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Farm Credit System

Jim Monke
Analyst in Agricultural Policy
Resources, Science, and Industry Division

Summary

The Farm Credit System is a nationwide financial cooperative that lends to agricultural producers, rural homeowners, certain agriculture-related businesses, and agricultural, aquatic, and public utility cooperatives. Established by the Federal Farm Loan Act in 1916 as a government-sponsored enterprise (GSE), it has a statutory mandate to serve agriculture and related enterprises. The System's lending associations are governed by directors elected from System borrowers. Funds are raised through the sale of System bonds and notes. Federal oversight is designed to provide for the safety and soundness of System institutions. This report will be updated as events warrant.

What It Is

Rural Lender. The Farm Credit System (FCS or System) was created to provide a permanent, reliable source of credit to American agriculture. When Congress enacted the Federal Farm Loan Act in 1916, credit was frequently unavailable or unaffordable in rural areas. Many lenders avoided such loans due to the inherent risks of agriculture. Current statutory authority is in the Farm Credit Act of 1971, as amended. The most comprehensive recent changes were enacted in the Agricultural Credit Act of 1987.

The System is authorized to lend to farmers, ranchers, and harvesters of aquatic products. Loans may also be made to finance the processing and marketing activities of these borrowers, for home ownership in rural areas, certain farm- or ranch-related businesses, and agricultural, aquatic and public utility cooperatives.

As of September 30, 2003, the System had $91 billion in loans outstanding, 51% of which was in long-term agricultural real estate loans, 26% in short- and intermediate-term agricultural loans, 17% in loans to cooperatives, 3% in export financing, and 3% in rural home loans. The System holds 30% of the farm sector's total debt (second to the 39% share of commercial banks) and has the largest share of farm real estate loans (36%).

Government-Sponsored Enterprise (GSE). FCS is a GSE, a privately owned, federally chartered corporation designed to provide credit nationwide, and limited to servicing one economic sector (such as agriculture). Each GSE is given certain features or benefits (such as implicit federal guarantees on its funds or exemptions from taxes) to enhance its ability to borrow money. Such benefits presumably allow GSEs to overcome barriers that prevented purely private markets from developing, and thus serve the pubic purpose that Congress intended.[1] Unlike the housing GSEs, which are secondary markets, FCS is a direct lender.

System of Banks and Associations. FCS is composed of four regional Farm Credit Banks (FCBs) and one Agricultural Credit Bank (ACB). These large banks provide funds and support services to smaller Agricultural Credit Associations (ACA), Federal Land Credit Associations (FLCA), and Production Credit Associations (PCA). These associations in turn, provide loans to eligible borrowers. The most common operating structure (due to favorable tax and regulatory rules) is a "parent ACA" with FLCA and PCA subsidiaries. FLCA subsidiaries are exempt from federal income taxes. As of April 1, 2004, there were 85 ACAs and 12 stand-alone FLCAs.[2]

CoBank, the one ACB, has a nationwide charter to finance farmer-owned cooperatives and rural utility systems. CoBank also finances U.S. agricultural exports and provides international banking services for farmer-owned cooperatives. It operates field offices in Mexico City, Singapore, and Buenos Aires. In addition, CoBank provides funding to five ACAs located in the northeastern and northwestern United States.

Cooperative Organization. As a nationwide financial cooperative, all System banks and associations are governed by boards of directors elected by the stockholder-borrowers of each institution. Each has one vote, regardless of the size of his/her loan. Directors are member-borrowers, but federal law requires that at least one be elected from outside the System. Association directors elect the directors for their affiliated bank.

What It Is Not

FCS is not a government agency and the System's debt instruments and loans are not explicitly guaranteed by the U.S. government.[3] FCS is not a depository institution; loanable funds come from selling bonds and notes to investors. FCS is not a lender of last resort; FCS is a commercial, for-profit lender with a statutory mandate to serve agriculture and related enterprises. Borrowers must meet creditworthiness requirements similar to those of a commercial lender. (The USDA Farm Service Agency (FSA) is a lender of last resort. To obtain an FSA loan, a borrower first must be rejected by a commercial lender, which can include FCS.)

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[1] For further information on GSEs, please see CRS Report RL30533, *The Quasi Government: Hybrid Organizations with Both Government and Private Sector Legal Characteristics*. Presently, there are five GSEs, properly defined: Federal National Mortgage Association (Fannie Mae), Federal Home Loan Mortgage Corporation (Freddie Mac), Federal Agricultural Mortgage Corporation (Farmer Mac), Federal Home Loan Bank System, and FCS.

[2] On July 30, 2004, Farm Credit Services of America, an FCS association, initiated procedures to leave the Farm Credit System and be purchased by a private company. The action still requires regulatory and stockholder approval. For more information, see CRS Report RS21919.

[3] Because of the significant role of GSEs in the U.S. economy, most investors feel the federal government never will allow a GSE to fail. Thus, an implicit, albeit not statutory, guarantee exists for FCS and all other GSEs.

Loans and Eligibility

FCS provides three types of loans: (1) operating loans for short-term financing of expenses that are part of the normal course of a crop or livestock operating cycle, such as for feed, seed, fertilizer, or fuel; (2) installment loans for intermediate-term financing of durables such as machinery, equipment, vehicles, facilities, or breeding livestock; and (3) real estate loans for long-term financing (up to 40 years) of farmland, farmsteads, and home construction in rural areas.

Since FCS has a statutory mandate to serve agriculture and rural America, borrowers must meet certain eligibility requirements in addition to creditworthiness. Eligible borrowers and their scope of their financing can be grouped into four categories.

Full-Time Farmers. For individuals with over 50% of their assets and income from agriculture, FCS can lend for all agricultural, family, and non-agricultural needs (including vehicles, education, home improvements, and vacation expenses).

Part-Time Farmers. For individuals who own farmland or produce agricultural products but whose income from agriculture is less than 50% of their total income, FCS can lend for all agricultural and family needs. However, non-agricultural lending is limited relative to the agricultural income. For example, if 20% of income comes from agriculture, a person may borrow up to 20% of his/her non-agriculture related expenses.

Businesses. FCS can lend to businesses that process and/or market farm, ranch or aquatic products, provided that more than 50% of the business is owned by farmers who provide at least some of the "throughput." FCS also can lend to businesses that provide services to farmers and ranchers, such as crop spraying and cotton ginning. The extent of financing is based on the amount of the business' farm-related income.

Rural Homeowners. FCS can lend for the purchase, construction, improvement, or refinancing of single family dwellings in rural areas with populations of 2,500 or less. Loans also can be made for the purchase or refinancing of unimproved residential lots.

Source of System Funds

With the exception of seed money that was repaid by the 1950s and a Treasury line of credit temporarily made available during the financial crisis of the 1980s, FCS operates without any direct federal money. Moreover, System banks and associations do not take deposits like commercial banks.

Instead, a separate System entity, the Federal Farm Credit Banks Funding Corporation, raises funds in capital markets through the sale of Systemwide bonds and notes. These debt securities become the joint and several liability of all System banks. The banks act as financial intermediaries providing wholesale funds to their member associations which, in turn, act as retail lenders to the farmer customers.

FCS also raises some funds through two other methods. When a borrower acquires a loan from FCS, the borrower is required to pay the lesser of $1,000 or 2% of the loan amount and become a System stockholder. Additionally, FCS also generates loanable funds through profits that are not returned as patronage to borrowers (see below).

Consolidation

The number of banks and associations has been declining for decades through mergers and reorganizations. This consolidation accelerated, however, in 1999 when the Farm Credit Administration (FCA), the System's regulator, approved the "parent ACA" structure and the Internal Revenue Service declared FLCA subsidiaries tax-exempt. In the mid-1940s, there were over 2,000 lending associations, nearly 900 in 1983, fewer than 400 by 1987, 200 in1998, and only 97 in 2004. The system operated with 12 districts into the 1980s but, by 1998, had only eight district banks (including CoBank). By 2004, the number of banks (including CoBank) had dropped to five.

The typical FCS association 20 years ago covered a small geographic area of several counties and specialized either in land or farm production loans. Today, the typical FCS association covers a much larger region, delivers a wide range of farm and rural credit programs and services, and has an extensive loan portfolio. The System and associations benefit when consolidation creates more diversified portfolios. Customers may benefit if greater institutional efficiency is passed along through lower interest rates. However, consolidation may weaken the original cooperative concept of local borrower control and close many local offices at which farmers had established relationships.

Charter Territories

Each association within FCS has a specific "charter territory" where it can extend credit. If an association wants to lend outside its charter territory, it first must obtain approval from the other territory's association. For example, associations within the FCB of Wichita can compete for loans, but associations in AgFirst FCB cannot. Charter territories ensure that borrowers are well-served by a local association and maintain local control of that association. Charter territories and any changes to such boundaries must be approved by FCA. In 2001, FCA proposed to allow national charters so that associations would not be restricted by geographical boundaries. The FCA board subsequently dropped the idea after opponents raised concerns that national charters would weaken the System's mission by pitting associations against each other for prime loans and reducing commitments to local areas.

Patronage Refunds

As a cooperative, System associations are owned by the member-borrowers who purchase stock, typically as part of their loan. If an association is profitable, the directors may choose to retain the profits to increase lending capital, or distribute some of the net income to members by declaring a dividend or patronage refund. Distributing patronage refunds to members effectively reduces the cost of borrowing. A member's refund is proportional to the size of the loan. Some associations tend to regularly pay a higher level of patronage while others prefer to retain their earnings or charge lower interest rates initially. Patronage may be paid in cash, allocated surplus,[4] or stock.

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[4] Allocated surplus is the retained portion of a member's patronage and is recorded on the books of the association, or allocated to the member's equity account.

Federal Regulation

Congressional Oversight. Congressional oversight of FCS is provided by the House and Senate Agriculture Committees.

Farm Credit Administration (FCA). The FCA ([http://www.fca.gov]) is an independent agency that serves as the federal regulator responsible for examining and ensuring the safety and soundness of all System institutions. FCA is directed by a three-member board[5] nominated by the President and confirmed by the Senate. Board members serve a six-year term and may not be reappointed after serving a full term or more than three years of a previous member's term. The President designates one member as Chairman of the Board, who serves until the end of that member's term. FCA's operating expenses are paid through assessments on System institutions.

Other System Entities

Federal Farm Credit Banks Funding Corporation. The Funding Corporation ([http://www.farmcredit-ffcb.com]) is based in Jersey City, NJ, and manages the sale of Systemwide bonds and notes in capital markets. The Funding Corporation also provides financial advisory services, including interest rate risk management, to System banks and is governed by a 10-member board.

Farm Credit Council (FCC). FCC ([http://www.fccouncil.com]) is the national trade association of FCS. FCC has offices in Washington, DC, and Denver, CO, and represents the System's legislative and regulatory interests before Congress, the Executive branch, and others. FCC also provides support services to its members on a fee basis in areas such as training, marketing, insurance, and purchasing. Membership in FCC is made up of four District Farm Credit Councils and CoBank.

Farm Credit System Insurance Corporation. The Insurance Corporation ([http://www.fcsic.gov]) was established in 1988 primarily to ensure timely payment of principal and interest on Systemwide debt securities. The FCA Board comprises its board of directors. Annual premiums are paid by each bank into the Insurance Fund through an assessment based on loan volume until the secure base amount of 2% of total outstanding System loans is reached.

Federal Agricultural Mortgage Company (Farmer Mac). Farmer Mac ([http://www.farmermac.com]) was established in the Agricultural Credit Act of 1987 to serve as a secondary market for agricultural loans — purchasing and pooling qualified loans, then selling them as securities to investors.[6] While it is part of FCS and regulated by FCA, Farmer Mac has no liability for the debt of any other System institution, and the other System institutions have no liability for Farmer Mac debt. Farmer Mac is organized

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[5] FCA board members are Nancy C. Pellett (chairman since May 22, 2004), appointed in November 2002 for a term that ends in May 2008; Douglas L. Flory, appointed in August 2002 for a term that ends in October 2006; and Michael M. Renya, member from 1998 to May 2004 (chairman from 2000-2004). Mr. Reyna may serve until a new member is appointed.

[6] However, Farmer Mac continues to hold most of the loans it purchases, a potentially more profitable activity for the company, but also more risky.

as an investor-owned corporation, not a member-owned cooperative. Voting stock may be owned by commercial banks, insurance companies, other financial organizations, and FCS institutions. Nonvoting stock may be owned by any investor. The Board of Directors has 15 members — five elected from the System, five elected from commercial banks, and five appointed from the public at-large.

By purchasing loans from agricultural lenders, Farmer Mac allows lenders to provide additional loans to borrowers. For example, if a lender makes a 30-year loan, the lender can sell the loan to Farmer Mac and use proceeds from the sale to make another loan, rather than have its funds tied up in the 30-year loan.

Farmer Mac operates two programs: Farmer Mac I (loans not guaranteed by USDA) and Farmer Mac II (USDA-guaranteed loans). A majority of Farmer Mac I volume comes from the sale of long-term standby purchase agreements (LTSPC). Under an LTSPC, Farmer Mac promises to purchase specific agricultural mortgages under specified circumstances, essentially guaranteeing the loans against default risk while the participating lender retains interest rate risk. Under Farmer Mac II, the company purchases the portion of individual loans that are guaranteed by USDA. On these purchases, Farmer Mac accepts the interest rate risk but carries no default risk.

In 2003, the Government Accountability Office recommended that Congress establish clearer goals for Farmer Mac (GAO-04-116). GAO was concerned with risk management practices (including geographic concentration), lack of secondary market development, and corporate governance. On June 2, 2004, the House Agriculture Committee held a hearing. Questions have also arisen whether a certain type of swaps are reducing insurance premiums paid to the System without any reduction in risk exposure.

Farm Credit System Banks (as of April 1, 2004)

AgFirst FCB (Columbia, SC) has 22 parent ACAs and 2 ACAs in Delaware, Maryland, Pennsylvania, Virginia, West Virginia, North and South Carolina, Georgia, Mississippi, Alabama, Florida, Puerto Rico, and parts of Ohio, Kentucky, Tennessee, and Louisiana.

Agribank FCB (St. Paul, MN) has 18 parent ACAs serving Arkansas, Missouri, Illinois, Indiana, Iowa, Michigan, Minnesota, Nebraska, North Dakota, South Dakota, Wisconsin, Wyoming, and part of Ohio, Tennessee, and Kentucky.

FCB of Texas (Austin, TX) has 12 parent ACAs and 10 FLCAs serving Texas, Alabama, Louisiana, Mississippi, and part of New Mexico.

U.S. AgBank FCB (Wichita, KS) has 27 parent ACAs and 3 FLCAs serving Kansas, Oklahoma, Colorado, Arizona, Nevada, Utah, California, Hawaii, and part of New Mexico, eastern Idaho, and the western edge of Wyoming.

CoBank, ACB (Denver, CO) has a national charter to provide financial services to farmer-owned cooperatives and rural utilities. International banking services are provided through its headquarters in Denver and field offices in Mexico City, Singapore, and Buenos Aires. CoBank has specific authority to lend to five parent ACAs in its chartered territory of Connecticut, Maine, Massachusetts, New Hampshire, New Jersey, New York, Rhode Island, Vermont, and Montana, Washington, Oregon, Alaska, and western Idaho.