February 27, 2019

Statement for the Record

On Behalf of the

American Bankers Association

before the

Agriculture Committee

of the

United States House of Representatives

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Chairman Peterson, Ranking Member Conaway, and members of the Committee, the American Bankers Association (ABA) would like to thank you for holding this hearing on the state of the rural economy.

ABA is the voice of the nation's $18 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard $14 trillion in deposits and extend over $10 trillion in loans. ABA is uniquely qualified to comment on agricultural credit issues as banks have provided credit to the 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 2018 with a total outstanding portfolio of more than $186 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 2018, farm banks — banks with more than 16.05 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 $107 billion in total farm loans. Farm banks are an essential resource for small farmers, holding more than $49 billion in small farm loans, with $12.3 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 2019. However, farm and ranch incomes have been some of the best in history. ABA would like to thank the committee for it's hard work and dedication to completing the 2018 Farm Bill. With the 2018 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 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 increase of the loan 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.

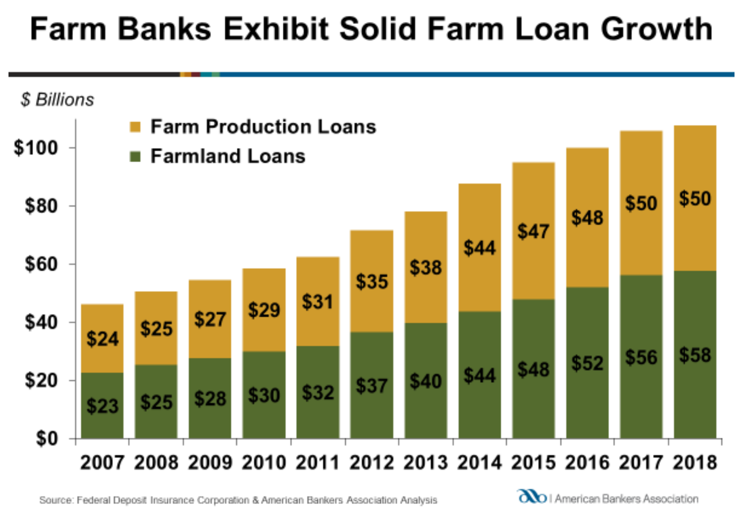
Our nation's farmers and ranchers are critical resources to our economy. Ensuring that they continue to have access to adequate credit to thrive is essential for the well-being of our whole nation. America's banks remain well equipped to serve the borrowing needs of farmers of all sizes. An important 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 are pleased with the passage of the 2018 Farm Bill, but there are credit issues that Congress should be aware of in 2019;
- Banks are working with USDA Rural Development to help rural America grow and prosper;
- 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.

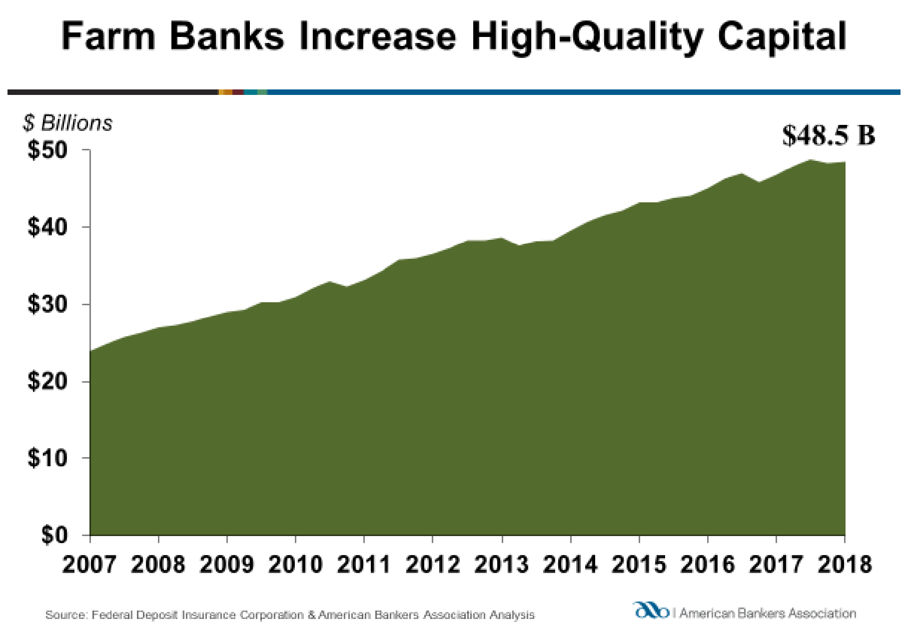
For many of our members, agricultural lending is a significant component of their business activities. ABA has studied and reported on the performance of "farm banks" for decades and, we are pleased to report that the performance of these highly specialized agricultural lending banks continues to be strong. ABA defines a farm bank as one with more than 16.05 percent farm or ranch loans (to all loans).



At the end of 2018, there were 1,760 banks that met this definition. Farm lending posted solid growth during 2018. Total farm loans at farm banks increased by 5.3 percent to $107.5 billion in 2018 up from $102.1 billion for these banks in 2017. 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 2.8 percent, or $1.59 billion, to a total of $57.8 billion. Farm production loans rose by 0.24 percent, or $120 million, to $49.87 billion. Farm banks are a major source of credit to small farmers — holding more than $49.86 billion in small farm loans (origination value less than $500,000) with $12.3 billion in micro-small farm loans (origination value less than $100,000) at the end of 2018. The number of outstanding small farm loans at farm banks totaled 769,142 with the vast majority — over 496,070 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 0.2 percent to $48.5 billion in 2018. Since the end of 2007, farm banks have added $21.0 billion in equity capital, building strong high-quality capital reserves. These capital reserves will enable flexibility among farm banks, as the agricultural sector adjusts to lower commodity prices — allowing bankers to work with and serve the needs of our nation's farmers — 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 2019 likely a response to expectations of lower farm earnings due to declines in crop and livestock receipts.

II. Banker's Perspective on the 2018 Farm Bill and the 2019 Rural Economy

ABA wants to reiterate that the 2018 Farm Bill was very successful from a lender's perspective, especially the increase of loan limits on FSA Guaranteed Operating Loans. However, there are some issues within USDA and in agricultural credit that Congress should consider over the upcoming year.

The most important Farm Bill change for lenders was increasing the limits on FSA Guaranteed Farm Ownership and Guaranteed Farm Operating Loans to $1.75 million. Additionally, increasing FSA Direct Farm Ownership Loans to $600,000 and increasing FSA Direct Farm Operating Loans to $400,000 has created more flexibility for lenders. These programs are vital to helping farmers and ranchers in both good and bad times. ABA thanks the agriculture committees and FSA for working with lenders to implement these important changes.

Within the FSA loan programs, ABA believes there should be consideration to create a national level approval process for FSA Guaranteed Loan Programs. Banks that work across multiple county and state lines often have to adhere to different standards based on where the loan was originated. FSA could model a national option after Small Business Administration Guaranteed Loan Programs. This would ease the ability for larger banks to use FSA Guaranteed Loans.

The creation of farmers.gov has created a platform that will be very useful for farmers and lenders in the future. ABA envisions farmers.gov as a way to modernize loan programs across 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 efficient rate. Without simple updates, such as better functioning websites to check on loan balances, we are creating unnecessary work for FSA staff. If supported properly, farmers.gov has the ability to solve these basic issues. As we have learned in the banking industry, upgraded technology can create greater efficiency across an organization, which ultimately benefits our customers.

There needs to be serious consideration for increasing staff levels at FSA within the loan program area. As veteran staff retire, there are not 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. It should be noted that FSA has done a tremendous job of training young staff over the past few years, but with the potential for a high number of retirements in the near future, FSA needs continued support of Congress to continuing operating at a high level.

We believe FSA should consider bringing back their interest assistance program. This program helps to buy down the cost of interest for young and beginning farmers, which is timely considering the rising interest environment we are entering. In the past, the program allowed FSA to buy down as much as four percent of all guaranteed operating loans. If this program were to be reinstated, ABA suggests that the program would be no more than two percent, would be eligible for only beginning and young farmers, and would be eligible for all FSA guaranteed loan programs.

An issue that should be further examined by the Agriculture Committee is the National Environmental Policy Act (NEPA) regulations that have been put in place for Confined Animal Feeding Operations (CAFO) for FSA loan programs. We fully understand why the regulations have been put in place, but there needs to be serious examination on potential changes to the regulations. Additionally, we have found that the regulations can vary from state to state and county to county, making it very difficult to properly put together the loan. The Agriculture Committee should consider offering changes to the NEPA regulations on CAFOs so lenders can better serve this constituency into the future. USDA can assist in this process by working with the Small Business Administration to make sure that rules for CAFO lending are uniform across agencies.

III. Bankers Work with Rural Development to Help Rural America

ABA has been actively working with Rural Development to enhance and ease the use of their programs. ABA is very supportive of OneRD and the opportunities this presents for the lending community. By working with the lending community, OneRD will make it easier for banks to provide financing to projects in rural America. As the agricultural economy faces a potential downturn, it is even more important to create employment opportunities in rural America. Farmers and ranchers often rely on off-farm income, and Rural Development can help provide those off-farm opportunities.

The addition of guaranteed loan programs for rural broadband create a new tool for bankers to use to help the development of rural broadband. The expansion of rural broadband is vital to growing rural communities. As we look to potentially tough times in agriculture, the need to connect rural communities to the rest of the world is very important. Bankers look forward to using this program to grow rural broadband across the country.

ABA will continue to work with Rural Development to align the needs of rural bankers with changes that are being made within Rural Development. For example, ABA is fully supportive of creating a preferred lender program for Rural Development loan programs. This would make it easier for banks to make multiple Rural Development loans, thus injecting more capital into rural America. Rural Development has done a tremendous job soliciting stakeholder feedback, and ABA looks forward to continuing this relationship.[1]

[1] ABA Comment Letter on OneRD; https://www.aba.com/Advocacy/commentletters/Documents/ABA-Comment-Letter-One-RD-File-Reference.pdf?utm_campaign=ABA-Newsbytes-102418&utm_medium=email&utm_source=Eloqua

IV. 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 103 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 $335 billion in assets. If it were a bank, it would be the seventh largest bank in the United States. It is tax-advantaged and enjoyed a combined local, state, and federal tax rate in 2017 of only 0.73 percent (a significant decrease from the effective tax rate of 3.61 percent in 2016).

The Farm Credit System is a Government Sponsored Entity

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"*[2]

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 more than 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 tax-paying institutions. In fact, the heavily subsidized 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[3] to just 15.2 percent in 2017. 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.

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

[3] "FCA's Annual Report on the Farm Credit System's Young, Beginning, and Small Farmer Mission Performance: 2017 Results". Office of Regulatory Policy, June 12, 2014 Board Meeting

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. At year-end 2018, USDA had farm and ranch solvency ratios — debt-to-asset and debt-to-equity ratios — at 13.5 and 15.6 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 or 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 be involved in the Farm Bill process and will offer assistance to Congress as it 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.