Testimony of

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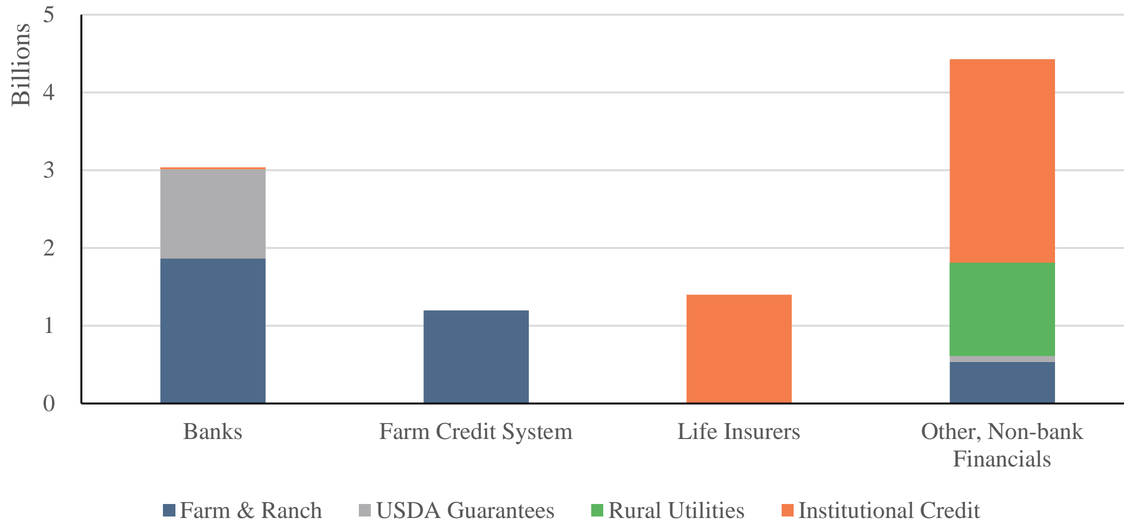
Introduction

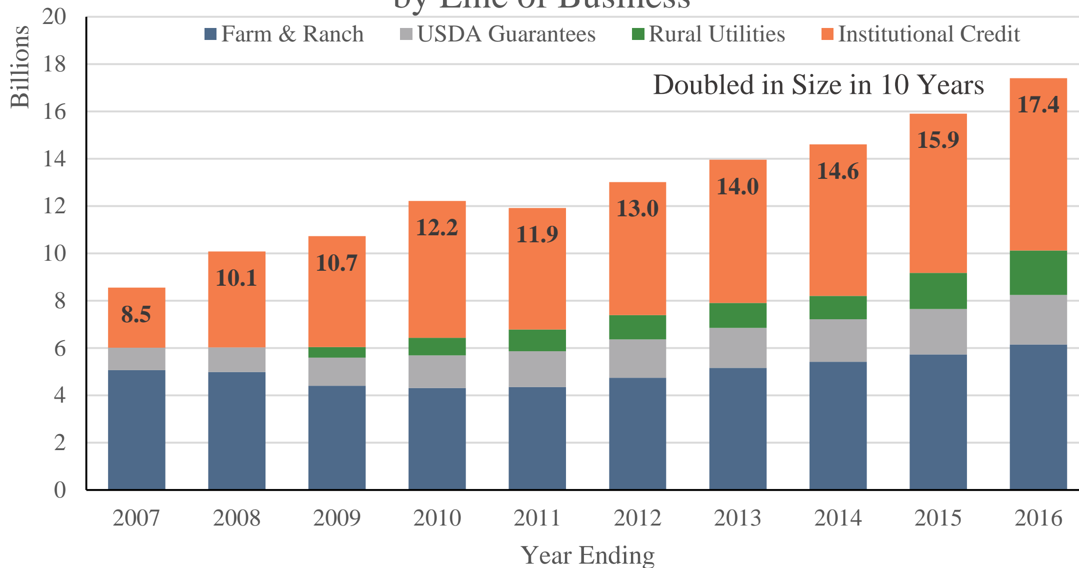
Chairman Scott, Ranking Member Scott, and distinguished Members of the Subcommittee, thank you for your invitation to appear today to testify on behalf of the Federal Agricultural Mortgage Corporation, which is commonly known as "Farmer Mac." My name is Tim Buzby, and I am the President and Chief Executive Officer of Farmer Mac. I appreciate the opportunity to appear before your Subcommittee today to provide some input on the next Farm Bill.

Farmer Mac

Farmer Mac's position at the intersection of Main Street and Wall Street allows us to provide a unique perspective about the current environment for agricultural credit and what might be beneficial to the secondary market in ensuring a vibrant credit environment. 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.

For nearly thirty years, Farmer Mac has played a vital role in financing rural America by helping America's rural lenders meet the evolving needs of their customers, bringing the financial strength, flexibility, and innovation of the secondary market for agriculture right to their customers' farms and ranches. Since Farmer Mac's creation in 1988, over 1,400 lenders across the nation have used Farmer Mac's programs and solutions to increase liquidity and lending capacity while better managing capital, interest rate risk, and credit risk. This translates into Farmer Mac having helped fund loans to over 76,000 rural borrowers in all 50 states for more than $43 billion of investments in rural America since 1988. By working with such a vast network of rural lenders, Farmer Mac introduces more competition, more types of loan products, and efficient funding into the marketplace, which helps your rural constituents receive low interest rates on favorable terms tailored to meet their financing needs and keep pace with today's capital-intensive environment. Farmer Mac has also been successful in encouraging the inclusion of loans for small farms and family farmers in the agricultural mortgage secondary market. In 2016, 46% of loans in the Farm & Ranch line of business were to small farms (less than $350,000 in annual gross farm income) and 96% of loans in the Farm & Ranch and USDA Guarantees lines of business were to family farming operations. The two figures below provide more information about Farmer Mac's growing importance in financing rural America.





Farmer Mac grew out of the financial crisis that gripped agriculture and farm lenders during the mid-1980s. As this Committee and Congress contemplated solutions to this crisis, it became clear that the rural credit market would benefit from a new source of liquidity and long-term credit that could help provide new risk management tools to lenders and the necessary capital

and liquidity demanded by the producers of agricultural commodities and products. That vision and the related solution resulted in the creation of Farmer Mac.

The agricultural credit conditions in the 1980s that led to the creation of Farmer Mac are somewhat different compared to current conditions, but they are similar in many ways. Currently, many producers in several sectors of the agricultural economy have seen significant declines in income and experienced other challenges for the past few years. The existence of a strong, vibrant secondary market continues to be essential because it can still be difficult to attract capital to invest in rural America like it was when Farmer Mac was created. Simply put, rates of return in rural communities are generally not as high as in urban areas, so obtaining capital to meet the lending needs of rural America can be challenging and is often more expensive. Congress has always responded to the unique challenges faced by rural America, which has resulted in tremendous improvements in the lives of your constituents and Americans in general. Rural Americans provide the food and fiber that all Americans and much of the world relies upon. The legislative initiatives that your predecessors on the Agriculture Committee supported to increase the availability of credit in rural America, such as the Farm Credit Act, the Rural Electrification Act, and the creation of Farmer Mac, were designed to ensure that we as a nation can grow and prosper. As times and business practices change, so can some of these programs to better reflect the current realities of rural finance and the needs of rural borrowers.

Proposals That Could Enhance Farmer Mac's Financing of Rural America

U.S. Agriculture represents one of the greatest success stories in America's modern history. In the span of only 50 years, the United States has more than doubled its total agricultural production while substantially increasing efficiency. The share of disposable income spent on food in the country is only about 9.8% - a number that the world at large strives toward. This has been achieved while the share of the population directly involved in agriculture has shrunk to such historically low numbers that each commercial scale farm is responsible for feeding over 200 people. However, although actual agricultural production and operations have evolved over time, some policies related to rural finance enacted through legislation, including several provisions of Farmer Mac's charter, have not kept up with the changing landscape.

"1,000-Acre Rule"

On a near daily basis, Farmer Mac receives requests from lenders of all types to either purchase or provide credit protection for agricultural mortgage loans secured by parcels of land larger than 1,000 acres. Unfortunately, we must reject many of those requests because our charter limits our activities related to those loans unless the loan amount is equal to or less than $12.6 million (an amount that is adjusted annually for inflation). We have heard from many customers who believe that this "1,000-acre rule" is counterintuitive and inconsistent with Farmer Mac's mission of increasing the availability of credit in rural America because it limits the amount of loans for larger operations that generally have a significant need for capital, while smaller operations with generally lower capital needs have no statutory loan limit.

The legislative history of Farmer Mac's charter does not explain the policy reason for this limitation on Farmer Mac's authority to offer the benefits of a secondary market to the lenders and borrowers on loans secured by more than 1,000 acres. However, whatever the original purpose of the limitation was, the most likely reasons for the 1,000-acre rule's inclusion in Farmer Mac's charter no longer apply to the same degree as when Farmer Mac was created and therefore should be removed for the following reasons:

- If the 1,000-acre rule was originally designed as a means of mitigating risk to ensure the safety and soundness of a start-up operation, Farmer Mac now has a demonstrated track record of sustained strong financial performance, sound underwriting, a diversified portfolio, and minimal credit losses that argue against the need for the limitation. Indeed, Farmer Mac is well-positioned to manage the risks associated with higher loan limits for larger operations, with a Tier 1 capital ratio of 12.7% as of December 31, 2016.

- If the original intent of the 1,000-acre rule was to limit the benefits of Farmer Mac's programs available to large farms owned by passive investors outside of rural America, the rule is now preventing benefits from flowing to many large operations owned and operated by individuals and families. Outside and passive investors have not come to dominate agricultural production as once feared, as family farms continue to dominate farm production. Family farms currently make up approximately 97% of all farms, 90% of land operated, and 85% of the value of agricultural production, so most of the tracts of agricultural real estate of more than 1,000 acres are owned by families.

- If the original intent of the 1,000-acre rule was to limit the benefits of Farmer Mac's programs available to very large operations, the limitation is now also preventing benefits from flowing to even mid-size operations because the acreage limit was not indexed to increase over time to reflect changes in the agricultural economy and production practices. When Congress created Farmer Mac, half of agricultural production occurred on farms with 589 acres or less. Today, based on USDA's most recent Agricultural Census in 2012, the midpoint cropland farm size has increased to 1,200 acres, meaning that more than half of agricultural production takes place in operations that could be adversely affected by the 1,000-acre rule. Elimination of this limitation in Farmer Mac's charter would better reflect current farm ownership sizes and the capital needs of agricultural producers.

The 1,000-acre rule constraint on Farmer Mac's activities is having a detrimental effect on the liquidity, capital, and risk management tools that Farmer Mac can provide directly to rural lenders and the pricing and product benefits that Farmer Mac can provide indirectly to America's farmers and ranchers. This negative effect applies not only to Farmer Mac's loan purchase and credit protection products, but also to its institutional credit products designed to provide efficient, low-cost wholesale funding advances to rural lenders. Therefore, the elimination of the 1,000-acre rule would also increase the eligible collateral that would facilitate these wholesale funding advances. Congress can alleviate the negative effects of the antiquated 1,000-acre rule by eliminating this limitation in Farmer Mac's charter altogether. This would allow Farmer

Mac's board of directors to set overall loan limits without regard to acreage as a part of the company's overall risk management, subject to appropriate oversight by Farmer Mac's independent safety and soundness regulator – the Farm Credit Administration.

Eligible Borrowers

Another simple proposed change to Farmer Mac's charter that would reflect the evolution and current realities of agricultural lending and better serve the needs of rural borrowers is to expand the definition of the borrowers who are eligible to have their loans participate in Farmer Mac's programs. Under Farmer Mac's charter, the company's secondary market activities related to Farm & Ranch loans are limited to the obligations of individuals or private corporations or partnerships. This limited definition of the eligible borrowers for qualified loans does not contemplate other borrowing and land ownership vehicles that have become much more common over time, including family trusts and other business entities and family farming ownership structures such as limited liability companies. In particular, the family trust structure has become a much more common way to own agricultural land and to borrow money secured by that land. Including trusts and other business entities as eligible borrowers for loans included in Farmer Mac's Farm & Ranch line of business would simply recognize the reality that these types of ownership vehicles are widely-used structures now, unlike in 1988 when Farmer Mac was created, and would increase Farmer Mac's ability to serve America's farmers and ranchers.

USDA Guaranteed Loans

Congress revised Farmer Mac's charter in 1990 to authorize Farmer Mac to purchase the guaranteed portions of loans guaranteed by the Secretary of Agriculture under the Consolidated Farm and Rural Development Act (the "ConAct"). The business permitted by this expanded operating authority is known as Farmer Mac's USDA Guarantees line of business, which offers lenders ready access to competitive funding rates available in the capital markets. Lenders can in turn pass those benefits on to borrowers in the form of longer-term rates, lower rates, or both.

At the time of the creation of Farmer Mac's USDA Guarantees line of business, it appears that Congress used the ConAct as a proxy for all the USDA guarantee programs that could benefit rural America and did not envision rural-related loans that USDA might one day guarantee under authority other than the ConAct. Since 1990, USDA has continued to expand the programs it offers to qualified rural borrowers through various programs. However, with Farmer Mac's limited authorities to purchase only the guaranteed portions of loans guaranteed under the ConAct – primarily Farm Service Agency (FSA) loans, Community Facility (CF) loans, and Business & Industry (B&I) loans – Farmer Mac has been unable to provide liquidity to lenders making loans under new and other longstanding non-ConAct USDA programs that benefit rural America. Many rural lenders want to make additional USDA guaranteed loans but need a secondary market for the liquidity it provides. USDA could expand service, lending, and liquidity to rural America through Farmer Mac's secondary market if Congress amended Farmer Mac's charter to authorize the purchase or securitization of the portion of <u>any</u> loan guaranteed by USDA. This expanded authorization would include USDA's guarantee programs related to agricultural exports, rural housing, rural utilities, and renewable energy, all of which have the

potential to benefit rural America. As with the other two proposed charter updates described above, all types of lenders who use Farmer Mac would both benefit from these proposed changes.

Crop Insurance

As the Committee begins its preparation for the next Farm Bill, I would also like to point out the importance of federal crop insurance programs to the agricultural lending community and express Farmer Mac's strong support for this essential part of the safety net for agriculture. Crop insurance has become the cornerstone of farmers' risk management activities, allowing a very capital intensive industry to make production decisions that include considerable external risk from weather and market vagaries, and achieve the remarkable efficiency and productivity noted earlier. Some key points about the federal crop insurance programs:

- Crop insurance has undergone a modernization and scaling that parallels production agriculture with total program liability that has grown from about 1.1 million policies with $840 million in premium and $12.8 billion in liability in 1990 to over 2.2 million policies with $9.3 billion in premium and over $100 billion in liability in 2016.

- Crop insurance programs now cover virtually all the commercially important acreage of major row crops, and there are now nearly 200 total different crop policies.

- Farmers' use of crop insurance has moved dramatically toward higher coverage level elections and toward revenue products, further signaling the successful design and deployment of the programs.

The effects of crop insurance are profound both for insured producers and for those beyond the farmgate. For example, in 2012 the eastern corn belt experienced a historic drought, and crop insurance worked as intended, largely filling in the deepest gaps and preventing widespread financial disasters while allowing affected farmers to continue in production in future years. Additionally, there were no ad hoc disaster payments that year, and very minor spillover effect to lenders and other capital providers. In the absence of crop insurance, it is safe to say that the financial malaise in the drought stricken areas likely would have been of historic proportions. Clearly, lenders rely indirectly, but very importantly, on the coverage provided to their borrowers and would be less able to provide financing in the absence of these critical programs.

In terms of possible designs of safety nets, those studying crop insurance note several positive features including the direct countercyclicality of insurance – it pays when revenues are low and not when revenues are higher thus directly reducing financial risk. Furthermore, farmers have a direct stake or deductible in the program and are induced to continue to improve efficiency and make best management practices along the way while customizing their coverages and unit designs for their own circumstances. Crop insurance coverage also allows meaningful marketing and advance pricing decisions to be made, thereby improving related management practices as well. Finally, and perhaps most importantly, modern crop insurance programs allow farmers to

make efficient use of debt, and allow lenders to more confidently lend to an industry in which one of the key risks is related to weather risk outside of the control of the managers.

Social benefits have also been noted related to crop insurance, including the fact that lower risk production systems likely reduce the cost of food to consumers. Crop insurance also has appropriate classification in the World Trade Organization (WTO) support classification system, and most importantly, has preferred attributes relative to ad hoc disaster programs which it has largely offset. A final critical point is that crop insurance naturally "scales" relatively easily. As farm sizes have continued to grow, and as the costs of production and capital intensity of agriculture have increased, crop insurance remains proportional to the risks covered by its very design. In this regard, it is a mechanism that is naturally indexed to the changing scale and intensity of agricultural production units, a desirable feature of any program that is intended to continue to serve the agricultural sector as it evolves further toward ever increasing scale and efficiency.

Conclusion

I want to thank you for this opportunity. Farmer Mac serves as an essential bridge between investment capital and main street rural America, and we are honored to collaborate with our customers in helping to build stronger rural communities. Throughout the inevitable agricultural economic cycles, Farmer Mac remains resolute in our commitment to provide financial tools to extend the type of flexible, low-cost financing that is necessary to help allow rural America to adapt, grow, and flourish. Our commitment to our mission has never been stronger or more important at this time when significant portions of the agricultural economy continue to face challenges. Because Farmer Mac does not depend on funding from taxpayers, Farmer Mac's secondary market is one of the few resources that can be brought to bear to help increase the availability of credit in rural America without running up against federal budget restraints. By updating our charter to recognize the ever-evolving financing mechanisms that facilitate modern farming, we will be better able to bring the power of the secondary market to our customers and your constituents.