FARMER MAC

FINANCING RURAL AMERICA

Testimony of

Timothy L. Buzby
President and Chief Executive Officer

Federal Agricultural Mortgage Corporation (Farmer Mac)
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Introduction

Chairman Scott, Ranking Member Scott, and distinguished Members of the Subcommittee, thank you for your invitation to appear today to testify on behalf of the Federal Agricultural Mortgage Corporation, which is commonly known as "Farmer Mac." My name is Tim Buzby, and I am the President and Chief Executive Officer of Farmer Mac. I appreciate the opportunity to appear before your Subcommittee today to provide some insight about what Farmer Mac sees taking place in the rural credit financing markets, especially as it pertains to the availability of credit.

Farmer Mac

Farmer Mac's position at the intersection of Main Street and Wall Street allows us to provide a unique perspective about the environment for rural credit. We are a stockholder-owned, federally chartered corporation that combines private capital and public sponsorship to serve a public purpose. Established under legislation first enacted in 1988, Congress has charged Farmer Mac with the mission of providing a secondary market for a variety of loans made to borrowers in rural America, including mortgage loans secured by agricultural real estate, loans made to rural utility cooperatives, and certain loans guaranteed by the U.S. Department of Agriculture (USDA). This secondary market increases the availability of long-term credit at stable interest rates to America's rural communities, including farmers, ranchers, rural residents, and rural utility cooperatives, and provides those borrowers with the benefits of capital markets pricing and product innovation. In Farmer Mac's role as the secondary market for rural America, we work closely with lenders of all sizes, including commercial and community banks, Farm Credit System institutions, credit unions, rural utility cooperative lenders, and insurance companies to offer more financial choices to their rural customers and help them keep pace with today's capital-intensive environment.

For over a quarter-century, Farmer Mac has remained steadfast in its mission of delivering capital and liquidity and increasing lender competition for the benefit of American agriculture and rural communities. Our team of 72 employees located in Johnston, Iowa and Washington, D.C. share a mutual passion for rural America and in serving our customers. We take pride in the work we do and the important role we play in American agriculture. While we work directly with rural lenders, ultimately the greatest benefit we are able to provide is to your constituents – America's farmers, ranchers, rural utility cooperatives, and business owners in rural communities. To date, over 1,400 lenders across the nation have used Farmer Mac's programs and solutions to increase capital and liquidity and reduce their credit risk. By working with such a vast network of rural lenders, we inherently introduce more competition into the marketplace, which helps your rural constituents to receive the lowest interest rates and most favorable terms for their financing needs. In fact, the interest rates available to borrowers through the products offered by Farmer Mac are some of the most competitive in the market today. However, whether or not a rural borrower ultimately chooses a Farmer Mac loan product, Farmer Mac's participation in the rural lending arena provides that borrower with the opportunity to obtain a low interest rate on terms that work for that individual. That is good for rural borrowers, their families, their communities, and rural America in general. Since its creation, Farmer Mac has helped to fund loans to nearly 70,000 borrowers in all 50 states, resulting in approximately $39 billion of investment in rural America.

Agricultural Credit Demand and Availability

American agriculture is no stranger to cyclicality. The industry has been through three widely recognized business cycles, the first in the 1940s, followed by the second in the late 1970s through the 1980s, and most recently beginning in 2005. Each cycle has been characterized by a rapid increase in farm profitability followed by a reversion to trend or an overcorrection below trend. In the trench of the cycle, producers often offset lower income levels by consuming working capital earned during the profitable years, perhaps selling liquid assets, or taking on additional debt to meet cash flow demands of their farming operations. For 2016, USDA forecasts a third consecutive year of lower farm incomes. While the financial health of the sector remains largely intact, the industry is certainly feeling some stress as the current cycle nears its trough. Working capital levels are under stress today, and it appears farm debt is slowly climbing from historical lows.

Recent activity in both the retail and secondary lending markets underscore the growing need for agricultural financing. According to year-end call report data for 2015, the Farm Credit System (FCS) reported $147.3 billion in loans outstanding for agricultural production, intermediate-term, and real estate lending, up nearly seven percent from 2014.[1] Similarly, commercial banks and savings institutions reported $171.9 billion in loans outstanding for agricultural production and real estate lending at the end of 2015, also up nearly seven percent from 2014.[2] Applications for credit through Farmer Mac's programs remained elevated through 2015. Farmer Mac approved more than 80 percent of all applications for Farm & Ranch lending during the calendar year and purchased a record $748 million of Farm & Ranch loans during the year. Farmer Mac's purchases of Farm Service Agency (FSA) and other USDA guaranteed loans also remained robust in 2015 with $363 million in transactions, up eight percent from 2014. This rising lending activity highlights the growing demand for agricultural credit but also demonstrates the willingness and ability of agricultural lenders to meet that demand.

Despite the cyclical headwinds from the overall agricultural economy, Farmer Mac sees other indicators of credit availability to a wide variety of borrowers. In 2015, Farmer Mac purchased or committed to purchase loans secured by agricultural real estate that were producing more than 70 different agricultural commodities in 42 states from over 300 lending institutions. Participating lenders included commercial banks, FCS institutions, insurance companies, and many other non-bank financial institutions dedicated to serving the financial needs of our nation's farmers and ranchers. We continue to see strong interest in our programs from rural

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[1] Federal Farm Credit Banks Funding Corporation 2015 Annual Information Statement (https://www.farmcreditfunding.com/).

[2] Federal Financial Institutions Examination Council Quarterly Call Report Data, 2015Q4 (https://cdr.ffiec.gov/public/).

lenders, with some 80 new lenders signed up during 2015 and over 1,200 lenders eligible and approved to transact business with Farmer Mac. Approximately 40 percent of all Farmer Mac transactions during 2015 involved small operators, and over 95 percent of transactions involved a family operation. This business diversity by borrower location, size, and style as well as by customer and industry underscores the breadth and depth of agricultural lending today.

Although market data indicates good credit availability in early 2016, we urge market participants to exercise caution and patience as the current industry cycle plays out. Creditors should apply disciplined lending practices and at the same time be supportive but firm with their customers' requests. Regulators should be aware of the scope of potential credit problems, but they should also be cognizant that agriculture is a long-term endeavor and that sometimes the best cure for a troubled credit is not always liquidation. Producers should be aware that low commodity prices are likely to be with us for a while, and that cost containment could provide a new path to renewed profitability. Long-term fixed rate debt at today's historically low interest rates, which Farmer Mac helps many lenders to provide, can be an important tool to help stabilize the cost structure for many producers. In addition, lawmakers should continue to support the tools available to farmers and ranchers to help offset lower incomes and provide access to credit.

Land Values

Farm real estate represents the overwhelming majority of the agricultural balance sheet. Of the nearly $3 trillion in farm assets in 2014, over 80 percent was in the value of agricultural land and buildings. Between 2004 and 2014, the USDA estimate of the total value of farm real estate increased by more than $1 trillion, a doubling of asset values in just ten years. The rising tide of farmland values did not affect all regions equally – much of the rapid rise in land values was centered in the Midwestern United States in major grain producing states. The USDA reports increases in farmland value of 243 percent in Nebraska, 222 percent in Iowa, and 134 percent in Illinois between 2004 and 2014. These increases are undoubtedly a result of the industry's recent expansionary cycle and commodity price boom beginning in 2005.

More recently, factors influencing farmland values have been mixed. As previously mentioned, certain commodity prices have fallen sharply, and it is natural for an asset with declining future cash flow potential to also decline in total value. Farming expenses have not fallen at the same rate as farm revenues, which puts additional pressure on the ultimate profitability of farmland. In addition, the U.S. dollar strengthened tremendously in 2015, which lowered commodity prices and made U.S. agricultural exports less attractive in foreign markets. However, several factors have also combined to help support farmland values. Interest rates have not changed significantly since 2010 and remain near historical lows. A lower interest rate environment supports asset values by reducing the discount rate of future cash flows, and it makes the returns on farm assets more attractive relative to other investment opportunities. Additionally, the supply of farmland available for sale does not appear to be growing significantly. This current trend is particularly significant as lower supplies are typically associated with higher market prices. Finally, federal crop insurance and other support offered to farmers such as the Agricultural Risk Coverage (ARC), Price Loss Coverage (PLC), and the Margin Protection

Program (MPP) significantly lower market risk for producers and thus lower the inherent revenue volatility of the underlying farmland assets. We cannot stress enough how vital the current safety net policies are to agricultural lenders. They provide a great level of certainty in an industry that is anything but certain.

The combined market forces described above have netted out a modest decline in farmland values through early 2016, focused largely in the Midwest. According to the University of Nebraska-Lincoln, land values in Nebraska decreased six percent from early 2014 through February 2016.[3] A recent survey released by Iowa State University shows the value of medium-quality Iowa cropland fell 17 percent from September 2014 to March 2016.[4] Similarly, the annual survey results from the Illinois Society of Professional Farm Managers and Rural Appraisers (ISPFMRA) showed average farmland values in Illinois fell by nine percent in 2015.[5] The relatively modest declines experienced in some states are very different from the dramatic changes seen during the 1980's farm crisis, which is a testament to the strength and resiliency of U.S. agriculture today. Indeed, in other parts of the country, the appreciation of farmland values continued in 2015. According to data from the USDA's National Agricultural Statistics Service (NASS), farmland values in Western states like Washington, Oregon, and California increased in 2015. These states produced a wider variety of agricultural products and thus were not so sensitive to changes in grain and oilseed prices. Similarly, land values in states like Georgia and others in the South and Southeast were near zero or slightly positive with a greater diversity of agricultural production.

Agricultural Sector Analysis

Much of the decline in agricultural profitability in recent years is a result of market changes for bulk crop commodities like corn, soybeans, and cotton. Global supplies of nearly all bulk commodities are in surplus, putting downward pressure on world prices. U.S. producers are at an added disadvantage with a strengthening dollar that puts further downward pressure on both commodity prices (that are denominated in U.S. dollars) and the relative value of U.S. exports. Cotton producers face additional pressure from significant supplies in China, the world's largest consumer of cotton, and signals of the country's willingness to liquidate those supplies in large trade blocks. Combined, the USDA estimates that the decline in crop prices has caused a drop of nearly $50 billion in net farm income between 2013 and 2016.

However, bulk commodity producers are not the only ones coming under pressure. Milk and dairy product prices are down significantly in 2016 due to greater competition from foreign producers. Cattle prices are softening from historical highs as consumers began to balk at

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[3]2016 Trends in Nebraska Farmland Markets: Farming and Ranching on the Margin. University of Nebraska-Lincoln (http://agecon.unl.edu/2016-trends-nebraska-farmland-markets-farming-and-ranching-margin).

[4] Iowa Farm & Ranch Chapter #2 REALTORS© Land Institute March 2016 Land Value Survey. Iowa State University Extension and Outreach (https://www.extension.iastate.edu/agdm/wholefarm/html/c2-75.html).

[5] 2016 Illinois Farmland Value and Lease Trends. Illinois Society of Professional Farm Managers and Rural Appraisers (http://www.ispfmra.org/).

record-setting retail beef prices in 2015. Hog prices have decreased due to the rebound in hog inventories after the 2013 outbreak of the Porcine Epidemic Diarrhea Virus (PEDv) and tighter export markets. Poultry producers are also experiencing lower market prices due to higher domestic supplies, a result of several import bans on broiler meat after the 2015 outbreak of Highly Pathogenic Avian Influenza (HPAI). Finally, fruit and nut producers are seeing lower prices and tighter export markets affected by the stronger U.S. dollar in 2015. In general, the pattern of lower commodity prices has cause an increased demand for credit, as well as a need for the lender and borrower to work together more collaboratively when addressing the borrower's financing needs.

For additional insight into these and other topics, I have attached the spring edition of *The Feed*, Farmer Mac's quarterly perspective on agriculture. While much of what is trending in agriculture today seems negative, we believe the medium and long-term prospects for the sector remain favorable, a function of the many years of profitability in the last decade, the strength of the farm balance sheet, and the grit of America's farmers and ranchers.

Conclusion

As mentioned at the beginning of my testimony, American agriculture has always been cyclical in nature. Farmers and ranchers have long memories, and they, more than most, pay close attention to mistakes made in the past to avoid them in the future. The conservation programs enacted and maintained after the weather-related disasters in the early 20th century are a prime example of that. Farmers, ranchers, and their lenders also learned some hard lessons from the agriculture financial crisis of the late 1970s and 1980s. Today, producers are much more aware of the need to build working capital as the first line of defense against price volatility. I would be remiss if I did not also point out that the current low interest rate environment significantly helps borrowers. Looking ahead, credit conditions appear to be beginning to tighten modestly as the financial impacts of the recent stresses to farm incomes are becoming apparent in the financial position of some agricultural producers. For producers with higher profit margins and strong balance sheets, credit remains available at a low cost, while for other producers that lack these attributes, the cost is beginning to increase.

There is no doubt that policies which enable our farmers and ranchers to market and sell their commodities overseas are more important than ever. It is no secret that we can feed the world, but our friends working on the farms and ranches in rural America need the tools to do this. Free and fair trade agreements are essential. In addition, just as the nation's economy and the world's economy are very different than they were in the late 1980s, so is the agricultural economy. Farms have naturally grown larger through consolidation, especially to help lower costs through scale. This is not necessarily a bad thing, but it simply points to a new reality, which depends on increasing efficiencies to maintain profitability. The participants in the agricultural financing markets have adjusted to these changes, and we believe that public policies in this regard should also reflect this new environment while continuing to recognize the importance of small farms and family operations in maintaining the vitality and diversity of American agriculture.