Statement for the Record

On behalf of the

American Bankers Association

Senate Agriculture, Rural

Development, Food and Drug

Administration, and Related

Agencies Appropriations

Subcommittee

of the

United States Senate

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June 13, 2017

Chairman Hoeven, Ranking Member Merkley, and members of the Subcommittee, the American Bankers Association (ABA) would like to thank you for holding this hearing on the proposed budget for the United States Department of Agriculture.

The American Bankers Association is the voice of the nation's $17 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $13 trillion in deposits and extend over $9 trillion in loans. ABA is uniquely qualified to comment on agricultural credit issues as banks have provided credit to agriculture industry since the founding of our country. Nearly 5,000 banks –83 percent of all banks nationwide– reported agricultural loans on their books at year-end 2016 with a total outstanding portfolio of more than $175 billion.

Banks continue to be one of the first places that farmers and ranchers turn to, when looking for agricultural loans. Agricultural credit portfolios typically finance a wide array of customers, including large and small farms, urban farmers, beginning farmers, women farmers and minority farmers. To bankers, agricultural lending is good business and credit is available to all, who can demonstrate they have a sound business plan and the ability to repay.

In 2016, farm banks – banks with more than 15.65 percent of their loans made to farmers or ranchers – increased lending by 5.3 percent to meet the rising needs of farmers and ranchers, and now provide over $103 billion in total farm loans. Farm banks are an essential resource for small farmers, holding more than $48 billion in small farm loans, with $11.5 billion in micro-small farm loans (loans with origination values less than $100,000). Farm banks are healthy, well-capitalized, and stand ready to meet the credit demands of our nation's farmers large and small.

In addition to our commitment to farmers and ranchers, thousands of farm dependent businesses – food processors, retailers, transportation companies, storage facilities, manufacturers, etc. – receive financing from the banking industry as well. Agriculture is a vital industry to our country, and financing it is an essential business for many banks.

The agricultural economy has been slowing, with farm sector profitability expected to decline further in 2018. However, farm and ranch incomes have been some of the best in history. With the 2014 Farm Bill in place, farmers, ranchers, and their bankers achieved a level of certainty from Washington about future agricultural policy. Interest rates continue to be at or near record lows, and the banking industry has the people, capital and liquidity to help American farmers and ranchers sustain through the turbulence in the agricultural economy.

Banks work closely with the USDA's Farm Service Agency to make additional credit available by utilizing the Guaranteed Farm Loan Programs. The repeal of borrower limits on USDA's Farm Service Agency guaranteed loans has allowed farmers to continue to access credit from banks as they grow, ensuring credit access for farmers across the country.

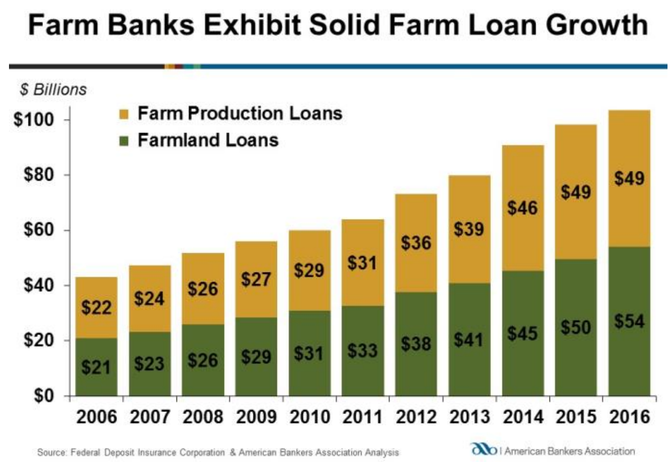
Our nation's farmers and ranchers are critical resources to our economy. Ensuring that they continue to have access to adequate credit to thrive is essential for the well-being of our whole nation. America's banks remain well equipped to serve the borrowing needs of farmers of all sizes. An important step in ensuring credit availability is to review entities, such as the Farm Credit System, and ensure that they stick to their charter of helping young, beginning and small farmers.

ABA would like to elaborate on the following points:

- Banks are a primary source of credit to farmers and ranchers in the United States;
- Banks work closely with the USDA to make additional credit available but there are concerns with the President's proposed budget;
- The Farm Credit System has become too large and unfocused, using taxpayer dollars to subsidize large borrowers and there is a real need to level the playing field with the Farm Credit System.

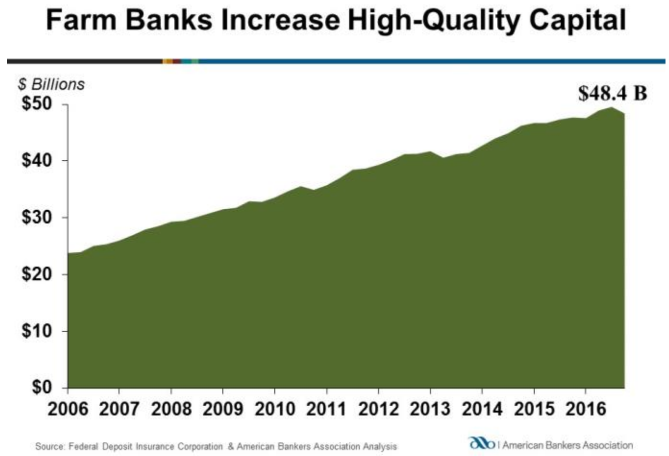
I. Banks Are a Primary Source of Credit to Farmers and Ranchers in the U.S.

For many of our members, agricultural lending is a significant component of their business activities. ABA has studied and reported on the performance of "farm banks" for decades and, we are pleased to report that the performance of these highly specialized agricultural lending banks continues to be strong. ABA defines a farm bank as one with more than 15.65 percent farm or ranch loans (to all loans).



At the end of 2016, there were 1,912 banks that met this definition. Farm lending posted solid growth during 2016. Total farm loans at farm banks increased by 5.3 percent to $103.4 billion in 2016 up from $98.3 billion in 2015. Approximately one in every three dollars lent by a farm bank is an agricultural loan.

Farm real estate loans grew at a faster rate than farm production loans. Outstanding farm real estate loans grew at a pace of 9.2 percent, or $4.5 billion, to a total of $54.1 billion. Farm production loans rose by 1.3 percent, or $640.5 million, to $49.4 billion. Farm banks are a major source of credit to small farmers – holding more than $48.4 billion in small farm loans (origination value less than $500,000) with $11.5 billion in micro-small farm loans (origination value less than $100,000) at the end of 2016. The number of outstanding small farm loans at farm banks totaled 766,762 with the vast majority – over 495,600 loans – with origination values less than $100,000. Farm banks are healthy, well capitalized, and stand ready to meet the credit demands of our nation's farmers large and small.



Equity capital —often thought of as the strongest form of capital—at farm banks increased by 3.7 percent to $48.4 billion in 2016. Since the end of 2007, farm banks have added $20.9 billion in equity capital, building strong high-quality capital reserves. These capital reserves will enable flexibility amongst farm banks, as the agricultural sector adjusts to lower commodity prices — allowing bankers to work with and serve the needs of our nation's famers — and will also act as a buffer, proving insulation from the risks associated with any downturn in the agricultural sector.

One area of concern for farm bankers and their customers has been the rapid appreciation in farmland values in some areas of the country. The run up in farmland values has not been a credit-driven event. Farm banks are actively managing the risks associated with agricultural lending, and underwriting standards on farm real estate loans are very conservative. The key consideration in underwriting any loan is the ability of the customer to repay regardless of the collateral position in the loan. To further manage risk, we regularly stress test our loan portfolios to judge repayment capacity under different scenarios.

After several years of large increases in farmland values, the consensus view among bankers is that the increase in farmland values has slowed. ABA watches the farm real estate market very closely. In recent years, over four-fifths of the agriculture sector's asset values were held in real estate. USDA projects a slight depreciation in the value of farm real estate in 2017 likely a response to expectations of lower farm earnings due to declines in crop and livestock receipts.

II. ABA's Perspective on the President's proposed budget

USDA programs have been crucial to helping bankers help their customers in rural America. Rural bankers use many different programs across USDA departments, and we leverage these programs to provide as much credit as possible to our producers. Without adequate funding within the loan programs, staff and technology, and crop insurance, it will become increasingly difficult for rural banks to help producers with their many credit needs.

Farm Service Agency

ABA would like to thank the appropriations committee for its commitment in the continuing resolution to loan programs across USDA, particularly the FSA Guaranteed Farm Ownership and Guaranteed Farm Operating Loan Programs. These programs continue to create a great public-private partnership between lenders and USDA, and future funding should reflect the strength of programs. By increasing these loan programs, the backlog for current loan applications should effectively cease to exist. This is will allow producers to receive funding when it is requested, instead of being pushed into the next fiscal year.

The increase in funding for loan programs will also make it more possible to increase the current loan limit of $1.399 million on FSA Guaranteed Loans. The formula for indexing the programs has not kept up with the increasing costs of agriculture. It is much more costly for a young, beginning or small farmer to get into agriculture, and the guaranteed loan programs need to reflect that reality. ABA has endorsed H.R. 831, the Beginning Agriculturist Lifetime Employment Act of 2017 (BALE Act), introduced by Representative Mike Bost. This legislation would increase the cap on GFOs and GOLs to $3.5 million. We believe this increase is necessary for lenders to be able to help as many producers as possible going forward. The BALE Act would also increase the size of Direct Operating Loans and Direct Ownership Loans from $300,000 to $600,000. This legislation is an important first step to modernizing FSA loan programs.

In addition to this legislation, the committee should look into changing the current rules on how a guaranteed loan is recorded within the federal government. According to the Office of Management and Budget (OMB) Circular A-11 states, "For purposes of calculating loan guarantee subsidy estimates, the loan guarantee commitment is the full principal amount of the loan that is guaranteed, not just the portion guaranteed by the Government."[1] With this rule in place, the entirety of a guaranteed loan is credited against the budget, not just the guaranteed portion. This is reducing the number of loans that could be made through public-private partnerships due to loan funding being allocated for a percentage of the loans that are already covered by lenders. The rule should be changed to only have the guaranteed portion of the loan count against loan funding.

In order to modernize loan programs across USDA, there needs to be adequate funding for upgrading and improving technology. This would create a more efficient and responsive USDA. As mentioned before, ABA is very involved in FSA Guaranteed Loan Programs, but the lack of basic upgrades to technology has greatly delayed the industry's ability to process loans at an

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[1] Office of Management and Budget; Circular A-11; Page 13

efficient rate. Without simple updates, such as better functioning websites to check on loan balances, we are creating unnecessary work for FSA staff. As we have learned in the banking industry, updating technology can create greater efficiency across an organization, which ultimately benefits our customers.

Along with funding for loan programs and upgrades to technology, there needs to be serious consideration for increasing staff levels at FSA. As veteran staff retires, there isn't enough new staff being trained to take over their loan portfolios. This is creating a knowledge gap within FSA loan programs and is making it much harder to turn around loans in a timely fashion. When it comes to financing agriculture, especially operating loans, loans need to be made as quickly as possible so farmers can get back into the field. As the agriculture committee is aware, windows for planting or harvesting can close very quickly and our loan programs need to keep pace.

Rural Development

ABA wants to ensure that Rural Development remains a cornerstone of USDA and we support the Secretary's decision to have Rural Development directly report to the Secretary.

ABA believes there needs to be serious consideration given to increasing and strengthening Rural Development guaranteed loan programs, as these programs are used by banks to provide credit to businesses in rural America. The appropriations committee should consider increasing flexibility on funding within Rural Development loan programs. Far too often, funding for one program will be completely used, while another program is untouched. Flexibility to shift funds between programs will help to solve this problem. Additionally, USDA should reintroduce preferred and certified lender programs to help streamline the loan making process within Rural Development. By creating an avenue to streamline loan making, more banks will be involved with the loan programs. Lastly, there needs to be additional education about Rural Development loan programs. ABA has started the process of working with the program, but there is a real need to educate lenders across rural America on the importance of this loan programs

ABA believes the guaranteed loan programs within Rural Development need to remain in place for the future. These programs help a different class of individuals than Small Business Administration loans. ABA is especially supportive of the Business and Industry Guaranteed Loan Program as it provides protection for lenders, making them more willing to extend credit to rural businesses. These loans are used to provide much-needed financing for economic development projects for rural businesses to purchase machinery and pursue business modernization. The USDA Business and Industry (B&I) Guaranteed Loan Program, and all programs of the USDA Rural Business Cooperative Service that complement the lending activities of private sector commercial banks are of vital importance to our nation's rural communities. The B&I program has historically realized full utilization and the program's delinquency rates are at an all-time low. In short, the program works and should be strengthened, not ended. By having a government guarantee, this program is particularly useful for helping start up business or non-traditional businesses in rural America. However, lengthy delays are commonplace due to the lack of modernization in the program which is still hurting the ability for banks to produce more B&I guaranteed loans. Without Rural Development loan programs, innovative businesses in rural America may be left behind.

Another important Rural Development loan program, is the Community Facilities Guaranteed Loan Program. This program relies on a partnership between the USDA and private lenders who provide vital capital for projects involving critical infrastructure and essential services in rural America such as hospitals and public safety services. The current over-emphasis by USDA on the Community Facilities Direct Loan program has become a very real threat to the continued viability of the Community Facilities Guaranteed Loan Program. The Direct Loan program excludes rural lenders in the private market because the USDA completely assumes the role of the lender with all risk and exposure assumed by the U.S. taxpayer. Today, only a fraction of program authority is allocated to the Guaranteed Loan Program compared to the Direct Loan Program ($146 million versus $2.2 billion; a 6%/94% split)[2]. We urge your support for strengthening the Community Facilities Guaranteed Loan Program to increase the participation of the banking industry in these types of loans.

ABA believes the Rural Energy for America Program (REAP) Guaranteed Loan Program needs to remain strong into the future. However, there should be consideration on increasing the current cap of $25 million on REAP as the cap is often too low for larger projects. Additionally, there needs to be better coordination with B&I as that will create more opportunities to for combined loans.

[2] United States Department of Agriculture Fiscal Year 2017 Budget Summary. Page 44.

Crop Insurance

Lastly, ABA cannot express more our support for crop insurance. We are very concerned about the negative affect the President's budget proposal will have on producers. By creating a premium assistance caps and an adjusted gross income limit, the proposed budget will fundamentally change the crop insurance risk pool. By reducing the size of the risk pool, crop insurance programs will become less actuarially sound, while driving up premiums and costs for producers. We believe crop insurance should be strengthened as it provides a safety net for our producers and lowers their overall risk portfolio. With a reduced risk profile, crop insurance has made it is easier for producers to obtain credit, and crop insurance is crucial for bankers when extending year by year operating loans.

The President's budget also proposes cuts to the harvest price option. Producers use the harvest price option to protect themselves against lost production. This is crucial for producers that forward contract or produce feed for their own livestock, as it provides coverage for potential losses. It should be noted that producers pay a premium to obtain the harvest price option. If the crop insurance safety net is weakened, it will become harder for producers to obtain credit for their operations.

III. The Farm Credit System is a Large Government Sponsored Entity That Primarily Serves Large Borrowers at the Expense of Taxpayers

The market for agricultural credit is very competitive. Banks compete with several other banks in their service areas, finance companies from all of the major farm equipment manufacturers, several international banks, credit unions, life insurance companies and finance companies owned by seed and other supply companies. The most troublesome competitor that banks face is the taxpayer-backed and tax-advantaged federal Farm Credit System (FCS). The FCS was chartered by Congress in 1916 as a borrower-owned cooperative farm lender at a time when banks did not have the legal authority to make long-term farm real estate loans. Over the ensuing 100 years, the FCS has received numerous charter enhancements, and has ventured into areas that are not appropriate for a farmer-owned farm lending business.

Today the FCS is a large and complex financial services business with $314 billion in assets. If it were a bank, it would be the ninth largest bank in the United States. It is tax-advantaged and enjoyed a combined local, state, and federal tax rate in 2016 of only 3.61 percent (a significant decrease from the effective tax rate of 4.0 percent in 2015). As Congress examines the President's proposed budget, it should also look at entities that are providing less revenue to the federal government, like the Farm Credit System.

In spite of their size, profitability, and tax advantages; the Farm Credit System presents the same kind of potential threat to the American taxpayer as Fannie Mae and Freddie Mac. As a Government Sponsored Enterprise (GSE) like Fannie Mae and Freddie Mac, the American taxpayer is the ultimate back-stop should the Farm Credit System develop financial problems. This reality was formalized in 2013 when the Farm Credit System Insurance Corporation arranged a $10 billion line of credit:

> "the Insurance Corporation has an agreement with the Federal Financing Bank, a federal instrumentality subject to the supervision and direction of the U.S. Treasury, pursuant to which the Federal Financing Bank would advance funds to the Insurance Corporation. Under its existing statutory authority, the Insurance Corporation may use these funds to provide assistance to the System Banks in exigent market circumstances which threaten the Banks' ability to pay maturing debt obligations. The agreement provides for advances of up to $10 billion and terminates on September 30, 2017."[3] ABA believes the farmers who own stock of the Farm Credit System—and the American taxpayers who back it—deserve a better understanding of what transpires between the Farm Credit System and the U.S. Treasury, but very little information is available to the public. Unlike the housing GSEs, which are subject to reform efforts to lessen the taxpayer's exposure, the Farm Credit System seems to be increasing its dependence upon the U.S. Treasury.

Congress created the Farm Credit System as a public option for farm finance when farmers were having trouble getting the credit they needed from non-government sources. The conditions that led to the creation of the Farm Credit System nearly 100 years ago no longer exist, and yet we continue to have a government assisted, tax advantaged, farm lender providing credit to customers, who would be able to easily borrow from taxpaying institutions. In fact, the heavily subsidized

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[3] Federal Farm Credit Banks Funding Corporation; 2016 Annual Information Statement of the Farm Credit System; March 1, 2017; Page 23

credit that FCS lends, often goes to those who need it least. Despite amendments to the Farm Credit Act of 1980, requiring each FCS lender to have a program for furnishing credit to young, beginning and small farmers and ranchers (YBS), the share of new YBS loans to total new FCS loans continues to be dismal—even as the assets of the system have expanded enormously. Loans to small farmers have steadily dropped over the past several years with small farm loans declining from a high of 30 percent of total new loan volume in 2003[4] to just 15.4 percent in 2016. Clearly, those who would benefit the most from the highly subsidized credit made available by the FCS are not receiving the benefits that Congress intended them to receive.

Conclusion

The banking industry is well positioned to meet the needs of U.S. farmers and ranchers. U.S. agriculture has begun to adjust to lower commodity prices after enjoying one of the longest periods of financial prosperity in history. USDA projected that at year-end 2017, farm and ranch solvency ratios — debt-to-asset and debt-to-equity ratios — would rise to 13.9 and 16.2 percent, respectively. Even as these measures have increased, each remains low relative to historical levels. During the past few years, while farmers experienced unprecedented high commodity prices and rising farm profits, farmers used their excess cash profits to retire debt and to acquire additional equipment and land. As a result, farmers and ranchers today have the capacity to tap their equity should there be a decline in farm profitability resulting in diminished cash flows. While no farmer nor rancher wants to take on additional debt, the strength of the U.S. farm and ranch balance sheet, gives producers options to do so if the need arises.

The banking industry remains cautious as it looks forward. There is a real concern that declining commodity prices will negatively affect the farm economy and make credit situations tighter. This is why the banking industry will continue to offer assistance to Congress as it works on farm policy and writes the next Farm Bill. With the changes that have been outlined earlier, the banking industry will continue to help producers be strong into the future. Bankers still see great opportunities in agriculture and they will stand with their partners in agriculture to develop the best outcomes for all in agriculture.

Thank you for the opportunity to express the views of the American Bankers Association.

[4] "FCA's Annual Report on the Farm Credit System's Young, Beginning, and Small Farmer Mission Performance: 2013 Results". Office of Regulatory Policy, June 12, 2014 Board Meeting