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United States Department of Agriculture
before the
House Committee on Agriculture
Subcommittee on Livestock, Rural Development and Credit

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Mr. Chairman and members of the Subcommittee, thank you for the opportunity to appear before you to provide an update on the credit conditions rural America now faces, and the current status and operations of the farm loan programs at the Farm Service Agency (FSA).

Credit Conditions

The farm economy has been strong the last couple of years with net farm income at an all-time high in 2013, and farmland values currently at, or near, record levels. However, record farm income is not sustainable. A bumper feed grain crop is being forecast for 2014 that could lead to a 27 percent decline in farm income from last year, but farm income is still forecast to be the 7^{th} highest to date. A slowdown in farmland value growth already has been observed. Furthermore, the high commodity prices in prior years did not benefit all producers equally as higher feed costs squeezed livestock and dairy producer margins leaving them with weak balance sheets in need of rebuilding. Compared to 2012, gross crop receipts are forecast to decrease by more than 15.2 percent in 2014, with a $20.2 billion decline in corn receipts and a $6.2 billion decline in soybean receipts expected.

On a historical basis, production expenses are anticipated to fall from 2013 levels, but will remain near their all-time highs, having grown to a forecasted $348.2 billion for 2014, which is a 21.1 percent increase over 2010. Therefore, large amounts of capital will continue to be required to finance agricultural production, increasing the demand for operating credit, financial leverage, and liquidity.

Finally with interest rates bottoming out and farmland values high, credit standards established by lenders and their regulators have been high since 2010 and will likely continue to be high for some time. Recent Federal Reserve Surveys indicate commercial lenders in most regions are maintaining stringent credit standards. This continued high level of loan scrutiny by lenders means some farmers still cannot qualify for commercial credit.

FSA Farm Loan Programs. Family farmers who do not qualify for commercial credit due to lender standards, but are otherwise creditworthy, can turn to the farm loan programs administered by FSA. The Agency assists farmers through direct and guaranteed farm loans. Direct loans are made and serviced by FSA; agency employees provide supervision and technical assistance to direct loan borrowers. Direct loans are not intended to be a permanent source of credit, and borrowers agree to obtain commercial credit and refinance their FSA debts when they are able to do so. In fact, of those borrowers having outstanding operating loans in 2000, only 14 percent remain in the FSA portfolio in 2014.

Guaranteed loans are made, funded and serviced by a commercial lender. FSA typically guarantees up to 90 percent of the loan principal and interest. FSA employees must evaluate and make a credit decision on all guaranteed loans. Guaranteed lenders must retain at least the non-guaranteed portion of the loan in their portfolio and are accountable for loan servicing under the FSA guarantee.

Funding. FSA farm loan programs are discretionary programs funded through annual appropriations. In accordance with the Federal Credit Reform Act of 1990 (as amended), appropriations for FSA farm loans are based on the projected total cost of loans when they are made. Federal budget resources are able to be significantly leveraged through the loan programs. In Fiscal Year (FY) 2014, $97.7 million in appropriations supported $5.53 billion in direct and guaranteed FSA loans which, when provided to American farmers and ranchers, resulted in a significant investment in the rural parts of our country. Prudent management and program administration, as evidenced by low levels of delinquencies and losses, has allowed FSA to increase leverage of limited budgetary resources over the past several years. For example, in FY 2010, $148.5 million in budget authority was required to support a total program level of $5.08 billion, while in FY 2014, a slightly larger program level requires 34 percent less budget authority.

Loan Demand. Activity in FSA's farm loan programs indicates that a significant number of farmers and ranchers continue to be unable to obtain commercial credit under current conditions. Farm loan program demand is usually a reflection of financial conditions in the farm economy: when the overall farm economy is strong, farm loan activity declines; during times of financial stress in the farm economy, demand for FSA loans rises. This makes sense, given that a basic requirement to qualify for the loan programs is to be unable to meet the criteria for commercial credit.

In early FY 2009, loan demand surged to levels that had not been seen since the early 1980s. Demand for farm loan program assistance in FY 2009, and in 2013, reached its highest levels since FY 1985. Demand has continued at, and in some programs increased above, those near-record FY 2009 levels. In each of the last four years FSA has closed out the fiscal year with a significant backlog in approved, but unfunded loans. Application activity in FY 2014 reflects demand levels similar to the higher levels of the previous 5 years. To manage the increased demand, the President’s budget request for FY 2015 recommended that loan levels to be increased to $6.4 billion. If these funds are provided, FSA expects, for the first time in many years, to have sufficient funds to meet the demand. This will allow our customers to better prepare and execute their business plans, and compete on an even playing field for land and pre-season discounts on inputs.

Over the past 2 years, an unusually high number of direct operating loan applications have been received from new customers. Normally, about 20 percent of direct operating loan applications in any given year are from farmers who do not have FSA loans. In FY 2013, 37 percent of the direct operating loans made were to customers who did not have existing FSA operating loans.

Performance and Portfolio Conditions

Farm loan programs continue to emphasize the importance of processing applications in a timely manner. Between FY 2008 and FY 2013, the length of time to process direct loans has averaged 28 days. During this period, FY 2010 (the largest loan volume year since the mid-1980s) had the highest average, at just less than 31 days, while the lowest of 25 days was achieved in FY 2013. Similarly, loan processing timeliness in the guaranteed loan program has remained very strong with an average of 9 days over the past 6 years. These results for both the direct and guaranteed programs represent historic lows. This strong performance is continuing in FY 2014. As of May 31, 2014, the average processing time for the direct loan program was 24 days, and 9 days for guaranteed loans. These long-term results are remarkable given that loan demand has surged and staffing levels have declined. The fact that there has not been a noticeable deterioration in application processing time is a testament to the dedication of FSA field staff, implementation of efficiency measures in loan processing, and the effectiveness of the Information Technology (IT) solutions farm loan programs has deployed.

As of May 31, 2014, the FSA direct loan portfolio consisted of $8.2 billion owed by 70,445 borrowers, while the guaranteed portfolio consisted of $11.5 billion owed by 33,847 borrowers. The quality of our portfolio has continued to improve, with foreclosure and loss rates falling while borrower graduation to commercial loans has increased.

Loss Rates. In FY 2013, losses in the direct loan program were just 1.6 percent (see Chart 1). Losses for FY 20l3 in the guaranteed loan program were 0.3 percent, (see Chart 1).

Delinquency Rates. As with losses, the direct loan delinquency rates have been at historic lows for the past two decades at 5.4 percent for FY 2013 (see Chart 2). 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 delinquent borrowers' loan obligations with their federal payments, salaries and income tax refunds. In the guaranteed program, the FY 2013 delinquency rate was 1.07 percent; the lowest on record (see Chart 2).
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Graduation rates: FSA does not provide permanent financing; direct loan borrowers are required to move to commercial credit or graduate when they are able to do so. Statistics indicate that the vast majority of borrowers leave the FSA portfolio in a relatively short (given a potential 40+ year farming career) period of time. Eighty six percent of the operating loan borrowers in the FSA portfolio in 2000 no longer owed an operating loan by 2013. In the farm ownership program, over 70 percent of the borrowers in the FSA portfolio in 2000 had left by 2013. These statistics indicate the program is providing new and beginning farmers an opportunity to obtain credit, but after establishing themselves financially, are able to seek and obtain commercial credit.

Equitable treatment and participation

I, along with all members of the FSA management team, remain fully committed to providing equal access and opportunity to all those FSA serves. In FY 2013, while FSA received more than 50,000 loan applications, more than 2,700 loan servicing requests, and tens of thousands of applications for various farm commodity, income support, and disaster assistance programs, the Assistant Secretary for Civil Rights received only 19 civil rights complaints related to FSA programs. While this is the lowest number of FSA civil rights complaints received since records have been kept, it is our goal to further reduce this number.

I will closely monitor the operations of farm loan programs to assure that our producers, program applicants, and employees receive fair and equitable treatment. I want to update you on a few key activities dealing with these important issues.

Program participation. An examination of the composition of FSA's loan portfolio indicates that FSA finances socially disadvantaged farmers at a much higher rate than that groups' proportion of the farm population. FSA has significantly increased the amount of loan funds provided to socially disadvantaged applicants. Between 2008 and 2013, the FSA direct loan caseload for socially disadvantaged borrowers increased from 14,068 to 15,514.

New and Beginning Farmers. The continuing increase in the average age of farmers and decline in rural population both point to a pressing need for more beginning farmers. As a result, assisting and fostering beginning farmers and ranchers remain a primary concern and focus for FSA farm loan programs. While the general strength of the agriculture economy is certainly a positive factor for rural America, the resulting increases in land values and other capital costs have made it ever more difficult for beginning farmers to get started and become established. More than ever, beginning farmers need a hand up to start their journey toward success.

FSA is committed to effective use of farm loan programs and authorities to assist beginning farmers. Beyond implementation of the 2014 Farm Bill provisions benefitting beginning farmers, FSA has implemented or modified programs under existing authorities to better fit the needs of beginning farmers. Most notably, the microloan program, a subset of the direct operating loan program, has been tremendously successful in assisting beginning farmers. This program, launched in January 2013, reduces paperwork by half and is designed to fit the business plans of non-commodity operations such as local food, community-supported agriculture, urban agriculture and niche market farm businesses which are attracting many beginning farmers. So far this year, 72 percent of the microloans made have gone to beginning farmers. Although the program is still new, performance, so far, is very good, with over 7,200 loans made.

In addition to the microloan program, FSA implemented a “streamlined loan” application process for repeat operating loan customers with good repayment history on FSA loans. This allows FSA to provide more timely service to many beginning farmer borrowers and frees staff time so they may spend more time with those borrowers who need additional help or technical assistance.

2014 Farm Bill Implementation. Congress also recognized the criticality of the situation for beginning farmers and re-affirmed the focus on them for FSA programs in the 2014 Farm Bill. FSA continues to strive to reach more beginning farmers and ranchers and has increased the amount of loan funds provided to beginning farmers and ranchers. The FSA direct loan caseload for beginning farmers increased from 18,785 in 2008 to 31,659 borrowers in 2013.
FSA was able to implement several nondiscretionary provisions of the Farm Bill shortly after enactment, including provisions to increase the guarantee percentage on guaranteed conservation loans, reduce the interest rate on joint financing loans, increase the loan limit on down payment loans, eliminate guaranteed loan term limits, change the land ownership limitation for beginning farmer applicants, eliminate the restriction on youth loans to rural areas, and reduce credit limitations for delinquent and defaulted youth loan borrowers. Several of these had an

immediate impact on beginning farmers. In particular, the change in interest rates on joint financing farm ownership loans benefitted hundreds of applicants with applications pending, but not yet funded, at the time of implementation.

Several additional Farm Bill provisions will be implemented through an interim rule scheduled for publication in October 2014, including changes to eligibility rules for entities, experience requirements for direct ownership loans, and increasing the microloan limit to $50,000. These provisions will add flexibility or enhance programs for beginning farmers as well. The Agency plans to publish a request for suggestions for pilot projects authorized in Section. 5302, and hopes to receive suggestions for projects that demonstrate new approaches to assist beginning farmers and others through farm loan programs. In addition, we are prepared to implement the Individual Development Accounts authorized by the Farm Bill if funding is provided.

IT Modernization. Farm loan programs has also implemented modern, web-based systems to manage the loan application, approval and funding process. This system provides real-time management data on application activity and allows the Agency to better cope with funding problems and act quickly when necessary. For example, when the Agency received supplemental funding in the American Revitalization and Recovery Act, over 2,000 farmers were waiting for desperately needed direct operating loans to pay 2009 planting and other farming expenses. When funds were made available to FSA, the Agency was able to process obligations overnight, and funds began flowing into farmers' bank accounts only 3 days later. I am proud to say that FSA was one of the first agencies in the Government to get recovery dollars flowing to those who urgently needed it. The modern, web-based IT systems in place for farm loan programs, such as the Direct Loan System and the Program Funds Control System, were, and are, a key factor in our ability to provide such timely service.

The continued efforts to move all automated systems to the Web will allow for the elimination of duplicate data collection and for farm loan services to be delivered even more efficiently. This will further our mission to conduct USDA business from any location where there is broadband or WIFI Internet access and allow us to conduct business with producers at locations and times convenient to them. Additionally, loan information is stored on a centralized server allowing employees to quickly access portfolio information and provide real time management reports.

Conclusion

Through modernization efforts, maintaining focus on program objectives, and the hard work and dedication of FSA employees, FSA farm loan program staff has 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 socially disadvantaged farmers, reflects remarkable success as well.

However, we continue to face challenges. Government resources are increasingly limited and the agriculture production landscape is changing. It will require every bit of innovation, management expertise, and determination that we can muster to maintain the efficiency and efficacy of farm loan programs over the next several years.

We are experiencing a unique set of conditions in the credit and banking sectors, and to a large extent, in agriculture. 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 look forward to working with you to continue efforts to modernize our delivery systems, 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 and to seek a level of resources appropriate for this important mission.

Because of our rural delivery system and experienced loan officers, FSA’s farm loan programs staff is well positioned to continue providing high quality delivery of existing programs and new initiatives to assist small, beginning, and socially disadvantaged family farmers.

Thank you for allowing me to share our Department of Agriculture perspective as you seek to address this important issue. I am available to answer your questions now or at any time in the future.

Chart 1:

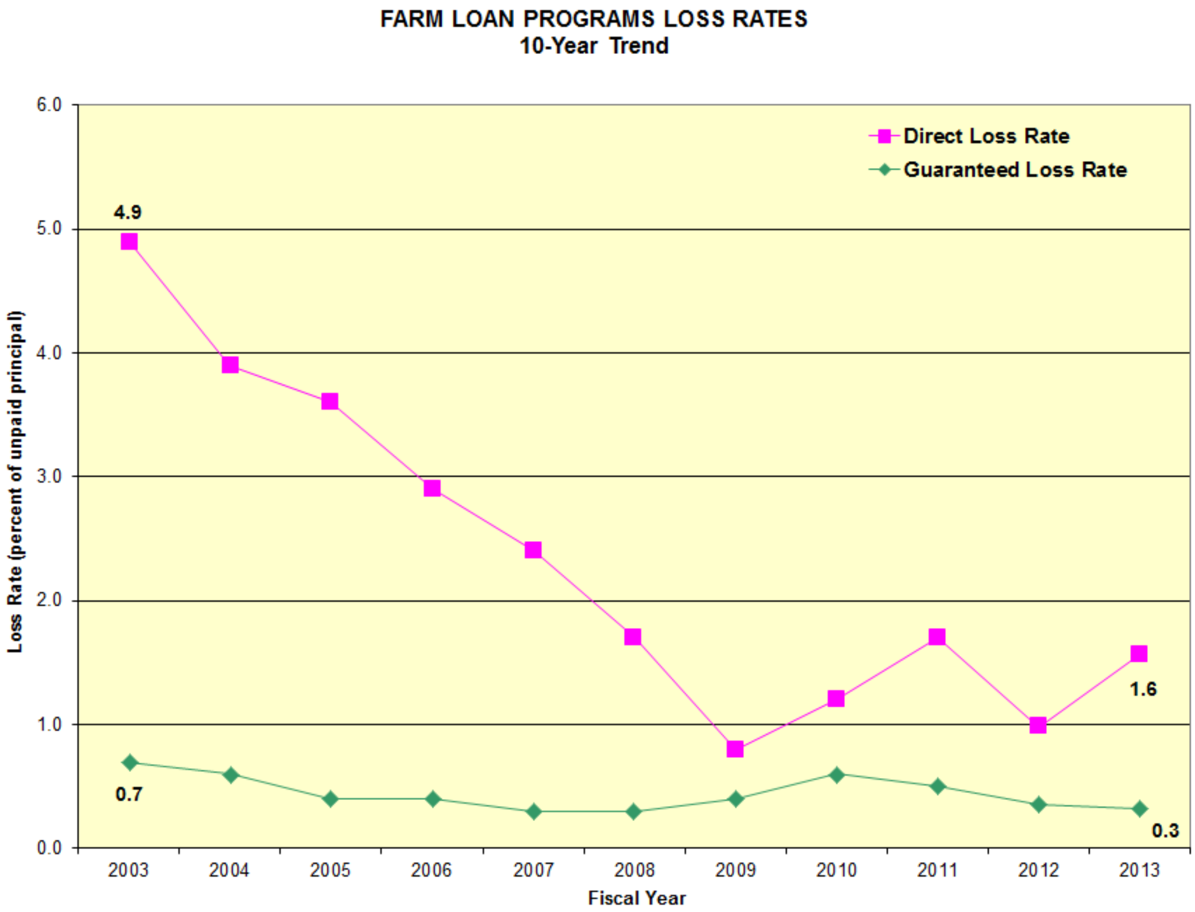
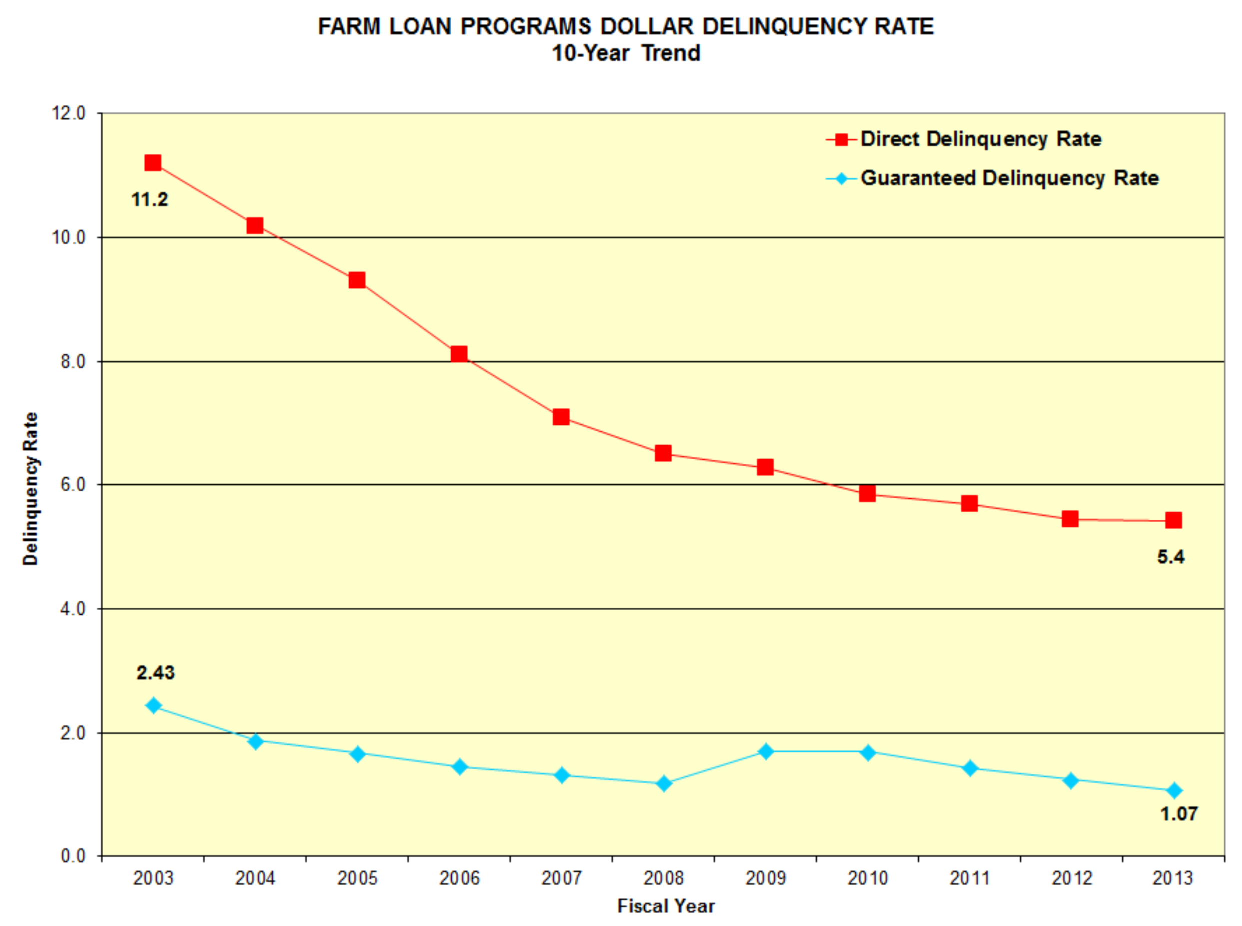

FARM LOAN PROGRAMS LOSS RATES
10-Year Trend
Direct Loss Rate
Guaranteed Loss Rate
Loss Rate (percent of unpaid principal)
6.0
5.0
4.0
3.0
2.0
1.0
0.0
4.9
1.6
0.7
0.3
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Fiscal Year

Chart 2:



FARM LOAN PROGRAMS DOLLAR DELINQUENCY RATE
10-Year Trend
Direct Delinquency Rate
Guaranteed Delinquency Rate
11.2
5.4
2.43
1.07
12.0
10.0
8.0
6.0
4.0
2.0
0.0
Delinquency Rate
2003
2004
2005
2006
2007
2008
2009
2010
2011
2012
2013
Fiscal Year