Up and Down the Hill

by Joshua P. Tenuta

On March 24, 1994, Rep. Eva Clayton (D-N.C.) introduced H.R. 4129, the Rural Credit and Development Act of 1994. Not withstanding the title of this legislation, H.R. 4129 seeks to broadly expand the lending authority of the Farm Credit System institutions well beyond their original purpose of providing credit to America's farmers and ranchers.

While the American Bankers Association is certainly supportive of workable rural development initiatives, ABA remains opposed to all provisions under H.R. 4129 seeking to expand the current lending authorities of Farm Credit System. There is nothing in this legislation that provides credit for rural communities that is not already provided by a wide variety of private lending institutions, which are currently subjected to strict regulatory guidelines governing safe and sound lending practices with proper taxpayer protections.

The Farm Credit System

The Farm Credit System (FCS) is a tax-advantaged, special purpose Government Sponsored Enterprise (GSE) given direct access to the New York capital markets at Federal agency rates by utilizing an implied backing from the federal government. This funding advantage over all private providers of credit for rural America was afforded them because of their original purpose of providing consistent credit to bona fide farmers and ranchers for on-farm purposes.

Specifically, the FCS was created by the Federal Loan Act of 1916. By this Act, Congress established the Federal Land Banks to provide a "dependable" source of agricultural credit at competitive rates. The FCS was expanded with the creation of the Federal Intermediate Credit Banks in 1923, and the Production Credit Associations and Banks for Cooperatives in 1933. The FCS is currently subject to the provisions of the Farm Credit Act of 1971, as amended,[1] with the following policies and objectives:

(1) to furnish sound, adequate, and constructive credit and closely related services to American farmers and ranchers, their cooperatives, and to selected on-farm related businesses necessary for efficient farm operations, to improve their income and well-being.

(2) to encourage farmer and rancher borrowers' participation in the management, control and ownership of a permanent system of credit for agriculture; and

(3) to modernize and improve the authorizations and means for furnishing such credit and credit for rural housing in rural areas.[2]

Recent history has demonstrated that the Farm Credit System is a very unreliable source of stable and consistent credit for rural America. Dubious lending practices based primarily upon unsafe and unsound real estate speculation during the 1980s forced the FCS to seek federal assistance under the 1987 Agricultural Credit Act. During that period, the Farm Credit System showed itself as a very inflexible creditor, foreclosing on many of its less creditworthy member borrowers, because it was generally unwilling to renegotiate a struggling farmer's troubled loans.

Many of these farmers and ranchers, some with decades of experience with the old Federal Land Bank, are no longer welcome customers at the new, streamlined, modernized, profit motivated Farm Credit Bank. This new farm credit institution now appears only interested in turning from its traditional mandate of providing "consis-

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Total Farm Debt, Excluding Operator Households
December 1976-1993

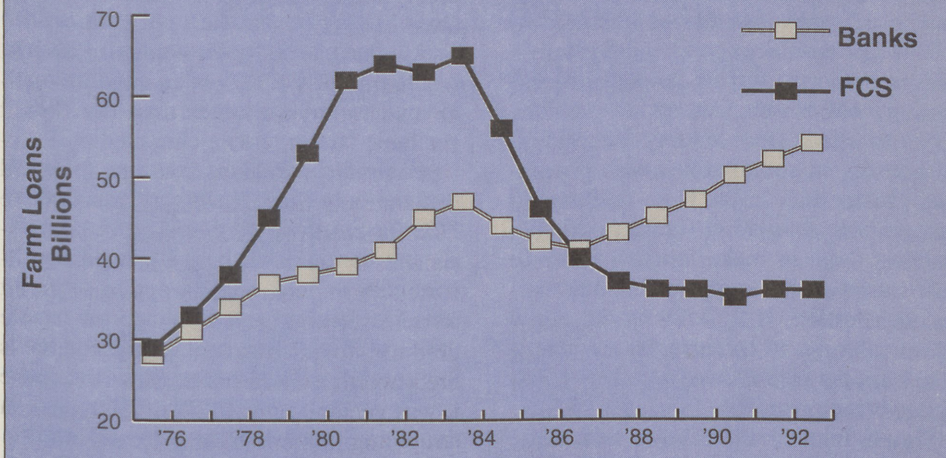
Debt Owed to Reporting Institutions (Million dollars)

Years	Farm Credit System	Commercial Banks	Total Debt*
1976	29,007	28,077	96,065
1977	32,992	31,289	110,855
1978	37,564	34,435	127,400
1979	45,376	37,125	151,551
1980	52,974	37,751	166,824
1981	61,566	38,798	182,381
1982	64,220	41,890	188,806
1983	63,710	45,422	191,070
1984	64,688	47,245	193,787
1985	56,169	44,470	177,599
1986	45,909	41,621	156,970
1987	40,030	41,130	144,411
1988	37,138	42,706	139,368
1989	36,218	44,795	137,231
1990	35,567	47,425	137,367
1991	35,382	50,169	138,871
1992	35,616	51,571	139,270
1993P	35,556	53,739	141,355

**Includes Life Insurance Companies, FmHA, individuals and others (land for contract, merchants and dealer credit, etc.), CCC storage and drying facility loans, and Farmer Mac loans.*

P = Preliminary

Farm Loan Trend Lines
FCS vs. Commercial Banks



Source: Agricultural Income and Finance; Situation and Outlook. USDA, Economic Research Service, Feb. 1994, p. 57

tent" credit to bona fide farmers and ranchers, to acquiring the lending authority of a commercial bank – without assuming any of the regulatory responsibility that comes with obtaining a bank charter.

Original Purpose Abandoned

H.R. 4129 makes dramatic changes in the lending authority of the Farm Credit System by enabling FCS institutions to abdicate their original purpose of on-farm lending without relinquishing their special purpose GSE status. More specifically, H.R. 4129 boldly eliminates all of their "on-farm" lending requirements, allowing FCS institutions to use their federal funding advantage to make mainstreet business loans for any "goods and services" used by farmers and ranchers.

Moreover, H.R. 4129 would greatly expand the FCS Bank for Cooperatives by simply eliminating its need to lend to cooperatives. Under the bill, all businesses that do any business with a cooperative are eligible for credit from the Bank for Cooperatives. This clearly goes against their original purpose.

The American Bankers Association opposes expanded Farm Credit System lending authority.

In addition to expanded authority to lend to off-farm mainstreet businesses, H.R. 4129 would expand the System's lending authority for off-farm residential housing loans as well. Current law prohibits FCS institutions from lending for residential housing in communities with populations greater than 2,500. H.R. 4129 would increase this population figure to 20,000, enabling them to make housing loans in most suburban and many urban communities. In addition, H.R. 4129 would allow FCS institutions to increase the amount of these loans they are allowed to hold as a percentage of their portfolios from 15% to 20%.

Simple mathematics shows how these figures will lessen the amount of credit available in rural communities for farming and ranching purposes. Furthermore, H.R. 4129 eliminates the current constraint on the Farm Credit System to provide residential credit for "moderately" priced rural homes. The bill even goes so far as to allow them to make home equity loans. Is this why the federal government provided the Farm Credit System with a GSE classification with its implied federal backing?

Unproven Need for Additional Powers

The Farm Credit System is attempting to get from under their current lending responsibilities through an elaborate ruse – arguing that their expansion of powers is the answer to legitimate rural development concerns. Recent statistics suggest that the FCS may not be adequately serving those markets which it currently has the authority to serve, namely loans to farmers and ranchers. For example, the USDA's Economic Research Service report "Agricultural Income and Finance," published in February, shows the total farm debt held by the FCS to continue on a 10-year decline (see chart). At the same time, farm debt held by commercial banks continues to grow – even in an overall shrinking farm debt market.

Bankers indicate that the decline in FCS loans to farmers and ranchers has little to do with the competitive pricing of loans. In fact, the Farm Credit System access to the Treasury markets provides it with a clear pricing advantage over commercial banks. One reason for the continued decline on the part of the FCS is an unwillingness to lend to anyone other than the "best" available farmer and rancher credits.

Commercial bankers continue to report that the only bank customers solicited by FCS for business are their best customers. As the commercial banking community continues to seek better ways to serve its broad farmer and rancher customer base – utilizing available federal guaranteed lending programs when necessary – the Farm Credit System appears only interested in the overall quality of its current portfolio. Why should this practice be any different for non-farm credits? There has never been a credit availability problem for well-capitalized mainstreet businesses.

With respect to FCS expansion of authority for residential housing, bankers continue to indicate that the FCS institutions, particularly those in the Midwest, are not

making residential loans in the markets they are currently authorized to serve (those less than 2,500 in population).

Because many of these residential mortgages do not qualify for conventional financing, making them less salable into the secondary market, the FCS appears less likely to make them. Instead, the FCS is interested in turning further away from the rural communities it is authorized to serve, and, by using its funding advantage, moving into the suburban marketplace, where the availability of credit for residential housing buyers is readily abundant now and the competition is already very intense.

Recent history has demonstrated that the Farm Credit System is a very unreliable source of stable and consistent credit.

Where rural housing funds are needed today are for those borrowers who lack the equity necessary to obtain traditional financing. For banks and thrifts interested in serving this particular needy rural borrower, the Farmers Home rural housing program has proven an invaluable lending tool, enabling them to utilize a guarantee in order to finance up to 100% of the loan. This program has proven so successful for marginal rural residential borrowers, that it was oversubscribed in FY93, and it may well be again this fiscal year.

As for the FCS, it has chosen to participate very little in this program, mainly because it demands equity participation on the part of the borrower for all of its housing loans. Yet, even with its apparent lack of interest in serving the needy rural residential borrowers today, the FCS deems it necessary for the Congress to expand its lending ability well beyond its rural constituency, to eliminate restrictions on making home equity loans, and to remove the constraint which precludes it from financing residences not considered "moderately" priced.

Summary

While the American Bankers Association stands committed to working with the Congress on workable rural development initiatives that seek to address the unfulfilled needs of rural communities, we remain opposed to the unsubstantiated and unnecessary need for the expansion of the current lending authorities of the Farm Credit System institutions.

In addition, we would ask that the Congress scrutinize the current practices of the Farm Credit System to determine whether it is fully utilizing its current lending authorities in the rural communities it has been empowered to serve today. And finally, we would ask the Congress and the Administration to very carefully examine any proposals for expansion of the Farm Credit System and consider not only the effect on the safety and soundness of its institutions and the ability of the Farm Credit Administration to regulate them, but also the advantage the Farm Credit System's tax-favored, GSE status has on competition with private financial institutions and the potential economic liability of the taxpayers. ▲

Notes

[1]The '71 Act is amended in a variety of places, most notably, the 1987 Agricultural Credit Act which provided federal assistance to failing FCS institutions.

[2]FCS credit for rural housing is permitted for moderately priced on-farm residences in bona fide rural communities of less than 2,500 residences. The FCS institutions may not have more than 15% of their loan portfolios comprised of rural housing loans.