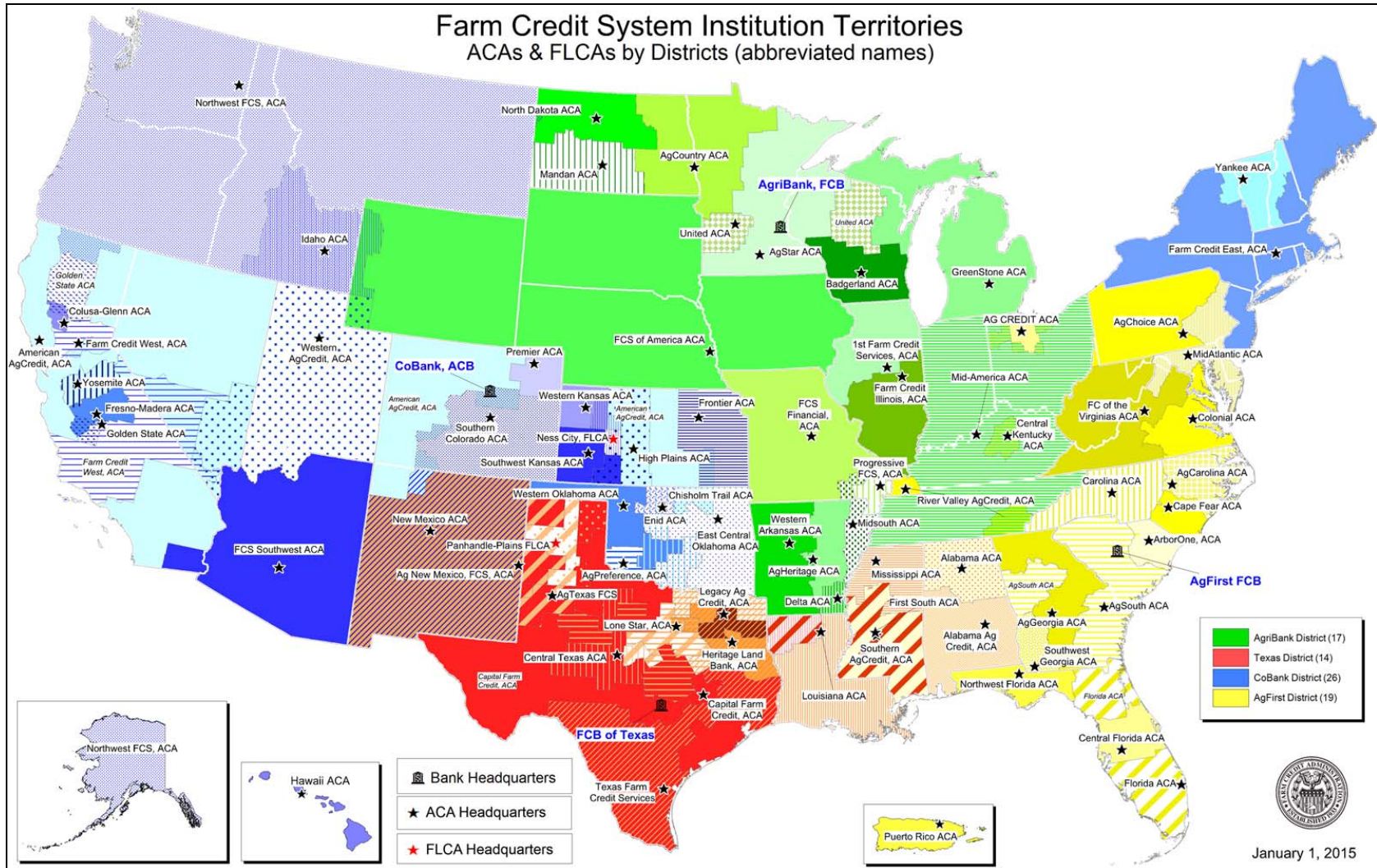
**Figure 2. Farm Credit System Regional Banks**



**Source:** Farm Credit Administration, at <http://www.fca.gov/info/directory.html>.

<sup>7</sup> The Farm Credit Administration maintains a directory of FCS institutions at <http://www.fca.gov/info/directory.html>.

**Figure 3. Farm Credit System Associations That Deliver Loans to Borrowers**



Source: Farm Credit Administration, at <http://www.fca.gov/info/directory.html>.



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 may 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.

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. 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.

## Types of Loans and Borrowers

The FCS provides three types of loans to farm producers: (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.

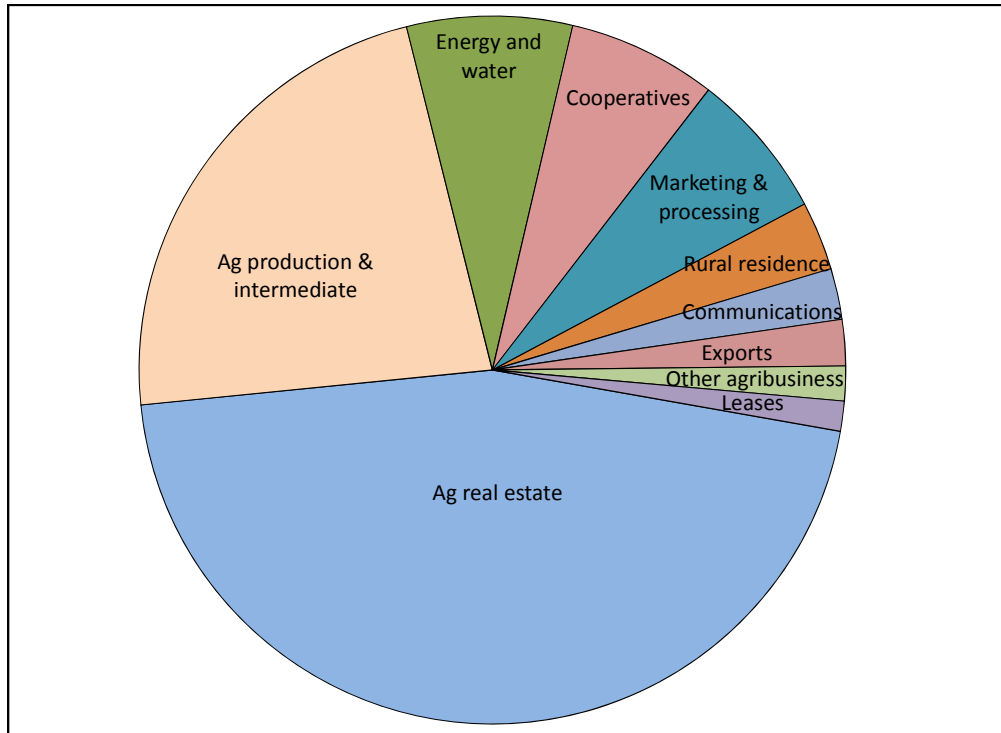
The FCS has a statutory mandate to serve agriculture, and certain agribusinesses and rural homeowners. Borrowers must meet eligibility and creditworthiness requirements. Types of eligible borrowers and their scope of their financing can be grouped into four categories.

- **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 living 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. Non-agricultural lending is limited.
- **Farming-related businesses.** 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, 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 (2,500 population limit).

FCS can also finance certain farmer-owned cooperatives and agricultural exports. **Figure 4** illustrates FCS’s portfolio of loans outstanding (\$217 billion at the end of 2014) by the type of loan. About 70% of the loan portfolio is in the primary categories of farm real estate and operating loans.

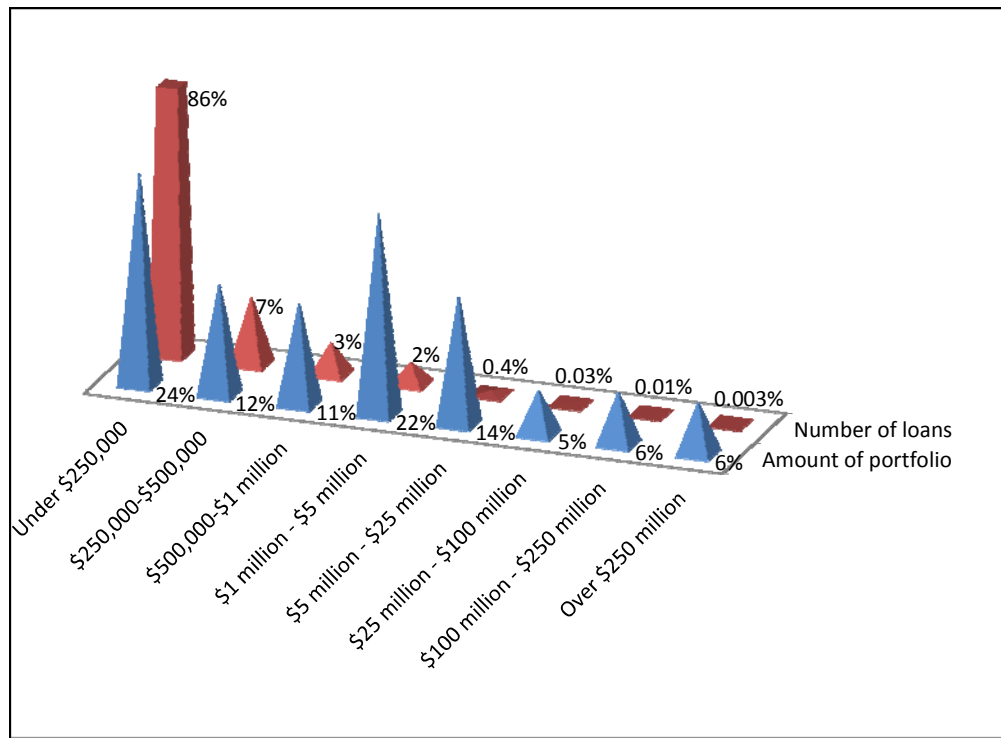
**Figure 5** presents the loan portfolio by size of loan and the number of borrowers in each size category. Nearly 86% of the number of loans (861,000 out of nearly 1 million) are under \$250,000 in size and account for 24% of the loan portfolio. At the other extreme, 28 loans each over \$250 million account for 6% of the loan portfolio.

**Figure 4. Farm Credit System Loan Portfolio by Type of Loan**



Source: CRS, based on Farm Credit System 2014 Annual Information Statement, March 11, 2015, p. 49.

**Figure 5. Farm Credit System Loan Portfolio by Size of Loan**



Source: CRS, based on Farm Credit System 2014 Annual Information Statement, March 11, 2015, p. 52.

# Federal Regulation

## Congressional Oversight

Congressional oversight of FCS is provided by the House and Senate Agriculture Committees. The most recent hearings on agricultural credit were in the House on June 25, 2014 (including witnesses from the FCS),<sup>8</sup> and in the Senate on June 13, 2006 (agricultural credit, but not specifically the FCS).<sup>9</sup> The Senate Agriculture Committee also holds hearings on nominees for the Farm Credit Administration board of directors.<sup>10</sup>

## Farm Credit Administration (FCA)

The Farm Credit Administration 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 places a limit on FCA's administrative expenses (\$60.5 million in FY2015).

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. Members may continue to serve on the board until their replacement is confirmed.

**Table I. Farm Credit Administration Board of Directors**

Name	Senate Confirmation and Comments	Term Expires
Kenneth A. Spearman, Chairman	Confirmed on 10/8/2009 to complete the term of Dallas P. Tonsager that was to expire 5/21/2010. Reappointed to full term. Appointed Chairman of the Board and CEO on March 13, 2015.	5/21/2016
Jeffrey S. Hall	Confirmed on March 9, 2015.	10/13/2018
Dallas P. Tonsager	Confirmed on March 9, 2015. Previously an FCA board member for a partial term from 2004-2009.	5/21/2020

**Source:** CRS.

<sup>8</sup> House Committee on Agriculture, "A Review of Credit Availability in Rural America," hearing on June 25, 2014, at <https://agriculture.house.gov/hearing/review-credit-availability-rural-america>.

<sup>9</sup> Senate Committee on Agriculture, Nutrition and Forestry, "Review of USDA Farm Loan Programs," hearing on June 13, 2006, at <http://www.ag.senate.gov/hearings/review-usda-farm-loan-programs>.

<sup>10</sup> Senate Committee on Agriculture, Nutrition and Forestry, "Nominations," at <http://www.ag.senate.gov/nominations>.



## Other FCS Entities

### Federal Agricultural Mortgage Company (Farmer Mac)

Farmer Mac was established in the Agricultural Credit Act of 1987 as a secondary market for agricultural loans. It purchases and pools qualified loans, and sells them to investors as securities. Although Farmer Mac is part of FCS by statute and is 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 an investor-owned corporation, not a member-owned cooperative. Voting stock may be owned by banks, insurance companies, and FCS institutions. Nonvoting stock may be owned by any investor. The board of directors has members from the FCS, commercial banks, and 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 holds most of the loans it purchases, a potentially more profitable and risky activity.

### Farm Credit System Insurance Corporation

The Insurance Corporation 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 is the trade association of FCS and lobbies on behalf of FCS.

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