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# The Farm Credit System:

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Lending Anywhere  
But on the Farm

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How the Farm Credit  
System is aggressively  
seeking to increase its  
off-farm lending activities

by  
Bert Ely





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**Bert Ely**

November 2006

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The paper has been produced under a grant from the American Bankers Association.  
The author, however, retains full responsibility for its contents.



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## Executive Summary

The Farm Credit System (FCS), a tax-advantaged government-sponsored enterprise (GSE) was created in 1916 and expanded in 1933 to meet agricultural financing needs that no longer exist. The only GSE with retail lending authority, the FCS was created at a time when banks were barred from providing to farmers and ranchers the full range of financing they needed. The FCS's lending powers was broadened in 1933, after widespread banking failures left many rural areas without adequate sources of credit. Now the countryside is amply populated with banks and other private-sector lenders competing aggressively to meet all of rural America's financing needs, on as well as off the farm.

Like any government bureaucracy threatened with extinction, the FCS has tried to reinvent itself, in a futile attempt to remain relevant, in a manner which Congress never intended or envisioned. This reinvention has accelerated since Congress bailed out the FCS in 1987 following the bursting of a farmland bubble largely inflated by the FCS's reckless lending in the 1970s and early 1980s. The FCS's HORIZONS Project is the FCS's latest, and perhaps boldest, attempt to reinvent itself as a taxpayer-subsidized lender.

The FCS's transformation since 1987 has been evident in three respects. First, it has experienced tremendous consolidation, shrinking from more than 800 local lending associations in 1984 to 95 much larger associations in October 2006. Second, the FCS increasingly lends for non-agricultural purposes, specifically to businesses not closely related to agricultural production and to finance a rural lifestyle of country estates, weekend getaways, hunting preserves, and the like. Third, as the FCS has consolidated, almost all of its loan growth in recent years has flowed to larger, wealthier, and older borrowers, making a mockery of the FCS's legal obligation to serve young, beginning, and small (YBS) farmers.

Lending trends within the FCS are difficult to decipher because of the FCS's lack of transparency. Although the Farm Credit Administration (FCA), the FCS's regulator, began publishing more data about FCS activities earlier in this decade, that effort has faltered in recent years. At the same time, the FCA increasingly facilitates the FCS's expansion, by looking the other way when FCS lending violations are brought to the FCA's attention and by stretching the Farm Credit Act (the FCS's chartering legislation) as far as possible to give the FCS greater lending powers. Worse, the FCA is an active promoter of the HORIZONS Project. The FCA has become a classic "captured regulator," responding to the desires of those it regulates, rather than serving the broad public interest.

Congress must act in three ways to corral the FCS before it sets off on another unwise lending binge comparable to the FCS's reckless lending in the 1970s and early 1980s. First, Congress must not enact any statutory provision advocated by the HORIZONS Project. Second, Congress must amend the Farm Credit Act to bring the FCS back in line with its initial mission while clawing back that portion of the FCS's taxpayer subsidy, now approximating \$1.2 billion annually. Third, Congress must begin considering how to privatize the FCS, coupled with recasting the delivery mechanism for the agricultural financing subsidy the FCS now delivers.



## Introduction

The Farm Credit System (FCS) has long since recovered from its self-inflicted financial problems which triggered its taxpayer bailout in 1987. Today, the FCS is financially strong, due to its high credit-quality assets and overcapitalization. While this strength is commendable, from a safety-soundness perspective, it has become increasingly evident that the FCS is no longer needed to serve the mission Congress assigned to it. Fearing to acknowledge that obvious fact, the FCS is attempting, through its HORIZONS Project, to broaden its lending powers and geographical reach while still emphasizing its lending to financially strong farmers and ranchers, those least in need of taxpayer-subsidized credit.

Chartered in 1916 as the first government-sponsored enterprise (GSE), the FCS was tasked with supplying credit to farmers and ranchers because branching and lending restrictions prevented banks from fully meeting agriculture's credit needs. Like all GSEs, the FCS was given tax exemptions and other privileges, including the ability to borrow at lower interest rates than private-sector financial firms, in return for providing credit to underserved areas of rural America and to young, beginning, and small (YBS) farmers.

Since its 1987 bailout, the FCS has moved dramatically away from its intended purpose. Over the last two decades, the FCS has increasingly focused on serving larger, wealthier, and older farmers and ranchers while also boosting its off-farm lending. However, the FCS has run out of growing room within the markets it has been empowered to serve due to its virtually unlimited on-farm lending powers. Therefore, the FCS is now seeking, through HORIZONS, to greatly expand its off-farm lending powers as well as its geographical reach into more urbanized areas.

This report addresses changes which have taken place within the FCS and outlines what should be done to rectify the FCS problem. The first chapter summarizes the history of the FCS since the 1987 bailout, drawn in part from previous reports published by the author.<sup>1</sup> The second chapter discusses the FCS as it operates today. The third chapter describes the HORIZONS Project, as best that can be divined from available information.

The fourth chapter outlines how those concerned about FCS expansion should address the HORIZONS Project and summarizes what can be done about the FCS problem. The only long-term solution, though, is to fully privatize the FCS. This chapter also summarizes a detailed privatization proposal first set forth in the author's 1999 report on the FCS. Before privatization becomes a reality, though, Congress should take five steps to better align the FCS with legitimate public-policy objectives, including increased lending to YBS farmers and ranchers.

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<sup>1</sup> *The Farm Credit System: Reckless Lender to Rural America* (1990, with Vicki Vanderhoff), *The Farm Credit System: Reckless Past, Doubtful Future* (1999), and *The Farm Credit System: Reinvented and Mission-Challenged* (2002).



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# 1

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## The History of the Farm Credit System

The history of the FCS can be divided into two chapters, with the breakpoint being the 1987 congressional bailout of a nearly bankrupt FCS. That bailout launched the transformation of the FCS from what Congress intended it to be to what it has become today.

### **Ancient history – the FCS prior to its 1987 bailout<sup>2</sup>**

The FCS's origins lie with the formation of twelve regional federal land banks in 1916. Congress chartered those banks to increase the ability of farmers to obtain credit to finance the purchase of farms and ranches. At that time, national banks and many state-chartered banks were barred from making real estate loans; those banks authorized to make farm real estate loans were limited as to how much they could lend for that purpose. Further, branching restrictions and prohibitions in most states restricted the size of banks, which limited the size of real estate loans that banks actually could make. The inflation in farmland values during World War I increased the demand for farm real estate credit. Rather than lifting banking's branching and real estate lending restrictions, Congress created a new, government-backed lender to do what banks were barred from doing.

Farmers also need short- and intermediate-term credit to finance the annual planting cycle and to purchase tractors and other types of farm equipment. Banks readily provided that credit, but during the 1920s, as hundreds of small, rural banks closed or failed (often due to branching restrictions), farmers found it increasingly difficult to obtain short- and intermediate-term credit. Congress responded to that need in 1923 by creating twelve regional federal intermediate credit banks (FICBs) as a second arm of the FCS. The FICBs initially were not authorized to be direct retail lenders. Instead, the FICBs were authorized to lend to banks and other retail suppliers of rural credit; for a variety of reasons they never became significant lenders. Price deflation during the Great Depression triggered a dramatic increase in bank failures in the 1930-33 period, as over 9,000 banks failed – mostly small, rural banks. The failure of so many banks led Congress in 1933 to authorize production credit associations (PCAs) within the FCS to supply short-term credit directly to farmers. Congress also authorized FCS lending to agricultural cooperatives.

Had the states and Congress, through its enactment of the McFadden Act in 1927, not so severely restricted bank branching, rural America would have been served by a banking system which could have survived the Great Depression while continuing to meet agriculture's credit needs. Interestingly, Canada, which had long had unrestricted bank branching, did not

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<sup>2</sup> The FCS's pre-1988 history is discussed in greater detail in the author's 1990 and 1999 reports on the FCS.

experience a single bank failure during the Depression even though it suffered a price deflation nearly as severe as the United States. Like the rest of the economy, American agriculture began to recover from the Depression during World War II. Of particular importance to farmers and ranchers, farmland values began to rise after hitting an inflation-adjusted low in 1940.

As farmland values declined during the Depression and then recovered with the onset of World War II, Congress made two important changes in the amount that FCS lenders could lend on farmland. In 1933, the limit on the total amount which could be lent on farmland was set at 75% of its “normal value,” a valuation based on the land’s ability to produce income. In 1947, Congress reduced that limit to 65% of normal value, possibly because of concerns raised several years earlier by the head of the Farm Credit Administration (FCA) – “heavy loans [to farmers] would help to generate another fast rise in farm land prices”<sup>3</sup> comparable to the World War I boom in farmland prices. The FCS operated under the 65% limit until 1971. However, as part of a major rewrite of the Farm Credit Act in 1971, the FCS succeeded in obtaining a significant liberalization of its real estate lending limit, getting it raised to 85% of appraised or current market value from 65% of the usually lower normal value.

Congress’s 1971 rewrite of the Farm Credit Act launched the FCS on a lending binge. From 1971 to 1980, FCS lending quadrupled. During those years, the Federal Reserve pushed real interest rates (i.e., the nominal interest rate minus the rate of inflation) to very low and even negative levels, unleashing the tremendous price and asset-value inflation of the 1970s. The FCS drove the already low real interest rates of that era even lower by failing to reflect in the interest rates it charged the full cost of the funds it was borrowing. This combination of low real interest rates and the FCS’s liberalized lending created such a demand for farmland in the 1970s that a classic, unsustainable bubble developed, as the inflation-adjusted value of farmland nearly doubled during those years.

A sharp reversal in Federal Reserve monetary policy in October 1979 popped that bubble. Farmland prices, in real terms, plunged as high interest rates bankrupted farmers and farm foreclosures skyrocketed. By 1986, farmland prices had fallen back to 1972 levels, on an inflation-adjusted basis. The carnage from those collapsing values spread throughout rural America. Hundreds of farm suppliers went out of business as farmers cut back on all but their most essential spending while 300 banks failed because of ag lending problems stemming from falling land values as the FCS-induced farmland bubble deflated. The FCS itself was badly damaged as collapsing farmland prices bankrupted thousands of FCS borrowers. In 1985 and again in 1986, Congress passed emergency legislation designed to ameliorate the FCS’s increasingly severe financial problems, but those legislative patches failed to work. Finally, in 1987, with six of the twelve Farm Credit Bank (FCB) districts holding nonperforming assets exceeding 10% of their total assets, Congress was forced to risk taxpayer dollars to bail out the FCS, and its creditors.

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<sup>3</sup> Hoag, W. Gifford, “The Farm Credit System: A History of Financial Self-Help,” The Interstate Printers & Publishers, Inc., Danville, Illinois, 1976, pg. 253, quoting former FCA Governor Albert G. Black.

## The transformation of the FCS launched by the bailout

The FCS's modern history commenced in 1987, when Congress bailed out the FCS.<sup>4</sup> That bailout saved the FCS as even more farmers defaulted on their loans following the bursting of the farmland bubble. The 1987 bailout legislation created the Farm Credit System Financial Assistance Corporation. It was authorized to issue up to \$4 billion of taxpayer-backed bonds to provide capital assistance to FCS institutions financially weakened by losses arising from collapsing farmland prices. Bonds totaling \$1.261 billion were issued, with 15-year maturities. The last of these bonds, \$325 million, were paid off in June 2005, along with \$440 million of interest the U.S. Treasury advanced during the first 10 years the bonds were outstanding. The 1987 bailout stabilized the FCS sufficiently so that it could slowly regain its financial health. Today, the FCS is strong financially, as will be discussed in the next chapter.

The 1987 bailout fundamentally transformed the FCS, from a financially weak organization with over 400 independent entities to a very strong, highly competitive organization with just 100 independent entities. **Chart 1** (next page) shows market share trends in farm credit since 1970 while **Chart 2** plots the growth of FCS loans and its capital ratio. Together, these two charts show how the FCS has regained market share as its loan volume has more than doubled from a 1989 low. **Chart 3** shows the steady growth in the FCS's pre-tax earnings, which have more than tripled since 1990. At the same time, the FCS's effective corporate tax rate has dropped by more than half during this decade, due to an organizational restructuring discussed in the next chapter.

**Chart 4** shows the tremendous consolidation among FCS associations since 1987. However, some areas of the country have seen more consolidation than others. For example, the largest three associations – FCS of Mid-America (\$10.6 billion of assets), FCS of America (\$10.3 billion), and Northwest Farm Credit Services (\$5.8 billion) – together serve all or portions of 15 states and hold 28.5% of all FCS association assets. On the other hand, Texas has 13 associations, California eight, Oklahoma seven, Kansas six, Florida five, and Arkansas and North Dakota four each, to cite the states with the greatest number of associations.

Consolidation also has occurred among the FCBs. At one time, there were 37 FCBs which the bailout legislation consolidated to 13. Since then, consolidation has shrunk the number of FCBs to five.

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<sup>4</sup> The Agricultural Credit Act of 1987 was signed into law on January 6, 1988.

Chart 1

## Market Share Trends in Farm Credit

Real estate plus non-real estate lending – 1970 to 2005

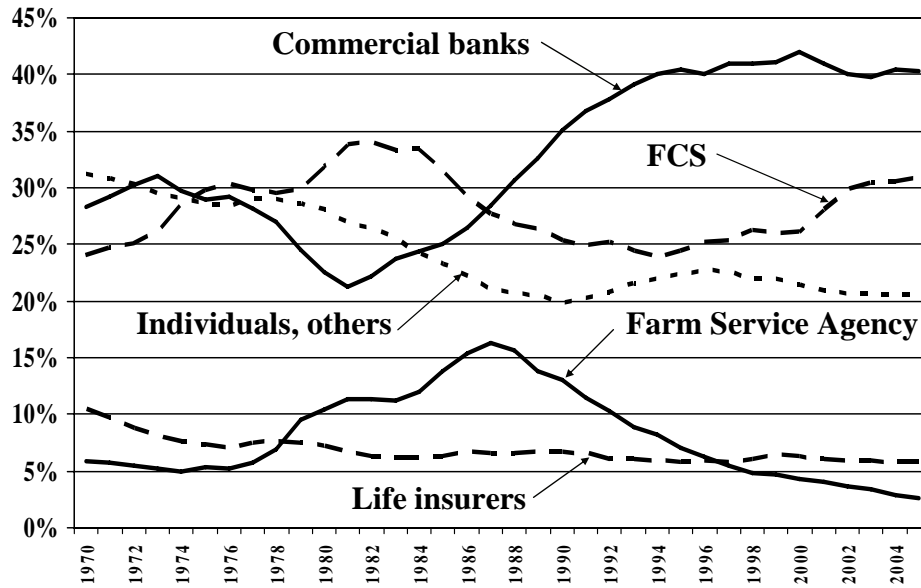


Chart 2

## FCS Loans and Capital Have Grown

(Calendar year-end data, except June 30, 2006)

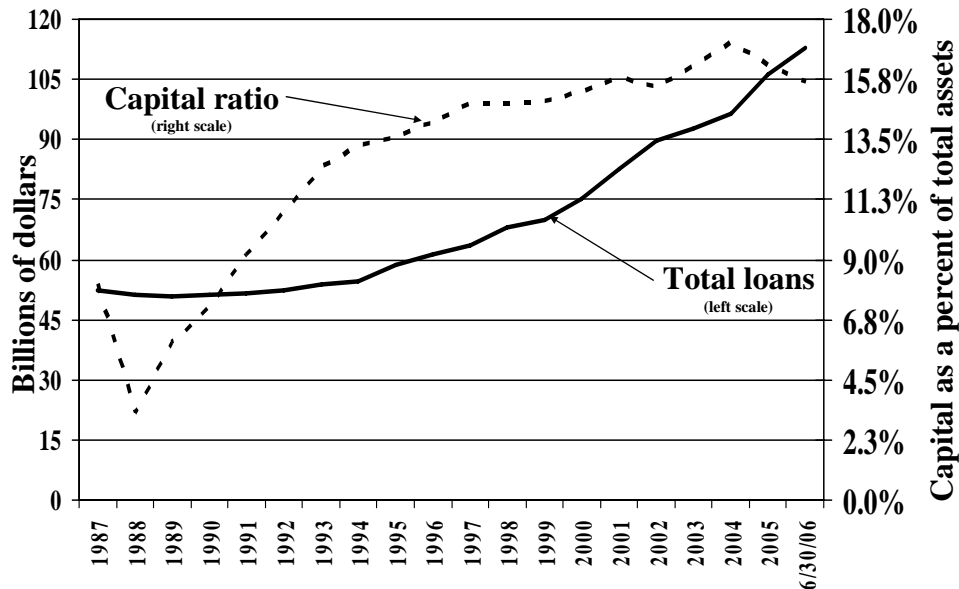


Chart 3

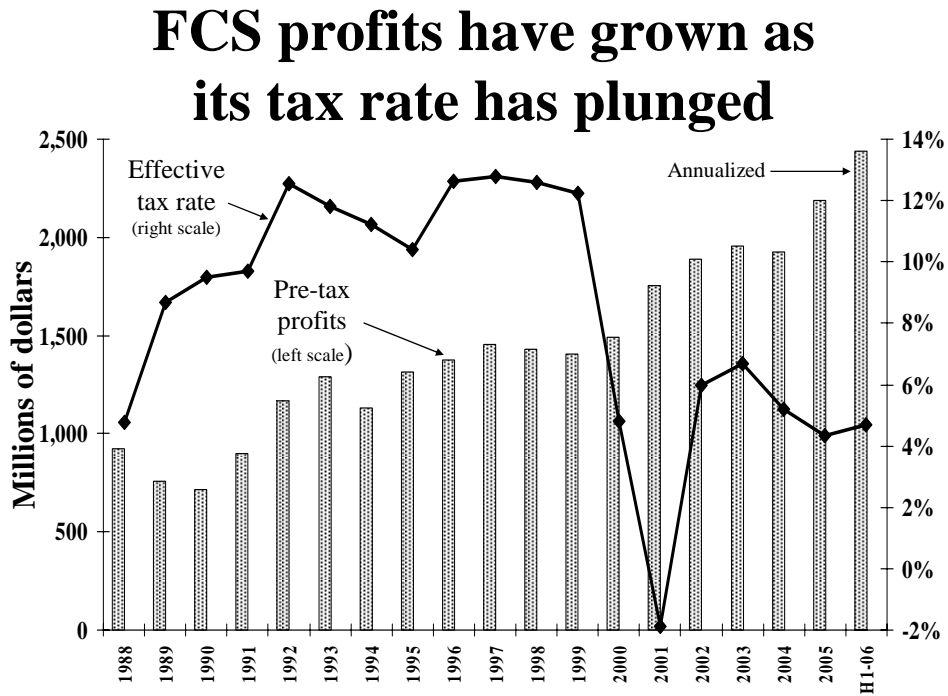
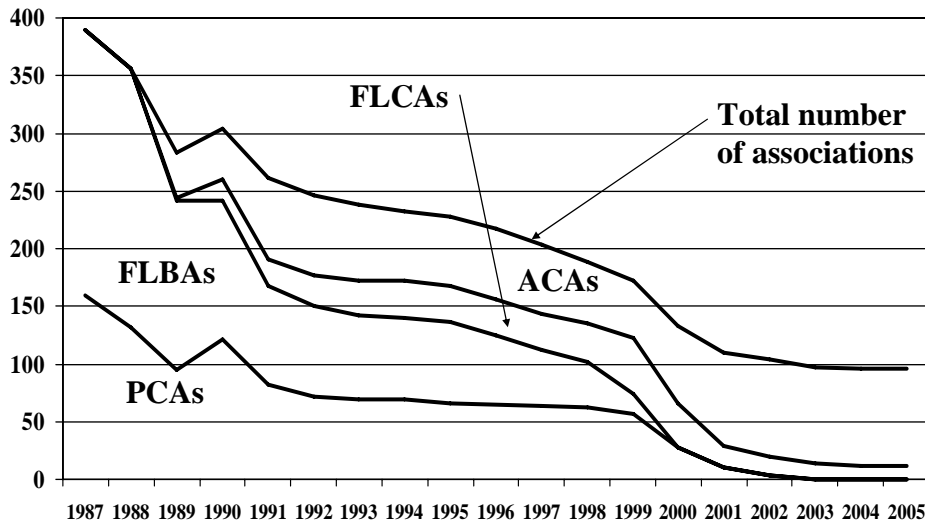


Chart 4

## The Number of FCS Associations Has Shrunk Significantly

(End of calendar year)





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## 2

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### The Farm Credit System Today

FCS today is quite different from the FCS of one or two generations ago. Once a collection of small, local cooperative lending associations, the FCS has transformed itself into a large, strong financial institution capitalizing on the many benefits Congress has bestowed on it over the years. Once run by its farmer-owners-borrowers, who had intimate knowledge of local farming conditions, today the FCS is run by a very well-paid cadre of professional managers. In the larger, multi-state associations, which now dominate the FCS, directors are much less knowledgeable about farming conditions across the entire region their association serves, leaving them no choice but to rely on the association's management in setting policy and making business judgments for the association.

#### The structure of the FCS

Due to consolidation, the FCS now consists of five regional FCBs and 95 retail or direct-lending associations. **Chart 5** (page 13), which shows the flow of funds from Wall Street to FCS borrowers, effectively illustrates the structure of the FCS. The FCBs borrow monies in the capital markets that they lend to their member associations, which the associations in turn lend to their member/borrowers. The Federal Farm Credit Banks Funding Corporation is the FCS entity which actually issues the Systemwide Debt Securities that the five FCBs collectively issue, and cross-guarantee, through joint-and-several liability. This joint-and-several liability is further reinforced by the \$2.2 billion of capital which has accumulated in the Farm Credit System Insurance Corporation, through premium payments from the FCBs as well as interest earnings. Although FCS institutions are barred from accepting deposits, some hold functional equivalents of deposits, through various subterfuges, such as readily redeemable, dividend-paying preferred stock and short-term, interest-bearing investment accounts.

Each association belongs to, borrows from, and is a stockholder in the FCB serving the territory designated for that FCB by the FCA, the FCS regulator. The FCBs hedge the interest-rate risk associated with the associations' lending and exercise some lending oversight over their member associations. The FCBs also manage the FCS's investment portfolio, currently \$31 billion. In addition to funding five associations, one of the FCBs, CoBank (technically an Agricultural Credit Bank), has the exclusive right within the FCS to lend to agricultural cooperatives and to finance U.S. agricultural exports.

Currently, there are two types of FCS associations, as shown in **Chart 4** – 85 Agricultural Credit Associations (ACA) and 10 Federal Land Credit Associations (FLCA). FLCAs are empowered to make real-estate-secured loans with maturities up to 40 years. ACAs combine the long-term mortgage lending activities of an FLCA with the short- and medium-term lending powers of a PCA.

Just like the FCBs, FCS associations are assigned specific geographical territories. With a few minor exceptions, associations do not have overlapping territories, which minimizes competition among the associations. Attempts to allow greater competition within the FCS, notably the National Charters proposal earlier this decade, have so far been defeated, in part because of objections from within the FCS.

All 85 ACAs are now organized as “parent” ACAs, as illustrated in **Chart 6**. Under this structure, all of an ACA’s personnel and operating activities are located in the parent ACA, but the ACA’s loans are owned by its subsidiary FLCA and PCA. The ACA then directs any lending secured by real estate, including even short-term loans formerly made by PCAs, into the FLCA while the ACA’s remaining lending gets placed in the PCA.

The parent ACA became the organizational model of choice within the FCS because of its superior tax advantages. The IRS blessed the ACA “parent” form of organization in 2000. This IRS action reflected a 1998 Federal District Court decision which held that ACAs were due refunds on taxes they previously had paid related to income generated from the ACAs’ long-term mortgage lending activities. Ultimately, the IRS refunded \$282 million in previously paid taxes to FCS associations plus \$92 million of interest on those refunds, for a total of \$374 million. These refunds are the reason why the FCS had a negative effective tax rate in 2001, as shown in **Chart 3**. Not surprisingly, the FCS’s tax liability, as a percentage of its income, has dropped dramatically as the ACAs have sought to minimize the taxable income of their subsidiary PCAs.

Although consolidation within the FCS has slowed in recent years, as shown in **Chart 4**, the FCS may be on the verge of another wave of consolidation, particularly in the states with numerous small associations. The 23 associations with more than \$1 billion of assets on June 30, 2006, held 67.9% of all association assets while 50 associations with less than \$500 million of assets held 14.8% of all association assets. The 23 associations in the middle held the other 17.3%. While consolidation will largely occur among the smaller associations, even the larger ones will not be exempt from future mergers. On October 1, 2006, two Texas associations merged to form the largest Texas association, with \$2.5 billion in assets; on October 12 the FCA approved the merger of two other Texas associations. One can easily envision the FCS shrinking to 20 associations, or fewer, with most operating across several states. Association consolidation most likely will lead to more FCB mergers, reducing that number to three or possibly two – CoBank and one other FCB.

### **The FCS’s numerous competitive advantages**

The FCS enjoys numerous competitive advantages – the most significant are its substantial tax exemptions and its highly favorable cost of borrowed funds.

**Tax advantages** The FCS tax advantage is far greater on its real-estate-secured lending – an estimated 118 basis points per dollar lent<sup>5</sup> – than it is on its non-real-estate lending, where its advantage is about 24 basis points. The greater advantage of the FCS’s real-estate

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<sup>5</sup> One basis point equals .01 percent.

Chart 5

## Flow of funding within the FCS

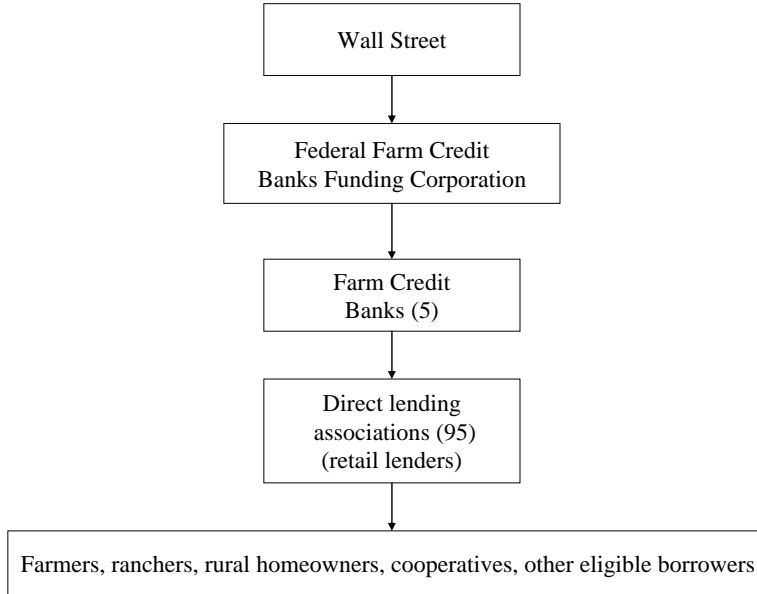
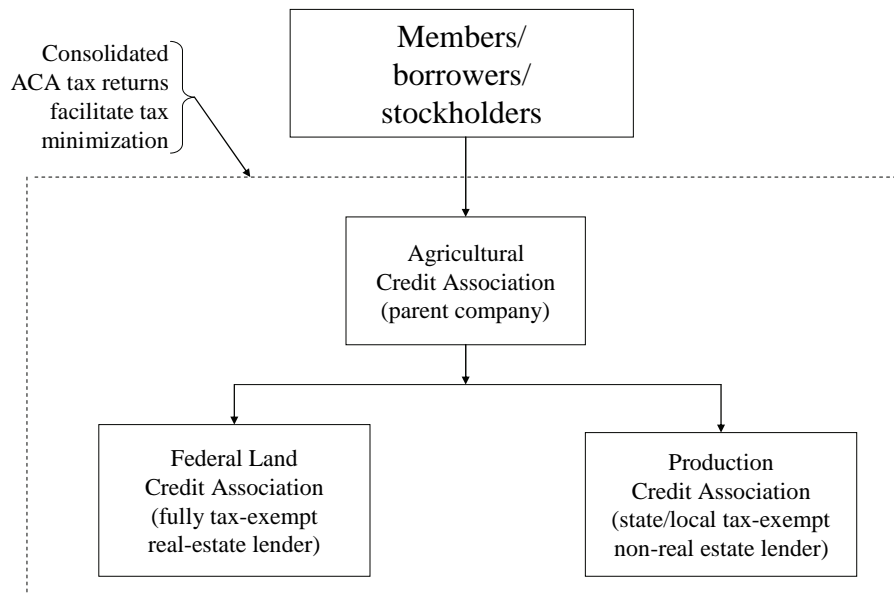


Chart 6

## The structure of an ACA



lending occurs because the profits from this lending are exempt by law from all corporate income taxes; FCS profits on its non-real-estate lending are exempt only from state and local corporate income taxes. This difference in taxation has given the FCS a very profitable tax-arbitraging opportunity, which the FCS has capitalized on, through the ACA parent structure, with steadily increasing efficiency.

By adopting the parent ACA structure, FCS associations, through aggressive tax management, can shift income into their fully tax-exempt FLCA subsidiary while shifting expenses into their federally taxable PCA subsidiary. These tax maneuvers maximize the fully tax-exempt income of an ACA's FLCA subsidiary while minimizing the federally taxable income of the ACA's PCA subsidiary.

Additionally, ACAs appear to allocate a disproportionately high percentage of their patronage dividends<sup>6</sup> to their federally taxable subsidiary PCA, where the dividend is tax-deductible, than against their fully tax-exempt FLCA, where there is no comparable tax deductibility. The tax-deductibility of patronage dividends reduces their cost to the ACA by 35%, the federal corporate income-tax rate.

Based on the FCS's current size, its tax exemptions are worth about \$850 million annually – \$725 million on its real-estate lending and \$125 million on its non-real-estate lending. This estimate of the FCS tax advantage is based on FCS financial results for 2005 and the first half of 2006.<sup>7</sup> For the first half of 2006, the FCS's overall after-tax profit, per asset dollar, was approximately 161 basis points. Assuming a combined federal/state/local income-tax rate, at the margin, of 38%,<sup>8</sup> the tax savings the FCS enjoyed on its real-estate lending were about 99 basis points, or approximately 1%, per dollar lent. The FCS's tax savings on its non-real-estate lending, assuming a 3% net tax-cost rate, is much smaller, in the range of just five basis points per dollar lent.

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<sup>6</sup> Patronage dividends represent a partial rebate of interest paid by a borrower to the FCS association from which it borrowed. Patronage dividend policies vary widely within the FCS – many associations do not pay patronage dividends to their member/borrowers while others have paid them for years. The failed attempt of Rabobank in 2004 to take over Farm Credit Services of America (FCSA), which led FCSA to pay a patronage dividend, may lead to more patronage dividends across the FCS, but that cannot be determined at this time.

<sup>7</sup> The FCS's financial results are reported in its Combined Financial Statements, which encompass all FCBs, FCS associations, and wholly-owned service corporations. These financial statements are presented in Annual and Quarterly Information Statements published by the Federal Farm Credit Banks Funding Corporation, the FCS's funding arm. These statements can be found at [www.farmcredit-ffcb.com](http://www.farmcredit-ffcb.com).

<sup>8</sup> The marginal federal corporate income-tax rate is 35%. State and local corporate income taxes are deductible from federal taxable income, which means the effective state/local tax rate is reduced by approximately one-third to reflect a corresponding reduction in the federal tax liability. Assuming an average combined state/local tax rate of 4.5%, the effective state/local tax rate (net of federal tax savings) would be 3%, which when added to the federal tax rate produces a combined federal/state/local tax rate of 38%.

According to the FCS's 2005 financial statements, approximately 46% of FCS lending in 2005 was not real-estate secured lending, which suggests the FCS should have an effective tax rate of 16.1% (46% of the federal tax rate). However, the FCS reported a 4.7% tax rate for the first half of 2006. Hence, it appears that income, expense, and patronage-dividend shifting within the FCS may have reduced the FCS's overall tax rate by 11.4 percentage points. These additional tax savings equate to approximately 19 basis points per dollar lent. Spread proportionally across the FCS's real-estate and non-real-estate lending, this additional tax-avoidance raises the FCS's total tax savings to 118 basis points on its real-estate lending and 24 basis points on its non-real-estate lending.

**Funding cost advantage** As a GSE, the FCS can borrow at rates comparable to the other GSEs. Congress's 1987 bailout of the FCS reinforced the belief in the capital markets that if the FCS sank into financial difficulty again, Congress would ride to the rescue, again, protecting FCS creditors from any loss. GSE interest rates fall between AAA corporate borrowing costs and rates on U.S. Treasury debt, which is widely considered to be riskless debt. Given the FCS's current strong capital position, it is not unreasonable to assume that FCS debt would be rated AAA or at least AA+ on a stand-alone basis; that is, if it were not a GSE.

At the long end of the interest-rate yield curve, on October 13, 2006, Moody's seasoned AAA corporate bonds were yielding 5.59% while the 20-year Treasury bond yielded 5.02%, resulting in a 57 basis point spread differential. Splitting the difference between the 20-year Treasury bond and AAA corporate debt suggests that for longer-maturity debt, the FCS currently has a funding cost advantage in the 30 basis point range over the best-rated corporations. At other times, the FCS's long-term funding advantage has been much greater. For example, on November 22, 2002, the 20-year Treasury-AAA spread was 124 basis points.

For shorter maturities, the FCS funding cost advantage is somewhat less, as calculated by looking at the spread differential between 3-month Treasury bills (secondary market yield) and yields on 3-month financial commercial paper, 3-month tradable CDs, and 3-month Eurodollar deposits. As of October 13, 2006, that spread fell in the range of 30-44 basis points; on November 22, 2002, the range was 12-14 basis points.

On a net basis, the FCS swaps from longer-term maturity debt (generally 1-5 years) into shorter-term debt (0-6 months), presumably to capture the greater yield advantage it has further out the interest-rate yield curve.<sup>9</sup> Therefore, the FCS's overall funding cost advantage most likely is more reflective of its longer term cost advantage over the best-rated corporations. Most likely this advantage falls in the 30-40 bps range overall, but with a greater funding-cost advantage for its long-term, fixed-rate real-estate lending. Because almost all banks are not rated AAA, the FCS's funding cost advantage is even greater, perhaps as high as 75 basis points. However, unlike its tax-cost advantage, the FCS's funding cost advantage does fluctuate

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<sup>9</sup> Using interest-rate swaps and other hedging devices is complex and does expose the FCS to accounting errors of the type which have forced the other four GSEs to undergo significant, expensive financial restatements. As of June 30, 2006, the FCS had hedges in place with a notational or nominal value of \$40.7 billion. Each of the five FCBs does its own hedge accounting and documentation, which compounds the chance for accounting errors which could force the FCS to restate its financial statements.

over time. Presently, the FCS's after-tax funding cost advantage conservatively falls in the range of approximately \$350 million of additional profit annually.

**Other tax and fee advantages** As governmental entities, FCS institutions often are exempt from various state and local taxes, fees, and other requirements. One of the most common advantages the FCS enjoys in many states is an exemption from paying a recordation fee when recording a property lien. The FCS also is exempt from registering its debt securities with the SEC, which saves it millions of dollars annually in securities registration fees.

**Investment arbitrage profits** A not-insignificant-portion of the FCS's profits flow from the GSE arbitrage profit the FCS makes on its considerable investment portfolio, which totaled \$31.2 billion on June 30, 2006. This arbitrage opportunity arises from the fact that the FCS can borrow at the relatively low GSE interest rates discussed above and then invest those funds at a higher rate of interest. Assuming an arbitrage profit of 40 basis points per investment dollar, the FCS's current investment arbitrage profit approximates \$125 million annually. This arbitrage profit helps to fund the FCS's lending subsidy.

By regulation, FCS investments are limited to 35% of FCS loans. On July 14, 2005, the FCA raised that limit from 30%. The rationale for that increase was quite weak: “. . . to help ensure that FCS banks have adequate liquidity if a market disruption or other extraordinary situation occurs.”<sup>10</sup> In fact, by virtue of its GSE status, the FCS can borrow with great ease at any time, and especially when there is great stress in the financial markets, as that is when investors flee to high-credit-quality investments, such as GSE debt.

**Poorly defined public mission** As noted above, the FCS was founded, and later given broader lending authority, to provide credit to farmers and ranchers who could not otherwise obtain credit. Congress later added a statutory mandate that the FCS make a special effort to lend to YBS farmers and ranchers, yet as the author's 2002 report documented (pages 10-12), the FCS has fallen far short of meeting its YBS obligations. That conclusion was echoed in a 2002 report by the Government Accountability Office (GAO).<sup>11</sup> Despite claims to the contrary by the FCS and the FCA, there is no concrete evidence that the FCS has improved its YBS lending since then nor has the FCA improved the accounting and financial reporting of FCS YBS lending. Instead, the FCS increasingly focuses on lending to larger, low-credit-risk borrowers, on and off the farm.

**No statutory conforming loan limit** The two largest GSEs, Fannie Mae and Freddie Mac, are limited as to how much they can lend on a single-family home; currently, that limit is \$417,000. Congress has not imposed a comparable limit on the FCS. Interestingly, **the FCS has a self-imposed lending limit to any one borrower – \$750 million!** That limit actually was increased during 2005 from \$500 million. At the end of 2005, two unnamed borrowers exceeded that limit, with outstanding loans plus unfunded commitments to lend to each

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<sup>10</sup> Farm Credit Administration news release NR-05-10, dated July 14, 2005.

<sup>11</sup> *Farm Credit Administration: Oversight of Special Mission to Serve Young, Beginning, and Small Farmers Needs to Be Improved*, GAO-02-304, March 8, 2002.

borrower falling between \$563 million and \$750 million. It appears the FCS boosted its lending limit solely to accommodate these two customers, each of whom undoubtedly can readily borrow from banks and in the capital markets.

**No membership restrictions** Unlike credit unions, FCS associations are not subject to any membership restrictions. Although credit union membership limitations have been liberalized quite a bit in recent years, particularly for so-called community credit unions, these limits still exist. Anyone can join an FCS association, though, if the loan they seek is of a type the FCS can make and if the association agrees to make that loan.

**An extremely friendly regulator** The FCA is the exclusive regulator of the FCS.<sup>12</sup> The banking regulators, for example, have no supervisory oversight over the FCS. As an independent federal agency, the FCA largely escapes review by the Executive Branch – the FCS effectively answers only to Congress. In recent years, the FCA has moved from being a somewhat balanced regulator back to what it traditionally has been – a promoter of FCS expansion. The FCA’s unblinking support for the HORIZONS Project is the latest incidence of this mentality. Consequently, FCA board members and staff (many of whom used to work in the FCS) turn a blind eye to lending abuses reported to the FCA. Instead, the FCA focuses on giving the FCS what it can, stretching, if necessary, the boundaries of what Congress has authorized.

### **Who owns the FCS – no one**

Legally, the FCS is a lending cooperative, owned by its member/borrowers. That is, in order to borrow from the FCS, one must become a “member” of the FCS. This is not an onerous requirement because the stock-purchase requirement is so low – the lesser of 2% of the amount borrowed or \$1,000. Consequently, the \$1,000 ceiling applies to all loans over \$50,000. As a practical matter, buying FCS stock and borrowing occur simultaneously – to quote from the FCS’s Annual Information Statement for 2005, “the borrower usually does not purchase capital stock for cash; rather the stock purchase is typically made by adding the aggregate par value of the stock to the principal amount of the related loan obligation.”<sup>13</sup> Many FCS borrowers probably are not even aware that they own stock in the association they have borrowed from.

Because of this low stock-purchase requirement, the FCS is largely capitalized by its retained earnings, capital to which no one can claim ownership, except arguably “allocated surplus,” which represents patronage dividends attributable to specific borrowers, but which have been retained by the association. On December 31, 2005, the FCBs and the FCS associations had \$20.712 billion of capital; the rest of the FCS’s capital represented the restricted capital of the Farm Credit System Insurance Fund, which provides another level of insolvency protection for holders of the FCS’s Systemwide Debt Securities.

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<sup>12</sup> The FCA website will be found at [www.fca.gov](http://www.fca.gov).

<sup>13</sup> Footnote 13 to the 2005 Combined Financial Statements for the Farm Credit System, page F-24.

This capital broke down as follows (dollars in millions), with each category's percentage in parentheses:

Preferred stock	\$ 1,017	(4.9%)
Capital stock/participation certificates	1,333	(6.4%)
Allocated surplus	1,280	(6.2%)
Unallocated surplus, net of Accumulated Other Comprehensive Losses	<u>17,082</u>	<u>(82.5%)</u>
Total capital (excluding insurance fund)	<u>\$20,712</u>	<u>(100%)</u>

In effect, over 80% of the FCS's capital is unspoken for – no one explicitly owns, and therefore controls, this capital. What the lack of a meaningful stock-purchase requirement means is that control of the FCS has shifted to its management, and to some extent its directors. In this regard, the FCS differs dramatically from the other GSE cooperatively owned lender – the Federal Home Loan Banks (FHLB). Most of the capital of each of the twelve FHLBs consists of stock which can be redeemed, subject to minimum regulatory capital requirements, by a stockholder as the stockholder pays down its FHLB borrowings. This ability to withdraw capital imposes much greater stockholder discipline on the FHLBs than exists within the FCS.

### **Who can borrow, legally, from the FCS**

Legally, the FCS is constrained by the Farm Credit Act as to whom it can lend to. FCS institutions can lend to the following broad categories of borrowers:

- Bona fide farmers, ranchers, and producers and harvesters of aquatic products.
- Agricultural processing and marketing operations, if eligible borrowers (i.e., farmers, ranchers, and fishers) own at least 50% of the voting stock or equity capital invested in the operation or provide some portion of the throughput, i.e., raw materials input. This class of borrowers includes farmer-owned cooperatives.
- Farm-related service businesses. The FCS can finance all of the business when at least 50% of its sales are “from furnishing farm-related services that are directly related to the agricultural production of farmers and ranchers.” If eligible borrowers account for 50% or less of the business's sales, then the FCS can finance “only the farm-related services activities” of the borrower.
- Rural housing, where the home is (1) a single-family dwelling, (2) “moderately priced,” (3) located in a rural area or a town of not more than 2,500 population, (4) the owner is not a bona fide farmer, rancher, or aquatic harvester or producer, and (5) the house is owned and occupied by the borrower as the rural homeowner's principal residence.

In addition to being the FCS's exclusive lender to agricultural cooperatives, CoBank has been granted certain powers that other FCS institutions do not possess, including the right to lend to rural electric, telephone, water, and sewer utilities and to finance agricultural exports. CoBank also owns a leasing subsidiary, Farm Credit Leasing Services, with \$1.4 billion in leases outstanding to agribusinesses, cooperatives, rural electric and water systems, rural communications companies, FCS associations, and agricultural producers.

FCS associations and FCBs participate loans among themselves; i.e., they divide up a loan (usually a loan too large for any one association) among several or many FCS institutions. FCS institutions also can participate in loans to a "similar entity"<sup>14</sup> that is originated by a non-FCS institution, provided that the combined amount lent by all FCS institutions is less than 50% of the total amount lent to the "similar entity."

### Who the FCS actually lends to

FCS lending activity, utilizing data published by the FCS, can be analyzed from several perspectives – types of loans, loan sizes, and YBS lending.

**Types of FCS loans** FCS real estate mortgage loans, which account for almost one-half of FCS lending, represent the loan category where the Farm Credit Act's lending restrictions are stretched the furthest, specifically on rural properties which are not actively farmed or ranched, or even lack any "potential for agriculture."<sup>15</sup> Processing and marketing loans and loans to farm-related businesses is the other category where anecdotal reports indicate the FCS is lending well outside what is permitted under the Farm Credit Act.

[Tables on next page]

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<sup>14</sup> A "similar entity" is an entity which is not eligible to borrow from the FCS, but which "has operations that are functionally similar to a person that is eligible for a loan" from an FCB or FCS association. In effect, private-sector competitors of FCS borrowers can borrow from the FCS, provided that private-sector lenders provide at least 50% of the amount lent. Presumably, this provision in the Farm Credit Act helps to level the competitive playing field between those who can borrow from the FCS and those who cannot, but it does not level the playing field between the FCS and its private-sector, tax-paying competitors.

<sup>15</sup> The author cannot claim credit for coining the term "potential for agriculture" – credit goes to the former president of an FCS association who defended an \$840,000 FCS first mortgage on a 50-acre wooded hillside estate because the land had the "potential for agriculture." This FCS lending abuse was summarized in the author's 2002 report on the FCS, page 15.

As of June 30, 2006, and December 31, 2005, FCS lending broke down as follows (dollars in millions):

<u>Type of loan</u>	<u>6-30-06</u>	<u>12-31-05</u>
Real estate mortgage loans	\$ 53,523	\$51,690
Production and intermediate-term loans	26,529	24,935
Agribusiness:		
Loans to cooperatives	9,567	8,778
Processing and marketing loans	5,198	4,083
Farm-related business loans	1,923	1,812
Energy loans	5,474	5,014
Rural residential real estate loans	3,151	2,950
Communication loans	2,988	2,605
International loans	2,135	2,277
Lease receivables	1,365	1,290
Water and waste disposal loans	464	444
Loans to other financial institutions	<u>448</u>	<u>394</u>
Total loans	<u>\$112,765</u>	<u>\$106,272</u>

**Loan size** Another perspective on the scope of who the FCS lends to is provided by a breakdown of FCS loans by loan size. As of December 31, 2005, FCS loans, by loan size and number of loans in each category, were distributed as follows (dollars in millions; actual number of loans):

<u>Loan size range (\$000)</u>	<u>Amount Outstanding</u>	<u>Number of loans</u>
\$1 to \$250	\$36,311	669,843
\$251 to \$500	<u>13,661</u>	<u>39,324</u>
Subtotals	<u>49,972</u> (47.0%)	<u>709,167</u> (95.9%)
\$501 to \$1,000	11,606	16,793
\$1,001 to \$5,000	23,395	11,725
\$5,001 to \$25,000	13,905	1,586
\$25,001 to \$100,000	3,842	111
\$100,001 to \$250,000	2,905	21
Over \$250,000	<u>647</u>	<u>2</u>
Subtotals	<u>56,300</u> (53.0%)	<u>30,238</u> (4.1%)
Totals	<u>\$106,272</u>	<u>739,405</u>

This data shows the FCS's strong bias towards making larger loans, which obviously are made to larger, more creditworthy borrowers. Just 4.1% of the FCS loans outstanding at the end of 2005 were for \$500,000 or more, but those loans accounted for over one-half of all FCS lending. The average size of these loans was \$1.86 million. For loans over \$5 million, there were just 1,720 loans outstanding at the end of 2005 (.23% of all FCS loans), yet these loans, with an average size of \$12.38 million, accounted for 20% of the total amount the FCS had lent.

The FCS tilts even more towards lending to the larger, highly creditworthy farming operations and agribusinesses than is evident from the above table, for the FCS does not publicly disclose its loan distribution by borrower; that is, it does not report lending data aggregated by borrowers even though the FCS, for credit-risk management purposes, uses its Loan Account Reporting System (LARS) to track the total amount lent to a single borrower regardless of how many loans that might encompass. For example, if a farmer has an FCS real-estate loan, a seasonal operating loan, and a five-year installment note on a combine, that one borrower is counted three times. A larger borrower might have many loans, some secured by real estate and some not, depending on how the borrower has structured its operations.

One example illustrates the shortcomings of non-aggregated loan data. The FCS's 2005 Annual Information Statement reported that at the end of 2005 the FCS had credit exposures to two customers, including unfunded commitments, which fell in the range of \$563 million to \$750 million. Together, the FCS has extended credit totaling at least \$1.126 billion to these two borrowers, yet as of the end of 2005 the FCS reported just two loans over \$250 million, totaling \$647 million. Unless the two largest borrowers had substantial unfunded credit commitments, they must have had multiple FCS loans.

**YBS lending** While downplaying its lending to large, highly creditworthy borrowers, the FCS increasingly touts its lending to YBS farmers and ranchers. The YBS loan data the FCS publishes is highly misleading in three ways.

First, as is the case with all its loan data, the FCS counts YBS loans, not YBS borrowers. This lack of loan aggregation by borrower reflects the FCS practice of not publishing any data on the total amount lent to individual borrowers.

Second, the FCS double and triple-counts loans to YBS farmers. The FCA defines a young farmer as "35 years old or less," a beginning farmer as having "10 years or less of farming or ranching experience," and a small farmer as having "less than \$250,000 annual gross [farm] sales." A 31-year-old individual who has been farming for eight years and who reaped \$223,000 of gross farm sales in 2005 gets triple-counted in the FCA's YBS data. The FCA readily admits to this data shortcoming, stating that "a farmer/rancher may be included in multiple categories since they are included in each category in which the definition is met."<sup>16</sup>

The third problem with YBS data, and FCS data generally, is the definition of "farmer" and "rancher." As has become increasingly evident in recent years, many FCS loans are made to people who, in fact, are not farmers. This includes loans to finance country estates, weekend getaways, hunting preserves, and the like. Most of these properties generate little, if any, sales of farm crops or livestock. The definition of small – "less than \$250,000 of annual gross sales" – encompasses zero. Someone who borrows from the FCS but generates no farm sales is hardly a small farmer.

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<sup>16</sup> Farm Credit System Annual Information Statement – 2005, page F-47.

The FCS's 2005 Annual Information Statement illustrates the absurdity of the FCS's YBS lending data, and specifically its double and triple-counting of its YBS loans.<sup>17</sup> According to this data, as of December 31, 2005, the FCS had 738,225 loans and loan commitments outstanding, totaling \$111.845 billion. (Why the number of loans and loan commitments was 1,180 less than shown in the previous table was not explained.) The total number of loans the FCS claimed to have outstanding to young or beginning or small farmers at the end of 2005 was 751,046. That number is 12,821 more than the FCS's total number of loans and commitments – stark evidence of this double and triple-counting phenomenon. Further, these YBS loans and commitments totaled to \$67.56 billion, or 60.4% of total FCS lending at the end of 2005, yet 47% of all FCS lending at that time was in loans under \$500,000. This discrepancy further confirms FCS's gross overstatement of its YBS lending.

### **The FCS's financial condition**

By any measure, the FCS is in excellent financial shape today, a far cry from its near insolvency twenty years ago. **Table 1** presents the FCS's combined balance sheet, as of June 30, 2006. **Chart 2** shows how strong its capital ratio has been since the early 1990s while **Chart 3** shows a steady growth in the FCS's taxpayer-subsidized earnings. The FCS has excellent credit quality, with non-performing assets (nonaccrual loans, restructured loans, and accruing loans more than 90 days past due) totaling \$605 million on June 30, 2006, just .43% of total FCS loans on that date, and less than the FCS's \$742 million loss reserve. At the end of 2005, the FCS had only \$16 million of "other property owned," which generally includes foreclosed assets; a more recent number has not been published. Actual loan charge-offs during the first half of 2006 totaled \$11 million, just 2 basis points (annualized) of its outstanding loans. Recoveries from earlier loan charge-offs and other adjustments, though, gave the FCS a \$14 million loan-loss reversal during the first half of 2006, another indication of excellent credit quality.

The FCS's financial strength and excellent credit quality reinforce the fact that the FCS has drifted so far from its congressionally chartered mission that it no longer plays a constructive role in financing agriculture or any other activity in rural America. Far from lending to the credit-starved, to those with no access to other sources of credit, the FCS now lends primarily to the strongest borrowers, those least in need of taxpayer-subsidized credit, those best-positioned to borrow from private-sector lenders.

### **The changing nature of rural America has further reduced the FCS's relevance**

Rural America has changed in ways which have obviated the need for the FCS. Not only has farming changed dramatically, but so too has the nature of rural living and the way people make a living in rural areas. The rural America that existed when Congress created the FCS and later expanded its powers disappeared decades ago, and will not return.

While the USDA counted 2.12 million farms in 2002, just 1.6% of them accounted for 50% of all farm sales. In 2003, approximately 300,000 farms had farm sales exceeding

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<sup>17</sup> Ibid.

Table 1

**Farm Credit System**  
**Condensed Combined Balance Sheet**  
**As of June 30, 2006 (unaudited)**  
**(in millions of dollars)**

ASSETS	
Cash	\$ 355
Federal funds sold, repurchase agreements	2,160
Investments:	
Available-for-sale, carried at fair value	27,238
Held-to-maturity, at amortized cost	1,771
Loans	112,765
Less: allowance for loan losses	(742)
Net loans	<u>112,023</u>
Accrued interest receivable on loans	1,618
Premises, equipment, and other assets	2,878
Restricted assets, held by the FCS Insurance Corporation	<u>2,181</u>
Total assets	<u>\$ 150,224</u>
LIABILITIES AND CAPITAL	
Systemwide Debt Securities	
Due within one year:	
Systemwide discount notes	\$ 13,099
Systemwide bonds, medium-term notes and master notes	<u>31,669</u>
Total systemwide debt due within one year	44,768
Due after one year:	
Systemwide bonds, medium-term notes and master notes	<u>77,488</u>
Total Systemwide Debt Securities	122,256
Other bonds, notes payable, and other interest-bearing liabilities	1,062
Accrued interest payable	1,131
Other liabilities	2,015
Mandatorily redeemable preferred stock	225
Total liabilities	<u>126,689</u>
Capital:	
Preferred stock	988
Capital stock and participation certificates	1,290
Restricted capital attributable to the FCS Insurance Corp.	2,181
Accumulated other comprehensive income, net of tax	(327)
Surplus, largely unallocated	<u>19,403</u>
Total capital	<u>23,535</u>
Total liabilities and capital	<u>\$ 150,224</u>

\$100,000. Of those farms, 159,000 had sales exceeding \$250,000, the amount considered by many as the minimum annual sales for a commercially viable farm. The number of commercial farms is steadily shrinking as farming continues to consolidate. One force driving consolidation is the increasing specialization of farming as this business becomes more capital intensive, particularly in equipment and buildings. These trends reflect increased farm productivity, which is highly positive for agriculture, and for all of America – rural as well as urban.

While the number of commercially viable farms has declined, the total number of farms has held constant since the early 1970s. Additionally, America's rural population has reversed a long-term decline as an increasing number of people are attracted to a rural, small town life style unrelated to agriculture. In 1935, when the number of farms peaked at 6.8 million, rural America (as then defined by the Census Bureau) had a population of approximately 55 million, or about one farm for every 8.1 people. Rural America in 1935 was very heavily oriented towards agriculture. Seventy-one years later, the story is quite different.

The 2000 Census classified 59.1 million people as living in rural America; that number probably is higher today. That equates to about one farm for every 28 rural residents. However, given that most farms today are not commercial operations, but instead part-time and lifestyle farms, there are approximately 370 rural residents per farm with annual farm sales exceeding \$250,000 and 200 per farm with annual sales of at least \$100,000. By any measure, rural America has become much more diversified economically over the last two generations.

Another major change in rural America is the delivery of financial services. In recent decades, and especially over the last decade, federal and state bank-branching restrictions have almost entirely disappeared, which has led to significant bank consolidation within and across state lines. Today, rural America is served by banks of all sizes, from banks with no or a few branches to regional banks to the very largest banks with thousands of offices, many of them headquartered in rural and small-town America. Numerous non-bank lenders and other financial firms also compete in rural America. Banks and non-banks alike increasingly rely on technology, and specifically the Internet, to reach their customers, and vice versa. That change has not run its course. Without question, residents, businesses, municipalities, and other rural organizations can readily find and inexpensively access credit and other financial services, without any need to rely upon the FCS.

The FCS recognizes, as much as anyone, how much rural America has changed, and will continue to change. Since the FCS's congressionally mandated mission no longer exists, the FCS is desperately trying to reinvent itself. That is why it created the HORIZONS Project.

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## The Farm Credit System's HORIZONS Project

The HORIZONS Project represents the FCS's latest, and perhaps boldest, initiative to expand its off-farm lending powers. Because the FCS already has unlimited on-farm lending powers, the HORIZONS Project will not enhance the financing of farming and ranching operations. Instead, HORIZONS is designed solely to broaden the FCS's ability to leverage its tax and funding-cost advantages, off the farm, against tax-paying, private-sector lenders.

### The origins of the HORIZONS Project

The HORIZONS Project was first announced in 2004 by the Farm Credit Council (FCC), the trade association for the FCS.<sup>18</sup> Since then, the FCC has maintained a steady promotional drumbeat for HORIZONS.

The FCC took a very measured approach towards building support for HORIZONS. First, it commissioned 19 agricultural experts, mostly from land-grant universities, to prepare "External Expert Papers" on a "variety of customer, financial and marketplace issues affecting U.S. agriculture and rural America." The obvious purpose of these papers is to reinforce the FCS's argument that it needs to be empowered to lend to anyone in America for any purpose. Not surprisingly, the FCC did not cite any papers which would be critical of the FCS's expansionist agenda, for example, papers which might suggest that rural America's financing needs, including agriculture, already are amply served by taxpaying lenders and that rural America does not need more taxpayer-subsidized FCS lending.

The view that rural America is amply served by private-sector lenders, notably banks, was reinforced by an unbiased authority, the USDA's Economic Research Service (ERS) in its 1997 report, "Credit in Rural America. In its Executive Summary, the report stated that "[i]n the most general of terms, this report concludes that rural financial markets work reasonably well in assembling capital and servicing the financial needs of the major groups of borrowers in rural communities."<sup>19</sup> In the nine years since this report was published, the banking industry has become even better positioned to meet the full range of agriculture's and rural America's credit and other financial services needs.

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<sup>18</sup> The FCC website address is [www.fccouncil.com](http://www.fccouncil.com).

<sup>19</sup> "Credit in Rural America," Rural Economy Division, Economic Research Service, United States Department of Agriculture, Agricultural Economics Report No.749, April 1997.

Second, the FCC asked FCS institutions what was on their lending-powers wish-list and fed this information into seven FCS task forces. The FCC also held national and regional meetings with FCS folks and likely allies. These meetings, of course, were preaching to the choir, a choir which seeks even broader lending authority. The outcome of the process by which the FCC came up with its HORIZONS proposals, what the FCC called its “Research Methodology,” was entirely predictable and intended solely to make the HORIZONS agenda seem less self-serving than in fact it is.

From this FCC “research” came eight findings, summarized as follows:

- American farmers are not a homogeneous group.
- A small number of *farming-only* businesses remain in today’s agriculture.
- Business models and ownership structures in farming continually evolve and adapt.
- Despite the declining number of farmers, agriculturally-related jobs and agriculturally-dependent communities, American agriculture has a bright future.
- Some rural areas retain few ties to agriculture. Conversely, more agriculture and related businesses are located in the suburbs and near cities.
- Regional collaboration, public-private partnerships, and coalitions of investors are key to the future of many rural communities.
- Entrepreneurs remain the lifeblood of American agriculture.
- Ongoing access to debt and equity capital is paramount to the future prosperity of U.S. agriculture and rural America.

These “findings” are hardly earthshaking nor do they relate in any way to the FCS’s mission – they would be as true today as if Congress had never created the FCS. They certainly don’t make the case for expanded FCS powers. From these “findings” the FCC identified the following “four essential financial needs”:

- Producers and rural entrepreneurs of all types require access to a dedicated, specialized lender to meet their complete credit needs.
- A broad range of processing, marketing and other agriculturally related businesses on which farmers depend require ongoing access to reliable, flexible financial products and services to compete in a rapidly changing business environment.

- Rural America and agriculture need investors and financial/business partners to meet the growing requirements of rural entrepreneurs and to fuel economic growth in rural communities.
- Rural residents and producers living in increasingly diverse communities require access to full-service residential mortgage products and the ability to leverage real estate equity for other family needs and obligations.

Again, these needs are hardly earthshaking. The good news is that private-sector, taxpaying lenders are and have been meeting these needs for decades, and will meet them going forward. Try as hard as it has, the FCS has not, and cannot, demonstrate that (1) these needs are going unmet today and (2) only an FCS with much broader off-farm lending powers can meet those needs.

The FCS tried to reinforce its case by posting the following seven “testimonials” for HORIZONS on its website. Ironically, each of these testimonials, quoting the words of those who gave them, made it quite clear that banks and other lenders met their financial needs.

- A farmer-owned farm-equipment dealership, which the FCS is not authorized to finance, has “never had a problem attracting financing.”
- A processor recycling out-of-date food into animal feed “got the line of credit” it needed from a bank.
- A chicken farmer which diversified by establishing an auto parts store “found a bank to lend to the store. Two years later, the business is exceeding financial projections.”
- A manufacturer of premium horse feed “draws positive attention from all types of lenders.”
- The general manager of a non-profit fish exchange in a seaport town states that “we have a strong balance sheet, and it’s not difficult to get credit these days.”
- The executive director of a housing authority in a town of 3,000 seeks financing for a middle-income rental property that FCS is not authorized to finance. He stated that “we need a national program to address . . . the need for medium-income rental housing.” Numerous federal and state programs already provide low-cost funding for local housing authorities. It is highly unlikely that the FCS would provide such funding because this loan would exceed the FCS’s risk tolerance.
- A CPA whose family farms 8,900 acres sought to build an office building for \$500,000, a type of project the FCS is barred from financing. The CPA’s firm “found the financing it needed and moved into a new building two years ago.”

Some time after these seven “testimonials” were posted on the FCC website, an eighth appeared, most likely at the behest of CoBank. Headlined, “Iowa farmers find a new way to build an ethanol plant,” it attempted to make the case that without CoBank financing, the ethanol plant would never have been built. That, of course, is not true. According to the Renewable Fuels Association, the number of ethanol plants today, about 100, has doubled since 1999, with another 33 under construction. Financing for those plants has come from a wide variety of sources. CoBank certainly is not essential to the financing of ethanol-plant construction or expansion.

These testimonials clearly demonstrate that rural America is not lacking credit. Further, Congress created the FCS for a purpose which no longer exists – to lend to credit-starved farmers and ranchers. Nancy Pellett, the FCA chairman, stated clearly the purpose of the HORIZONS Project in an August 2, 2005, speech, when she acknowledged “the desires of the [FCS] to expand and grow into new markets.”

### **The true objectives of the HORIZONS Project**

The true objectives of the HORIZONS Project were spelled out in the FCC’s “Draft Project Recommendations,” dated October 15, 2005, a report not meant for public consumption. These recommendations for expanded powers were broken into four sections: agricultural producers, agriculturally related businesses, agriculture and rural partners, and rural infrastructure. These recommendations were subdivided into 23 categories, plus three Systemwide initiatives. Together, they provide a detailed check list of regulatory changes the FCS would like the FCA to make so as to accommodate the FCS’s expansionist dreams. Where regulatory change will not do the job, the FCC has specified the statutory changes it would like Congress to enact.

It is not necessary in this report to go through the FCS’s laundry-list of desired regulatory and statutory changes. They can be summarized as follows:

- Redefine “rural” to include communities of up to 50,000 people. This would be an increase from today’s cap of 2,500 for town populations where the FCS can lend to finance moderately priced housing. These communities of 50,000 (presumably as defined by the Census Bureau) could lie within larger metropolitan statistical areas, specifically in outlying suburbs where there is substantial subdivision development readily financed by banks and other private-sector, taxpaying lenders.
- Finance much more expensive homes. Today, the FCS is supposed to finance only “moderately priced” rural homes which serve as the borrower’s “principal residence.” Although FCS associations routinely finance much more expensive homes, such as million-dollar-plus country estates, and second homes, such as weekend getaways, it seeks authority to lend without limit on housing, without having to pretend that the property has the “potential for agriculture.”

- Eliminate borrower eligibility requirements so that the FCS can meet all of a farmer's credit needs, off-the-farm as well as on-the-farm. Of course, providing farmers with taxpayer-subsidized credit for their off-farm businesses would give those farmers an unfair competitive advantage over businesses not owned by those the FCS determines to be "farmers."
- Although the FCS does not say this explicitly, the obvious implication of its desire to meet all of a farmer's off-farm credit needs is that the FCS would like to cream-skim the strongest borrowers, off-the-farm, even if they did not engage in farming or ranching.
- While the FCS does not boldly state this, it clearly wants the authority to make equity-capital investments in rural America, particularly in high-risk business start-ups. In a few circumstances, the FCA already has permitted equity or quasi-equity investments by FCS institutions. In effect, the FCS wants to become rural America's taxpayer-subsidized venture capitalist.

Taken together, these changes would fulfill the FCS's initiative to rebrand itself as "Rural America's Customer-Owned Partner," which reflects FCS's unspoken, but readily evident mantra: We want to lend to anyone, anywhere, for any purpose.

### **How the FCS is trying to implement HORIZONS**

It is clear from the FCC's "Draft Project Recommendations" that the FCS is looking to its very friendly regulator to give the FCS as much as the FCA can, not through reasonable, judicially defensible interpretations of the Farm Credit Act, but through the most liberal, expansionist interpretations of the Act possible. The FCA has strongly signaled, by word and deed, that it will do just that. Chairman Pellett's August 2005 speech cited above is just one example of her widely-voiced support for HORIZONS and all of its goals.

Those words have been reinforced by recent FCA regulatory actions. For example, on September 14, 2006, the FCA agreed to publish a proposed regulatory change, dealing with FCS financing of farm processing and marketing activities, which would greatly expand the number of entities eligible for FCS financing, in three regards:

- The FCS could lend to a processing or marketing operation where "eligible borrowers" (i.e., farmers and ranchers) own 50 percent or less of its voting stock or equity, but where they have majority voting control, management control, or "documented power and authority" to run the entity. Presently, eligible borrowers must own more than 50 percent of the entity's voting stock or equity.
- Eligible borrowers could own as little as 25% of the entity's voting stock, if they provide at least 20% of its throughput.

- The operation is a “direct extension or outgrowth of an eligible borrower’s operation” and the borrower “provides some throughput” to it. However, the permissible scope of the operation’s activities is so broad as to open the door to almost any type of activity, such as financing a chicken farmer’s auto-parts store.

Combined, these provisions would open the door much wider to FCS financing of clearly non-ag related businesses, a key objective of the HORIZONS Project. If the FCA continues to be as accommodating as it has been in recent years, it will try to adopt this proposed regulation with as few modifications and restrictions as possible.

Within the last year, the FCA has advanced HORIZONS’ goals by using its regulatory power to authorize, in two of the five FCB districts, a three-year pilot program for “Rural America Bonds,” or RABs. The FCA authorized RABs under its statutory authority to approve “other investments” by FCS institutions. On a case-by-case basis, the FCA also has authorized RAB issuance in the other three FCB districts. According to one FCS insider, the intent is to structure loans as RABs so as to sidestep the FCS’s existing lending restrictions. That is, a loan whose purpose lies outside what is permissible for an FCS loan could be recast as a RAB.

It appears likely that the FCS will try to obtain changes in the Farm Credit Act to accomplish what it is seeking when actions by its regulator are insufficient. The next Farm Bill, in 2007, is the most likely legislative vehicle for the Farm Credit Act changes the FCS will seek. Hopefully, a public outcry about the liberalizing changes the FCS is seeking will encourage Congress, and more specifically, the House and Senate Agriculture Committees, to reject these expansionistic proposals.

### **Safety-and-soundness concerns HORIZONS raises**

Despite the FCS’s apparent strength today, it was only 20 years ago that the FCS, and much of rural America, experienced severe economic distress as the FCS-fueled farmland bubble collapsed and Congress had to throw a \$4 billion lifeline to the FCS to keep it from sliding further into insolvency.

The FCS is seeking to greatly broaden the types of lending it does as well as where it lends. In particular, it wants to lend to businesses which are completely unrelated to agriculture (presumably the FCS’s area of expertise) and to finance property development, where it has absolutely no expertise.<sup>20</sup> The FCS failed in the 1980s because of the expanded lending authority Congress granted it in 1971. If past history is any guide, another expansion of the FCS’s lending authority, as contemplated by the HORIZONS Project, could lead to severe safety-and-soundness issues in the future.

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<sup>20</sup> One example of FCS financing property development: MidAtlantic ACA, the FCS association serving the Eastern Shore of Maryland, has lent \$2.9 million to finance the acquisition and development of a 658-acre project, called “The Plantations,” near Salisbury, Maryland, which will consist of 42 “equestrian-themed farmettes.” The author has visited the project site and viewed the planning documents for it to confirm that there is no agricultural purpose to this project – it is strictly a subdivision development.

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### **Responding to the HORIZONS Project**

The FCS represents a serious, and growing threat to the economic health of agriculture and all of rural America. This threat comes not just from the potential of the HORIZONS Project, but from the continued existence of the FCS, as a GSE. Even if the FCS's HORIZONS initiative is defeated, the FCS will continue to compete unfairly, misusing its tax and funding-cost advantages to attract the most creditworthy borrowers, those least in need of the FCS's financing subsidy. Congress must rein in the FCS, redirecting it back to its original mission, until such time as the FCS is privatized.

#### **Fully understanding HORIZONS's potential scope, implications, and consequences**

Bankers and others concerned about the FCS's expansion dreams need to fully understand the potential scope, implications, and consequences of the HORIZONS Project. While agricultural lenders have long endured FCS's taxpayer-subsidized competition, all bankers must come to fully appreciate the FCS's potential competitive threat as an off-farm lender. As noted above, the FCS already can lend without limit to farmers and ranchers, as well as to closely related agricultural businesses. If the FCS could have its way, it would lend to anyone anywhere for any purpose. HORIZONS represents a major step in that direction, for it would empower the FCS to lend, without any practical limit, to any person or any business or other type of organization anywhere in rural America and for anything even remotely related to agriculture. Few banks and other private-sector lenders would escape a much more empowered FCS.

#### **The only long-term solution – completely privatize the FCS**

No matter what the outcome of efforts to block the HORIZONS Project and to otherwise constrain the FCS, privatization is the only feasible long-term solution to the FCS problem. The author's 1999 report on the FCS explains how the FCS could be privatized while focusing the farm finance subsidy it now delivers on just those farmers and ranchers most in need of that subsidy.

Four factors are driving FCS privatization. First, if the FCS wishes to lend to anyone for any purpose, which is HORIZONS' intent, it should surrender its government-backed GSE privileges. Second, the farm-finance subsidy delivered through the FCS increasingly goes to larger, older, wealthier farmers and ranchers, the very people who should not be subsidized, as well as to other rural borrowers who can readily borrow from taxpaying, private-sector lenders. Third, as the FCS continues to consolidate, the FCA may lack the supervisory vigor to regulate the largest FCS institutions, just as the Office of Federal Housing Enterprise Oversight has experienced great difficulty regulating Fannie Mae and Freddie Mac. Fourth, it has been

decades since the FCS has met farm finance needs that otherwise would go unmet. There simply is no need for an FCS today, given intense competition in rural America among banks and other private-sector lenders. American agriculture and rural America would be better off without the FCS.

The author's 1999 FCS report proposed that the \$1 billion-plus annual farm finance subsidy now delivered through the FCS be targeted toward those farmers – the struggling middle – most in need. The most efficient way to deliver this subsidy would be through a tax credit that eligible farmers would receive regardless of whether they borrow from the FCS, a bank, insurance company, or any other source of credit. Those farmers eligible to receive the subsidy could claim this credit as an offset against their individual income-tax liability. The 1999 report provided a detailed illustration of the operation of this tax credit.

The 1999 report also outlined three legislative changes which would encourage individual FCS associations to privatize themselves once they were no longer the delivery vehicle for the farm finance subsidy:

- Amend the Farm Credit Act to permit an FCS association terminating its FCS status to retain all of its capital. The FCA recently adopted a regulation to make it even harder for an association to leave the FCS.
- Permit a departing institution to retain its existing government-backed borrowings until they mature.
- Permit FCS managers and directors to share in the ownership allocation of the substantial retained earnings or surplus that FCS lenders have accumulated.

In effect, FCS lenders would undergo mutual-to-stock conversions comparable to the conversions that hundreds of mutually owned S&Ls and savings banks have undertaken successfully. The failed 2004 effort by Farm Credit Services of America to leave the FCS dramatically illustrated the importance of these rules.

One GSE already has privatized itself. In 1993, Sallie Mae, the student-loan lender (officially known as the SLM Corporation), launched its privatization initiative. Congress passed the necessary enabling legislation in 1996 and Sallie Mae commenced its privatization in 1997, completing this process in December 2004. Sallie Mae is now a completely private, and very successful, New York Stock Exchange-listed company.

### **Five steps Congress should take in the interim to rein in the FCS**

In order to encourage the FCS to privatize, Congress must take five steps to rein in the FCS so as to better align it with legitimate public-policy objectives for today's FCS.

**One, establish explicit public-policy goals for the FCS** The FCS's present statutory lending authorities are too vague, particularly with regard to the FCS's YBS lending. The FCS should be required to direct an increasing percentage of its lending to YBS farmers. Further,

FCS's double- and triple-counting of its present YBS lending must stop so that there can be an honest measurement of FCS compliance with this objective. Congress also should strengthen the Farm Credit Act provisions limiting FCS financing for rural housing to moderately priced homes which serve as the borrower's principal residence. That would help to end taxpayer-subsidized FCS financing of rural estates and weekend getaways for the urban elite.

**Two, publish the outcome of FCA enforcement actions** Currently, the FCA does not disclose the regulatory enforcement actions it has taken against FCS institutions. This is especially true in the case of complaints about FCS lending abuses (making loans which are not permissible for FCS lending institutions). These complaints usually disappear into a black hole at the FCA, with no response to the complainant and no indication as to what action was taken. The same holds true for enforcement actions the FCA initiates against FCS institutions, such as addressing violations of the Farm Credit Act or the regulations the FCA promulgates under the Act. A cult of secrecy rules at the FCA, perhaps because it sees itself as a promoter of the FCS, not a true government regulator. Without transparency, there cannot be accountability.

A former FCA insider characterized FCA's decided lack of transparency as a hangover from its pre-1987 bailout days, when the FCA was much more integral to the FCS. Although Congress sought in the 1987 legislation to establish the FCA as an independent regulator, congressional intent has not taken hold at the FCA. Worse, by failing to publicize its enforcement actions, the FCA has not communicated to FCS institutions, or to anyone else, what the FCA considers to be acceptable conduct under the Farm Credit Act and that which is not acceptable.

The congressional solution to this problem is quite straight-forward – Congress should apply to the FCA the same enforcement-action disclosure requirements now applicable to bank regulators. Briefly, the bank regulatory agencies are required to disclose formal enforcement actions they take against the institutions they regulate. This disclosure includes the entirety of the enforcement order, including the corrective actions which must be taken under the terms of the order. This policy applies to actions against individuals as well as institutions, with the names of the offenders publicly disclosed. The regulators usually post links to their enforcement orders on their agency websites.

**Three, require the FCS to register with the Securities and Exchange Commission (SEC)** Of America's five GSEs, the FCS is the only one which has not registered or is in the process of registering with the SEC. SEC registration might be of little benefit to the FCS's owners, its member/borrowers, since each borrower owns so little stock in the FCS institution from which it is borrowing. However, the holders of over \$122 billion of the FCS's Systemwide Debt Securities as well the owners of \$988 million of preferred stock issued by various FCS entities clearly would benefit from SEC scrutiny of the FCS's financial disclosures. SEC review of the FCS's financials also could lead to more accurate FCS reporting of such data as its YBS lending. The SEC might also require the FCS to report its lending data aggregated by borrower, a practice the FCS eschews today.

The Federal Home Loan Banks and Fannie Mae have become SEC registrants, at the direction of their regulators. Freddie Mac will register with the SEC as soon as it can publish

financial statements in a timely manner. The fourth GSE, Farmer Mac (also regulated by the FCA), has been required to register with the SEC since its inception. At this time, only the FCS is exempt from SEC oversight of its financial reporting. While the FCA presumably could direct the FCS to register its debt securities and preferred stock with the SEC, it has not shown any intention of doing so.

**Four, limit FCS agricultural lending to individuals and corporations who report farming income** Beyond rejecting HORIZONS, Congress should limit FCS’s agricultural lending to real farmers; i.e., those individuals, partnerships, and corporations who report farm income and expenses on their tax returns. For example, individuals engaged in farming append a Schedule F (Profit or Loss from Farming) or Form 4835 (Farm Rental Income and Expenses) to their annual Form 1040. This requirement would bar FCS loans to the owners of country estates, hunting preserves, and other non-agricultural rural properties.

**Five, claw back the taxpayer subsidy now flowing to large, creditworthy FCS borrowers** Limiting FCS lending to some multiple of agricultural sales will still permit large, well-capitalized, highly creditworthy farmers and other lawful FCS borrowers to capture the FCS’s taxpayer subsidy, in the form of below-market interest rates. These borrowers are least in need of any taxpayer-subsidized financing – they can readily afford to pay an unsubsidized, market rate of interest on funds they borrow. Therefore, Congress should recapture or “claw-back” the FCS subsidy these borrowers now receive.

**Table 2** illustrates how this clawback feature would work. Every FCS borrower would be placed in one of the 24 cells or buckets in the table, based on two criteria – the average amount borrowed and the borrower’s creditworthiness. Careful consideration has been given to the amount in each cell, but these amounts certainly are subject to revision. The larger the amount borrowed and the higher the credit rating, the larger the clawback, in basis points. This clawback would take the form of a payment the FCS institution making the loan would pay into a special fund, discussed below. That payment would effectively force the FCS lender to factor into its loan interest rates the appropriate clawback charge. Most FCS borrowers do not have published credit ratings, but the FCS already has a 14-point risk-rating scale for its borrowers which can readily substitute for a published rating.

Here are some examples of how this clawback would work. FCS borrower A is a large agricultural co-op whose FCS loans average \$140 million and which has a published credit rating of A. According to **Table 2**, its clawback, or interest-rate add-on, would be 125 basis points. The FCS lender would have to add 125 basis points to the borrower’s interest rate in order to make an acceptable profit on the loan. This add-on would generate \$1.75 million annually for the special fund.

Borrower B is a substantial farming corporation owned by two families. Its FCS borrowings average \$12 million. It does not have a published credit rating, but it is classified under the FCS 14-point scale as having the equivalent of a BBB rating. Its clawback add-on would be 80 basis points, which would generate \$96,000 annually for the special fund.

Borrower C is the classic family farmer, with FCS borrowings averaging \$450,000; its FCS credit-rating would be less than BBB. It would not be subject to any clawback.

The monies going into the special fund could be used for a variety of rural-related purposes, such as an Affordable Farming Program to assist YBS farmers or an Affordable Rural Housing Program to subsidize affordable housing for low-income rural residents and farm workers. This program would be comparable to the highly successful Affordable Housing Program funded by the Federal Home Loan Banks. In order to prevent FCS institutions from funding their clawback payments with arbitrage profits from the FCBs’ investment portfolios, Congress should lower the maximum ratio of FCB investments to loans they have made to their member associations from the present 35% to 20%.

Table 2

## FCS Subsidy Clawback Matrix

Subsidy clawback from borrowers, in basis points per dollar lent

Credit quality (published rating or equivalent)

	AA/AAA	A	BBB	<BBB	
Size range of total lent (millions)	> \$100	150	<b>125</b>	100	50
\$50-\$100	140	115	90	40	
\$10-\$50	130	105	<b>80</b>	30	
\$5-\$10	120	95	70	20	
\$1-\$5	110	85	60	10	
< \$.5	100	75	50	<b>0</b>	



## **Conclusion**

Since its 1987 taxpayer bailout, the FCS has strayed further and further from its congressionally mandated mission of financing farmers and ranchers who cannot otherwise obtain credit. Today, farmers, ranchers, and rural residents everywhere have gained broad access to private-sector credit from banks and other private-sector lenders. As the FCS has strayed, it has increasingly distorted competition within the agricultural credit markets, to no one's benefit except that of highly paid FCS managers and larger, wealthier borrowers. The FCS's HORIZONS Project represents a giant step in the wrong direction, in an attempt to further aggrandize a no-longer-needed GSE.

The time has come for Congress and the American public to recognize that the FCS now exists only for the "fortunate few." That was never Congress's intent, nor is that in the public interest. Ultimately, the FCS must be privatized. Privatization, though, will take time, which is why Congress must reject the HORIZONS initiative while herding the FCS back to its original mission – financially assisting farmers and ranchers who cannot obtain credit elsewhere.

## Glossary of Terms/Frequently Used Acronyms

**Agricultural Credit Association (ACA)** ACAs are FCS associations which enjoy the full range of FCS lending powers – short-, medium- and long-term lending secured by real estate or non-real estate assets or made on an unsecured basis – except lending to agricultural cooperatives and to finance international trade. All 85 ACAs in existence on October 1, 2006, were organized as ACA “parents”. That is, each ACA owns a subsidiary PCA, which is subject only to the federal corporate income tax, and a subsidiary FLCA, which is exempt from all income taxation. This structure permits the ACA to minimize its tax liabilities. **Chart 6** illustrates this corporate structure.

**Call report** A call report is a financial report each FCS association and FCB files quarterly with the FCA. Each report provides an income statement, balance sheet, and supporting financial schedules. Individual call reports can be downloaded by going to this FCA webpage, <http://www.fca.gov/apps/instit.nsf/Active%20Institutions%20Page?OpenPage>, and then clicking on the name of the institution, which will bring up a webpage for that institution. Click on the link in the upper right-hand corner to access its call reports.

**Farm Credit Administration (FCA)** The FCA is the regulator of the FCS as well as another GSE, Farmer Mac (officially the Federal Agricultural Mortgage Association). The FCA is an independent agency within the federal government run by a three-member board; its members are appointed by the President and confirmed by the U.S. Senate.

**Farm Credit Bank (FCB)** FCBs provide funding and some safety-and-soundness oversight over member FCS associations. There presently are five FCBs, but that number could shrink to three or even two. One of the FCBs is CoBank (technically an Agricultural Credit Bank), which has the exclusive right within the FCS to lend to agricultural cooperatives and to finance U.S. agricultural exports. FCBs obtain their funding from the Federal Farm Credit Banks Funding Corporation, which raises its funds on Wall Street. The flow of funds within the FCS is illustrated in **Chart 5**.

**Farm Credit System (FCS)** The FCS consists of the FCS associations and FCBs. The FCS and its member institutions, have been chartered under the Farm Credit Act of 1971, as amended. Farmer Mac, also chartered under the Farm Credit Act, operates independently of the FCS.

**Federal Land Credit Association (FLCA)** FLCAs make long-term real estate loans and carry those loans as an asset on their own balance sheets. Ten independent FLCAs were in existence as of October 1, 2006. Each of the ACAs also owns a subsidiary FLCA.

**Government Accountability Office (GAO)** The GAO is the auditing and investigative arm of the U.S. Congress. Individual members of Congress as well as congressional committees routinely ask the GAO to investigate the programs and activities of federal agencies, such as the FCS and the FCA.

**Government Sponsored Enterprise (GSE)** A GSE is a government-backed lending enterprise chartered by Congress to meet a specific credit need. In addition to the FCS and Farmer Mac, there are three housing GSEs – Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System.

**Loan Account Reporting System (LARS)** LARS is a data-collection system within the FCS which gathers information on every FCS loan. While LARS data is aggregated for certain internal financial reporting and control purposes, detailed LARS data is not available to the general public.

**Production Credit Association (PCA)** Congress authorized PCAs in 1933 to provide short- and medium-term credit to farmers and ranchers to finance seasonal operating needs, such as buying seed and fertilizer, and farm equipment. There no longer are independent PCAs, but each ACA owns a subsidiary PCA.

**Young, Beginning, and Small (YBS) farmers and ranchers** Congress, in Section 4.19 of Title IV of the Farm Credit Act (12 U.S.C. Sec. 2207), mandated that the FCS make a special effort to meet the credit needs of YBS farmers and ranchers, charging the FCS with “. . . furnishing sound and constructive credit and related services to young, beginning, and small farmers and ranchers.” The FCA has defined a young farmer as someone 35 or younger, a beginning farmer as someone with no more than 10 years of farming experience, and a small farmer as someone with less than \$250,000 in annual gross agricultural sales.

## About the Author

Bert Ely has specialized in deposit insurance and banking structure issues since 1981. As the S&L situation worsened, in 1986 he became one of the first persons to publicly predict a taxpayer bailout of the FSLIC. In 1991, Mr. Ely was the first person to correctly predict the non-crisis in banking. In 1990, he issued his report on the 1980s' ag crisis, *The Farm Credit System: Reckless Lender to Rural America*. The sequels to that report, *The Farm Credit System: Reckless Past, Doubtful Future* and *The Farm Credit System: Reinvented and Mission-Challenged*, were published in 1999 and 2002, respectively.

On an ongoing basis, Mr. Ely monitors conditions in the banking and S&L industries, the government-sponsored enterprises and the politics of the credit allocation process, and monetary policy. His publications include two monographs about Fannie Mae, Freddie Mac, and the Federal Home Loan Bank System. Since 1998, he also has written the monthly Farm Credit Watch, which is distributed by the American Bankers Association.

Mr. Ely has helped to draft legislation to enact the cross-guarantee concept for privatizing banking regulation and its related deposit insurance risk. Mr. Ely has testified on numerous occasions before congressional committees on banking issues and he often speaks on these matters to bankers and others.

Mr. Ely first established his consulting practice in 1972. Before that, he was the chief financial officer of a public company, a consultant with Touche, Ross & Company, and an auditor with Ernst & Ernst. He received his MBA from the Harvard Business School in 1968 and his Bachelor's degree in economics in 1964 from Case Western Reserve University.

### Subscribe to Bert Ely's Farm Credit Watch

Bankers should keep abreast of the FCS's activities as it promotes the HORIZONS Project. An excellent way to do this is to register to receive, via email, Bert Ely's Farm Credit Watch, which is published monthly, generally on the last Wednesday of the month. In addition to staying abreast of the HORIZONS Project, FCW reports on news and trends within the FCS.

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