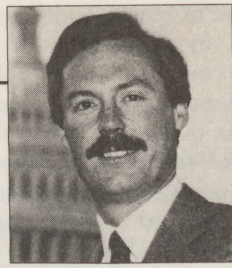
Profile

The Secondary Market



Sen. David Karnes

As the 31st United States Senator from Nebraska, David Karnes offers an unusual combination of abilities to the U.S. Senate—agricultural and banking savvy. That blend enables Karnes to understand the needs of agricultural lenders. The Republican senator, a cattle feeder, points out that he is one of only two senators serving on both agriculture and banking committees. The other is Republican Sen. Christopher (Kit) Bond from Missouri.

Karnes says his unique committee assignments helped him play an instrumental role in the recent passage of the Farm Credit System (FCS) legislation, particularly in regard to the creation of the new secondary market (Farmer Mac).

He contends that Farmer Mac will strengthen banks' abilities to compete, since they will be able to pool and securitize their real estate portfolios. He also thinks banks will have the opportunity for long-term loans at fixed rates, which will shift much of the risk involved to investors rather than farmers.

"I realize that some simply will not like Farmer Mac, but I think it will provide positive competition for lenders and ultimately improve farmer-lender relationships," he notes.

As a result of the FCS legislation, Karnes notes that Wall Street has expressed interest in doing business under the umbrella of agriculture.

"With Wall Street entering the scene, I think agricultural credits will be packaged better with new, innovative financing techniques," he states.

Unlike those who have resisted the legislation, Karnes believes that Farmer Mac will be a new and useful tool for FCS to implement. He points out that two options exist now for FCS: standard (direct) lending, and the pooling and securing of loans.

"I have to reiterate that Congress took into full consideration the impact that this legislation would have on FCS," he says. "And as a result, we put in place volume limits on it in the first three years."

During the first year, Farmer Mac can provide guarantees totaling up to 2 percent of all outstanding farm real estate debt (excluding FmHA); an additional 4 percent in the second year, and an additional 8 percent in the third year. The legislation provides that the FCS pooled loans Farmer Mac guarantees will not be counted against these limits.

"The interesting thing to me is that FCS is owned by and for farmers," he points out. As a result of the new law, commercial banks, insurance companies and FCS institutions will all have equal access to the capital markets for agricultural real estate lending.

"What I want to stress is that farmers now—more than ever before—have the opportunity to choose the lenders they want to work through."

Chapter 12 legislation

Karnes anticipates that no changes will be made to Chapter 12 in 1988. However he advocates a policy of "shared appreciation" between farmers and lenders.

"What we're seeing—with some of the turnaround in agriculture—is that after bankruptcy courts adjust down the value of loans, in some cases the assets eventually appreciate," he explains. "When there is appreciation of collateral, I'd like to see it shared between the lender and farmer."

Although shared appreciation is not a part of Chapter 12, Karnes says that bankruptcy judges should be able to implement it at their own discretion.

"Bankers should not be penalized for the credit they extended to farmers in good faith, and I think bankruptcy judges need to take that into consideration," he says. "When assets appreciate, a split of 80% to the lender and 20% to the farmer would be appropriate."

A Look Ahead

One of Karnes' concerns for the near future is the conservation program with which farmers must comply by 1990. The plan requires all farmers to have a conservation program in place for highly- erodible soils. Those who do not comply will be unable to participate in government farm programs. As a result, Karnes notes that the conservation plan could have a chilling effect on agricultural lenders.

"We've got to make sure we don't cast out good farmers who can't follow bureaucratic regulations set here in Washington," he notes. "We need flexibility built in at the county level that farmers can live with."

He points out that on some soils the cost for mechanical improvements would exceed the value of the land.

"Land that cost a farmer $500 an acre doesn't justify mechanical conservation practices—such as terracing—at $500 an acre," he explains.

Because of this he recommends that the Agricultural Stabilization Conservation Service (ASCS) Soil Conservation Service (SCS) and the U.S. Department of Agriculture (USDA) consider alternatives to mechanical practices such as minimum-and no-tillage practices.