Testimony of the Honorable Glen R. Smith
Chairman and Chief Executive Officer
Farm Credit Administration
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Energy, and Credit
U.S. House of Representatives Committee on Agriculture
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Chairman Scott, Ranking Member Scott, and Members of the Subcommittee, I am Glen R. Smith, board chairman and CEO of the Farm Credit Administration (FCA or agency). On behalf of my board colleague, Jeffery S. Hall of Kentucky, and all the dedicated men and women of the agency, I am pleased to provide this testimony. Mr. Hall also serves as chairman of the board of directors of the Farm Credit System Insurance Corporation (FCSIC).

In my testimony today, I will discuss the agency's responsibilities, the current state of the farm economy, and the condition of the Farm Credit System (FCS or System) and Farmer Mac.[1] I would also like to take a moment to thank the subcommittee members and staff for their assistance during the development of the 2018 Farm Bill. The provisions included in the credit title modernized our governing authorities and added to and enhanced our enforcement powers; the provisions also updated and clarified FCSIC's conservator and receiver authorities. Your efforts are very much appreciated and will help us in our oversight of the System and Farmer Mac.

FCA's responsibilities

FCA is an independent agency responsible for examining and regulating the banks, associations, and related entities of the System. The FCS is a government-sponsored enterprise created by Congress in 1916 to provide American agriculture with a dependable source of credit. The System's banks and associations form a nationwide network of cooperatively organized lending institutions that are owned and controlled by their borrowers, serving all 50 states and Puerto Rico. The System is currently made up of 4 banks, 68 associations, 5 service corporations, and the Federal Farm Credit Banks Funding Corporation. FCA is also responsible for the oversight of the Federal Agricultural Mortgage Corporation (Farmer Mac), which was established in 1988 under Title VIII of the Farm Credit Act.

As directed by Congress, FCA's mission is to ensure that System institutions and Farmer Mac are safe, sound, and dependable sources of credit and related services for all creditworthy and eligible persons in agriculture and rural America. We accomplish this mission in two important ways.

[1] Although Farmer Mac is an FCS institution under the Farm Credit Act, we discuss Farmer Mac separately from the other institutions of the FCS. Therefore, in this testimony, unless Farmer Mac is explicitly mentioned, the Farm Credit System refers only to the banks and associations of the System.

First, we protect safety and soundness by examining and supervising all FCS institutions and Farmer Mac, and we ensure that they comply with applicable laws and regulations. Our examinations and oversight strategies focus on an institution's financial condition and any material existing or potential risks, as well as on the ability of its board and management to direct its operations. We also evaluate each institution's compliance with laws and regulations to ensure it serves all eligible borrowers. If an institution violates a law or regulation or operates in an unsafe or unsound manner, we use our supervisory and enforcement authorities to take appropriate corrective action.

Second, we develop policies and regulations that govern how System institutions and Farmer Mac conduct their business and interact with customers. Our policies and regulations protect safety and soundness; implement the Farm Credit Act; provide minimum requirements for lending, related services, investments, capital, and mission; and ensure adequate financial disclosure and governance. We approve the corporate charter changes of System institutions, System debt issuance, and other financial and operational matters.

Challenges facing the farm economy

Many U.S. farmers and ranchers are facing a more challenging economic environment than in past years. Trade uncertainties, large commodity supplies, and weather extremes have suppressed farm prices and producer returns for key commodities. USDA estimates net cash farm income in 2019 will remain well below record levels set 6 to 7 years ago. With the large payments provided by USDA's Market Facilitation Program, net cash farm income will likely be close to the average for the past two decades.

Debt is also rising. U.S. farmers have taken on an estimated $41 billion in additional farm debt over the past three years. Adjusted for inflation, total farm debt outstanding is nearing the record set almost 40 years ago. Income shortfalls have cut working capital and elevated borrowing needs. With cash flows tight, the number of producers finding it difficult to repay their loans is growing, albeit at a modest pace. Increasingly, producers are restructuring their debts to improve their cash flow.

High-cost producers and those with significant leverage are feeling financial pressure. Producers most vulnerable to financial stress are farmers with crop losses (particularly corn and soybeans in parts of the Midwest in 2019). The combination of low prices and crop losses is creating a significant challenge for some producers. Smaller or higher-cost dairy farms represent another segment experiencing stress despite the improvement in milk prices.

Crop insurance indemnities and disaster funds continue to provide financial support to farmers and ranchers as they strive to overcome the weather-related calamities of the past 18 months, including multiple hurricanes, wildfires in the West, and record-setting spring rainfall in the Midwest. Recently, heavy snow has affected fall harvest in the Northern Plains, while drought across parts of the South has damaged feed supplies and late-harvested crops.

Despite production losses resulting from poor weather in these regions, supplies of corn, soybeans, wheat, and livestock commodities remain relatively high as markets await resolution of trade disruptions. Cotton production will likely exceed use for the third consecutive season, elevating stocks and weakening prices.

Trade impacts

Trade disruption from retaliatory tariffs has affected much of agriculture. The short-run impact has been negative for producers of export-dependent commodities, particularly soybeans, cotton, pork, dairy products, and tree nuts.

Longer term, the administration expects the focus on trade policy will benefit the U.S. economy and international trade in general by addressing foreign practices that damage U.S. economic interests. Additional gains for U.S. agriculture are expected as trade agreements are implemented, such as the pacts with Japan and Mexico/Canada.

The Market Facilitation Program compensates producers for economic shortfalls caused by temporary export losses. This compensation has been critical to shoring up profitability and underpinning the finances of producers impacted by market losses from trade disputes. Rolling out the remaining portions of the 2019 payments will further help producers meet their financial commitments and plan cash flows for next year.

Farmland values

Farmland values are generally holding up but with some notable regional weaknesses and strengths. While farmer interest and financial ability to purchase land have waned, the limited amount of land for sale, solid nonfarmer demand, and low interest rates have contributed to the stability in land markets. Farmland accounts for over 80% of total farm assets and hence serves as the primary source of collateral for farm lenders.

Stability in farmland markets has enabled borrowers to restructure their balance sheets with longer-term debt and freed up working capital. It has also allowed some borrowers to sell land parcels, if needed, to shore up their finances.

Amid the current stability in land values, however, lies a major concern. If larger amounts of land were to be put up for sale, greater downward pressure on land values would likely ensue. With declining land prices, farm balance sheets could deteriorate more quickly, and a farm borrower’s ability to restructure debt or obtain additional financing could weaken.

Today’s government farm safety net authorized in the 2018 Farm Bill continues to provide a strong underpinning to the farm economy. The combination of farm commodity programs, disaster assistance, crop and livestock revenue insurance programs, and the 2018 and 2019 Market Facilitation Program payments puts a floor under farm income and helps stave off a potential collapse.

Credit conditions

Although overall farm finances have declined in recent years, most farms remain financially strong. Census of Agriculture data show only about one-third of all U.S. farm operations owe debt during a given year. For small farms (those with less than $250,000 in annual farm sales), loan repayment often depends more on off-farm income than farm income. A strong economy and labor market are helping support the incomes of these producers as well as larger producers.

Many producers continue to find ways to cut costs and make the most of the marketing opportunities when prices rise temporarily. Still, the financial pressure can be significant for individual producers, particularly those who suffered yield losses in recent years.

Larger farms are more likely to carry debt. They owe most of the total U.S. farm debt. Some of these large operations are highly leveraged and more likely to experience financial stress following weak commodity prices or below-normal production. Because of their size, very large producers can have an outsized impact on local land markets and credit providers.

Credit stress within the System's farm loan portfolio remains low, but loan weakness continues to creep up. Financial stress is regionalized and most prevalent in commodities such as dairy and grain (corn, soybeans, and wheat). Of the 10 states with the highest levels of less-than-acceptable loans, 6 states are in the Midwest, and only Texas and California are outside key grain-production regions.

Some farmers will continue to restructure their balance sheets (to the extent they are able) and/or make changes in their operations to reduce production costs. FCA encourages System lenders to work with borrowers to help navigate current financial conditions without jeopardizing the long-term viability of the borrower or the System institution.

Fortunately, both the Farm Credit System and the Farm Credit Administration are laser-focused on cash flow and loan repayment. This approach contrasts with "collateral lending," which contributed to the 1980s farm financial crisis. Lenders are also much more proactive with borrowers encountering difficulty, encouraging them to adjust their operations before it is too late. Importantly, in the most recent farmland price runup, System institutions used lending caps and other practices to mitigate lending risks associated with higher land prices. Current FCA examination activities include a focus on institutions that have a higher risk profile based on the commodities produced in their territory.

System institutions have indicated that, as lenders, they will work with customers if they are willing and able to make changes to their operations to restore profitability. Fortunately, System institutions have the financial capacity to work with their customers. Other lenders may not have this capacity, or some borrowers may have already used up their opportunities to restructure their balance sheets. Either case creates concern if farm stress intensifies in the coming years.

Condition of the FCS

The System's agricultural financing capacity remains strong during this period of large commodity supplies, retaliatory tariffs, weak returns, and weather difficulties. Overall, the System is safe and financially sound. Through June of 2019, the System reported strong earnings and sound capital levels. While credit stress in the System's loan portfolio is increasing, System institutions have strong risk-bearing ability and are well-positioned to respond to the credit needs of U.S. agriculture.

The System's strong capital base enhances its risk-bearing capacity at a time when System borrowers in certain agricultural sectors face significant financial challenges. As of June 30, 2019, total System capital equaled $61.2 billion, up from $57.3 billion a year before. The System's total capital-to-assets ratio at June quarter-end was 17.4% as compared with 17.2% a year ago. Overall, almost 80% of total capital is in the form of retained earnings. Growth in System capital is due in large part to the System's strong earnings. For the six months ended June 30, 2019, the System reported net income of $2.7 billion, up from $2.6 billion for the same period a year ago. Net interest margin was 2.40% compared with 2.44% for the six months ended June 30, 2018.

The System continues to grow at a manageable pace. Gross loans as of June 30, 2019, totaled $276.2 billion, up $14.2 billion or 5.4% year over year. Real estate mortgage lending was up $4.8 billion or 3.9%. Overall, real estate mortgage loans represent just over 46% of the System's loan portfolio. Production and intermediate-term lending increased by $3.2 billion or 6.5% from the year before, and agribusiness lending for processing and marketing increased by $3.5 billion or 14.8%.

Despite the challenges facing agriculture, loan credit quality is sound, and the System's portfolio continues to perform well. Nonperforming assets totaled $2.5 billion, or 0.92% of loans and other property owned as of June 30, 2019. This is up from $2.3 billion or 0.83% at year-end 2018. Loan delinquencies (accruing loans that are 30 days or more past due) increased to 0.36% of total accruing loans from 0.31% at year-end 2018. While credit risk in the System's portfolio has increased, the System's risk-bearing capacity remains strong. The allowance for loan losses at June 30 was $1.8 billion and amounted to 69% of the System's nonperforming assets.

The System continues to have reliable access to the debt capital markets. Investor demand for all System debt products remains positive, allowing the System to continue to issue debt on a wide maturity spectrum at competitive rates. Risk spreads and pricing on System debt securities remain favorable relative to corresponding U.S. Treasuries.

With a balance of $5 billion as of June 30, the Farm Credit Insurance Fund further enhances the financial integrity of the System. Administered by FCSIC, this fund protects investors in Systemwide consolidated debt obligations. System banks also maintain liquidity reserves to ensure they can withstand market disruptions. As of June 30, the System's liquidity position equaled 178 days, significantly above the 90-day regulatory minimum required for each FCS bank.

Young, beginning, and small farmers and ranchers

Congress requires each System association to have a program to provide credit and related services to young, beginning, and small (YBS) farmers and ranchers. In the late 1990s, FCA established a system to monitor the associations' YBS programs and activities and to receive reports regarding the associations' YBS lending. We compile data from these reports into our annual reports to Congress.

Using some of the increased resources recently approved by Congress, we have examined the System's data on YBS farmers and ranchers in a more sophisticated manner and have found potential areas for improvement in data collection, quality, and granularity. We are working to identify ways to improve the accuracy of YBS data and reporting. We are also reviewing the definitions of the young, beginning, and small categories, which have not been updated since the 1990s.

On February 21, 2019, we published an advance notice of proposed rulemaking to seek public comment on ways to improve the YBS data collection process and definitions. Currently, we are reviewing and considering the comments received from the public, and we will use this input to help us improve our ability to measure service to YBS producers.

Condition of Farmer Mac

Congress established Farmer Mac in 1988 to create a secondary market for agricultural real estate and single-family rural housing mortgage loans. Farmer Mac has authority to purchase agricultural real estate mortgages and rural home loans, USDA-guaranteed farm and rural development loans, and rural utility cooperative loans. It is also authorized to create and guarantee securities and other secondary market products that are backed by such loans.

As a ready source of liquidity for primary lenders, Farmer Mac is committed to enhancing the availability of reasonably priced credit to agriculture and rural America through its secondary market activities. Farmer Mac provides wholesale portfolio funding, credit guarantees, and other products for its network of lenders, including agricultural banks, insurance companies, Farm Credit System institutions, nonbank lenders, and rural utility cooperative lenders. Since its inception, Farmer Mac has helped fund farmers, ranchers, rural electric cooperatives, and agribusinesses in all 50 states and has provided more than $53 billion of investment in rural America.

As of June 30, 2019, Farmer Mac's outstanding program volume reached an all-time high of $20.7 billion. Net income available to common stockholders for the six months ended June 30, was $50.2 million, up 2.7% from the same period in 2018. Farmer Mac's core capital totaled $786.6 million as of June 30, which exceeded its statutory minimum requirement of $594.9 million by $192 million.

Despite recent stress in the agriculture sector, Farmer Mac's credit quality remains sound. No delinquencies exist in Farmer Mac's institutional credit, USDA Guarantees, and rural utilities lines of business, which represent 65% of program volume. The Farm and Ranch portfolio represents the remaining 35% of outstanding volume. As of June 30, 2019, substandard loans were 3.3% of the total Farm & Ranch portfolio, up 0.2% from a year earlier, and loans more than 90 days delinquent decreased to 0.38% from 0.62% as of June 30, 2018.

Conclusion

We at FCA remain vigilant in our efforts to ensure that the Farm Credit System and Farmer Mac remain financially sound and focused on serving agriculture and rural America. We will continue our commitment to excellence, effectiveness, and cost efficiency and will remain focused on our mission of ensuring that System institutions and Farmer Mac are safe, sound, and dependable sources of credit for agriculture and rural America.

This concludes my statement. On behalf of my colleagues and the staff at the agency, I thank you for the opportunity to share this information.