Testimony of Glen Keppy
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United States Department of Agriculture

before the

Committee on Agriculture, Nutrition, and Forestry
United States Senate
June 13, 2006

Mr. Chairman, and members of the committee, thank you for the opportunity to appear before you to review the current state of Farm Loan Programs (FLP) at the Department of Agriculture. I am pleased to be able to share vital administrative and FLP accomplishments by the Farm Service Agency (FSA) over the past several years. We will provide a brief overview of our key programs, a comparative analysis of current trends versus where we were ten years ago, and perspectives of ongoing implementation challenges we face as we continue to administer FLP.

Farm Loan Programs Overview

FSA makes direct and guaranteed farm ownership (FO) and operating loans (OL) to family-size farmers and ranchers who cannot obtain commercial credit from a bank, Farm Credit System, or other lenders (Chart 1). FSA loans can be used to purchase land, livestock, equipment, feed, seed, and supplies. Our loans can also be used to construct buildings or make farm improvements.

Under its Farm Ownership and Farm Operating Loan programs, FSA has the following amounts outstanding:

- Direct Farm Ownership: $2.928 billion
- Guaranteed Farm Ownership: $5.311 billion
- Direct Operating Loan: $2.524 billion
- Guaranteed Operating Loan: $3.428 billion

Emergency loans are also available to help producers recover from losses in counties declared or designated as disaster areas or plant and animal quarantine areas and contiguous counties. Other programs include the Indian Tribal Land Acquisitions Loan Program (ITLAP) and the Boll Weevil Eradication Loan Program.

FSA loans are often provided to beginning farmers, ranchers and applicants designated by the Congress as socially disadvantaged (SDA) who cannot qualify for conventional loans because they have insufficient financial resources. FSA provides temporary assistance to established farmers who have suffered financial setbacks from natural disasters, or whose resources are too limited to maintain profitable farming operations at commercial lending rates and terms. FSA guaranteed loans provide conventional agricultural lenders with up to a 95 percent guarantee of the principal and/or interest losses should the borrower default. The lender is responsible for servicing a borrower's account for the life of the loan. All loans must meet certain qualifying criteria to be eligible for guarantees, and FSA has the responsibility to monitor the lender's servicing activities. Farmers first apply to a conventional lender, which then arranges for the FSA guarantee.

FSA makes and services direct FO and OL loans. We provide direct loan customers with credit counseling and supervision so they have a better chance of success in their farming operation. To qualify for a direct loan, the applicant must meet the eligibility criterion as well as show sufficient repayment ability and pledge collateral to fully secure the loan.

Modernization Trends
Agriculture is a very dynamic industry. Recent changes in the operating environment have been enormous. This requires that FSA also must be aggressive in keeping pace and must modernize our operations.

Briefly, our recent accomplishments include:

Farm Business Plan. Business plans for FSA borrowers are now processed through a Web based system. This provides access to "real time" data on our portfolio while sharing data among our automated systems. This system also provides a reporting option. We have established some standard reports that reveal the financial status of our portfolio. In the future, we will be developing additional reports that will allow us to assess the impact of economic changes in the agricultural sector so that we can anticipate their impact on our borrowers. This also allows lenders to provide information to FSA on guaranteed loans electronically. In the future, we expect that borrowers and applicants using this software will be able to provide their financial information to us via the Web.

This system has allowed our loan officers to conduct more extensive and meaningful financial analysis of our borrower's portfolios thus enhancing their opportunities for success and graduation to commercial lending.

Currently, we are moving all of our automated systems to the Web. When this project is completed we will eliminate duplicate data collection and farm loan services will be delivered more efficiently. Our employees will be able to conduct USDA business from any location where there is broadband, WIFI or dial-up Internet access. This will allow us to conduct business with producers at locations and times convenient to them. Additionally, this information will be stored on a centralized server allowing employees to quickly access portfolio information and provide real time management reports.

Guaranteed Loans are processed under the Guaranteed Loan System (GLS), an integrated software system shared between USDA's Rural Development and FSA. GLS has been Web enabled since May 2001, with ongoing refinements to make it more efficient and user-friendly. Lenders will soon have access to the system to report their loan closings, which will further reduce the time of finalizing the guarantee transaction.

FLP Streamlining. FLP is in the final stages of streamlining regulations on its direct loan programs (guaranteed loan regulations were streamlined in 1999). This streamlining effort will provide FSA employees with additional time to devote to servicing other customer needs. Once implemented, it will deliver three key benefits:

1) Consolidate and reorganize 13 CFR parts into five parts and 42 instruction manuals into four handbooks;
2) Modify loan making and servicing processes within current statutory authorities; and
3) Improve, rather than eliminate, existing program processes.

Farm Loan Programs Risk Assessment (FLPRA). FSA developed a risk based oversight program to identify areas for potential risk in our portfolios. State reviews are conducted by national FLP staff once every five years and by state office staffs who must review one-third of their service centers each year. Potential risk areas are separated into three broad categories:

1) Program Management;
2) Program Objectives; and
3) Financial Integrity.

Data is obtained from the FLP automation sources. This process was piloted in FY 2005 and implemented in FY 2006.

800-Number. In February 2006, FSA introduced a new 24-hour, toll-free line that borrowers can call to get information on their accounts. They can check their current account status, loan balance, due date of the next installment, historical data on their various loans, and general information – such as the amount of interest paid – to help them in calculating their income taxes.

To date, the 800-number has received more than 1,200 calls. FSA will be expanding awareness of this resource by highlighting its availability on year-end statements sent to each borrower, as well as on all courtesy reminder notices that are sent 60 days before payments are due.

Comparative Framework: That Was Then – This Is Now

The quality of our portfolio has improved significantly due in large part to our modernization efforts, better customer service and the dedication of FSA employees, as well as the much improved farm financial environment of the past six years.

FLP continues to emphasize the importance of processing applications in a timely manner. Between FY 2001 and FY 2005, FLP reduced its direct application processing timeframes by nine days (20 percent), and reduced guaranteed processing timeframes by four days (22 percent).

Loss Rates. In FY 2005, losses in the direct loan program fell to their lowest level in nearly twenty years – just 3.6 percent. FSA has experienced a steady decrease in direct losses over the past decade, from a high of 11 percent in FY 1996 (Chart 2).

Losses for FY 2005 in the guaranteed loan program were 0.4 percent, the lowest level in at least 10 years (Chart 3).

Delinquency Rates. As with losses, the direct loan delinquency rates are at historic lows for the past two decades at 9.3 percent for FY 2005 (Chart 4). This is the result of steady and dramatic decreases from a 23.8 percent delinquency rate in FY 1995. The decrease was facilitated by expanded authority, since 1996, to offset federal payments, salaries and income tax refunds to delinquent borrowers.

In the guaranteed program, the FY 2005 delinquency rate was 1.67 percent, the lowest since 1995 (Chart 5).

Foreclosures. Foreclosure rates continue to be very low in the direct loan program. In 2005, FSA participated in 229 foreclosures, including cases initiated by other lenders against individuals who also had loans with FSA. This represents less than one-third of 1 percent of the agency's direct loan caseload, and is a slight decrease from the previous two years, when the rate was just over the one-third of 1 percent level.

Inventory Properties. Inventory farm properties – those that have come into government ownership through voluntary conveyance or foreclosure – are also at historic lows with just 133 farms covering 25,000 acres in FY 2005. Just a decade ago, FSA held nearly 1,800 farms covering 598,000 acres. Many of those inventory properties were sold to established and beginning farmers, providing those individuals with prime opportunities to expand or create new operations.

Graduation Rates. Federal law requires FSA to "graduate" its borrowers to commercial credit when they have made sufficient progress to be able to qualify for loans from other lenders. They are assisted by the agency in refinancing their direct loans with FSA guaranteed loans from commercial lenders. Some 3,611 direct loan borrowers (4.63 percent) were able to graduate in FY 2005, a percentage comparable to the rates over the past ten years.

Beginning and SDA Farmer Participation. FSA has annual performance goals in place for field offices that reflect the Government Performance and Results Act requirements. These goals include increasing lending to beginning and SDA farmers and ranchers.

FSA continues to provide assistance to minority farmers in greater proportions than their demographic percentage of the total farming population (Chart 6 / Table 1).

FSA has increased the amount of loan funds obligated to beginning farmers and ranchers and to SDA applicants. The FSA direct loan beginning farmer caseload increased from 3,474 in 1995 to 15,704 in 2005. During this same period the FSA direct SDA caseload increased from 3,260 to 14,238. Guaranteed caseloads for beginning farmers and ranchers and SDAs were first reported in 1997. The FSA guaranteed beginning farmer caseload increased from 3,617 in 1997 to 7,910 in 2005. During this same period, the FSA guaranteed SDA caseload increased from 1,730 to 3,015.

Independent Study Results

Now, these improvements just cited are not our only assessments. Independent research verifies that FSA direct loan programs are operating effectively, and make a significant, positive impact on the groups they are intended to serve. Researchers at the University of Arkansas recently conducted a comprehensive review of FSA direct loan programs. In one facet of their research, they studied loan originations in fiscal years 2000-2003 and found that 92 percent of the direct loans originated in those years went to small farmers, that is, farmers with less than $250,000 in gross sales. They found that although FSA

farm loans assist only 4 percent of all farmers, because FSA farm loans are targeted to family farmers, an estimated 18 percent of all non-hobby family farmers depend on FSA for at least a portion of their financing.

The researchers also examined longer term outcomes of FSAs FLP. They reviewed the status of farmers who received loans between 1994 and 1996. The research found that 78 percent of the loans made during this period had been satisfied. They also found that of all the loan recipients during that period, only 11 percent left farming involuntarily. Bear in mind that all of these farmers cannot get commercial financing when they come to FSA for a direct loan.

In one key finding, the researcher concluded that given that direct loan recipients typically have weakness in their financial profiles and would likely have difficulty qualifying for commercial credit, the direct FLPs are largely servicing the intended clientele based on the agency's mission. Study findings, and other indicators in this testimony, clearly show that FSA's FLPs are doing a remarkable job of accomplishing what can only be described as challenging program objectives, and controlling operating costs and losses, as well.

Ongoing Challenges

As we look ahead in the ever-changing environment, FSA will face significant and ongoing challenges in the years to come. Some of the most prominent are term limits, loan limits, staffing constraints, and finding ways to help beginning farmers overcome the barriers to enter production agriculture.

Term Limits. The statute presently limits a borrower to direct OL loans in each of seven years, with an additional one-time, two-year waiver on an individual case basis:

- There are more than 7,000 FSA borrowers who can only receive direct operating loan assistance one more year from the agency; and
- There are more than 11,000 FSA borrowers who can only receive direct operating loan assistance two more years from the agency.

Without FSA direct loan assistance, many of these borrowers may be forced out of farming as they may not have access to the capital necessary for them to conduct their farming operations.

The statute presently limits borrowers with guaranteed OL loans to 15 years of eligibility, with receipt of a direct OL loan also counting as a year of eligibility for guaranteed OL loans. The 2002 Farm Bill suspended enforcement of this provision, but the suspension expires on December 31, 2006. Once the statutory suspension expires, more than 500 borrowers will be ineligible for any further assistance. An additional 1,200 borrowers will become ineligible for further assistance during 2007.

Loan Limits. The direct farm ownership loan limit ($200,000) was last adjusted in 1978. The direct operating loan limit ($200,000) was last adjusted in 1984. These limits are not

adjusted annually for inflation. Due to a statutory change in 1998, guaranteed loans are adjusted annually.

With the rising costs of farmland and operating expenses, these direct limits restrict the ability of direct loan borrowers to sustain their family operation and make it difficult for a beginning farmer to get started in farming.

Staffing Challenges. We estimate that as many as 25 percent of FSA's current loan officers will be eligible to retire by the year 2009.

On average, it requires about two years to hire and train a loan officer in order to provide the level of effective supervision, expertise and customer service needed to maximize every opportunity for success for FSA borrowers. The two year training window for new loan officers complicates an already cloudy staffing forecast.

FSA's portfolio and borrowers could be exposed to financial risk if retirement attrition projections for loan officers are even marginally accurate. A large percentage of FSA borrowers are either beginning farmers or financially stressed borrowers who need financial supervision. FSA loan officers provide this supervised credit which requires a complete knowledge of FSA programs, finances, and agriculture enterprises.

Barriers for Entry Level Farmers and Ranchers. There are some obstacles that make it difficult for entry level farmers and ranchers to launch production agriculture operations. There are several underlying factors that create barriers, including:

1) Initial capital investment;
2) High land values;
3) Inability to access credit;
4) Lack of farm succession planning;
5) Increasing interest rates; and
6) Higher energy costs.

Conclusions

Through modernization efforts, maintaining focus on program objectives, and the hard work and dedication of FSA employees, FSA farm loan programs have made great strides in improving program performance. Loan failures and losses have declined which is a strong indication that the program mission of helping farmers become successful is being accomplished. At the same time, increased assistance to small, beginning, and minority farmers, reflects remarkable success as well.

However, more challenges lie ahead. Government resources are increasingly limited and the agriculture production landscape is changing. The structure of agriculture continues to change as most farms become larger and increasingly more reliant on technology, resulting in increased capital needed to gain entry. The cost of assets required to operate a farm continue to increase as well. These changes pose significant barriers and challenges to the groups that FSA farm loan programs are intended to assist. These

issues create major challenges for the agency as well, since the success of the program depends on those whom the programs are intended to serve. To keep pace with these changes, we will continue efforts to modernize the delivery system, and to refine and adjust program requirements and operations to maximize the opportunities for our nation's small, beginning, and socially disadvantaged farmers and ranchers.

Because of our rural delivery system and experienced loan officers, the FSA farm loan programs staff is well positioned to continue the high quality delivery of existing programs and new initiatives to assist small, beginning, and minority family farmers. We look forward to working with this Committee to address the challenges we face in accomplishing this worthwhile mission to strengthen family farmers and rural America.

APPENDIX

Chart 1

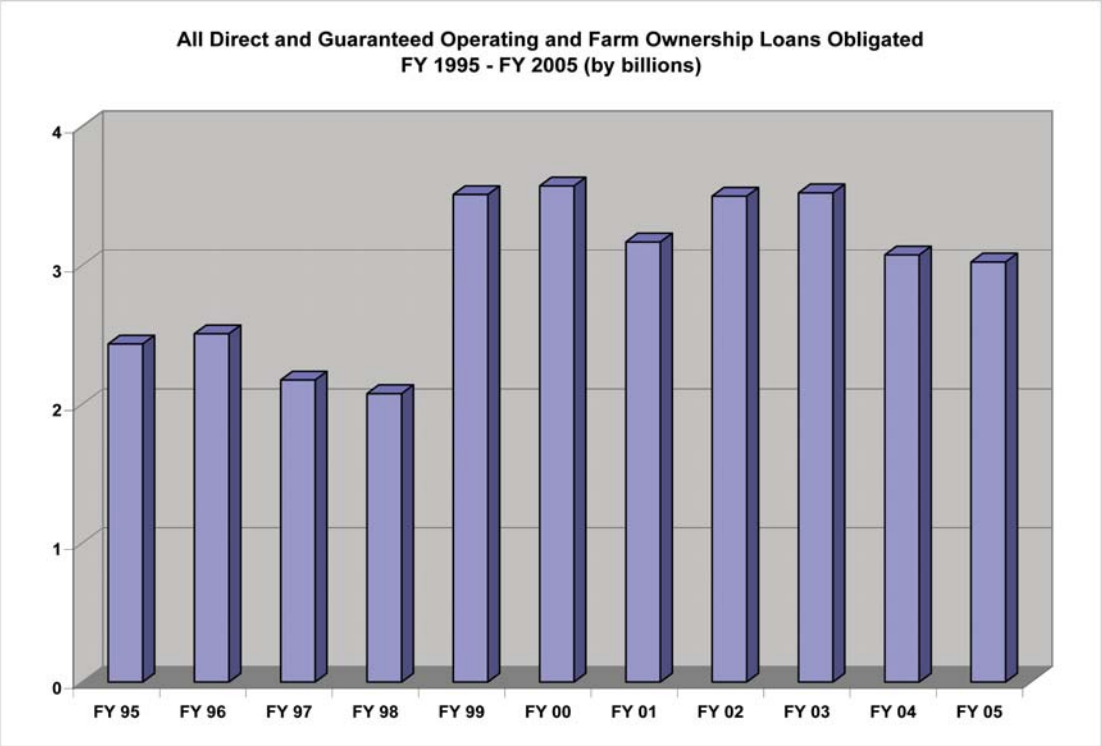

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Chart 2

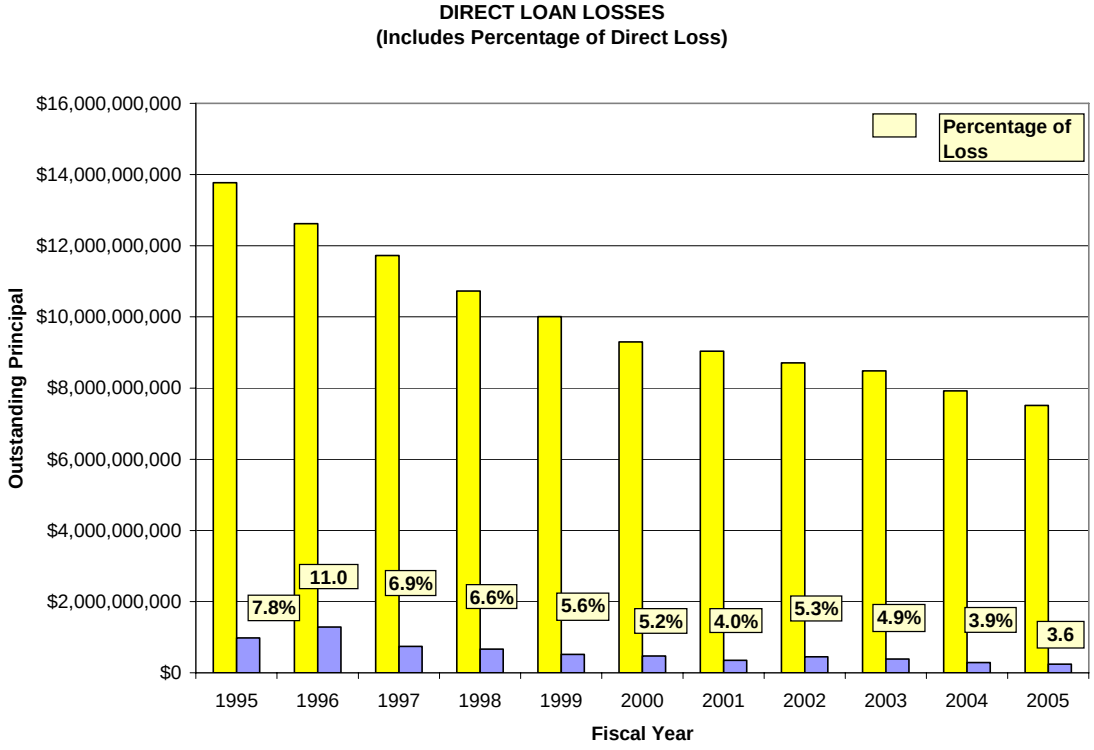


Chart 3

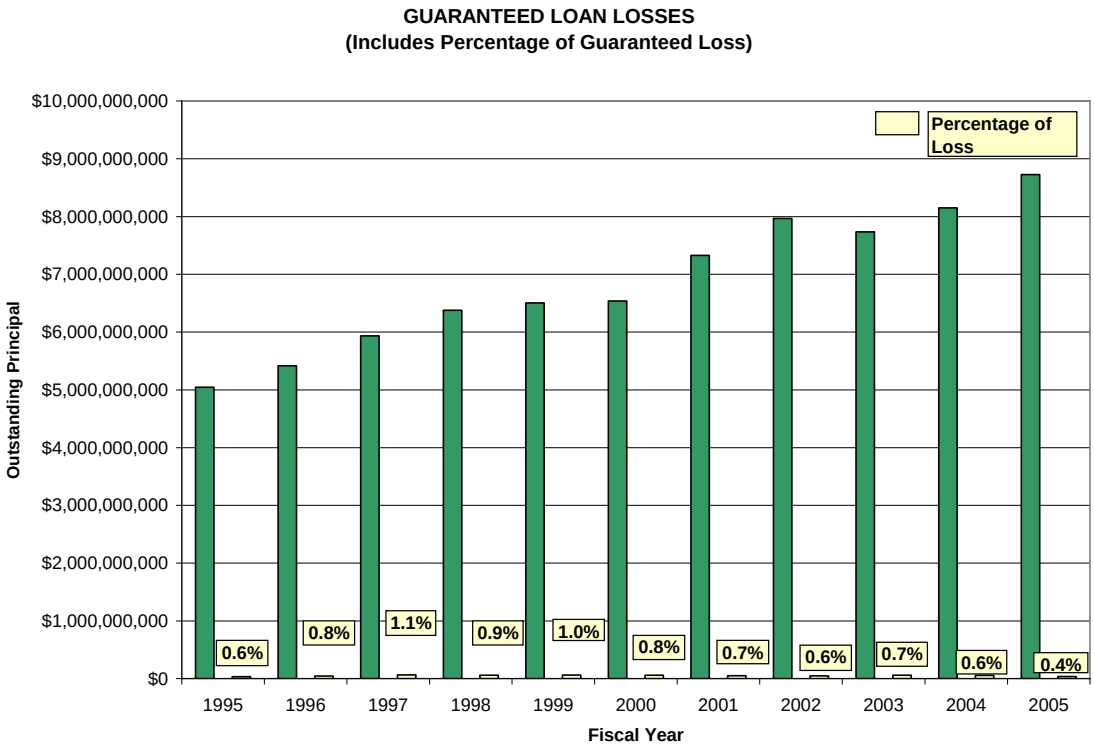


Chart 4

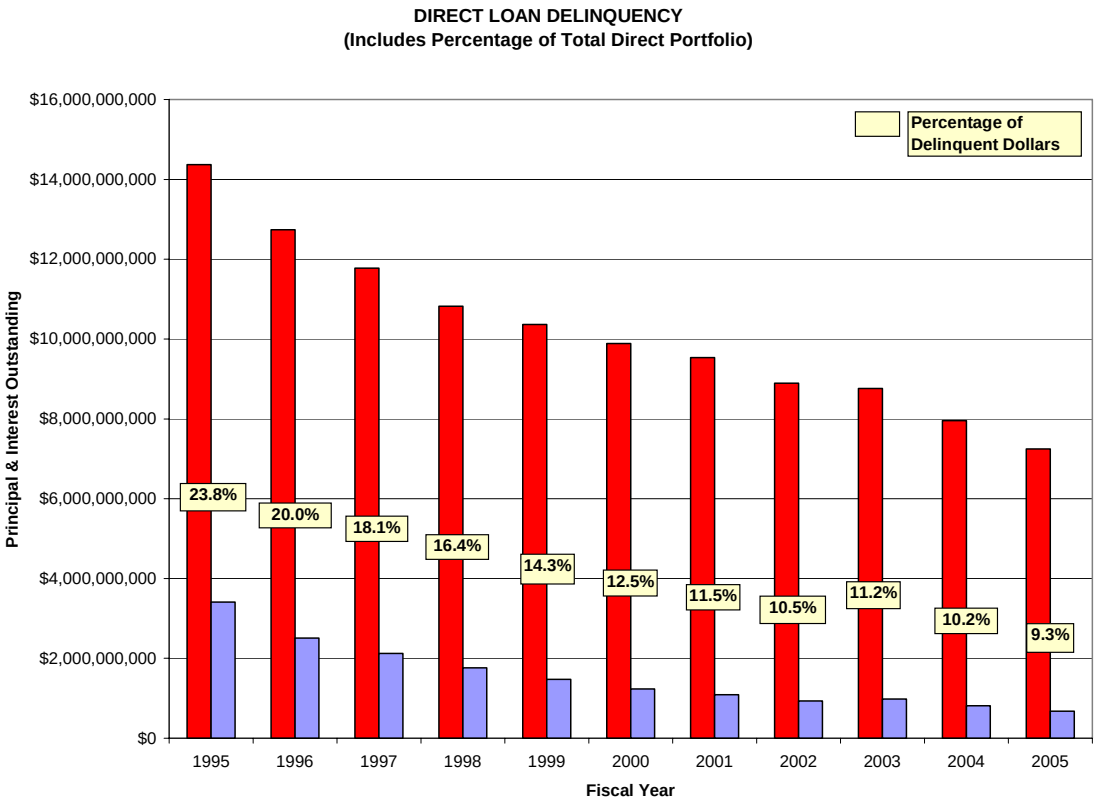


Chart 5

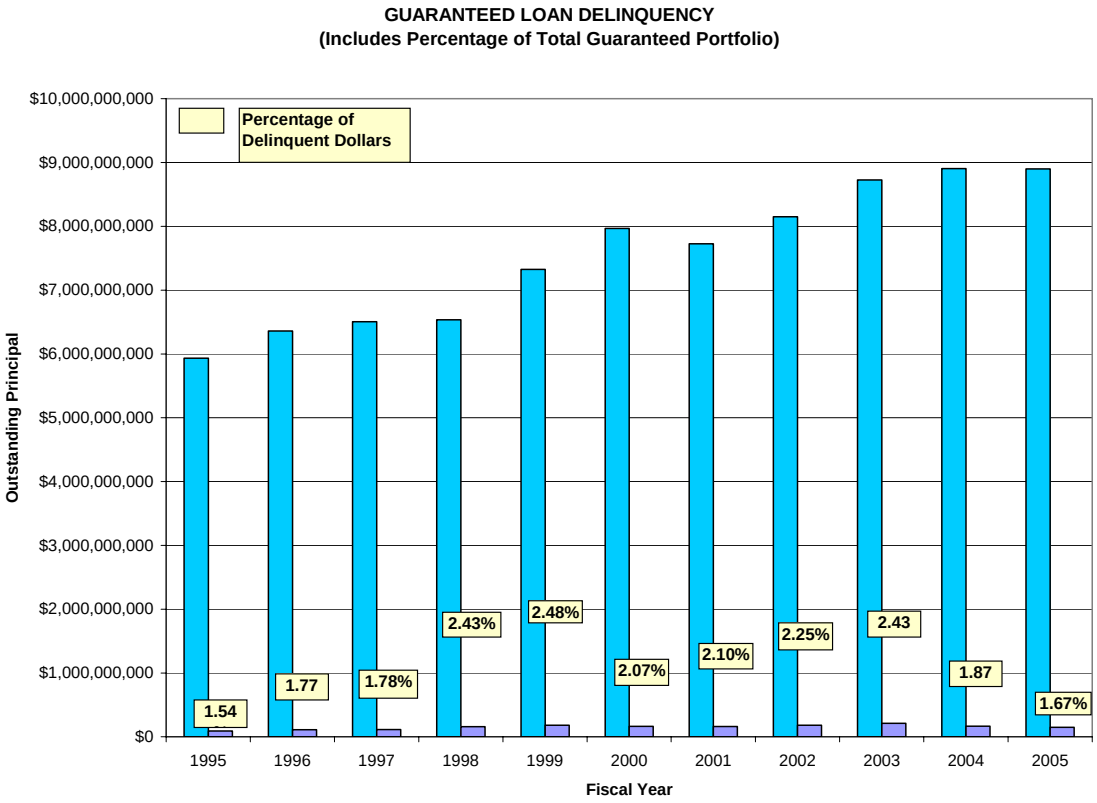
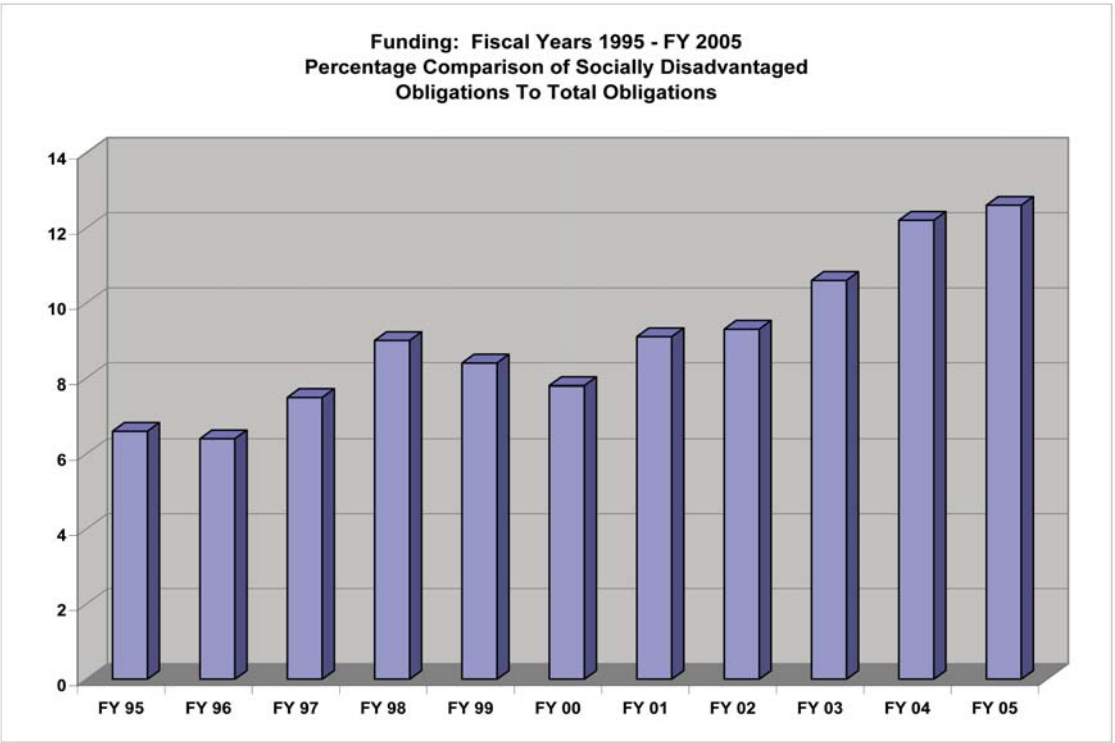

GUARANTEED LOAN DELINQUENCY
(Includes Percentage of Total Guaranteed Portfolio)
Percentage of Delinquent Dollars
Outstanding Principal
$10,000,000,000
$9,000,000,000
$8,000,000,000
$7,000,000,000
$6,000,000,000
$5,000,000,000
$4,000,000,000
$3,000,000,000
$2,000,000,000
$1,000,000,000
$0
1.54
1.77
1.78%
2.43%
2.48%
2.07%
2.10%
2.25%
2.43
1.87
1.67%
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
Fiscal Year

Chart 6



Percentage of Obligations to Total Obligations

Chart 6 / Table 1

FY 2005 BORROWER CASELOAD BY RACE
(As Compared to 2002 Census Data)

	Percent of 2002 Census Population	Percent of FY 2005 Direct Caseload	Percent of Population being served by FSA Direct Farm Loans	Percentage of FY 2005 Guaranteed Caseload	Percent of Population being served by FSA Guaranteed Farm Loans
White	97.46	88.13	3.16	95.38	1.77
Black	1.37	3.74	9.53	0.59	0.78
Asian/Hawaiin	0.44	0.92	7.30	2.09	8.56
Amer Ind/Al Nat	0.73	2.77	13.24	1.46	3.61
* Hispanic	N/A	4.27	N/A	0.37	N/A
Other	N/A	0.17	N/A	0.12	N/A

* Hispanic Americans are not a separate race category within the 2002 Census of Agriculture, therefore no reliable comparison can be established.