THE FARM CREDIT COUNCIL

Statement by Mr. Bob Frazee, President and CEO
MidAtlantic Farm Credit
Westminster, Maryland
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Subcommittee on Livestock, Rural Development, and Credit
House Committee on Agriculture
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Mr. Chairman and members of the Subcommittee, thank you for the opportunity to testify today on behalf of the Farm Credit System. My name is Bob Frazee and I am President and CEO of MidAtlantic Farm Credit.

MidAtlantic is part of the nationwide Farm Credit System. My remarks today will provide some background on the Farm Credit System, an overview of current credit conditions, and comments on how Farm Credit is meeting our mission, and serving the credit needs of agriculture and rural communities.

**Background on the Farm Credit System**

The Farm Credit System is a federally chartered network of borrower-owned lending institutions. Established in 1916, the Farm Credit System is comprised of 82 privately owned institutions. This includes four wholesale banks and 78 direct lending local associations. Farmers, ranchers, agricultural cooperatives, rural utilities and others in rural America cooperatively own all of these institutions. The four wholesale banks include CoBank. In addition to lending to Farm Credit associations, CoBank lends to agricultural, rural electric and telephone cooperatives, as well as rural water and sewer systems, broadband providers, agribusiness and to support exports. Farm Credit's mission is to provide sound and dependable credit and other related financial services to our owners and others consistent with the eligibility criteria set out in the Farm Credit Act.

MidAtlantic is a direct lending association. We are owned by more than 10,000 farmers that borrow from us in Delaware, and parts of Maryland, West Virginia, Virginia and Pennsylvania. As President and CEO, I report to an 18-member board of directors. Sixteen of these directors are farmers elected by the borrower-owners of our cooperative. In addition to elected borrower-owners, each System institution is required to have at least one appointed outside director on their board that has financial expertise. At MidAtlantic, we have chosen to have two appointed directors. In no case are employees allowed to serve as directors of our lending institutions.

The board of directors is responsible for setting the policies that guide how we run our institution and serve our marketplace. They approve the cooperative's capitalization plan consistent with federal regulations and ensure that management makes available loan products and related financial services appropriate to the unique needs of agriculture in the territory the association serves.

Each Farm Credit association obtains funds for its lending programs through one of the four Farm Credit banks. At MidAtlantic, we get our funding through AgFirst Farm Credit Bank, located in Columbia, South Carolina. AgFirst is owned by MidAtlantic and 18 other associations.

The four Farm Credit System banks cooperatively own the Federal Farm Credit Banks Funding Corporation. The Funding Corporation, as agent for the banks, markets to the investing public the Systemwide debt securities that are used to fund the lending operations of all Farm Credit System institutions. Unlike commercial banks, Farm Credit institutions do not have access to secured deposits guaranteed by the Federal Deposit Insurance Corporation and backed by the U.S. Treasury as a source of funding.

**Regulatory Oversight by the Farm Credit Administration**

All Farm Credit System institutions are regulated by the Farm Credit Administration (FCA). The FCA is an arm's-length, independent safety and soundness regulator. The Agency's three Board members are nominated by the President and confirmed by the Senate. The FCA has the oversight and enforcement powers that other federal financial regulators have in order to ensure that Farm Credit institutions operate in a safe and sound manner. FCA examiners are required to be engaged with every System institution at least once every eighteen months. As one who is on the receiving end of that attention, you should feel comfortable that they are doing their job thoroughly.

The terms of two of the three FCA board members have now expired. I understand that this Committee is not directly involved in the nomination and confirmation process; however, we urge the Committee to encourage the White House to bring forward nominees to the Senate in a timely basis.

The Farm Credit System's mission, ownership structure and authorizing legislation are unique among financial institutions. It is critically important that Farm Credit's safety and soundness regulator understands our mission and what it takes to be successful in accomplishing that mission. Sometimes they need to be reminded of that, so we appreciate very much the language included in the Farm Bill reminding the regulator that the System's unique cooperative structure should be taken into consideration as they promulgate rules.

The System's safety and soundness also is overseen by the Farm Credit System Insurance Corporation (FCSIC). FCSIC administers the Farm Credit Insurance Fund. The Fund and the operations of the Insurance Corporation are supported by premiums paid by Farm Credit institutions every year. The Fund is there to protect investors in System debt against loss of their principle and interest to the extent there are funds available in the Fund. There is no direct taxpayer backstop for the Fund. The Farm Credit Act sets the funding goal for the Fund at 2% of the aggregate outstanding insured obligations of the System. FCSIC also has the authority to examine System institutions and would act as the conservator or receiver of a System institution should one fail.

**Fulfilling Farm Credit's Mission of Service to U.S. Agriculture and Rural America**

All Farm Credit institutions are focused on accomplishing the mission established for us by Congress: to serve agriculture and rural America. Our cooperative structure and governance is designed specifically to ensure that our lending and related financial service activities are driven by the needs of our borrower-owners and to ensure that there is a reliable and competitive credit source available to agriculture that America's farmers and ranchers own and control. Our practice is to engage our customers in a consultative lending relationship, using our accumulated expertise and knowledge of agriculture and finance to craft long-term relationships. Our services are delivered in the manner that best suits our customers' needs — whether that means talking to them and completing loan documents at a poultry farmer's kitchen table, online while a vegetable producer is working in the field, or in the conference room of a regional agribusiness.

The diversity found in our customer base is indicative of the fact that farming has changed dramatically since the Farm Credit System was established almost 100 years ago. We are constantly evaluating our programs to ensure that we are able to serve the full breadth of agriculture. Much has been said and written about how agriculture needs to be prepared to feed a planet of 9 billion people by the year 2050. Very little focus has been given to the amount of capital that will be needed to make sure our agriculture and infrastructure that supports it will be up to the task. Many have different visions regarding what agriculture should look like to accomplish this. Our job is to be positioned to meet the needs of each – whether small and local, large and national, traditional or organic. As the Farm Credit Act makes clear, our responsibility is to meet the needs of all types of agricultural producers that have a basis for credit.

In our territory at MidAtlantic, we see the diversity that is today's agriculture first hand. We serve some of the premier poultry producing operations in the Nation. These are sophisticated, complex businesses with tight margins and substantial credit needs. Our staff understands the needs of this industry and works closely with them on a whole host of issues. On the other end of the spectrum, we serve the needs of the Amish farming community in Pennsylvania, financing business improvements like solar panels that provide energy to their farms. In between those extremes are customers and businesses with similarly varied needs, from entrepreneurs working to develop a wine industry in Maryland, to dairy farmers in Delaware, to fruit and vegetable growers in Virginia producing food for local farmers' markets right here in Washington, DC.

Our experience with this large swath of agriculture also gives us the knowledge, insight and expertise to develop special programs targeted at farmers who may need special help. We created the StartRight program in 2008, which is a suite of loan products specifically designed to address the challenges faced by young, beginning and small agricultural producers. Just last year, we developed a Farm Fresh Financing program, created to help producers committed to local foods and sustainable agriculture. As of the end of May, we had over $57 million in loans in the StartRight program, and over $83 million in loans in Farm Fresh Financing. I'd like to give you two examples of the types of businesses and organizations that these loans help:

The Urban Tree Connection in Chester, Pennsylvania has been building gardens in vacant city lots for over 10 years, growing both fresh produce for the neighborhoods, as well as growing a sense of community among neighbors. Farm Credit provided funding to help them purchase equipment. We also provided a revolving line of credit so that they could continue to grow and serve more communities. Since its inception, Urban Tree Farm has partnered with several additional companies to help them meet their community goals, and Farm Credit is currently talking to them about financing options.

Groundworks Farm in Pittsville, Maryland is another example. Owners Margaret Evans and Kevin Brown didn't grow up on farms, but they knew farming is what they wanted to do with their lives. Farm Credit helped them buy a small farm on the Eastern Shore of Maryland to grow produce and offer shares in their CSA, a Community Supported Agriculture farm. Last year, they offered almost 150 shares in their farm to local residents.

It should be of no surprise to the Committee that when you look across Farm Credit's loan portfolio you will see represented in it the broad array of operations that are U.S. agriculture. The Farm Credit Act was designed to ensure that we can continue to meet the needs of agriculture, cooperatives and rural infrastructure as they have developed. Parts of the law have not been updated for over forty years, and it can be challenging at times for us to continue to fulfill that mission when old law has to be applied in a very changed world.

Sometimes when changes in law are made, they take time to get implemented. Back in the 2002 Farm Bill Congress authorized the formation of Rural Business Investment Companies (RBIC) and made clear that Farm Credit institutions could create and invest in these entities to further the goal of making available equity capital for rural entrepreneurs. It took additional changes in the law and final regulations that were not completed until 2013 for our institutions to be able to put this authority to work for rural America. This summer a Farm Credit System funded RBIC will begin operations thanks to a commitment of about $140 million from Farm Credit to capitalize the new effort. This will mean jobs saved and jobs created in rural communities.

We also are very proud of our partnership with the Farmer Veteran Coalition to serve veterans involved in agriculture. As the result of a $250,000 grant from the Farm Credit System, farmers who are veterans now have access to a national labeling program that will allow consumers to choose products they know are produced by farmers that are veterans when they make purchases. These funds facilitated moving this program from one operated only in the state of Kentucky to a national program.

Our cooperative structure ensures that our focus remains on the success of our owners rather than on achieving quarterly returns to impress stockholders. When our customer-owners achieve success, our business will succeed as well. Farm Credit's lending relationship with our member-borrowers is based on constructive credit over the long haul – we make loans, retain loans and service loans. Farm Credit does not enter and exit agricultural lending as farm profitability waxes and wanes.

**Distributing Profits to Farmers Through Patronage**

Our commitment to our borrower-owners' business success is demonstrated further by the fact that we share our profits directly through patronage dividends with the farmers who borrow from us. Each year, MidAtlantic's board of directors makes a determination based on our profitability and financial strength as to what portion of our net earnings will be returned to our members who borrow from us.

In 2013, MidAtlantic distributed more than $18.9 million in earnings as patronage dividends to the member-borrowers of our cooperative. In total, the Farm Credit System in 2013 distributed over $1 billion in patronage. This patronage distribution puts money back in the pockets of farmers. It is a rural stimulus that allows our customer-owners to re-invest in their own operations and to support rural communities through local spending.

**Farm Credit's Financial Strength**

The Farm Credit System remains very strong financially. The System's combined net income was $4.64 billion for 2013, and we are pleased to report that in the first quarter of 2014, the System's net income was nearly $1.1 billion. Nationwide, Farm Credit ended 2013 with a loan portfolio of about $201 billion, and we added another $3.5 billion in loans during the first quarter of this year. Our capital position exceeds that of most every other financial institution. At the end of the first quarter of this year, the System had just over $43 billion of capital, or16.6 percent of total assets. This level of capital substantially exceeds that required by our regulator. This means that the investors that continue to make their capital available to farmers, ranchers and rural America through us should feel secure that they will be repaid.

**Overall Farm Credit Loan Portfolio**

As I noted before, at the end of the first quarter of this year we had outstanding about $204.5 billion in loans. To give you some perspective on the breadth of that portfolio of loans, that total was comprised of about $93 billion in real estate mortgage loans, $42 billion in production loans, $32 billion in agribusiness loans, $15.6 billion in energy and water and sewer, $6.5 billion in rural home loans and about $4.3 billion in communications loans. In addition we supported exports with $4.7 billion in financing.

Consistent with our authority under the Farm Credit Act, we are engaged in the rural community beyond agriculture. Because of the System's capital strength, institutions are also making investments that support the quality of life in rural communities. Institutions have invested in bonds issued to support critical care hospitals, nursing facilities, congregate housing for the elderly, and schools. Because our owners understand the needs of their communities, these investments demonstrate their commitment to making their hometowns the places where their children and grandchildren will want to live.

**A Commitment to Serving Young, Beginning and Small Farmers**

Every Farm Credit association must have programs in place targeted specifically at meeting the needs of three special categories of borrowers: those that are young, those that are beginning in farming, and those that are small farmers. Our regulator sets the definitions for each of these categories. Young farmers are defined as those 35 years old or younger. Beginning farmers are those with 10 or fewer years of farming experience. In the case of small farmers, we are required to look specifically at the gross farm sales of the individual producers. Small farmers are those with less than $250,000 in annual gross farm sales.

Each institution is required to report on their lending activity to these individual categories of producers. This data is not additive since individuals may fall into more than one category. During 2013 Farm Credit institutions made $8.3 billion in new loans to young farmers, almost $11 billion in new loans to beginning farmers and $11.4 billion to small farmers.

We work hard to serve the needs of young, beginning and small farmers. Across the country we do this not only by fulfilling their credit needs but also by supporting training and education programs, hosting seminars on intergenerational transfer of family farms, on risk management techniques and establishing and maintaining effective business plans. We are engaged across the spectrum with those entering agriculture whether they are focused on organic, sustainable, or local food related operations, direct-to-retail, or any other emerging business models. Our trade association, The Farm Credit Council, has been actively engaged with the support of USDA in reviewing the effectiveness of financial skills training for young and beginning farmers and encouraging the development of new tools that will help ensure those starting out in agriculture do so with the improved business management skills that are so necessary for farm businesses to be successful over the long term.

**Current Conditions in Agriculture**

Agriculture has experienced some very good years recently. As you know, however, several sectors have seen stress. We have seen many in what we call the green industry – sod, nursery and ornamental growers and greenhouse -- struggle alongside the struggling housing industry. The stagnant housing sector also affected the timber industry. While the protein sector was hit by high feed costs, we have seen improvements recently. In the Midwest, there has been considerable attention paid to land value inflation. Our institutions early on took aggressive steps to manage their lending programs so as to not take on increased credit risk exposure as land values increased similar to what some lenders did during the housing bubble. Farm Credit System institutions approach their markets prudently. Caps were placed on lending against land based on realistic projections regarding commodity prices. We make credit decisions based on the repayment capacity of the individual borrower rather than the inflating value of the collateral. Because we hold virtually all of our loans on our own balance sheet, we have a strong interest in seeing that our customers are successful and prudent in their own risk-taking, including the purchase and financing of farm real estate.

## Crop Insurance

Crop insurance remains an extremely important risk management tool for farmers throughout the country. We appreciate very much that the Farm Bill provided more crop insurance options and ensured new policies will be made available for specialty crops. We believe that it is important as a lender to agriculture that we know our customers have insured their production. This protects the farmer and it protects the lender as we provide credit to farmers to cover their operating expenses. A strong, effective, fully funded federal crop insurance program is vitally important to maintaining credit flows to agriculture. We look forward to providing input as implementing regulations are developed and proposed.

## Drought Conditions

Our institutions continue to monitor drought conditions in parts of Texas, Oklahoma, Kansas, New Mexico and particularly in California. While there has been some improvement in certain areas of the country, severe conditions still exist. I will address California separately but across all Farm Credit institutions it is important to note that in each situation we assess the circumstances of individual borrowers adversely impacted by weather conditions and work with them accordingly.

California is now in its third consecutive year of drought conditions and experiencing water restrictions to most areas of the state. This situation poses significant risk to agricultural production across the state in 2014, with ramifications into 2015 and beyond. It is fortunate that California farmers and agricultural cooperatives strengthened their balance sheets coming in to the current situation and are in a better overall financial position to withstand drought-related business impacts.

The drought's impact differs from region to region. Farm Credit institutions in California assess the drought's impacts by understanding the specific and unique circumstances of each customer. Our institutions then work collaboratively with individual borrowers who are experiencing distress related to the drought.

Overall, high grower liquidity, coupled with relatively strong commodity prices mean most agricultural producers should be able to adjust their plantings and their feed rations for livestock in the near term. It also is fortunate that the agricultural sector has become much more sophisticated in utilizing conservation measures to more efficiently use the water they have. However, the continuation of drought conditions risks adverse impacts on reserve groundwater storage and a substantial increase in groundwater overdraft. If this results, there will be substantial long-term costs of groundwater overdraft that are yet to be determined. Furthermore, if another critically dry year occurs in 2015, studies suggest the impacts likely will be much more severe, including reduction in water availability, crop acres and farm related employment. This will require close monitoring and early coordination among all interested parties to manage through without significant disruption.

The Farm Credit System remains well positioned to meet borrowing needs of agricultural producers impacted by the drought. The System's role is to stand by its customers and it will continue to fulfill that role in a safe and sound manner. This includes working collaboratively with individual borrowers who are experiencing financial distress related to the drought. Whatever the challenges presented by the drought, access to credit will not be one of them.

## Conclusion

The Farm Credit System remains financially strong, economically vital, and focused on fulfilling its mission of service to U.S. agriculture and rural America. We continue to make credit available to all segments of agriculture, including commercial producers as well as young, beginning and small farmers and ranchers. We support agricultural cooperatives, rural infrastructure and the marketing channels that agriculture depends on to sell their product and we serve the needs of rural communities to the extent our authority permits. We are proud of our commitment to rural America.

There are no federal dollars invested in the Farm Credit System. We pay for the expense of being regulated by the federal government through assessments on all Farm Credit System institutions. We pay insurance premiums to provide protection for those who invest in our debt securities. To continue serving our mission, we rely on continued access to the national debt markets and an independent, arm's-length regulator that comprehends the unique requirements of our cooperative structure and agriculture. In addition to being closely regulated, we have the built-in oversight mechanism of our member-owners holding our feet to the fire to keep service quality high while protecting their equity in their cooperative.

Mr. Chairman, thank you again for the opportunity to testify today on behalf of the Farm Credit System. I will be pleased to respond to your questions.