Credit Availability in Rural America

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Introduction

Mr. Chairman and members of the subcommittee, thank you very much for the opportunity to testify today on a topic of great interest to everyone in rural America including particularly the community banking industry. The availability of credit to rural America is vital for our nation's farmers and ranchers, and the thousands of community banks that serve rural America.

My name is Sean Williams. I am President and CEO of the First National Bank of Wynne in Wynne, Arkansas. I testify today on behalf of the Independent Community Bankers of America (ICBA). Our bank is a forty-six year member of ICBA.[1] Our bank is a long-time member of the Arkansas Community Bankers Association.

First National Bank of Wynne

Wynne is located approximately 60 miles northwest of Memphis, or 120 miles northeast of Little Rock. First National Bank of Wynne was established in 1915, providing financial services for almost 100 years. Our bank has branches in 5 communities throughout the region; nearly 80 employees; approximately $285 million in total assets and a $150 million loan portfolio. Seventy percent of our loans focus on farmers and the remainder serves businesses that supply farmers or are depend on their financial health for survival.

On a personal level, agriculture and the availability of credit are very important to me. I was born and raised on a farm in a Northeast Arkansas community near McCrory. My father, grandfather and I raised rice and soybeans. I worked on the farm while attending college and also for several years after beginning to work in the financial services industry. My farming background led me to pursue both a bachelors and masters degree in agricultural business and economics from Arkansas State University.

[1] **About ICBA**
The Independent Community Bankers of America® (ICBA), the nation's voice for nearly 7,000 community banks of all sizes and charter types, is dedicated exclusively to representing the interests of the community banking industry and its membership through effective advocacy, best-in-class education and high-quality products and services. ICBA members operate 24,000 locations nationwide, employ 300,000 Americans and hold $1.3 trillion in assets, $1 trillion in deposits and $800 billion in loans to consumers, small businesses and the agricultural community. For more information, visit www.icba.org

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Focus of Our Testimony

Mr. Chairman, our testimony this morning focuses on how our bank and community banks in general serve rural America; the key factors that influence credit availability in rural America; the effects of competition in influencing credit availability and the results of a brief survey conducted with ICBA's Agriculture-Rural America committee.

However, I want to stress upfront the vast majority of bankers believe credit availability is plentiful and competition for loans is intense. To the benefit of farmers and ranchers, interest rates are at or near historically low levels.

Serving Our Community; Serving Agriculture; Serving Main Street

Like most community banks, our bank's employees serve our communities by volunteering in many civic organizations, churches, city councils, school boards, and other activities.

First National Bank is one of the largest agricultural lenders in the state of Arkansas. Our employees know the people who bank at First National Bank and care about their success. We are predominately a farming region where the economic impact of farmers and their success is critical to the economic fortunes of our communities. Our market is row crop agriculture where rice, soybeans and corn are produced. Cotton, wheat and milo are other crops raised in our area. First National Bank provides the vital credit that farmers need to be successful.

On a broader scale, community banks play an important role in the nation's economy. There are approximately 7,000 community banks in the U.S. and the vast majority of these are located in communities of 50,000 or fewer residents. Thousands of community banks are in small, rural, and remote communities across our nation.

While community banks comprise just 20 percent of the banking industry's assets, institutions with less than $10 billion in assets provide nearly 60 percent of the industry's small-business loans. According to the Federal Deposit Insurance Corporation's third-quarter 2013 industry data, small-business lending at banks with less than $1 billion was up 3.8 percent from the previous quarter and 3.0 percent from the previous year.

This is important since small businesses represent an astounding 99 percent of all employer firms and employ one-half of the private sector workforce. In addition, the more than 26 million small businesses in the U.S. have created 70 percent of the net new jobs over the past decade. Small businesses are important in rural America since many farmers and/or their spouses have off-farm jobs. As small businesses ourselves, community banks specialize in small business relationship lending. When our customers do well, community banks do well.

Community banks under $500 million in assets extend about 50 percent of all agricultural credit from the banking sector. In addition, commercial banks under $1 billion in asset size extend approximately 56 percent of non-real estate loans to the farm sector and about 62 percent of all real estate credit from the banking sector.

Farm Bill and Crop Insurance

There are a number of factors that determine whether credit is available in rural America. Congress achieved an important objective in February when the President signed the new farm bill into law. The farm bill includes a number of programs that provide an economic safety net for the nation's farmers and ranchers.

These programs will provide farmers the choice of reference prices, formerly known as target prices, or the new Agriculture Risk Coverage (ARC) program on either a whole farm basis using individual farm data or an individual crop basis by using county based data. Cotton producers will have a new STAX program. The cyclical nature of agriculture and the uncontrollable risks of severe adverse weather combined with unknown commodity prices and costs of production expenses require a continued safety net for farmers and ranchers.

These programs are intended to complement a strong crop insurance program going forward and supplement crop insurance by providing support in periods of multi-year price declines and helping producers cover the crop insurance policy's deductible.

In 2013, over 86 percent of insurable acreage was covered by federal crop insurance in the U.S., over 290 million acres. Crop insurance protected $1.6 billion of cropland in Arkansas last year. Crop-hail insurance provided an additional $1.5 billion in liability insurance for Arkansas crops. This is very important since nearly 90 percent of Arkansas farms are less than 500 acres in size.

Crop insurance is essential as it allows community banks security for loan repayments if disastrous weather strikes. It is very important that Congress not diminish the crop insurance program by adopting amendments that restrict the ability of producers to enroll or discourage producers from obtaining high levels of coverage.

Guaranteed Loan Programs

The farm bill also continues the important guaranteed operating loan and guaranteed farm ownership (real estate) loan programs. Importantly, as ICBA requested, the farm bill also wisely removes the arbitrary 15 year term limit on guaranteed operating loans. This change ensures thousands of family farmers can continue farming utilizing credit extended by private sector community banks.

We are pleased the agriculture appropriations bills also contain funding levels adequate to meet loan demand. These programs are almost entirely self-funding.

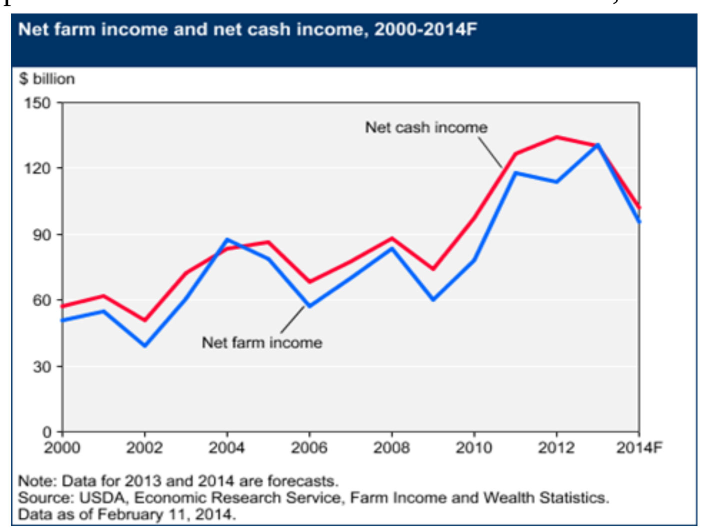
The farm bill's farm programs, combined with guaranteed loan programs and a strong crop insurance program are essential elements allowing community banks to ensure adequate credit is available to our nation's farmers and ranchers.

Farmer Mac

Another important tool for agricultural lenders is Farmer Mac, the secondary market for agricultural real estate loans and rural residential mortgages. Farmer Mac offers community bankers the opportunity to provide farm customers access to longer term, fixed rate mortgages. These loans, when sold to Farmer Mac's secondary market, allow lenders to replenish their existing funds so they can then make additional loans. As interest rates rise in the future, which they inevitably will, Farmer Mac will become an even more important program as farmers seek to lock in long term rates.

Some Concerns for Agriculture

A farm safety net is vital to agriculture and rural America due to the uncertainty, volatility, weather and cyclical nature of agriculture. Many farmers and ranchers and their lenders were concerned at the start of this year about the potential for lower farm income. In some areas, lower farm income is expected due to the severe drought impacting many Western states. In other areas, a large corn crop is expected to continue the downtrend in corn prices which began last year. Soybean prices are expected to be down as well.



Net farm income and net cash income, 2000-2014F

Note: Data for 2013 and 2014 are forecasts.
Source: USDA, Economic Research Service, Farm Income and Wealth Statistics.
Data as of February 11, 2014.

For example, USDA projects that net farm Income will decrease about 27 percent in 2014 to approximately $96 billion led by a projected $11 billion decline in corn receipts and a $6 billion decline in soybean receipts. Net cash income, projected at $102 billion, is projected to be down 22 percent from the $123.5 billion achieved in 2013.

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Although USDA notes net farm income will still be $8 billion above the previous 10 year average, we point out the last time we testified before this subcommittee in 2012, the net farm income projection was $16 billion above the previous 10 year average.

Although production expenses will be down slightly, by about $4 billion, 2014 is expected to still mark the second highest year ever for production expenses and farmers and ranchers have witnessed an 85 percent increase in production expenses from 2002 to 2013.

Additionally, USDA's Economic Research Service (ERS) noted recently that high operating costs, along with a sharp drop in prices, contributed to an 18 percent decline in net returns to corn operators from 2012 to 2013.

Fortunately, the ag economy has experienced record price levels in recent years allowing many farmers to pay down their debt load. Livestock producers are also now benefitting from lower feed costs and higher prices providing them much needed profits. The rapid rise in farmland values has slowed or stalled meaning that land prices are expected to be stable or slightly decline in the near future if crop prices continue declining or remain below the cost of production.

Federal Reserve Agriculture Perspectives

The Federal Reserve districts conduct quarterly surveys of agricultural bankers to determine their views on agricultural credit conditions. We have summarized a few of these surveys from the first quarter of 2014.

***Federal Reserve Bank of St. Louis Survey of Agricultural Credit Conditions*[2] [3]**

Little Rock zone Ag. bankers' expectations Q1-14 vs. Q1-13

	Lower	Higher	Net
Loan demand	20	20	0
Available funds	0	20	20
Loan repayments	20	0	-20
Farm income	29	14	-14
Capital expenditure	29	29	0

Producers are concerned about lower corn and soybean prices and high input costs. Lower feed prices will help producers retain cow herds. Quality farmland prices fell slightly in the first quarter, a reversal of the gain reported in the fourth quarter of 2013. However, quality farmland prices in the first quarter were 7.5 percent higher than a year earlier. Bankers continue to expect farm income and quality farmland values to decline over the next three months compared with year-earlier levels.

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[2] Federal Reserve Bank of Saint Louis, Agricultural Finance Monitor, First Quarter, 2014
http://research.stlouisfed.org/publications/afm/2014/afmq1.pdf

[3] Burgundy Book, A Report on Economic Conditions in the Little Rock Zone, First Quarter, 2014

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Similarly, bankers also expect farm household expenditures and farm equipment expenditures in the second quarter to be lower than a year earlier. The Saint Louis Fed noted their survey included an important conclusion: The vast majority of bankers' indicated the expectation of lower farm income in 2014 has not changed the highly competitive agriculture loan market.

Interest Rates

	2014:Q1	2013:Q4	Change
Interest rates (%)			
Operating			
Fixed	5.28	5.39	–0.12
Variable	4.84	5.01	–0.17
Machinery/ intermediate-term			
Fixed	5.53	5.65	–0.12
Variable	5.02	5.21	–0.19
Farm real estate			
Fixed	5.20	5.23	–0.03
Variable	4.77	4.93	–0.16

Federal Reserve Bank of Kansas City 10th District Agricultural Credit Conditions[4]

Crop producers faced tighter profit margins although livestock producers experienced improved profits. Lower corn and soybean prices and relatively high input costs limited farm income and cropland values. Winter wheat growers were concerned poor yields would limit profits despite a rally in wheat prices. With lower income, more crop producers borrowed to pay for operating expenses. Bankers saw higher levels of carry-over debt versus a year ago.

Cropland prices have generally stalled due to expectations of lower profits. The value of nonirrigated farmland dipped 1.4 percent from the fourth quarter of 2013 to the first quarter of 2014, and irrigated farmland values rose just 0.5 percent. Higher incomes for livestock producers resulted in slight increases in ranchland values.

Funds for farm loans remained sufficient to satisfy additional borrowing and interest rates on farm loans remained steady. Most bankers indicated collateral requirements were unchanged despite a slight decline in loan repayment rates.

Federal Reserve Bank of Minneapolis Agricultural Conditions Survey[5]

Reduced crop prices and high input costs continue to take a financial toll on farmers and may be putting downward pressure on land prices. The outlook for the second quarter of 2014 is downbeat, with bankers predicting further declines in incomes, capital expenditures and household spending. Bankers indicated crop producers face tighter profit margins but livestock producers are more profitable with lower grain prices.

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[4] Federal Reserve Bank of Kansas City, Survey of 10th District Agricultural Credit Conditions, First Quarter, 2014 http://www.kc.frb.org/research/indicatorsdata/agcredit/#/articles/research/agcredit/05-15-2014/farm-income-land-values-soften-further.cfm

[5] Federal Reserve Bank of Minneapolis, First Quarter 2014 Agricultural Credit Conditions Survey, http://www.minneapolisfed.org/publications_papers/pub_display.cfm?id=5318

Even with the drop in incomes, agricultural producers maintained their rate of loan repayments, but renewals increased slightly. Loan repayments were unchanged for 75 percent of bankers, while 13 percent reported repayment rates decreased.

A quarter of lenders reported increased loan demand, while another two-thirds experienced no change. The amount of required collateral increased slightly, with 92 percent of bankers reporting no change. After several years of very strong growth land prices have moderated, a trend that continued in the first quarter. Values decreased in some cases along with cash rents. Land values fell the most in Minnesota, where nonirrigated cropland prices dropped 8 percent compared with a year earlier.

Federal Reserve Bank of Chicago AgLetter[6]

Increases in farmland values in some areas contrasted with decreases in others. Demand to purchase agricultural land was weaker in the three to six-month period ending March 2014 than one year earlier, yet pockets exist where farmers remained interested in buying more land.

Percent change in dollar value of "good" farmland

	January 1, 2014 to April 1, 2014	April 1, 2013 to April 1, 2014
Illinois	−4	0
Indiana	−4	+7
Iowa	+1	−2
Michigan	−3	−1
Wisconsin	+1	+2
Seventh District	−1	+1

Demand for non-real-estate loans was up relative to a year ago for a second straight quarter, which hadn't occurred in four years. The availability of funds to lend improved compared with a year earlier, but repayment rates for non-real-estate farm loans were lower than a year ago. There were higher levels of renewals and extensions of these loans. The average loan-to-deposit ratio remained close to 67 percent for the third quarter in a row. Interest rates moved lower during the first quarter and a record low rate was set for feeder cattle loans. The livestock sector returned to profitability as milk, hog and cattle prices rose sharply (31 percent, 48 percent and 19 percent) since April 2013. Lower feed costs raised livestock profits helping support farmland values in some areas.

Survey Results of ICBA's Agriculture-Rural America Committee

ICBA conducted a survey of its Agriculture-Rural America committee in June to get our bankers' views on credit availability in rural America. ICBA's Agriculture-Rural America

[6] The Agricultural Newsletter from the Federal Reserve Bank of Chicago, Number 1964, May 2014 http://chicagofed.org/digital_assets/publications/agletter/2010_2014/may_2014.pdf

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committee consists of twenty-five bankers from every geographical region of the U.S. representing most agricultural commodities produced in the United States.

The survey asked bankers whether credit is plentiful, adequate or constrained in their area. No bankers felt credit was constrained and nearly all members stated credit was plentiful in their marketplace. We asked banks if they would desire to make more agricultural loans if demand existed. All bankers stated they desired to make more agricultural loans.

Record high commodity prices over the past four years, combined with good yields in many areas, has generated significant cash for producers, allowing them to pay down term debt, pay cash for capital purchases and has reduced the need to borrow for operating expenses. Banks are very liquid, allowing them ample funds to make more farm and rural loans. Regulators, of course, want to ensure that farm loans can cash flow.

We asked bankers if they believed their customers' farm income and farmland values would increase, decline or remain stable. Generally, bankers stated farm income and farmland values would decline or remain stable. Some bankers felt farm income would increase, reflecting their customers' involvement in livestock operations.

A large majority of bankers responded crop insurance is essential, allowing them to make loans to farmers and most bankers could not extend loans to most customers without the assurance of repayment which crop insurance provides. As a banker stated, "our ability to lend would be hurt dramatically without crop insurance."

Regarding farm bill programs, most bankers felt the farm bill was also indispensable to their ability to make farm loans. Regarding program options, most bankers felt the new reference prices were adequate but would not cover production costs. Most bankers also felt there was not enough information for customers to choose which farm program to sign up for. Most banks said they would work with their customers to help them decide farm program options.

Farm Credit System Abuses

We asked bankers several questions related to activities of the Farm Credit System (FCS). FCS is a tax advantaged, government sponsored enterprise given tax and funding advantages by Congress in the early years of the previous century. The expectation was that FCS would provide farmers and ranchers access to credit at a time when such access was much more limited than today, particularly for long-term, fixed-rate financing. However, the banker responses discussed below are quite troubling in terms of FCS abuses of their GSE advantages.

We asked bankers whether they had lost loans to the FCS and if so, was this a result of the FCS undercutting banks on their loan rates or a result of the FCS providing better service? Nearly all bankers said they had lost loans to the FCS and this was a result of FCS undercutting loan rates and in no case did bankers say that FCS provided better service.

Next, we asked if banks had lost loans to FCS due to FCS undercutting loan rates, was FCS targeting primarily the bank's financially strongest customers or a broad mix of customers based on financial strength. Nearly all bankers stated that FCS exclusively targets their best customers in terms of financial strength. As one banker stated, "I haven't seen FCS take any customers except the best and the biggest."

We asked bankers whether FCS was making non-farm loans in their marketplace. Several banks stated that FCS was indeed making non-farm loans. An example provided were FCS lenders making rural hospitals loans (an authority the FCS has never been granted by Congress).

The Harmful Impact of FCS Actions on Credit Availability to Rural America

We asked bankers if FCS activities undermine community banks' ability to make agricultural credit available in their market. Bankers believed this is the case and noted FCS targets the best operations, attracting these businesses through low rates which community banks are unable to match since they lack the tax and funding advantages of a GSE. Community banks cannot match the below market rates FCS offers to the best customers and still remain profitable. One banker noted there is stiff competition among all banks in his area; however, they cannot match the low rates offered by the FCS to the best customers.

The large, more stable operations are important to community bank portfolios as they spread lending risks over both small and large operations. By targeting the large and financially strongest borrowers, FCS elevates the risks in community banks' farm loan portfolios.

As one banker explained, "Almost every community and regional bank in our market is more than willing to make agricultural loans (operating, equipment and real estate), yet find ourselves undercut by FCS in all those categories."

As another banker stated, "Not only is there an issue with FCS lenders cherry picking the best loans in community bank portfolios, but also when FCS urges the newly acquired customers to move their deposit accounts to one of the large banks, thus taking deposits out of local, small communities and hurting the economic base of these remote, rural communities. This hurts community banks' ability to loan funds locally because of lower deposit balances."

Another example of a questionable lending practice by the FCS was a banker's comment noting they had lost a large real estate loan to the FCS because FCS was willing to take a minimal down payment while financing 93 percent of the real estate debt. The banker noted this is the type of practice common in the 1980s that led to the ag credit crisis and does not put borrowers in a healthy financial position. Borrowers with heavy debt loads ultimately lost farms in the 1980s.

FCS almost exclusively targets top borrowers; offers these targeted borrowers below market rates and is willing to fix those below market rates at longer terms. By taking top borrowers from community banks, FCS weakens the overall community bank portfolio, and leaves the less seasoned/younger borrowers and higher leveraged borrowers with community banks. Similarly, if community banks stretch to keep top borrowers, community banks must accept less return and assume more interest rate risk by fixing the rate for a longer period.

Bankers typically stated the FCS largely ignores young, beginning and small farmers. As one banker stated, "FCS wants us to get these types of farmers started first and then later attempts to take them away once they become financially stronger."

FCS Mission Creep

We remind the subcommittee the FCS is a GSE, granted several unique advantages not afforded to the private sector. These advantages were intended to allow the FCS to serve the specialized niche of agricultural producers and their cooperatives. However, we are seeing the FCS run amuck into non-farm related activities.

The FCS's regulator, the Farm Credit Administration (FCA), is complicit in aiding and abetting this unauthorized behavior. The FCA works hand-in-hand with FCS to expand the customer base of the FCS even though Congress has said no to the FCS's non-farm legislative agenda.

Illegal Investment Schemes: Through its 'Investments in Rural America' (i.e., also termed by FCA as 'mission related investments') proposal, the FCA has sought to grant FCS powers to engage in practically all types of non-farm lending. These activities were initially granted as 'pilot projects' enabling FCS lenders to engage in loans to hospitals, commercial offices (doctors, lawyers), manufacturing, apartment complexes, hotels and motels, etc. While their initial proposal to grant national, blanket authority by regulation for these activities was withdrawn, the FCA is now proposing allowing these same activities if approved by FCA on a case-by-case basis. We point out these are loans, not 'investments' and they are inconsistent with the statute's focus on agricultural based lending. FCA needs to stop playing name games, calling loans 'investments' and stick to the laws Congress passed.

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$725 Million Verizon Loan: Additionally, the FCA apparently was unaware that CoBank, the FCS's large lender to cooperatives, had made a $725 million loan to Verizon to buyout Vodaphone's interest in a joint venture. Verizon and Vodaphone are headquartered in New York City and London and this extremely large loan was not rural-based, nor is it an allowable lending activity. While the FCA has excused this illegal loan as eligible under the Farm Credit Act's 'similar entity' provision, this provision was never intended to allow FCS lenders to make loans that are completely different from loans that are eligible under the statute. FCA is again abandoning their regulatory oversight responsibilities in an effort to go to any length necessary to allow FCS lenders to make whatever types of non-farm loans they desire.

$10 Billion Line of Credit: On September 24, 2013, the Treasury Department, through its Federal Financing Bank, entered into a $10 billion note purchase agreement with the Farm Credit System Insurance Corporation (FCSIC) to establish a standby line of credit to provide FCS lenders funds at the Treasury's cost of funds. This line of credit, which the FCA sought in secret, raises a number of serious questions. For example, why did the FCA seek a $10 billion line of credit at a time when FCS lenders were reporting record profits of $4.64 billion in 2013? Why did the FCA not seek Congressional approval?

When the FCS failed in the 1980s, the farmland values which the FCS utilized as collateral had collapsed. Yet, the $10 billion line of credit, according to FCA is "collateralized" meaning that the collateral backing for this line of credit could be dramatically reduced. If the FCS were to collapse, as it did in the 1980s, American taxpayers would be on the hook for the bailout.

It would appear the FCA and FCS desired to lower their borrowing costs even further by acquiring this line of credit. The FCSIC was created to collect premiums from FCS institutions as a backstop in the event of financial deterioration within the System. Why then did the FCA seek and obtain a line of credit from the Treasury's FFB as additional protection?

Further, a report[7] to the FCSIC prepared by the Brookings Institution on behalf of the FCSIC stated: "<u>FCS should be required to approach the Congress</u> and the administration for legislative help (emphasis added)." Yet, **FCA did not go to Congress** but secretly went to the Treasury to obtain the line of credit.

Mr. Chairman, we could raise a number of additional issues regarding FCS abuses. We believe these types of issues and questions warrant a series of separate hearings.

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[7] The Brookings Institution: Farm Credit System Liquidity and Access to a Lender of Last Resort, Report for the Farm Credit System Insurance Corporation, page 8, Kohn and McGarry; http://www.brookings.edu/~/media/research/files/papers/2012/11/06%20farm%20credit%20system%20liquidity%20kohn/06%20farm%20credit%20system%20liquidity%20kohn.pdf

There are many concerns Congress should explore in their oversight capacity of the FCS. Understandably, Congress has been knee-deep in writing a farm bill in recent years. However, Congress should not lose sight of this GSE's activities particularly when Congress is debating what to do with the housing GSEs. Certainly this GSE needs to have greater scrutiny.

Conclusion

Mr. Chairman, thank you for the invitation to testify. As explained, there is a plentiful amount of credit available to farmers and ranchers at very low interest rates. Community bankers and their customers will continue to look forward to implementing the new farm bill and we thank you for your hard work on the legislation. We also thank you for ensuring a strong crop insurance program and continuing the guaranteed loan programs with greater flexibility.

However, more attention and scrutiny needs to be paid to the FCS's inappropriate activities and their unauthorized actions as well as to the FCA's *laissez-faire* attitude towards regulating the mission of this GSE, particularly the expansion of their scope and eligibility parameters.

The purpose of today's hearing is to examine credit availability in rural America. However, the actions of the FCS undermine the availability of credit in rural America as they seek to drive out other providers of credit by leveraging their unique GSE advantages in their efforts to lend to the very best customers and often ignoring producers in a weaker financial position. Is that really what the purpose of a GSE should be?

We look forward to working with you in the future. Thank you.