Testimony of

Tony Hotchkiss

On Behalf of the

American Bankers Association

Before the

House Committee on Agriculture

United States House of Representatives

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Chairman Thompson, Ranking Member Scott, and members of the Committee, my name is Tony Hotchkiss. I am the current chairman of the American Bankers Association's Agricultural and Rural Bankers Committee and testify in that capacity today. I have worked in agricultural banking for 41 years, including the past 10 years as Director of Agriculture for Regions Bank based in Clayton, Missouri, from which I recently retired. Before Regions, I worked at a number of community banks helping to lead their agricultural lending. Agricultural bankers have a deep appreciation for the important role producers play in our economy and the unique challenges they face. I appreciate the opportunity to present the views of the ABA on Financial Conditions in Farm Country.

The American Bankers Association (ABA) is the voice of the nation's $24 trillion banking industry, which is composed of small, regional and large banks that together employ approximately 2.1 million people, safeguard $19 trillion in deposits and extend $12.4 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. At year-end 2023, 3,808 banks –83% of all banks nationwide– reported agricultural loans on their books with a total outstanding portfolio of more than $198.6 billion.

The Farm, Food, and National Security Act of 2024 (H.R. 8467), commonly known as the "2024 Farm Bill", includes comprehensive risk management tools for farmers and ranchers, loan guarantees for agricultural loans, rural development projects, nutrition support and investments in conservation. Banks play a critical role in rural America, and this legislation provides a vehicle for the banking industry to help meet the financial needs of farmers, ranchers, and agricultural communities across the country. The meaningful changes proposed in the 2024 Farm Bill will allow bankers to better serve their customers and ensure they have high levels of credit availability in the years to come.

Introduction

The ABA commends the Committee for including many of our priorities in this important legislation,[1] including modernizing the USDA's Farm Service Agency (FSA) loan guarantee limits, clarifying bona-fide operator rules for beginning farmer programs, modernizing and raising limits for the down payment assistance program, and providing robust risk management tools that allow our customers to have greater stability and predictability for each growing season.

Banks continue to be one of the first places that farmers and ranchers turn when looking for agricultural loans. Agricultural credit portfolios among banks of all types are very diverse – banks finance large and small farms, urban farmers, beginning farmers, women farmers and minority farmers. To bankers, agricultural lending is a productive way to serve our communities by doing business the right way: we make credit available to all who can demonstrate they have a sound business plan and the ability to repay. With our deep connection to farmers and ranchers, banks are often the first to see changes within balance sheets and cash flows on farm operations, often due to changing economic conditions.

In 2023, farm banks – banks with more than 14.32 percent of their loans made to farmers or ranchers – increased lending by 6.7 percent to meet the rising needs of farmers and ranchers, and now provide $110 billion in total farm loans. Farm banks are an essential resource for small farmers, holding more than $44.6 billion in small farm loans, with $9.2 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,

[1] https://www.aba.com/-/media/documents/advocacy/what-we-stand-for/2023-aba-farm-bill-priorities.pdf?rev=6e2953efd9ef417e9e69fcc7a1fa1cfb&hash=F0EFA3040E447A06EC220D5BF0DB8F3F

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.

Banks work closely with the FSA to make additional credit available by utilizing the Guaranteed Farm Loan Programs. The increased loan limits on FSA guaranteed loans is the right policy to ensure more credit availability to farmers and ranchers. Additionally, entities like Farmer Mac provide another avenue for banks to increase credit availability. By purchasing guaranteed loans from banks, Farmer Mac allows banks to lower interest rates for their customers and provide better loan products.

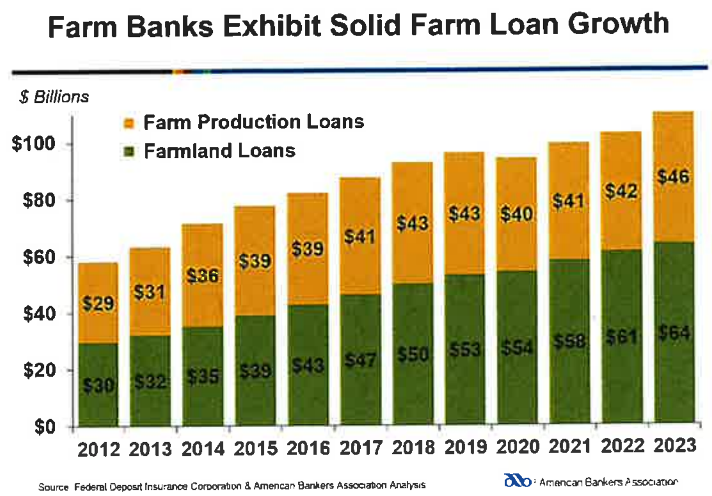
Our nation's farmers and ranchers are a critical resource to our economy. Ensuring that they continue to have access to adequate credit to thrive is essential for the wellbeing of our whole nation. America's banks remain well equipped to serve the borrowing needs of farmers of all sizes.

In my testimony today I will elaborate on the following points:

- Banks are a primary source of credit to farmers and ranchers in the United States.
- The Agricultural Economy is Experiencing Headwinds.
- The 2024 House Farm Bill provides needed changes to the Credit Title including increased limits for the FSA Guaranteed Loan Programs, changes to the bona fide operator definitions, and needed changes to Farmer Mac eligibility.
- There are still changes needed to help producers better receive agricultural credit. The passage of the Access to Credit for our Rural Economy (ACRE) Act would provide more competition for agricultural lending and lower the costs for producers.

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

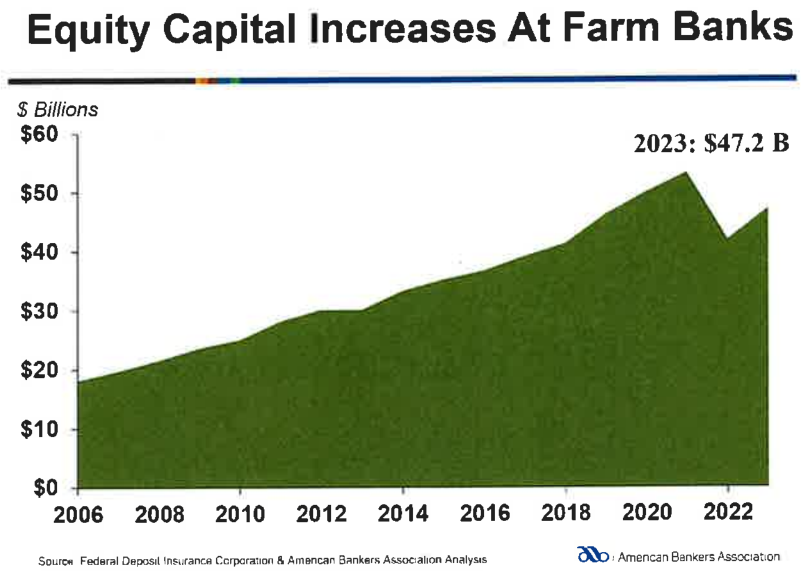
For many of ABA's members, agricultural lending is a significant component of their business activities. ABA has studied and reported on the performance of "farm banks" for decades and, we are pleased to report that the performance of these highly specialized agricultural lending banks continues to be strong. ABA defines a farm bank as one with more than 14.32 percent farm or ranch loans (to all loans).



At the end of 2023, there were 1,442 banks that met this definition. Farm lending posted solid growth over the year. Total farm loans at farm banks increased by 6.7 percent to $110 billion in 2023 up from $103.1 billion for these banks in 2022. Approximately one in every three dollars lent by a farm bank is an agricultural loan.

Farm production loans grew at a faster rate than farm real estate loans. Outstanding Farm production loans rose by 10.0 percent to $45.9 billion. Farm real estate loans grew at a pace of 4.5 percent to a total of $64.1 billion. Farm banks are a major source of credit to small farmers – holding more than $44.6 billion in small farm loans (origination value less than $500,000) with $9.2 billion in micro-small farm loans (origination value less than $100,000) at the end of 2023. The number of outstanding small farm loans at farm banks totaled 639,694 with over half – 373,353 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 at farm banks increased 14.0%, or $5.8 billion, to $47.2 billion in 2023. Meanwhile, tier 1 capital increased by 6.8%, or $3.4 billion, to $53.7 billion.[2]



Aggregate tier 1 leverage ratios[3] increased 30 basis points (bps) in 2023 to 10.6%. Aggregate tier 1 capital ratios (assessed on risk-based assets) fell slightly to 14.48%, down 2 bps from 2022 indicating that farm banks are still well capitalized. [4] Farm banks' median tier-1 leverage ratio remained 69 bps above where it was before the start of the Great Recession.

In 2020-2021, banks experienced an unprecedented influx of deposits, alongside a pullback in loan demand. This led many banks to increase their holdings of long-term assets such as Treasury securities. When the Federal Reserve began rapidly raising the federal funds rate over the course of 2022, the market value of those bonds fell in the rising interest rate environment. Under tangible capital calculations, unrealized gains and losses are recorded as though the bank intends to sell those securities immediately at market value. This volatility in market valuations can distort assessment of a bank's financial health; post Dodd-Frank, regulatory capital has replaced equity capital as a reliable measure of the capital available at banks to absorb shocks.

Farm banks have built strong, high-quality capital reserves and remain liquid and prepared to manage potential economic headwinds.

II. The Agricultural Economy is Experiencing Headwinds

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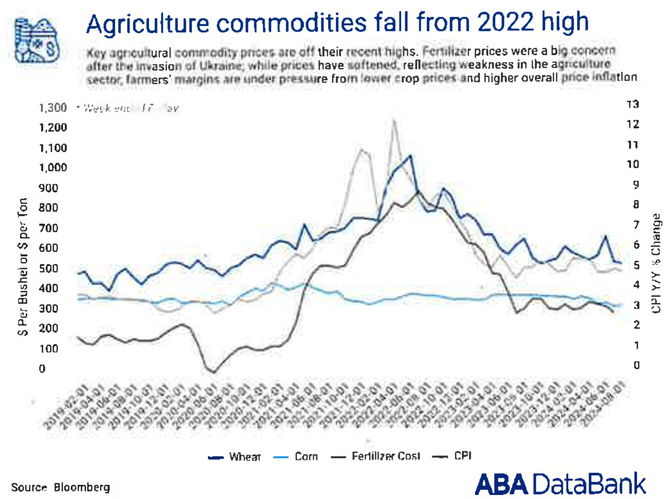
[2] Equity capital is invested capital; it consists of the funds invested in a bank on a long-term basis. Such capital is obtained by issuing preferred or common stock or retaining a portion of earnings.
[3] Tier-1 leverage ratio is Tier-1 capital divided by total average assets for leverage capital purposes.
[4] In 2023, 668 farm banks opted into the community bank leverage ratio and did not report risk-based capital ratios.

The agricultural economy is in a position it has not been in for many years. There is a return to the cyclical agricultural conditions that were present before the surge of government support during the COVID-19 pandemic. Rising input prices, combined with lower commodity prices, have resulted in USDA projecting a 25% reduction in net farm income in 2024 compared to 2023.

With rising input costs and lower commodity prices, farmers and ranchers have worked through the liquidity and working capital they built up over the past few years at a more rapid pace than anticipated. As a result, farmers and ranchers are naturally turning to credit to finance their agricultural operations. This has resulted in increased debt levels for agricultural producers across the country.



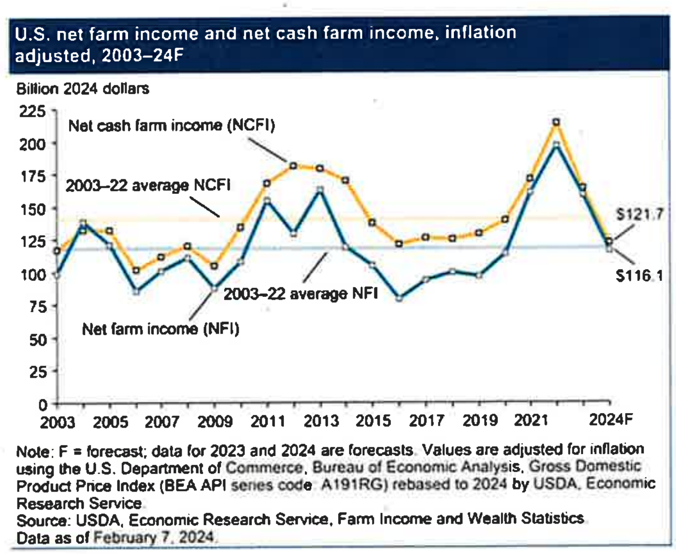
Bankers believe they may be 'looking over a cliff' in regard to the agricultural economy without changes to current government policy. This includes adjustments to reference prices and ensuring that crop insurance covers loss appropriately for producers. Additionally, bankers desire a faster payment system in the event of natural disasters. Waiting over a year to receive disaster payments can create unnecessary credit crunches, that ultimately hurt agricultural producers and their access to credit.

III. The 2024 Farm Bill Has Great Improvements to Credit Availability for Rural America

The 2024 House Farm Bill makes important improvements to the credit title that will increase credit availability in rural America. ABA has long advocated for the changes that were included in the legislation. The most significant change is the increase in the FSA Guaranteed Farm Ownership Loan Program to $3.5 million and the FSA Guaranteed Farm Operating Loan Program to $3 million. As the cost of agriculture continues to increase, it is vital to have the FSA loan programs keep pace with modern agriculture. These new limits will achieve that goal.

As supported by ABA, the bill also makes improvements to the down payment assistance program by removing arbitrary cap on the size of the loan and instead caps down payment loans at 45% of the lesser of acquired price or appraised value. The bill also includes a revised definition of owner-operator that allows for various business structures to increase eligibility to beginning farmer guaranteed loan programs to more producers and customers.

The bill expands options for the Agricultural Mortgage Secondary Market (Farmer Mac) by allowing guaranteed loans under the 9007 Rural Energy for America program to be eligible. The legislation also provides flexibility on farm structure acreage caps by allowing the Farm Credit Administration (FCA) to establish alternative loan amount limitations to reflect the treatment as a qualified loan or a moderately sized agricultural mortgage loan, as determined by the FCA, accounting for adjustments in geographic differences and valuations. I would like to thank Congress for these changes within Farmer Mac. Farmer Mac is a valuable tool in the toolbox for agricultural bankers because it provides another avenue for banks to increase credit availability. By purchasing guaranteed loans from banks, Farmer Mac allows banks to lower interest rates for their customers and provide better loan products. ABA still believes a needed change for Farmer Mac is to remove the cooperative lender requirement for energy loans to be sold to Farmer Mac. This limits the ability for banks to participate in rural energy projects, ultimately limiting available credit in rural America.



Lastly, there are many provisions within the 2024 Farm Bill to speed up the USDA loan approval process while making it easier for producers to use USDA loan programs. ABA is supportive of these measures.

It should be noted that the language to modify the Consumer Financial Protection Bureau's 1071 Final Rule reporting requirements for the Farm Credit System is problematic for the banking industry. ABA supports efforts to provide relief from the 1071 Final Rule, but that relief should be equal across all lenders.

IV. The Access to Credit for our Rural Economy Act

ABA is a proud supporter of H.R. 3139, the Access to Credit for our Rural Economy Act (ACRE Act). The ACRE Act has been introduced by Representative Randy Feenstra (R-IA) and Representative Wiley Nickel (D-NC). This legislation will help to lower lending costs for farmers, ranchers, and rural communities. ACRE would remove the taxation on income earned from interest on agricultural real estate loans, and for loans for rural residences in a population area of less than 2,500 people with a mortgage value of less than $750,000. By removing this taxation, banks will be able to lower their interest rates, which helps to lower costs for borrowers.

ACRE will be beneficial to both new and existing farmers by lowering interest rates on agricultural real estate. However, access to credit can be much more difficult for "Beginning Farmers and Ranchers" and "Socially Disadvantaged Farmers and Ranchers" due to a lack of preexisting land ownership and access to other sources of capital – 54% of young farmers say they need more land. ACRE will help new farmers and ranchers by lowering their costs to acquire land which is the most capital intense portion of any farming operation, and a critical asset to achieve long-term, reliable access to credit. Lastly, ACRE will reduce the need for farmers and ranchers to find off-farm income by reducing interest payments, which increases the cashflow from their operation and reduces the need for off-farm income. It has been estimated that ACRE will deliver approximately $950 million in annual interest expense savings for loans secured by farmland.

ACRE will also provide much needed access to credit for rural home mortgages. According to the 2020 Census, rural America lost population over the last decade for the first time in history. Additionally, rising interest rates are putting homeownership out of reach for many rural Americans. Current interest rates for rural mortgages are averaging 7.5%. ACRE is estimated to lower those interest rates between 50 and 100 basis points – bringing interest rates down to 6.5% to 7% from 7.5%, or possibly more. This will result in approximately $450 million in interest savings annually to homeowners.

The U.S. Census lists 17,113 communities with a population of less than or equal to 2,500. In 2021, $58.1 billion in bank mortgages were originated in these communities – a need that is only increasing. Given a conservatively estimated 3% growth, approximately $60 billion in rural mortgages will qualify for ACRE in 2023. Enacting ACRE will help provide the additional access to credit that is needed for rural communities to thrive.

Conclusion

The banking industry is well positioned to meet the needs of U.S. farmers and ranchers. Rising input prices and declining commodity prices, however, have resulted in lower net farm income for agricultural producers. Moreover, debt levels have been increasing, and bankers are concerned that without changes to government policy, agricultural producers may experience a tightening of credit availability. The 2024 Farm Bill and the ACRE Act provide opportunities to make the changes necessary to provide the credit needed for farmers and ranchers to successfully navigate tougher economic times. Bankers continue to see great opportunities in agriculture and will continue to stand with farmers and all our partners in agriculture going forward. We will also continue to work constructively with the Committee and your colleagues in Congress on the 2024 Farm Bill and ACRE Act to help ensure that farmers have the needed credit to be a successful and a strong part of the U.S. economy.

Thank you for the opportunity to express the views of the American Bankers Association. I would be happy to answer any questions that you may have.