



Congressional Oversight Panel

July 21, 2009

SPECIAL REPORT ON FARM LOAN RESTRUCTURING*

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Table of Contents

Executive Summary	2
Section One: Special Report on Farm Loan Restructuring.....	6
A. Introduction.....	6
B. Agriculture Markets Generally.....	8
C. Farm Credit Markets	28
D. Farm Loan Restructuring	58
E. Conclusion.....	98
Section Two: Additional Views.....	101
A. Damon Silvers.....	101
B. Congressman Jeb Hensarling and Senator John E. Sununu	102
Section Three: About the Congressional Oversight Panel.....	104

Executive Summary*

From the earliest days of the Republic, the Jeffersonian ideal of the yeoman farmer has held a special place in American culture. But the harsh reality of severe droughts, devastating floods, and dramatic fluctuations in commodity prices has intruded upon the ideal time and time again for those who work the land to provide for their families and to feed their communities.

Recognizing the importance of agriculture not only to the American identity but to our economy, and acknowledging the cyclical nature of the farm sector, Congress has established a variety of programs designed to support farmers during the painful yet inevitable low ebbs in their business cycles. Consequently, as last fall's acute crisis in the financial sector gave way to a deep and enduring global recession, Congress expressed concern about the ramifications that a sustained economic downturn could have for agriculture.

In response to fears that trends in farm loan delinquencies and farm foreclosures could escalate to rival the foreclosure crisis in the residential mortgage sector, Congress directed the Congressional Oversight Panel to issue a special report that analyzes the state of the commercial farm credit markets and the use of loan restructuring as an alternative to foreclosure by financial institutions receiving government assistance through the Troubled Asset Relief Program (TARP). Congress further directed the Panel to examine the farm loan restructuring programs in place at the U.S. Department of Agriculture's (USDA) Farm Service Agency (FSA) and the government-chartered Farm Credit System (FCS) – as well as Treasury's TARP-funded Making Home Affordable Program for residential mortgages – in an effort to determine the suitability of each as a model for a possible farm loan restructuring program to be carried out by TARP-recipient banks.

In considering these issues, two key questions arose:

- Considering the state of agriculture markets generally and farm credit conditions in particular, does a need presently exist for a program designed to restructure delinquent farm loans?
- If a need exists, is a TARP-based restructuring model or some other model likely to be the most effective in easing any stresses in the farm credit markets?

Thus far, the farm sector has fared somewhat better than the broader economy throughout the financial crisis. Buoyed by continued strength in farmland values, generally high commodity prices, record levels of farm income and farm operator household income, and historically low debt-to-asset ratios, the agriculture sector – on the whole – has entered the crisis on the heels of several notably robust years. Trends in farm loan delinquencies mirrored the positive conditions in the sector, and data on farm loans made by FSA, FCS, and commercial banks all reveal

* The Panel adopted this report with a 3-2 vote on July 20, 2009. Senator John E. Sununu and Rep. Jeb Hensarling voted against the report. Additional views are available in Section Two.

historically low levels of troubled farm loans in the months and years leading up to the crisis. Further, the relative lack of exotic financial products in the farm credit market has insulated the sector from some of the major challenges seen in residential mortgages.

Nonetheless, opposing trends within the agriculture sector ensured that the benefits over the past few years were not shared evenly. Last year's record high commodity crop prices led crop farmers to reap substantial rewards, but they also led to soaring input costs for livestock farmers and the dairy industry. These high costs caused the livestock and dairy sectors to operate in the red months before the cataclysmic financial shocks of last fall. Similarly, as the economic downturn has begun to take its toll on rural America, pain has been concentrated in some sectors more than others. In particular, significant stress persists in the livestock and dairy sectors.

The overall impact of the financial crisis on agriculture cannot be assessed with certainty. To date, while measures of the strength of the farm sector have fallen from the positive levels of the preceding years, they remain within historic averages. USDA projects that net farm income will decline by 20 percent in 2009, while remaining above a running ten-year average. The average U.S. farm operator household income is also projected to decline, although by considerably less than net farm income – a result of the rising importance of non-farm sources of income for American farmers. While USDA projections show net farm income recovering in 2010 and returning to record levels by the end of the projection period, the current crisis has defied the projections of all but the most pessimistic of forecasters. With such a weak forecasting capacity, the effect that continued economic troubles could have on agriculture simply cannot be known.

It is also significant that the economic crisis is truly global in scale. Agricultural exports have been a significant source of income for farmers over the past decade, and the long-term success of American agriculture depends in no small part on the sector's ability to market its products to a growing middle class overseas. As economic conditions deteriorate around the globe, the market for American farm products will shrink.

The ability to determine whether downward trends in agriculture markets generally may result in a need for a farm loan restructuring program is constrained by a lack of definitive data on trends in farm loan restructurings and farm foreclosures. While a review of available data on farm loan delinquencies, credit availability, and demand for loans from FSA – the lender of last resort – reveals some troubling trends, without definitive data, it is difficult to draw definitive conclusions or to make definitive recommendations at this time.

As the Panel noted in its March report on residential mortgage foreclosure mitigation, in order for Congress and regulators to respond properly and promptly to issues in the market, better information is essential. Congress should create a farm loan performance reporting requirement to provide a source of comprehensive intelligence about loan performance, loss mitigation efforts, and foreclosure. Banking regulators, USDA, and FCS could be required to analyze these data and to make the data and their analysis public. To the extent that lenders

already report delinquency and foreclosure data to credit reporting bureaus, the additional cost of federal reporting would be quite modest, but the better information could be very valuable both in identifying problems and in working out policy responses.

Should the current negative economic trends in agriculture level out or even reverse, as USDA projects, Congress could determine that no action to mitigate farm loan foreclosures is necessary. Conversely, should conditions continue to deteriorate, falling below historical averages and causing significant stress for farmers trying to repay their debt, Congress has a range of possible responses:

One possibility, and the topic of this report, is a farm loan restructuring mandate for TARP recipient banks. Congress could impose a restructuring mandate on TARP banks, following the pattern of the obligations imposed on lenders by FSA, FCS, or Treasury's Making Home Affordable program. Each model offers one possible means to require restructuring, but all would require some amount of adaptation to fit the TARP-recipient banks' loan model, and none can be considered ideal. Specifically, transferring the restructuring programs of either FSA or FCS – both specialized institutions designed to extend credit to farmers and rural America – would require revision to be implemented at commercial banks with diverse loan portfolios. For its part, the formulaic structure of the Making Home Affordable Program would impede its easy transfer to the idiosyncratic farm credit market.

While it is an option, mandatory modifications through the TARP might not be the most effective policy choice because of the limited number of farm loans held by TARP-recipient banks. Commercial banks hold only about 45 percent of overall farm debt – with the FCS, FSA, and other farm lenders collectively extending the majority of farm credit. When considering real estate debt, commercial banks hold an even smaller piece, only 38 percent. Further, TARP-recipient banks hold only 27 percent of the of the portion of farm real estate loans made by commercial banks, or only about ten percent of total farm real estate debt. Thus, a restructuring mandate for TARP-recipient banks would have very limited reach. Moreover, the role of TARP banks in the farm credit arena can be expected to diminish over time as such banks return their TARP funding.

Congress and Treasury have other options within the TARP to protect farm homes. In the same way that Congress has embraced the principle of using the TARP to protect non-farm homes, it could apply this principle in different ways. One possibility would be to devote some portion of the remaining TARP funding to a farm mortgage foreclosure mitigation program, patterned on the incentive-based program developed to protect homes, but focusing on bank participation that extends beyond current TARP recipients. Unlike residential mortgage restructurings, farm loan restructurings must also consider business plans, cash flows, and market factors. Therefore, the model would need to be adapted to provide the necessary flexibility. Another option for utilizing TARP money is to create a loan guarantee program for restructured farm loans.

Finally, if the farm sector continues to decline, Congress has options outside the TARP program. As noted above, the U.S. government has a longstanding commitment to farmers. This is embodied through the numerous existing programs designed to assist the farm industry, many of which are targeted toward different needs or sectors. If Congress determines that the farm sector in part or in whole needs assistance, then such assistance could be delivered through existing programs. While having a potentially wider impact than a TARP bank mandate, this alternative could also allow assistance to be narrowly targeted, such as to the struggling dairy and livestock sectors.

Section One: Special Report on Farm Loan Restructuring

A. Introduction

1. Past Farm Foreclosure Problems and Framing the Issue Today

The global financial crisis has led more than a few observers to draw parallels between today's economic woes and those of the Great Depression. While most of those comparisons have focused on weaknesses in the housing sector and a number of regulatory challenges, they have generally ignored discussions of the impact on agriculture. The American economic landscape has changed dramatically since the 1930s, but much of its identity remains rooted in the farming communities that sweep across the Great Plains from one coast to the other. In many of these communities, memories of devastating farm foreclosures from the Great Depression, and later, the farm crisis of the 1980s, remain fresh in the minds of those who rely on the land to make their living. Vulnerability to both severe weather and severe price swings in commodities keep farmers perpetually on guard against the next great crisis.

Thus far, the agriculture sector has fared somewhat better than the economy in general throughout the financial crisis. The balance sheets of farmers and agricultural lenders have remained relatively strong and credit is still available at reasonable prices. Rural areas were generally less exposed to the housing bubble, providing some protection for rural community banks from the shock of the financial crisis. Agricultural lenders also tend to cultivate close relationships with farmers, holding their loans to maturity rather than selling them in the secondary markets. Direct loans and guarantees from FSA and the farmer-friendly policies of the government-chartered FCS also help to bring stability to agricultural credit markets. Interest rates for farm credit remain at historically low rates.

Nonetheless, the agriculture sector has not remained immune to the crisis. Agricultural banks¹ have generally outperformed other commercial banks as the crisis has deepened, but profits have declined. The average rate of return on assets for agricultural banks dropped from 1.1 percent in 2007 to 1.0 percent in 2008, while the average rate of return on assets for other small banks dropped from 0.9 percent to 0.2 percent over the same period.² This trend continued

¹ The Federal Reserve defines agricultural banks as commercial banks that have a proportion of farm loans (real-estate and non-real-estate) to total loans that is greater than the unweighted average of this proportion at all banks. The first quarter 2009 unweighted average was 14.01 percent. Board of Governors of the Federal Reserve System, *Federal Reserve Bank E-15 Release: About the Release* (accessed July 6, 2009) (online at www.federalreserve.gov/releases/e15/about.htm). The American Bankers Association uses a slightly different definition. It defines "farm banks" as banks with assets less than \$1 billion whose proportion of domestic farm loans to total domestic loans is greater than or equal to the unweighted average of this proportion at all banks. The 2008 average was 14.20 percent. American Bankers Association, *2008 Farm Bank Performance*, at 1 (May 2009) (online at www.aba.com/NR/rdonlyres/05858407-284E-46CD-9443-38EB9601A25A/60074/AGBankPerformance2009.pdf) (hereinafter "ABA 2008 Farm Bank Performance").

² Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release E.15: Agricultural Finance Databook: Second Quarter 2009*, at 27 (July 2, 2009) (B.7 Selected Measures of Financial

into the first quarter of 2009. Farm commodity prices have fallen since last summer with the rest of the market, reducing expectations for farm income in 2009. USDA expects net farm income to decline 20 percent in 2009, reducing some farmers' ability to repay loans later in the year, though the impact of this reduction in net farm income is expected to be dampened by the significant role that off-farm income plays in farm operator household finances. Default rates have been historically low in recent years for all farm lenders, but they appear to have bottomed out and have begun to rise since the middle of 2008. The FCS nonperforming loan rate is at a level not seen since the mid-1990s, when the system had finally recovered from the farm crisis of the 1980s.³ Demand for direct operating loans from FSA, the lender of last resort, has increased 81 percent over the last year, and demand for direct ownership loans has increased by 132 percent. There are also signs that agricultural lenders have tightened credit standards in 2009 by virtue of more documentation requirements and oversight of loans, and possibly making or having less credit available to producers.

2. Congressional Oversight Panel Mandate

Amid increasing concerns that the financial crisis and the global recession may soon lead to increasing loan defaults in the agriculture sector, Congress included a provision in the *Helping Families Save Their Homes Act of 2009* (P.L. 111-22), signed into law on May 20, 2009, requiring the Panel to issue a special report on farm loan restructuring that:⁴

a. analyzes the state of the commercial farm credit markets and the use of loan restructuring as an alternative to foreclosure by recipients of financial assistance under the Troubled Asset Relief Program; and

b. includes an examination of and recommendation on the different methods for farm loan restructuring that could be used as part of a foreclosure mitigation program for farm loans made by recipients of financial assistance under the Troubled Asset Relief Program, including any programs for direct loan restructuring or modification carried out by the Farm Service Agency of the Department of Agriculture, the farm credit system, and the Making Home Affordable Program of the Department of the Treasury.

As one of the central pillars of the Treasury's Financial Stability Plan, a residential mortgage foreclosure mitigation program, the Home Affordable Modification Program, was announced in March of this year. The goal of this program is to stem the rising tide of mortgage defaults, creating more beneficial outcomes for lenders, borrowers, and the economy in general. The program provides incentives for all mortgage lenders to offer a standardized modification

Performance of Agriculture and Other Small Banks) (online at www.federalreserve.gov/releases/e15/current/pdf/databook.pdf) (hereinafter "Second Quarter Fed Databook").

³ Federal Farm Credit Banks Funding Corporation, *The Farm Credit System*, at 6 (June 2009) (online at www.farmcredit-ffcb.com/farmcredit/serve/public/invest/present/report.pdf?assetId=134793).

⁴ Helping Families Save Their Homes Act of 2009, Pub. L. No. 111-22.

process to troubled borrowers. Banks that receive new capital infusions through the TARP after the date of enactment of the program are required to offer the modification program as part of the terms of their capital assistance agreement. The Panel's reporting requirement asks it to contemplate whether a similar modification program would be advisable in the case of troubled agricultural loans held by recipients of financial assistance from TARP. This requires the Panel to explore the state of the nation's agriculture economy, general credit availability for agriculture, and the alternatives available when farmers hit hard times.

B. Agriculture Markets Generally

Despite the crisis conditions in financial markets and the U.S. economy in the closing months of 2008, USDA concluded in December that the American farm sector was in a "relatively strong financial position" entering 2009.⁵ While repercussions emanating from the global financial crisis have certainly not left farmers and the agriculture sector entirely unscathed, the farm sector entered the crisis in an historically strong financial position, providing farmers – on the whole – with a significant capital buffer to weather a downturn in commodity prices and a modest tightening of farm credit. In March, USDA projected that "declines [in exports, prices, and farm income], though substantial, will bring agriculture back to trend outcomes," and that the effects of the crisis would be "less severe" for agriculture than for many other sectors of the economy.⁶

Nonetheless, the agriculture sector is characterized by its volatility and cyclical nature, and, not infrequently throughout history, farmers have watched good times give way to times of great hardship. Further, inherently opposing trends within the agriculture sector ensure that, even during strong times, there are those who see their financial position weakened. For example, soaring commodity prices may lead to large profits for commodity farmers, but they also lead to high input costs for the livestock sector. Last, while USDA projections paint a reasonably positive picture for the agriculture sector compared with the economy on the whole, the current global economic crisis has been deeper, more widespread, and more enduring than all but the most pessimistic of forecasters could have projected. Consequently, it remains to be seen whether the added strain in the agriculture sector in recent months is indeed bringing agriculture back to trend outcomes, as USDA projects, or whether these negative trends are harbingers of more serious troubles to come as global economic challenges persist.

⁵ U.S. Department of Agriculture, Economic Research Service, *Agricultural Income and Finance Outlook*, at 1 (Dec. 2008) (AIS-86) (online at usda.mannlib.cornell.edu/usda/current/AIS/AIS-12-10-2008.pdf) (hereinafter "USDA Finance Outlook").

⁶ U.S. Department of Agriculture, Economic Research Service, *The 2008/2009 World Economic Crisis: What It Means for U.S. Agriculture*, at 2 (Mar. 2009) (WRS-09-02) (online at www.ers.usda.gov/Publications/WRS0902/WRS0902.pdf) (hereinafter "USDA Crisis Impact Report").

In order to provide context for this report's analysis of farm credit markets and farm loan restructuring, this section discusses agriculture markets generally, examining current markets, historical trends, and notable differences between certain sectors of agriculture.

1. Profits

Profits in the agriculture sector reached record high levels in recent years, whether measured in terms of net farm income or net cash income, as large increases in the value of crop production (crop receipts increased by 20 percent or more in each of the past two years) were only partially offset by rising costs of production.⁷ Net farm income, which is defined as “the portion of the net value added by agriculture to the national economy earned by farm operators,” is preliminarily estimated to have hit \$89.3 billion in 2008, the highest level on record and 47.6 percent above net farm income five years earlier, in 2003.⁸ Net cash income, “the cash earnings realized within a calendar year from the sales of farm production and the conversion of assets, both inventories and capital consumption, into cash,” is estimated at \$93.4 billion in 2008, also the highest level on record and 30.6 percent above net cash income realized in 2003.⁹ While both measures are worth noting, net cash income is generally considered a better measure of solvency, because it tracks the amount of cash available to farmers for living expenses and to pay down debt.¹⁰

According to USDA, both net farm income and net cash income are forecasted to decline in 2009 from these record levels, as livestock and commodity prices drop off more precipitously than costs of production, while remaining above the ten-year averages for the indicators. Specifically, net farm income is projected to fall by 20 percent, to \$71.2 billion, and net cash income is projected to drop by 17 percent, to \$77.3 billion.¹¹ These projected values for 2009 are still 9 percent and 7.6 percent above the rolling ten-year averages for net farm income (\$65.3 billion) and net cash income (\$71.8 billion), respectively. However, USDA also cautions that high dollar exchange rates coupled with a deeper than expected global economic downturn could lead net farm income to drop further, perhaps by as much as 33 percent from its 2008 level.¹² Nonetheless, the deleterious effect that this decline in net farm income could have on family

⁷ U.S. Department of Agriculture, Economic Research Service, *Farm Income and Costs: 2009 Farm Sector Income Forecast* (Feb. 12, 2009) (online at www.ers.usda.gov/Briefing/FarmIncome/nationalestimates.htm).

⁸ U.S. Department of Agriculture, Economic Research Service, *Farm Income: Data Files: Historical Data* (online at www.ers.usda.gov/Briefing/FarmIncome/Data/Constant-dollar-table.XLS) (accessed July 7, 2009) (hereinafter “USDA Historical Farm Income Data”); U.S. Department of Agriculture, Economic Research Service, *Farm Income and Costs: Glossary* (online at www.ers.usda.gov/BRIEFING/FARMINCOME/Glossary/def_nfi.htm) (accessed July 7, 2009) (hereinafter “USDA Farm Income Glossary”).

⁹ USDA Historical Farm Income Data, *supra* note 8.

¹⁰ USDA Farm Income Glossary, *supra* note 8.

¹¹ USDA Historical Farm Income Data, *supra* note 8.

¹² USDA Crisis Impact Report, *supra* note 6, at 2.

farmers across America is expected to be mitigated somewhat by off-farm sources of income; indeed, as discussed later in this section, the decline in average farm operator household income – factoring in all sources of income for farm families – is expected to be distinctly less severe (USDA projected in February that average farm operator household income would decline by roughly 2 percent in 2009, though it should be noted that the sustained economic downturn could lead to a steeper than expected drop off).¹³

Figure 1: Net Farm Income: 1998 – 2009 (projected)¹⁴

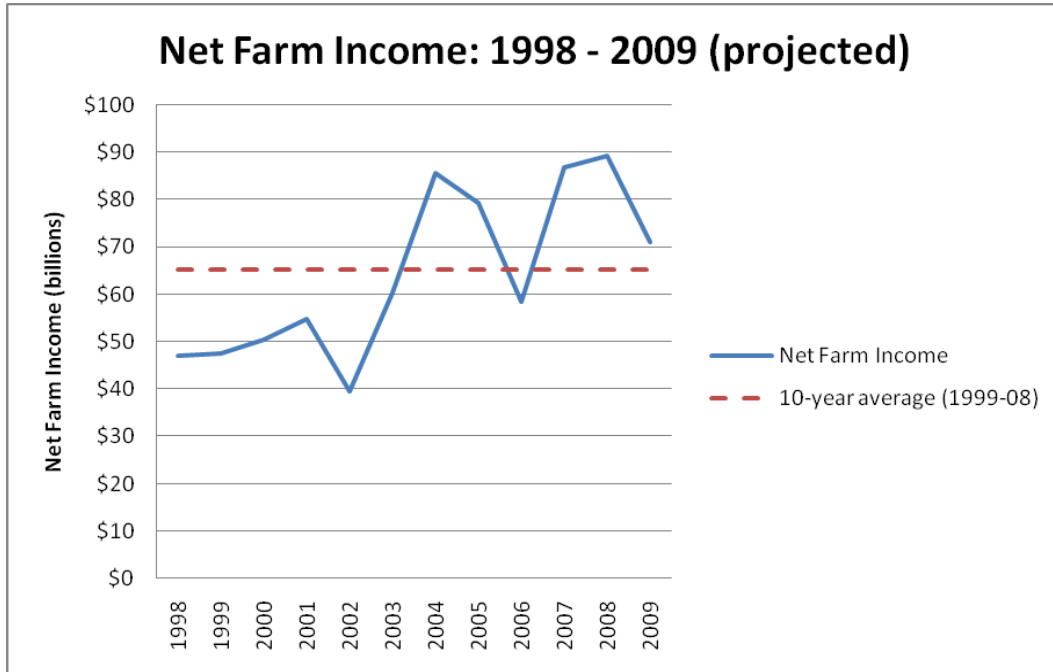
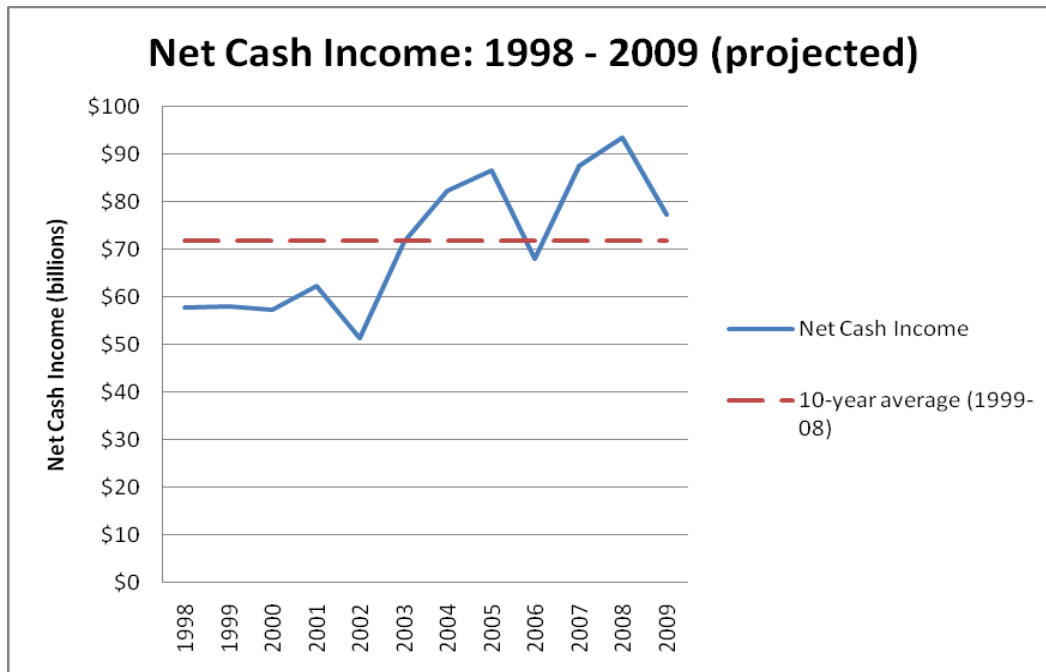


Figure 2: Net Cash Income: 1998 – 2009 (projected)¹⁵

¹³ U.S. Department of Agriculture, Economic Research Service, *Farm Household Economics and Well-Being: Historic Data on Farm Operator Household Income* (online at www.ers.usda.gov/Briefing/WellBeing/Gallery/historic.htm) (accessed July 8, 2009) (hereinafter “Farm Household Income Data”).

¹⁴ USDA Historical Farm Income, *supra* note 8.

¹⁵ USDA Historical Farm Income, *supra* note 8.



Nonetheless, USDA’s long-term projections for net farm income and net cash income show both indicators ticking back upward in 2010 and steadily increasing over the course of the next decade as a result of food demand growth in developing countries (due to rising populations, urbanization, and diet diversification), as well as of a growing global demand for biofuels.¹⁶ However, USDA also notes that “the main uncertainty for the long run concerns the value of the U.S. dollar compared with the currencies of other trading countries” (particularly the Chinese yuan), and it cautions that its projections for net farm income several years in the future depend heavily on the relative strength of the dollar.¹⁷ Under a “strong dollar” scenario, USDA estimates that net farm income could decline by roughly 7 percent from 2008 to 2013 (though this estimate still projects that income would rise from 2009 lows through 2013), but, under a “weak dollar” scenario, USDA projects that net farm income could soar to \$106 billion by 2013 – a 19 percent increase over the record 2008 level.¹⁸

2. Land Values

The value of farmland likewise reached a record high level in 2008 of \$2,170 per acre, as the average value per acre of farmland in the United States increased by 7.96 percent over

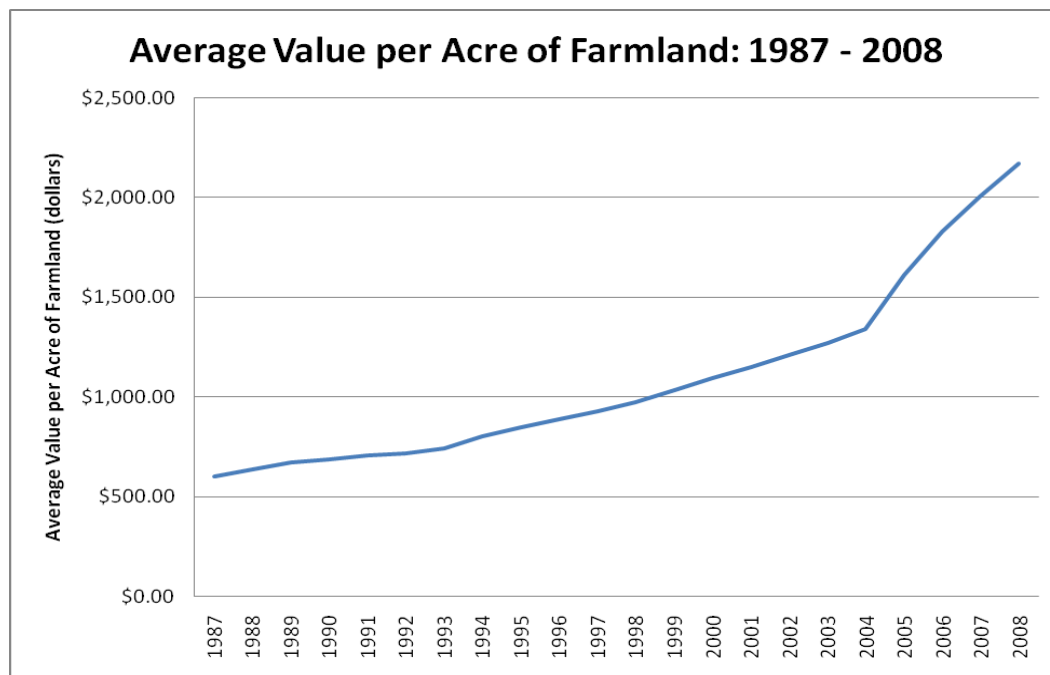
¹⁶ U.S. Department of Agriculture, *USDA Agricultural Projections to 2018*, at 60 (Feb. 2009) (Table 27: Farm Receipts, Expenses, and Income) (online at <http://www.ers.usda.gov/Publications/OCE091/OCE091.pdf>) (hereinafter “USDA Long-term Projections”).

¹⁷ USDA Crisis Impact Report, *supra* note 6, at 3.

¹⁸ USDA Crisis Impact Report, *supra* note 6, at 3.

2007.¹⁹ This marked the twenty-first consecutive year in which the price of farmland rose higher, with the last decrease occurring from 1986 to 1987, at the height of the 1980s farm crisis.²⁰ The USDA attributes this steady increase in farmland values to consistent growth in farm income, heightened non-farm demand for farmland, favorable interest rates, and generally rising (though volatile) commodity prices.²¹

Figure 3: Average Value per Acre of Farmland: 1987 – 2008²²



Generally, the percent increases in farmland value did not match the percent increases in housing prices during the real estate bubble in recent years (the percent increase from year-to-year in housing prices surpassed the percent increase in farmland value each year from 1998 to 2004). However, farmland values did increase by double digits year-over-year twice in the earlier part of this decade, jumping 20.1 percent from 2004 to 2005 and 13.7 percent from 2005 to 2006, with the percent increase in farmland values exceeding the percent increase in housing prices from year-to-year on both occasions.²³ Farmland values continued to increase in 2007 and

¹⁹ U.S. Department of Agriculture, Economic Research Service, *Farm Income: Data Files: Number of Farms, Land in Farms, and Value of Farm Real Estate, 1850-2008* (online at www.ers.usda.gov/Data/FarmIncome/FinfidmuXls.htm) (accessed July 7, 2009) (hereinafter “USDA Farm Real Estate Data”).

²⁰ *Id.*

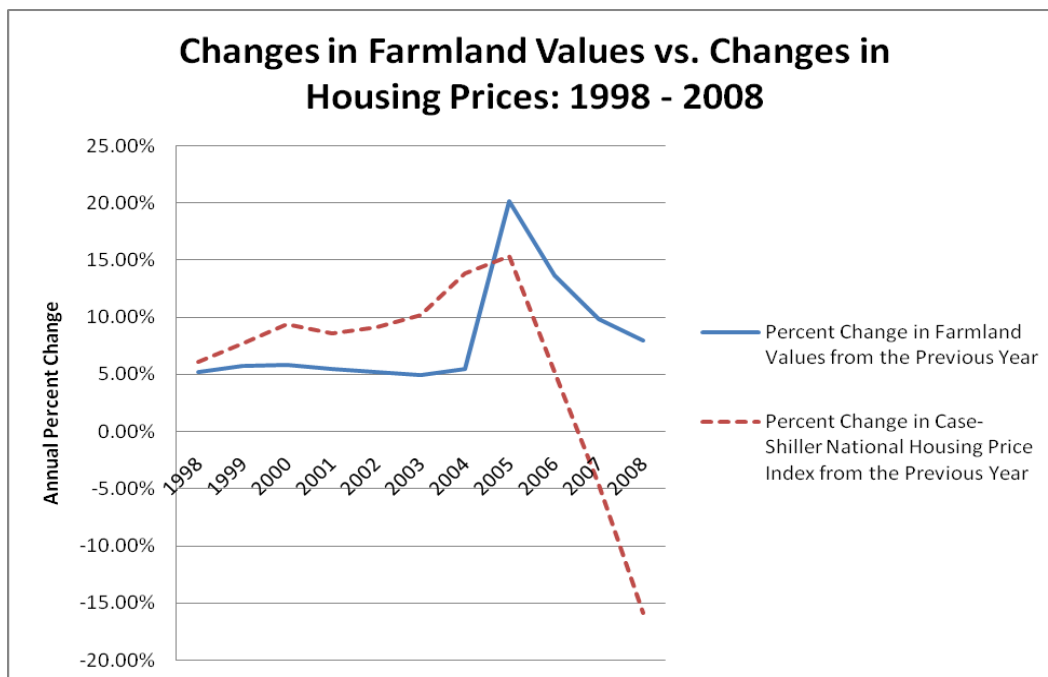
²¹ U.S. Department of Agriculture, Economic Research Service, *Farm Income and Costs: Assets, Debt, and Wealth* (online at www.ers.usda.gov/Briefing/FarmIncome/Wealth.htm) (accessed July 7, 2009) (hereinafter “USDA Farm Income and Costs”).

²² USDA Farm Real Estate Data, *supra* note 19.

²³ USDA Farm Real Estate Data, *supra* note 19.

2008, while housing prices dropped precipitously. Nonetheless, USDA projects that farm real estate values will fall by 2 percent in 2009, and, although USDA notes that “farm real estate values are not very sensitive to short-term changes in the returns to agriculture,” it will be critical to track this indicator in the months and years ahead as a gauge of the health of the farm sector.²⁴

Figure 4: Changes in Farmland Value vs. Changes in Housing Prices: 1998 – 2008²⁵



Data from quarterly, district-based Federal Reserve surveys of banks on farm credit conditions and farmland values confirm the continued strength of farmland values in 2008, while showing some modest weakening in values in the fourth quarter, as the crisis in the financial sector reverberated throughout the broader economy.²⁶ For example, the Kansas City District survey realized the highest ever year-over-year increase in the market value of good farmland, from the third quarter of 2007 to the third quarter of 2008 (21.2 percent for dry land and 23.4

²⁴ USDA Crisis Impact Report, *supra* note 6, at 24.

²⁵ USDA Farm Real Estate Data, *supra* note 19; Standard & Poor’s, *S&P/Case-Shiller Home Price Indices* (Instrument: Seasonally Adjusted U.S. National Values) (online at www2.standardandpoors.com/spf/pdf/index/SA_csnational_values_022445.xls) (accessed July 15, 2009). Yearly value is taken as the average of the index value for the four quarters of each year.

²⁶ Five Federal Reserve District Banks conduct quarterly surveys of commercial banks to gather information on agricultural land values and credit conditions in their Districts: Chicago, Kansas City, Minneapolis, San Francisco, and Richmond. The survey methodology and exact questions differ from District to District; however, answers to generally similar questions across Districts are compiled as part of the Board of Governors of the Federal Reserve System’s Statistical Release E.15, the Agricultural Finance Databook. This Databook, released quarterly, includes this survey information, along with other information on agricultural credit conditions compiled from Federal Reserve and FDIC sources. The databook is the most comprehensive source of data on farm credit. See Second Quarter Fed Databook, *supra* note 2.

percent for irrigated land).²⁷ However, by the fourth quarter of last year, the survey found that the year-over-year increase in value had dropped to 7.1 percent for dry land and 10.9 percent for irrigated land, with the value of both dry and irrigated land dropping by approximately one percent from the third to the fourth quarter of 2008.²⁸

Surveys in other Federal Reserve Districts, including Chicago, Minneapolis, San Francisco, and Richmond, noted similar trends, with the reported value of farmland increasing progressively more modestly over the previous year as 2008 wore on in most regions and with the value of good farmland decreasing from 2007 to 2008 in the Richmond region.²⁹ Further, in the fourth quarter 2008 surveys, banks surveyed in the Chicago and Richmond regions expressed pessimism about trends in farmland values in 2009, with 35 percent of those surveyed in the Chicago region predicting that farmland values would decline in the first quarter of 2009 and 25 percent of those surveyed in the Richmond region predicting such a decline (only 4 percent and 6 percent of respondents in the Chicago and Richmond regions, respectively, anticipated increases in the first three months of 2009).³⁰

Thus far, fears that farmland prices could decline precipitously – perhaps paralleling the “bust” in the residential housing market – have been unfounded.³¹ On the contrary, first quarter 2009 Federal Reserve surveys have found continued modest appreciation in farmland values on a year-over-year basis – 2.9 percent and 3.8 percent over first quarter 2008 for dry and irrigated farmland in the Kansas City region and two percent over first quarter 2008 for good farmland in the Chicago region.³² However, slowed year-over-year appreciation and some quarterly decreases in farmland values (the value of good farmland in the Chicago region decreased by six

²⁷ Jason Henderson and Maria Akers, Federal Reserve Bank of Kansas City, *Recession Catches Rural America*, Federal Reserve Bank of Kansas City Economic Review, at 71 (First Quarter 2009), (online at www.kc.frb.org/PUBLICAT/ECONREV/PDF/09q1Henderson.pdf) (hereinafter “Henderson Article”); Federal Reserve Bank of Kansas City, *Survey of Agricultural Credit Conditions* (First Quarter 2009) (online at www.kansascityfed.org/Agcrsurv/AGCR1Q09.pdf) (hereinafter “KC Fed First Quarter Survey”).

²⁸ Federal Reserve Bank of Kansas City, *Survey of Agricultural Credit Conditions: Historical Data* (online at www.kansascityfed.org/home/subwebnav.cfm?level=3&theID=9754&SubWeb=10658) (accessed July 7, 2009) (hereinafter “KC Fed Survey Historical Data”).

²⁹ Second Quarter Fed Databook, *supra* note 2, at 39 (C.6 Trends in Farm Real Estate Value and Loan Volumes).

³⁰ Second Quarter Fed Databook, *supra* note 2, at 39 (C.6 Trends in Farm Real Estate Value and Loan Volumes).

³¹ For a discussion of a possible farmland bubble, *see* U.S. Senate Committee on Banking, Housing, and Urban Affairs, Testimony of Iowa Superintendent of Banking Thomas B. Gronstal, *The Condition of the Banking Industry*, 110th Cong., at 6 (Mar. 4, 2008) (online at banking.senate.gov/public/index.cfm?FuseAction=Files.View&FileStore_id=f90776b5-ab3a-45d9-b9a2-231d9697dbcc) (“The dramatic increase of farmland value in the last few years makes the agriculture sector look strong...If there has been too much leveraged or loaned against the inflated value of farm land, the bubble will burst and we will once again experience an economic crisis similar to that of the 1980s”).

³² Second Quarter Fed Databook, *supra* note 2, at 39 (C.6 Trends in Farm Real Estate Value and Loan Volumes).

percent from the fourth quarter of 2008 to the first quarter of 2009) confirm USDA's projection that a modest decline in farmland values – or at least an end to steady appreciation – is likely to occur in the coming months.³³ Should these downward trends be more severe or more prolonged than anticipated, farmers could watch much of the equity they have built up in their land evaporate, straining their capacity to repay or restructure loans collateralized by their farm real estate. As noted above, this indicator should be monitored closely.

3. Debt-to-Asset Ratio

USDA estimates that both total farm debt and total farm assets will reach record high levels in 2009, with total farm debt hitting \$217 billion and total farm assets reaching \$2.39 trillion.³⁴ The resulting debt-to-asset ratio – a key measure of farmers' financial leverage – is expected to drop to 9.1 percent, down from 9.2 percent in 2008, and considerably down from its peak of 22.2 percent, reached in 1985.³⁵ The increase in farm assets has outpaced the increase in farm debt for ten consecutive years.³⁶ Indeed, USDA reports that American farmers have adopted an increasingly conservative approach to financing their operations in the years since the 1980s farm crisis, often paying cash for land, equipment, and inputs, with 70 percent of farmers carrying no outstanding debt from year to year.³⁷ According to USDA's 2007 *Agricultural Resource Management Survey*, the most recent such survey available, 63 percent of farmers reported no use of debt even to finance production within calendar year 2007.³⁸

While the agriculture sector is now generally characterized by low debt-to-asset ratios when compared to other sectors of the economy, with farmers often building up considerable equity in their farms and acquiring many physical assets that can serve as collateral for loans, there are signs that farmers have been taking on more debt and carrying over more debt in recent months than in the preceding period.³⁹ FSA⁴⁰ reports that, as of May 30, 2009, demand for its direct ownership loans was up 132 percent and demand for its direct operating loans was up 81 percent, with 45 percent of direct operating loans approved in FY 2009 going to customers who

³³ Second Quarter Fed Databook, *supra* note 2, at 39 (C.6 Trends in Farm Real Estate Value and Loan Volumes).

³⁴ USDA Historical Farm Income Data, *supra* note 8.

³⁵ USDA Historical Farm Income Data, *supra* note 8.

³⁶ USDA Historical Farm Income Data, *supra* note 8.

³⁷ USDA Finance Outlook, *supra* note 5, at 45.

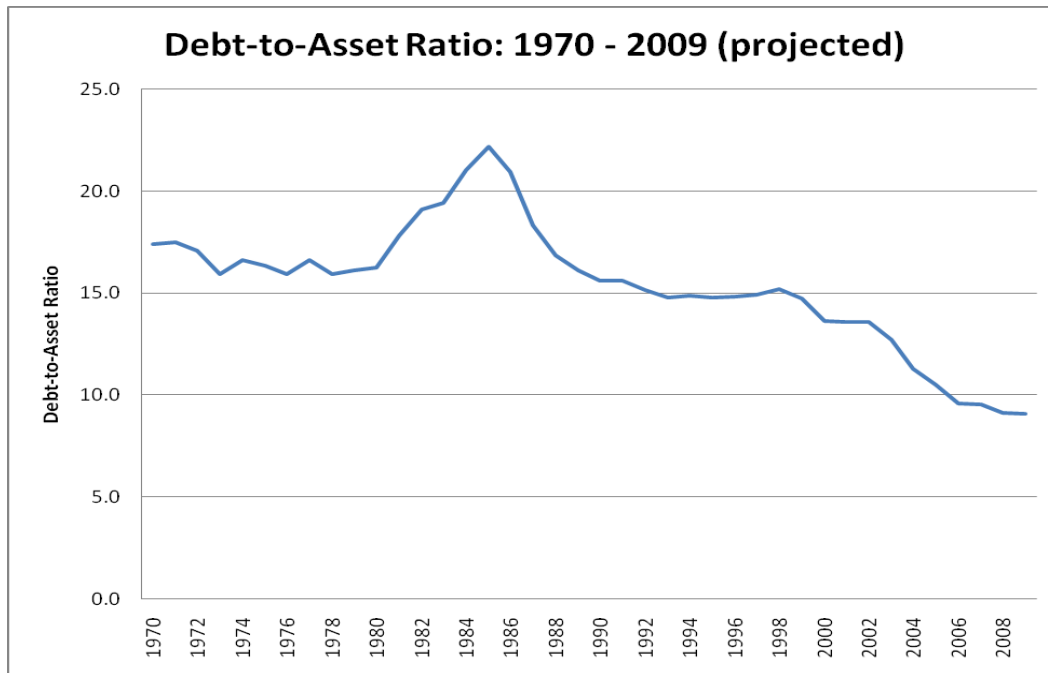
³⁸ USDA Finance Outlook, *supra* note 5, at 55.

³⁹ USDA Finance Outlook, *supra* note 5, at 49-50; Paul Ellinger and Bruce Sherrick, *Financial Markets in Agriculture*, Illinois Farm Economics Update, Department of Agricultural and Consumer Economics, University of Illinois at Urbana-Champaign, at 2 (Oct. 15, 2008) (online at www.farmdoc.uiuc.edu/IFEU/IFEU_08_02/IFEU_08_02.pdf) (hereinafter "Ellinger and Sherrick October Article").

⁴⁰ The Farm Service Agency and its loan programs are discussed in detail *infra*, Section One Part (C)(2)(b).

did not have existing FSA operating loans.⁴¹ Further, Federal Reserve Bank surveys of agriculture lenders note an increase in those carrying over operating debt from year-to-year, with between 18 and 25 percent of bankers surveyed reporting higher rates of renewals and extensions of farm operating loans in the first quarter of 2009 when compared with the first quarter of 2008.⁴² As discussed later in this section, fluctuations in input prices paid and market prices received by farmers in recent months, and the shrinking farm profit margins that have resulted, may contribute to an increased demand for credit to sustain farmers through the current downturn.

Figure 5: Farm Debt-to-Asset Ratio: 1970 – 2009 (projected)⁴³



4. Food Demand

Global demand for U.S. agricultural products increased dramatically in the years preceding the onset of the economic crisis last fall, contributing to the positive trends in farm income, farmland value, and the farm debt-to-asset ratio highlighted above. In particular, USDA cites strong global economic growth beginning in the mid-to-late 1990s, population growth, an increased demand for meat and dairy products (particularly in developing countries), and a rapid rise in demand for biofuels as key factors underlying the long-term upward trajectory of food

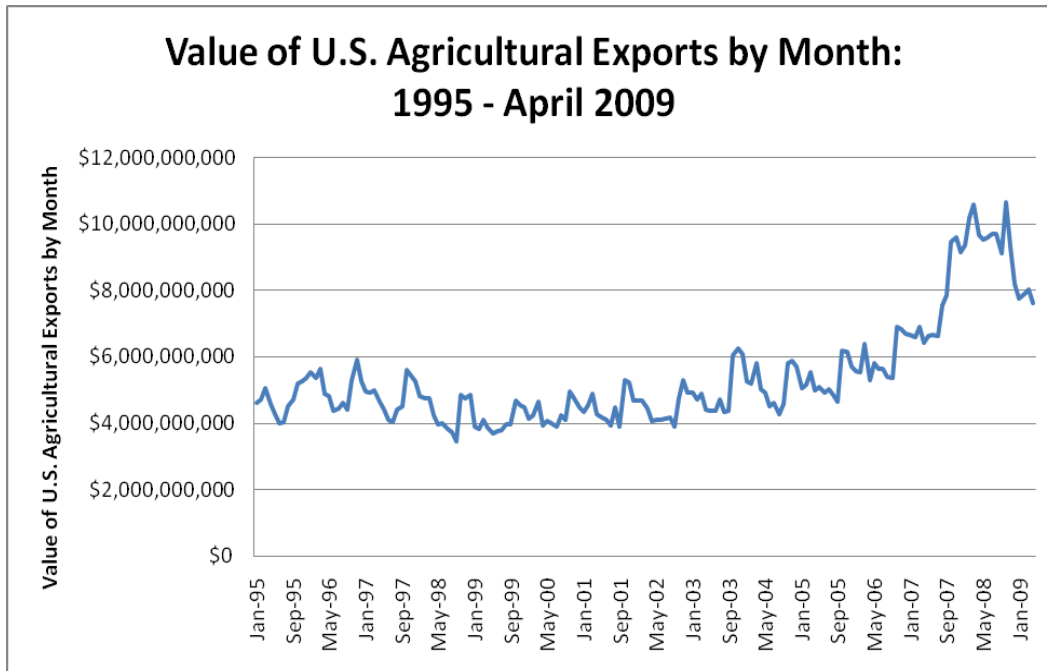
⁴¹ U.S. House Committee on Agriculture Subcommittee on Conservation, Credit, Energy, and Research, Testimony of Administrator of the Farm Service Agency Doug Caruso, *To Review Credit Conditions in Rural America*, 111th Cong. (June 11, 2009) (online at agriculture.house.gov/testimony/111/h061109sc/Caruso.doc) (hereinafter “FSA June Testimony”).

⁴² *Id.*

⁴³ *Id.*

demand, and, consequently, food prices.⁴⁴ Indeed, the annual value of U.S. agricultural exports increased by 117 percent from 2002 to 2008, reaching an all-time high of \$115.4 billion last year.⁴⁵ The declining value of the U.S. dollar beginning in the early years of this decade is also considered a major contributor to the increase in global demand for U.S. agricultural products.⁴⁶

Figure 6: Value of U.S. Agricultural Exports by Month: 1995 – April 2009⁴⁷



While food demand and food exports experienced significant increases in recent years, reduced consumer spending domestically and around the world as a result of the economic crisis is expected to lead to reduced demand for food products in 2009. In particular, USDA has found that American consumers have reduced consumption of food at home and away from home over the course of the past year (with more rapid decreases in food consumption away from home), as well as that consumption of meat and more expensive food products has declined faster than food consumption on the whole.⁴⁸ However, USDA also notes that “most U.S. consumers have a sufficiently high standard of living that demand for food is not very sensitive to changes in

⁴⁴ U.S. Department of Agriculture, Economic Research Service, *Global Agricultural Supply and Demand: Factors Contributing to the Recent Increase in Commodity Prices*, at 6 (Revised July 2008) (WRS-0801) (online at www.ers.usda.gov/Publications/WRS0801/WRS0801.pdf) (hereinafter “USDA Supply and Demand Article”).

⁴⁵ U.S. Department of Agriculture, Economic Research Service, *Foreign Agricultural Trade of the United States: Data Sets: Total Value of U.S. Agricultural Trade a Trade Balance, Monthly* (online at www.ers.usda.gov/Data/FATUS/DATA/moUStrade.xls) (accessed July 8, 2009) (hereinafter “USDA Agricultural Exports Data”).

⁴⁶ USDA Supply and Demand Article, *supra* note 44, at 6.

⁴⁷ USDA Agricultural Exports Data, *supra* note 45.

⁴⁸ Henderson Article, *supra* note 27, at 80; USDA Crisis Impact Report, *supra* note 6, at 7.

income.”⁴⁹ The recession and the reduced price of crude oil have also cut into the demand for ethanol, hurting that industry.⁵⁰ Similarly, since the fall of last year, as the economic downturn spread across the world and as the value of the U.S. dollar strengthened in comparison to foreign currencies, U.S. agricultural exports have dropped, falling from a record high of \$10.6 billion in October 2008 to \$7.6 billion in April of 2009 – a decline of over 28 percent.⁵¹

Nonetheless, in the long-term, global food demand and, therefore, demand for U.S. agricultural products, is expected to rise, driven in large part by economic growth and population growth in developing countries.⁵² A report recently released by the Organization for Economic Cooperation and Development (OECD), makes a similar prediction, noting that “once economic recovery begins, most of the growth in agricultural production and consumption will continue to come from developing countries,” and adding that “this is particularly evident for livestock products where the primary drivers are income and population growth, with a trend towards higher animal protein diets and continuing urbanization.”⁵³ USDA’s long-term projections for the agriculture sector (released in February 2009), predict that the current decline in agricultural exports will halt in 2010 and that exports will then increase steadily through 2018.⁵⁴ However, USDA again cautions that the exchange rate of the dollar will be a major determining factor in trends in U.S. agricultural exports and, as mentioned above, U.S. agricultural income over the long-term, noting further that this rate is difficult to predict.⁵⁵

5. Income

While net farm income is projected to decline by 20 percent from its record high level in 2008, average farm operator household income (which takes into account both farm and non-farm income) is projected to decline by much less – 1.98 percent in 2009, also down from an all-time record level of \$86,864 in 2008.⁵⁶ USDA defines the farm operator household population as “everyone who shares the dwelling unit with a principal operator of a family farm,” and it defines a family farm as “a farm where the majority of the business is owned by individuals related by blood, marriage, or adoption” (in 2007, 97.8 percent of U.S. farms were categorized as

⁴⁹ USDA Crisis Impact Report, *supra* note 6, at 7.

⁵⁰ Henderson Article, *supra* note 27, at 82.

⁵¹ USDA Agricultural Exports Data, *supra* note 45.

⁵² Henderson Article, *supra* note 27, at 84.

⁵³ Organization for Economic Cooperation and Development, *OECD-FAO Agricultural Outlook, 2009-2018*, at 11 (2009) (online at www.oecd.org/dataoecd/2/31/43040036.pdf) (hereinafter “OECD-FAO Outlook”).

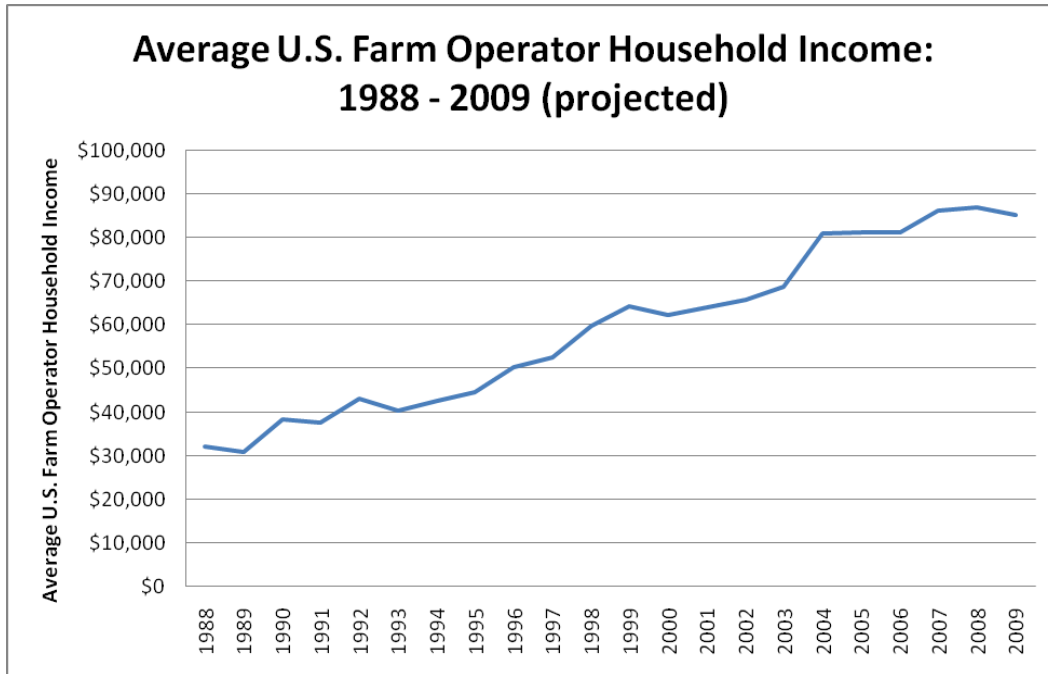
⁵⁴ USDA Long-term Projections, *supra* note 16, at 61 (Table 28: Summary of U.S. Agricultural Trade Long-term Projections).

⁵⁵ USDA Crisis Impact Report, *supra* note 6, at 9.

⁵⁶ Farm Household Income Data, *supra* note 13.

family farms).⁵⁷ USDA does not collect data on the income of farm-operator households that operate nonfamily farms.

Figure 7: Average U.S. Farm Operator Household Income: 1988 – 2009 (projected)⁵⁸



Comparing average U.S. farm operator household income with overall average U.S. household income, farm household income has surpassed average income for the population on the whole for every year since 1996.⁵⁹

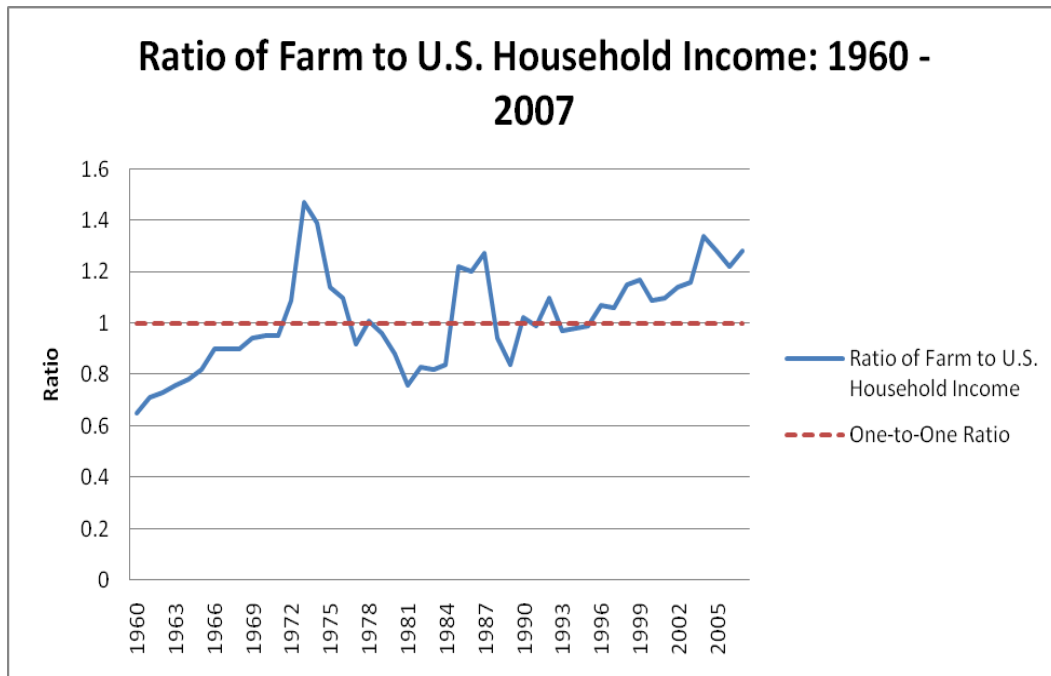
Figure 8: Ratio of Farm to U.S. Household Income: 1960 – 2007⁶⁰

⁵⁷ USDA Finance Outlook, *supra* note 5, at 32.

⁵⁸ Farm Household Income Data, *supra* note 13.

⁵⁹ Farm Household Income Data, *supra* note 13; USDA Finance Outlook, *supra* note 5, at 33.

⁶⁰ Farm Household Income Data, *supra* note 13.



Of particular note is the increasing reliance of farmers on non-farm sources of income. In 2009, the non-farm portion of farm operator household income is expected to exceed 95 percent for the first time in history (although USDA acknowledges that its definition of “earnings of the operator household from farming activities” does not completely capture the returns to the household provided by the farm).⁶¹ This trend of relying on off-farm income began in earnest during the 1980s farm crisis, and it has not abated over the past two decades. According to USDA, approximately 70 percent of farm operator households currently have either an operator or a spouse working at an off-farm job, and only for the households that operate the largest 8 percent of farms (with sales of \$250,000 or more) is average farm income greater than off-farm income on a yearly basis.⁶²

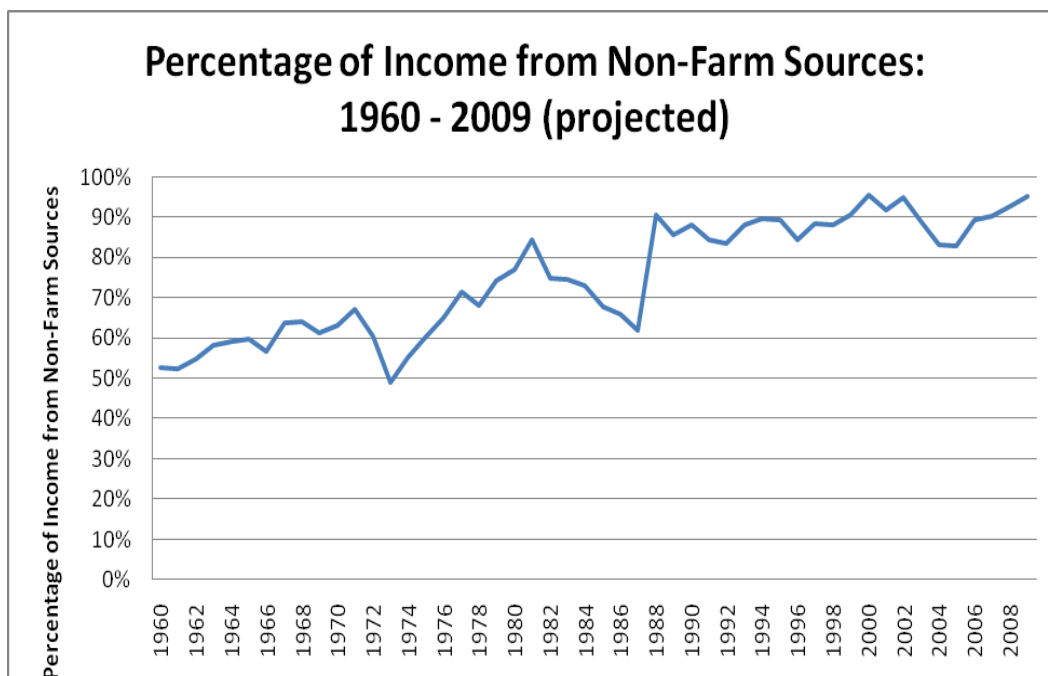
While the long-term trends in average farm operator household income have been positive, this rising dependence on off-farm income also makes smaller, family farms increasingly vulnerable to outside economic conditions, and, in particular, employment conditions in rural America. The fact that an estimated 95 percent of farm operator household income is derived from non-farm sources also calls into question whether any analysis of trends in the agriculture sector truly captures financial conditions for farmers in rural America.

Figure 9: Farm Operator Income from Non-Farm Sources: 1960 – 2009 (projected)⁶³

⁶¹ Farm Household Income Data, *supra* note 13.

⁶² USDA Finance Outlook, *supra* note 5, at 31.

⁶³ Farm Household Income Data, *supra* note 13.



6. Sectors

While the overall trends in agriculture have been very positive in recent years, there are some key differences across sectors of agriculture, and these differences, principally differences in the economic conditions and outlook for commodity crops versus livestock, have been exacerbated in the months since the onset of the economic crisis. In particular, a variety of issues, ranging from overproduction of cattle to declining dairy prices, swine flu, and the bankruptcy of significant companies in the industry, have combined to cause heightened stress across the livestock sector. Further, as discussed above, many trends in agriculture necessarily work at cross-purposes. As commodity crop prices go up, input costs for livestock farmers go up, and, when dairy farmers send their cows to slaughter because overproduction is driving prices down, the beef cattle sector sees increased stress in the form of oversupply. This section describes these notable differences, in an effort to highlight those sectors most at risk in the current economic climate.

This analysis of the relative health of various agriculture sectors and of the volatility of commodity and livestock prices and input costs is an important precursor to this report's discussion of farm credit conditions. Particularly because an important consideration in extending credit to farmers is cash flow (as is discussed in detail in later report sections), volatile and rising costs of production coupled with declining prices can quickly lead farmers to become less creditworthy – and lead banks to become more wary about extending credit to farmers in the affected sectors – at times when they most need credit to carry them through hard times.⁶⁴

⁶⁴ Congressional Oversight Panel, Testimony of U.S. Department of Agriculture Undersecretary for Farm and Foreign Agricultural Services Michael Scuse, *COP Field Hearing in Greeley, CO on Farm Credit* (July 7,

Indeed, witnesses at the Panel's Greeley, CO, field hearing noted that some reliable sources of agriculture credit have dried up, as "the volatility of ag[riculture] prices and profits is becoming more than most lenders care to bear."⁶⁵

a. Commodity Crops

Commodity crop farmers – which include those farmers who produce mixed grains, wheat, corn, soybeans, peanuts, cotton, and rice – have generally seen historically strong economic times in recent years, and commodity crop prices have held comparatively steady throughout the economic downturn. Specifically, farm businesses (defined by USDA as those farms whose operator indicates that farming was his or her primary activity, encompassing roughly 800,000 of the nation's 2.1 million farms) specializing in mixed grains, wheat, corn, and soybeans and peanuts were expected to realize double-digit percent increases in net cash income from 2007 to 2008 (11, 29, 25, and 22 percent, respectively).⁶⁶ However, cotton, rice, and specialty crop farmers were expected to see decreases in net cash income from 2007 to 2008.⁶⁷

USDA data on commodity crop prices in June 2009 demonstrate that, while commodity crop prices have fallen across the board over the course of the past year, their decline was not as dramatic as the drop in prices in the livestock sector (discussed below), and prices have begun to increase once again. The USDA all crops index increased by 8.0 percent from May to June 2009, but it remained 11 percent below its June 2008 level.⁶⁸ Overall, U.S. farm sector cash receipts from the sale of commodity crops are projected to decrease by 18.7 percent in 2009; however, this is down from a record high level of \$181.1 billion in 2008.⁶⁹

2009) (online at cop.senate.gov/documents/testimony-070709-scuse.pdf) (hereinafter "Scuse Testimony") ("A combination of limited or negative returns in much of the livestock industry, reduced profit margins in crop production, and increased sensitivity to credit risk has caused many farm lenders to raise their credit standards, reduce the amount they are willing to lend to agriculture, or both.").

⁶⁵ Congressional Oversight Panel, Testimony of Les Hardesty, Owner, Painted Prairie Farm, and Chairman, Dairy Farmers of America Mountain Area, *COP Field Hearing in Greeley, CO on Farm Credit* (July 7, 2009) (audio online at cop.senate.gov/hearings/library/hearing-070709-farmcredit.cfm) (hereinafter "Hardesty Testimony").

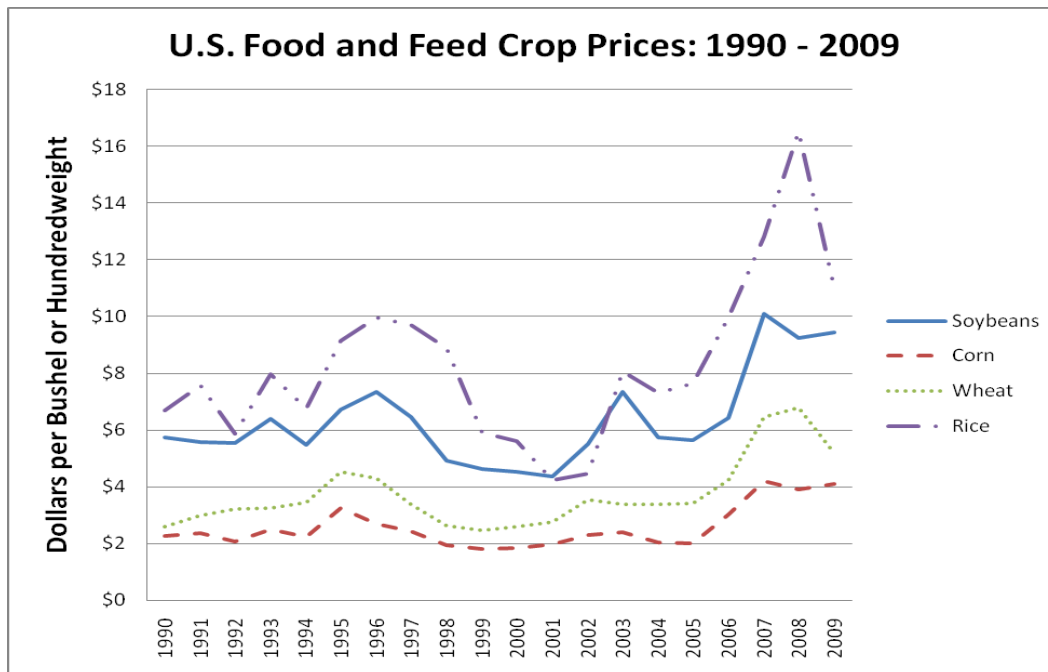
⁶⁶ USDA Finance Outlook, *supra* note 5, at 28.

⁶⁷ USDA Finance Outlook, *supra* note 5, at 31.

⁶⁸ Price increases for commercial vegetables, fruits and nuts, oil-bearing crops, and potatoes and dry beans surpassed decreases in prices for feed grains and hay, food grains, and cotton, allowing for the net increase in the index from May to June. See U.S. Department of Agriculture, National Agricultural Statistics Service, *Agricultural Prices*, at 2 (June 29, 2009) (online at usda.mannlib.cornell.edu/usda/current/AgriPric/AgriPric-06-29-2009.pdf) (hereinafter "USDA June Agricultural Prices").

⁶⁹ U.S. Department of Agriculture, Economic Research Service, *Farm Income and Costs: Farm Sector Income Forecast* (online at www.ers.usda.gov/briefing/farmincome/data/cr_t3.htm) (accessed July 8, 2009) (hereinafter "USDA Farm Sector Income Forecast").

Figure 10: U.S. Food and Feed Crop Prices: 1990 – 2009⁷⁰



b. Livestock

Conversely, the livestock sector has faced considerable challenges in recent months, as sharply declining prices for meat and, in particular, dairy products have added increased strain on livestock farmers, whose costs of production had begun to exceed the breakeven point even before the economic crisis hit. USDA’s livestock and livestock products price index dropped slightly from May to June 2009, falling by 0.9 percent; however, it is down 18 percent from June 2008.⁷¹ Overall, U.S. farm sector cash receipts from the livestock sector are projected to drop by 10.9 percent in 2009 – a smaller percent decrease than the percent decrease in cash receipts for commodity crops, but from a lower level (livestock receipts only increased by 5.3 percent from 2007 to 2008 while commodity crop receipts increased by 34.2 percent).⁷² Further, last year, as commodity crops hit record high price levels, livestock farmers, consequently, saw dramatic increases in feed costs, cutting into their profit margins and, in many cases, causing them to operate in the red.

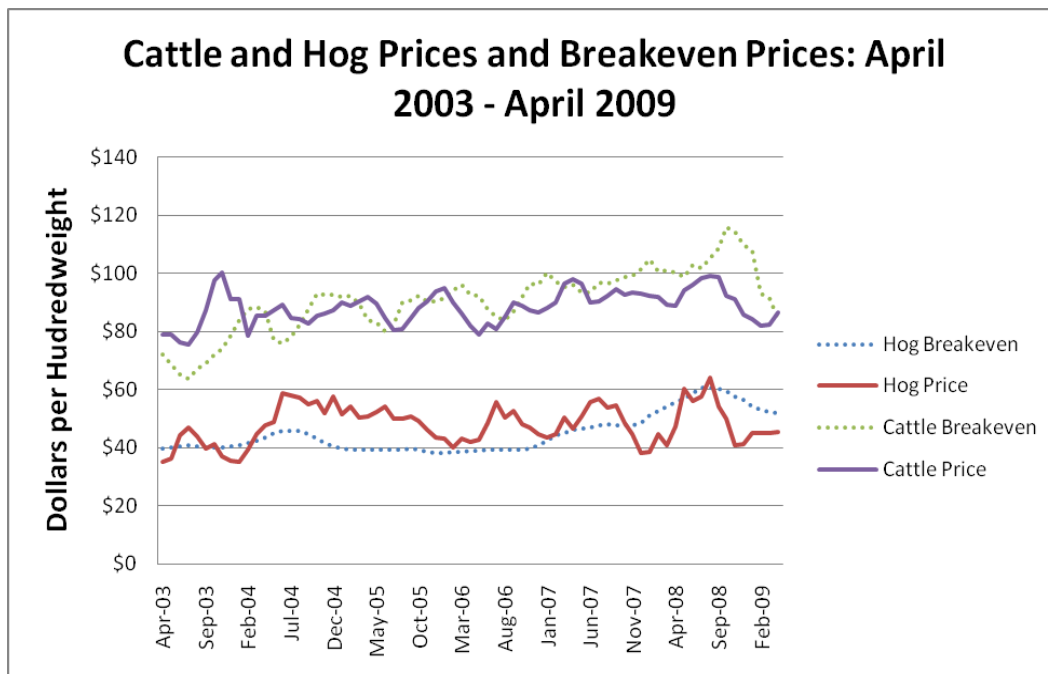
Figure 11: Cattle and Hog Prices and Breakeven Prices: April 2003 – April 2009⁷³

⁷⁰ *Id.*

⁷¹ USDA June Agricultural Prices, *supra* note 68, at 2.

⁷² USDA Farm Sector Income Forecast, *supra* note 69.

⁷³ U.S. Department of Agriculture, Economic Research Service, *Commodity Costs and Returns: U.S. and Regional Cost and Return Data* (online at www.ers.usda.gov/Data/CostsAndReturns/testpick.htm) (accessed July 13, 2009) (hereinafter “USDA Commodity Costs and Returns Data”).



i. Hogs. Net cash income for farm businesses specializing in hogs declined by approximately eight percent from 2007 to 2008, and, as demonstrated in the above chart, prices received by hog producers fell short of the breakeven point for much of 2008.⁷⁴ These existing problems were worsened with the onset of the economic crisis and the corresponding decline in meat demand. Prices in the hog industry were further damaged in the aftermath of the H1N1 virus (swine flu) scare.⁷⁵ Per USDA, which revised downward its second quarter 2009 estimate for hog prices, “consumer and foreign government reactions to the flu likely resulted in temporarily lower domestic and foreign demand for pork products.”⁷⁶ As of May 2009, hog prices were nearly 18 percent below their price one year ago.⁷⁷ Information recently released in the Federal Reserve’s *Beige Book* for the Chicago and Kansas City Districts indicates that these lower hog prices, coupled with higher feed costs, will continue to cause stress in the hog industry in the months ahead. However, USDA expects that hog prices will begin to tick upward as demand normalizes following the H1N1 scare.⁷⁸

⁷⁴ USDA Finance Outlook, *supra* note 5, at 28.

⁷⁵ Board of Governors of the Federal Reserve System, *The Beige Book: Current Economic Conditions by Federal Reserve District*, at VII-4 (June 10, 2009) (online at www.federalreserve.gov/FOMC/BeigeBook/2009/20090610/fullreport20090610.pdf).

⁷⁶ U.S. Department of Agriculture, Economic Research Service, *Livestock, Dairy, and Poultry Outlook*, at 3 (May 19, 2009) (LDP-M-179) (online at www.ers.usda.gov/publications/LDP/2009/05May/ldpm179.pdf) (hereinafter “USDA May Livestock, Dairy, and Poultry Outlook”).

⁷⁷ USDA June Agricultural Prices, *supra* note 68, at 9.

⁷⁸ USDA May Livestock, Dairy, and Poultry Outlook, *supra* note 76, at 3.

ii. Poultry. In comparison with other sub-categories within the livestock sector (hogs, cattle, and dairy), the poultry industry has held up fairly well. Farm businesses specializing in poultry saw net cash income decrease by approximately two percent from 2007 to 2008.⁷⁹ As of June 2009, the overall poultry and eggs price index was down by 4.5 percent from June 2008, but it increased by 3.5 percent from May to June 2009.⁸⁰ Specifically, prices for broilers and turkeys increased from April to May, by 2.0 cents and 2.2 cents per pound, respectively, while prices for eggs dropped by 2.6 cents per dozen.⁸¹ Broilers are up 3.0 cents from June 2008, while turkeys are down 7.5 cents and eggs are down 38.6 cents per dozen.⁸² Eggs are expected to remain a negative outlier throughout 2009, and prices for a dozen eggs are expected to decline by double digits from 2008 to 2009.⁸³

Despite some comparatively positive indicators, the poultry industry has been hit by high production costs, and the December 2008 bankruptcy of Pilgrim's Pride, the nation's largest chicken producer (controlling 23 percent of the U.S. market), has had significant consequences for many poultry farmers who act as assemblers on behalf of the company.⁸⁴ Pilgrim's Pride's bankruptcy also demonstrates that, even on the heels of good times in the agriculture sector, shrinking profit margins can quickly place farmers' finances in danger. Further, dependence on a large company such as Pilgrim's Pride for a steady stream of business can place farmers – and their ability to make good on their loans – in jeopardy through no fault of their own should the company fall on hard times.

iii. Cattle. The beef cattle industry saw dramatic increases in input costs in 2008 (fertilizer, fuel, and feed costs increased 64, 26, and 23 percent, respectively), leading to a drop in net cash income for farm businesses specializing in beef cattle of 27 percent from the 2007 level.⁸⁵ Further, meat prices have fallen over the past year – by roughly 12 percent from June 2008 to June 2009 –, and the industry has operated in the red for much of the past year, with the exception of April 2009, when meat selling prices edged above the breakeven price.⁸⁶ U.S. beef exports are expected to decline by roughly 8 percent in 2009, though this decline is likely to be

⁷⁹ USDA Finance Outlook, *supra* note 5, at 28.

⁸⁰ USDA June Agricultural Prices, *supra* note 68, at 2.

⁸¹ USDA June Agricultural Prices, *supra* note 68, at 2.

⁸² USDA June Agricultural Prices, *supra* note 68, at 2.

⁸³ U.S. Department of Agriculture, Economic Research Service, *Livestock, Dairy, and Poultry Outlook*, at 4 (June 17, 2009) (LDP-M-180) (online at www.ers.usda.gov/publications/ldp/2009/06Jun/ldpm180.pdf) (hereinafter "USDA June Livestock, Dairy, and Poultry Outlook").

⁸⁴ Henderson Article, *supra* note 27, at 70.

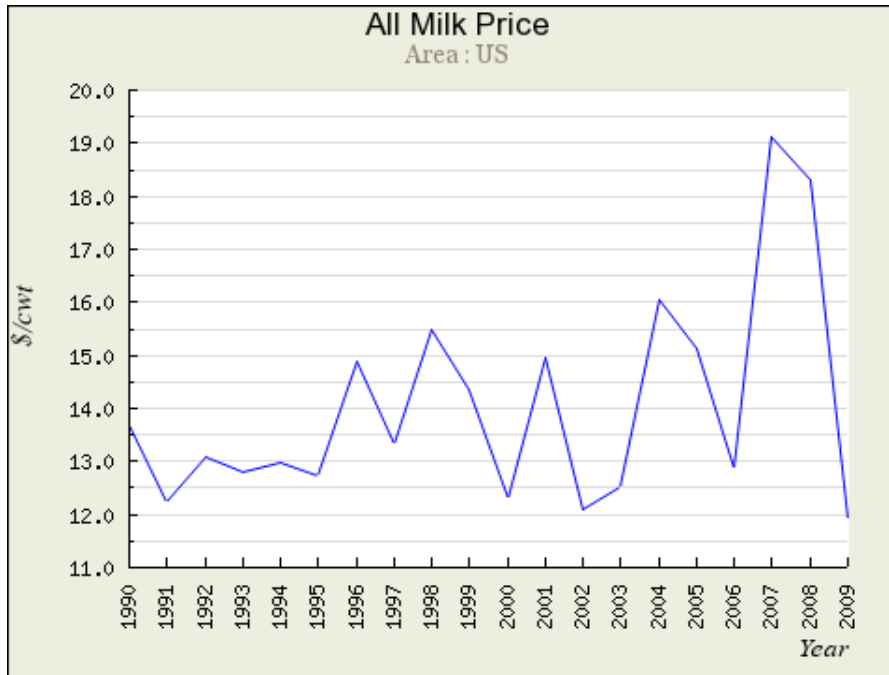
⁸⁵ USDA Finance Outlook, *supra* note 5, at 28.

⁸⁶ USDA June Agricultural Prices, *supra* note 68, at 9; U.S. Department of Agriculture, Economic Research Service, *Production Indicators* (June 30, 2009) (online at www.ers.usda.gov/Publications/ldp/xlstables/productionindicators.xls).

balanced out by an expected increase in beef exports of approximately 9 percent in 2010.⁸⁷ However, per capita consumption of red meat in the United States is projected to decline over the course of the next five years.⁸⁸

iv. Dairy. Even within agriculture, a sector of the economy known for its cyclical nature, the roughly three-year cycles of the dairy industry stand out for their predictability, as the chart below demonstrates.

Figure 12: Milk Prices: 1990 – 2009⁸⁹



Nonetheless, while the current drop in dairy prices is not out of character considering previous such drops over the past two decades, the dramatic nature of the drop-off from historically high prices – and the fact that this trough is as deep as any in recent memory – has made dairy without a doubt the hardest-hit sector of the farm economy in recent months. Farm businesses specializing in dairy had already seen their net cash income fall by 40 percent from 2007 to 2008, and the problems in the dairy sector have been compounded by sustained low milk prices.⁹⁰ Specifically, milk prices were down 41 percent in June 2009 compared to June 2008, and the USDA June 2009 dairy price index was likewise 41 percent below the index level in

⁸⁷ USDA June Livestock, Dairy, and Poultry Outlook, *supra* note 83, at 7.

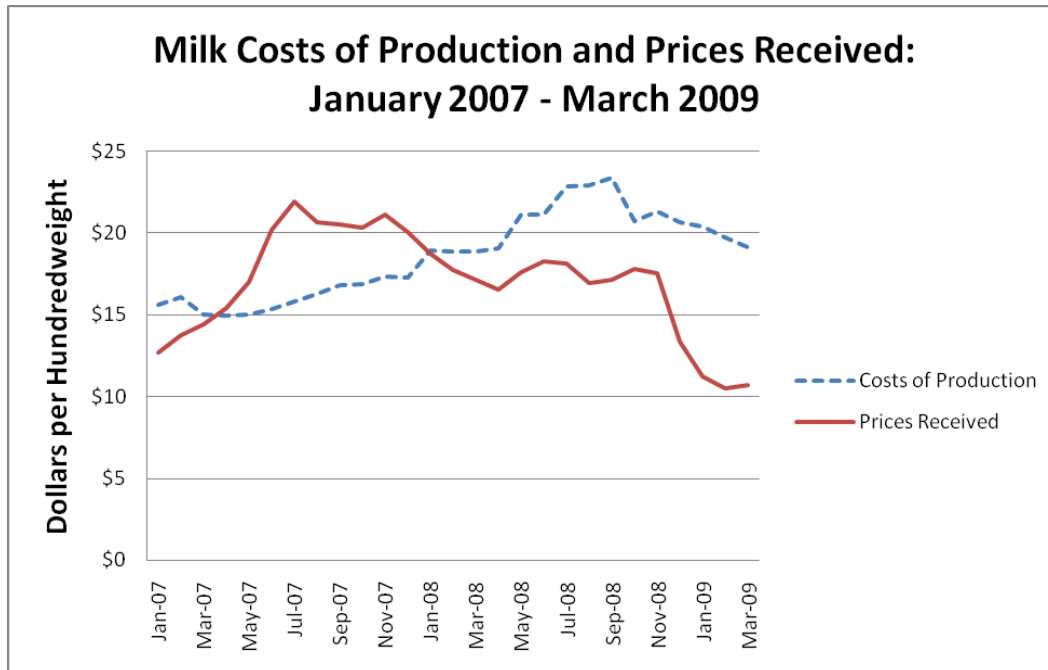
⁸⁸ USDA Long-term Projections, *supra* note 16, at 49 (Table 19: Per Capita Meat Consumption).

⁸⁹ Professor Brian W. Gould, *Dairy Marketing and Risk Management Program*, University of Wisconsin (online at future.aae.wisc.edu/data/annual_values/by_area/10?tab=prices&period=recent.com) (accessed July 13, 2009).

⁹⁰ USDA Finance Outlook, *supra* note 5, at 28.

June 2008.⁹¹ Dairy has been operating in the red since January 2008, with costs of production outpacing prices received.⁹² Average feed costs (which comprise roughly one-half of variable operating costs for the dairy industry) increased by about 35 percent in 2008, and energy costs increased by 30 percent.⁹³ These trends are particularly worrisome because dairy farms are among the most highly leveraged in the U.S. agriculture sector, and the added strain of the economic crisis has made the credit needs of the dairy industry even more acute.⁹⁴

Figure 13: California Milk Costs and Prices Received: January 2007 – March 2009⁹⁵



However, USDA projects that prices for milk and dairy products will recover slightly in the latter half of 2009 and continue to increase in 2010, while remaining below levels from 2007 and 2008.⁹⁶ USDA also projects that feed costs will fall by approximately 15 percent in 2009,

⁹¹ USDA June Agricultural Prices, *supra* note 68, at 2.

⁹² USDA Commodity Costs and Returns Data, *supra* note 73.

⁹³ U.S. House Committee on Agriculture, Subcommittee on Livestock, Dairy, and Poultry, Testimony of Under Secretary of Agriculture James Miller, at 3 (July 14, 2009) (online at agriculture.house.gov/testimony/111/h071409/Miller.pdf) (hereinafter “Miller Testimony”).

⁹⁴ *Id.*, at 3.

⁹⁵ Monthly milk costs of production are available only on a state-by-state basis. California is the nation’s largest milk producer. USDA Commodity Costs and Returns Data, *supra* note 73.

⁹⁶ USDA June Livestock, Dairy, and Poultry Outlook, *supra* note 83, at 1. Some project that prices may hit bottom in July 2009 and then slowly recover, based on the futures market. See Jim Dunn, *Dairy Outlook*, Penn State University, at 1 (June 2009) (online at dairyoutlook.aers.psu.edu/reports/Pub2009/DairyOutlookjun09.pdf).

easing some of the pressure on dairy producers.⁹⁷ In the near-term, though, USDA cautions that tighter cash margins in the dairy sector could lead the percentage of dairy farms with debt repayment issues to more than double from two years ago, going from 5 percent in 2007 to upwards of 13 percent in 2009.⁹⁸

C. Farm Credit Markets

1. Types of Credit Needed by Farmers

Farming is a cyclical business, and income and expenses are unevenly distributed through the cycle. Farmers rely on several primary types of credit to help them deal with this disparity and finance their operations. Within a growing cycle, farmers face upfront costs for seed, fertilizer, and similar inputs. These operating expenses are generally financed through an annual production loan.

However, some production expenses don't fit within the annual operating mold. For example, some farmers must purchase equipment, make real estate improvements, and purchase cattle or other livestock. These more significant and less frequent expenses are generally financed through intermediate term production loans. Some lenders may accept the production elements being purchased, such as equipment, as collateral, while other lenders choose to collateralize these loans with real estate. Intermediate production loans are often for terms between 14 months and seven years. Some farmers utilize a line of credit to finance annual or intermediate production costs.

Finally, farmers use real estate loans to finance the land and buildings necessary for their business. Farm real estate loans are usually the largest loans and generally feature the longest terms, often between five and 40 years. Given that all farms have both real estate and production expenses, it isn't uncommon for farms to have multiple lines of credit.

2. Major Sources of Credit for Farmers and Typical Characteristics of Farm Loans

Total farm debt outstanding is projected to rise to an all-time high of \$217.1 billion in 2009, with approximately 52 percent of this debt used to finance real estate and the remaining 48 percent used for non-real estate purposes.⁹⁹ This debt is divided among several principal sources of agricultural credit: FSA, life insurance companies, individuals, FCS, and commercial banks. This section describes these five major sources of credit for farmers, including differences in market share for the various sources across real estate and non-real estate loans and over time. Also discussed is the distribution of farm loans at commercial banks, in an effort to highlight the

⁹⁷ Miller Testimony, *supra* note 93.

⁹⁸ USDA Crisis Impact Report, *supra* note 6, at 20.

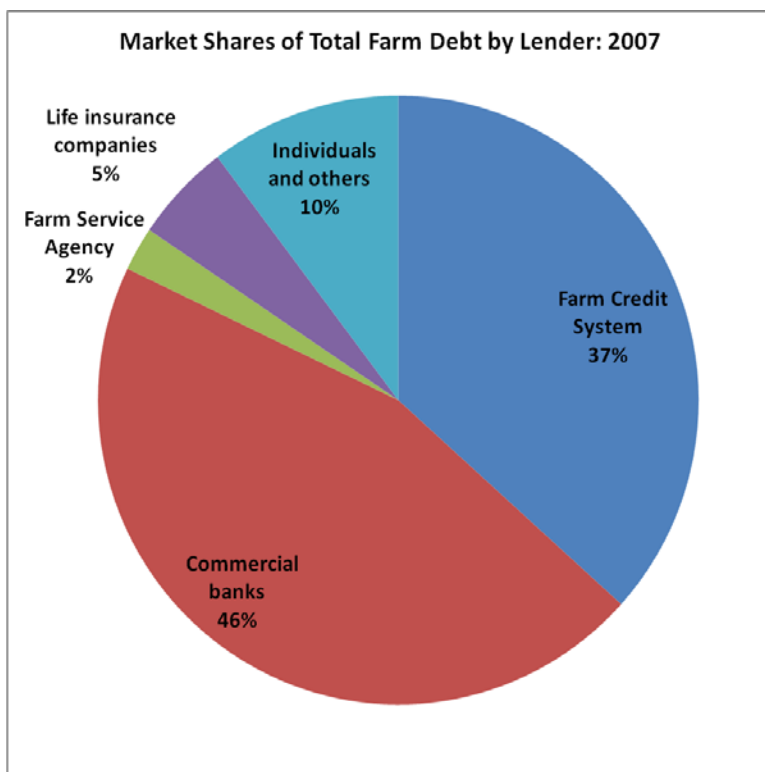
⁹⁹ USDA Farm Sector Income Forecast, *supra* note 69.

role of both large and small, TARP and non-TARP banks in providing credit to American farmers. Finally, typical characteristics of farm loans made by each of the major farm lenders are discussed.

a. Overview of Sources of Credit for Real Estate and Non-Real Estate Farm Loans

A look at the share of total farm debt held by the various sources of farm credit reveals that commercial banks hold more farm debt than any other one source of farm credit, with the FCS also holding a significant proportion of total farm debt. Comparatively, FSA held a mere two percent of farm debt in 2007, with individuals and others and life insurance companies holding 10 percent and 5 percent, respectively.

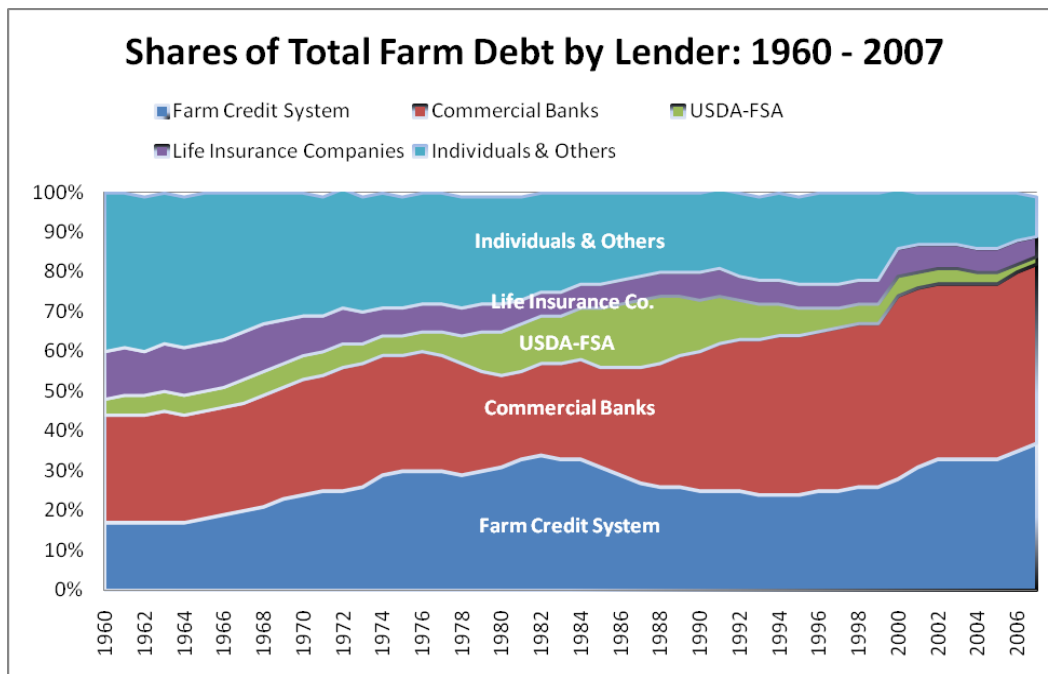
Figure 14: Market Shares of Total Farm Debt by Lender: 2007¹⁰⁰



A long-term view of sources of farm credit shows that the share of farm debt held by commercial banks has increased over time, while the share of farm debt held by individuals and others has fallen considerably from 1960 to the present. Fluctuations in debt held by FSA reflect the consequences of the farm crisis of the 1980s, with FSA debt peaking during that time period.

Figure 15: Shares of Total Farm Debt by Lender: 1960 – 2007¹⁰¹

¹⁰⁰ USDA Farm Sector Income Forecast, *supra* note 69.

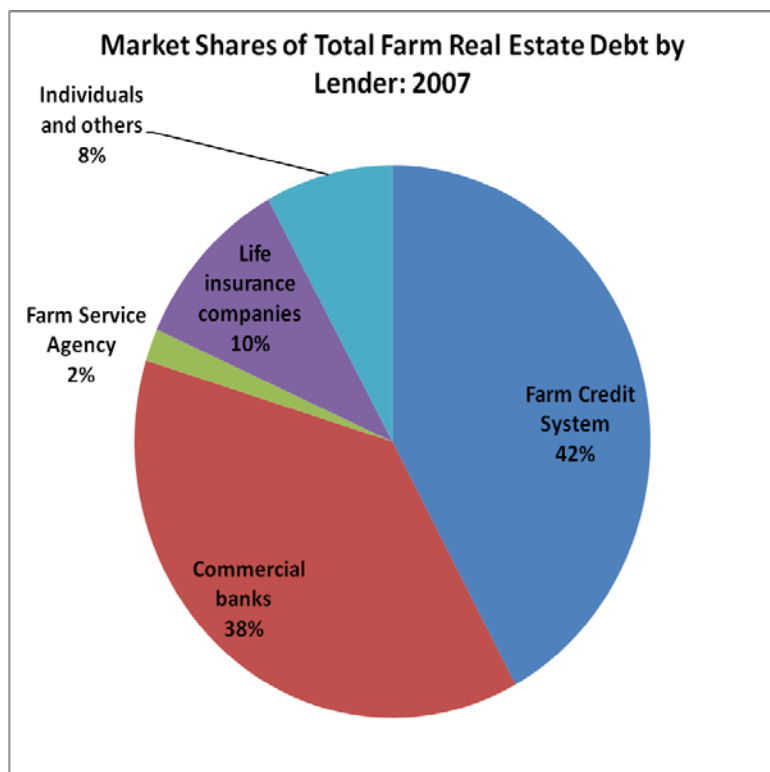


When isolating farm real estate debt from the entirety of farm debt, it can be seen that the FCS holds more of this type of farm debt than any other lender. Life insurance companies hold roughly 10 percent of farm real estate debt.

Figure 16: Market Shares of Total Farm Real Estate Debt by Lender: 2007¹⁰²

¹⁰¹ U.S. Department of Agriculture, Economic Research Service, *Farm Balance Sheet: Data Files: Farm Balance Sheet, 1960-2007* (online at www.ers.usda.gov/Data/FarmBalanceSheet/FBSDMU.HTM) (accessed July 13, 2009) (hereinafter “USDA Farm Balance Sheet Historical Data”).

¹⁰² USDA Farm Sector Income Forecast, *supra* note 69.

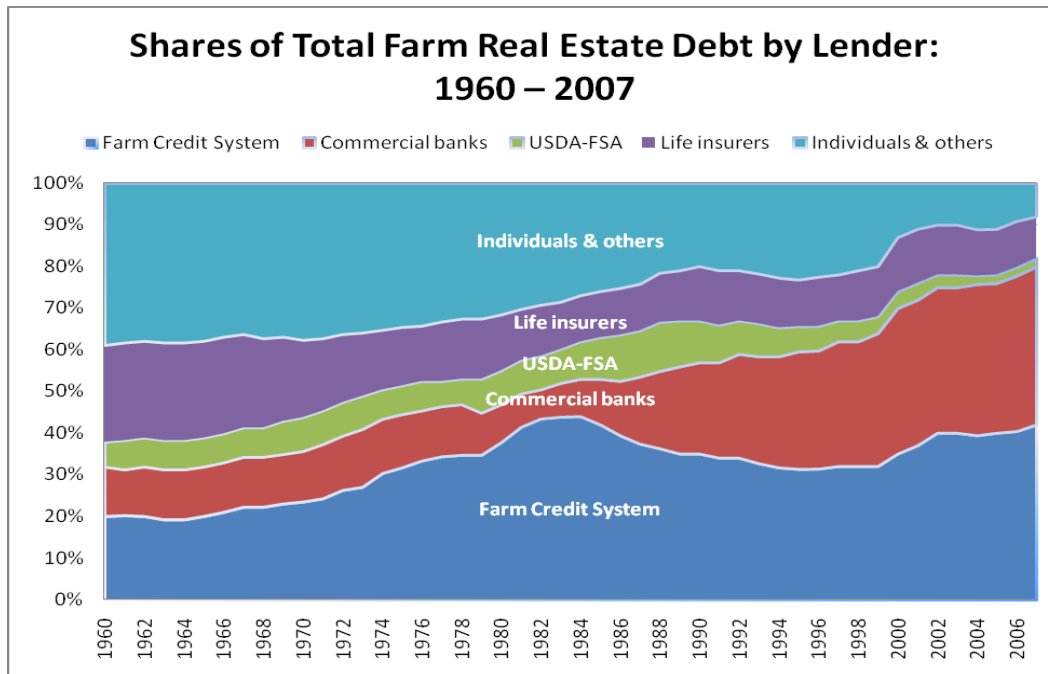


While commercial banks do not hold as much farm real estate debt as the FCS institutions, the share of farm real estate debt held by banks has increased considerably over the past two decades, in particular cutting into the share of farm real estate debt held by individuals and others. This increase in farm real estate debt held by commercial banks speaks to the ability of banks to offer competitive interest rates and a diverse range of services to attract and maintain customers (services with which many individuals, input suppliers, etc., could not compete).¹⁰³ The implications of the share of farm debt currently held by commercial banks will be discussed in the sections of this report on credit availability and farm loan restructuring.

Figure 17: Shares of Total Farm Real Estate Debt by Lender: 1960 – 2007¹⁰⁴

¹⁰³ Glenn Pederson and Tamar Khitarishvili, *The Competitive Environment for Farm Real Estate Lending of Commercial Banks in the Upper Midwest*, Department of Applied Economics, College of Agricultural, Food, and Environmental Sciences, University of Minnesota, at 19 (Dec. 1997) (Staff Paper P97-13) (online at ageconsearch.umn.edu/bitstream/13440/1/p97-13.pdf).

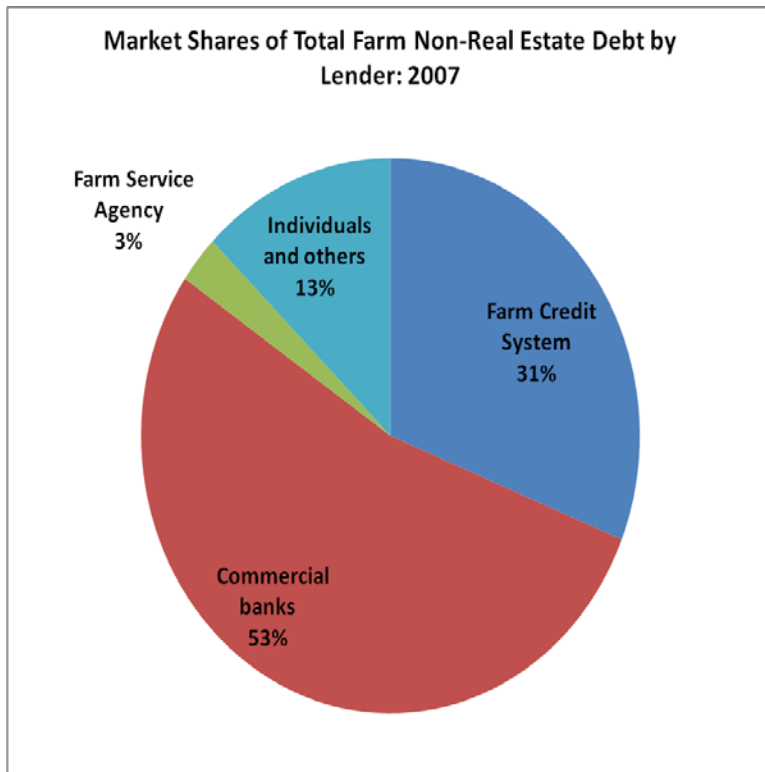
¹⁰⁴ USDA Farm Balance Sheet Historical Data, *supra* note 101.



Conversely, commercial banks hold a majority of non-real estate farm debt – 53 percent in 2007. The FCS holds a bit under a third, with individuals and others holding 13 percent and FSA holding 3 percent. Life insurance companies generally do not make loans to farmers for non-real estate purposes.

Figure 18: Market Shares of Total Farm Non-Real Estate Debt by Lender: 2007¹⁰⁵

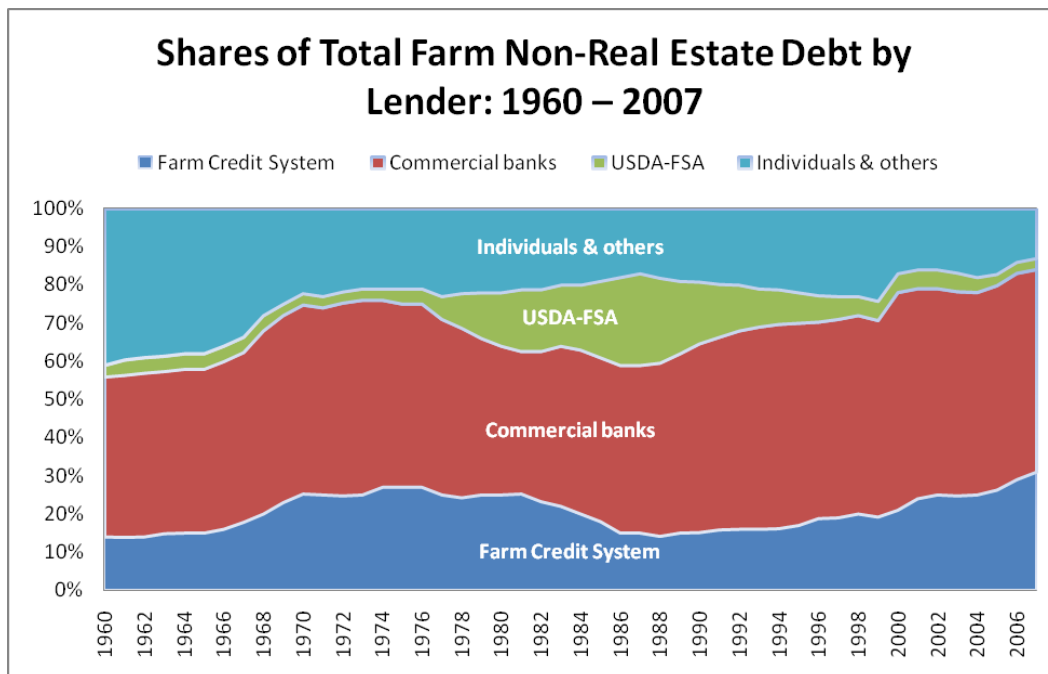
¹⁰⁵ USDA Farm Sector Income Forecast, *supra* note 69.



An historical view of non-real estate farm lending shows that the predominance of commercial banks in making non-real estate farm loans has persisted from 1960 to the present. Debt held by the other sources of credit has likewise remained somewhat constant, save for a marked uptick in debt held by FSA during the 1980s farm crisis.

Figure 19: Shares of Total Farm Non-Real Estate Debt by Lender: 1960 – 2007¹⁰⁶

¹⁰⁶ USDA Farm Balance Sheet Historical Data, *supra* note 101.



b. Farm Service Agency

FSA, a government agency within USDA, serves as the lender-of-last-resort for the agriculture sector, making direct loans to farmers and guaranteeing loans made by FCS and commercial banks for real estate and non-real estate purposes. FSA has its origins in the Great Depression of the 1930s, when farm failures were rampant, and it has evolved over the years to assist those in rural America through a variety of lending, training, and commodity assistance programs.

According to the authorizing statute for FSA’s lending programs, borrowers must “be or become owner-operators of not larger than family farms,” and borrowers are eligible for FSA loans only if they are “unable to obtain sufficient credit elsewhere to finance their actual needs at reasonable rates and terms.”¹⁰⁷ The maximum loan amounts of \$300,000 through FSA’s direct loan program and \$1,094,000 through FSA’s guaranteed loan programs (FSA generally guarantees up to 90 percent of qualifying farm loans though it can go as high as 95 percent for loans used to refinance FSA direct loans) further ensure that FSA’s programs tailor to family farmers and not to large, commercial farms.¹⁰⁸ Through July 7, 2009, FSA had made or guaranteed 14,400 direct operating loans, 5,767 guaranteed operating loans, 1,281 direct farm ownership loans, and 2,849 guaranteed farm ownership loans in fiscal year 2009.¹⁰⁹ Funding for

¹⁰⁷ Consolidated Farm and Rural Development Act, as amended by Pub. L. No. 109-171(codified at 7 U.S.C. § 1922(a)).

¹⁰⁸ U.S. Department of Agriculture, Farm Service Agency, *Farm Loan Programs* (online at www.fsa.usda.gov/FSA/webapp?area=home&subject=fmlp&topic=landing) (accessed July 8, 2009).

¹⁰⁹ U.S. Department of Agriculture, Farm Service Agency, *Farm Loan Programs: Funding* (online at www.fsa.usda.gov/FSA/webapp?area=home&subject=fmlp&topic=fun) (accessed July 8, 2009).

FSA's direct and guaranteed loan programs is dependent on congressional appropriations. Oftentimes, FSA lends at a pace that would lead it to exceed the appropriated amount during a given fiscal year, leading to the inclusion of additional funding for FSA's loan programs in supplemental appropriations bills passed by Congress outside of the yearly appropriations process.

The characteristics of loans made through FSA's direct loan programs vary depending on the purposes for which the loan is being made (short-term operating, intermediate-term operating, or long-term real estate), as well as the ability of the borrower to repay the loan.¹¹⁰ Interest rates on loans are fixed and are determined based on the federal government's cost of borrowing.¹¹¹ As of July 1, 2009, the interest rate on operating loans was 2.5 percent and the interest rate on real estate loans was 4.625 percent.¹¹² There is also a "limited resource" interest rate available, and these "limited resource" loans are reviewed periodically to adjust the interest rate based on repayment ability.¹¹³

FSA requires that direct loans be secured with collateral of 150 percent of the loan amount, if such collateral is available, and a minimum of 100 percent of the loan amount in any case.¹¹⁴ Collateral for operating loans consists of a first lien on crops to be produced or on livestock and equipment purchased with loan funds, though a lien can be taken on other chattel or real estate. FSA real estate loans must be secured by real estate. All FSA direct borrowers are required to refinance their loans with a private lender (such as a commercial bank or an FCS lender) when their finances permit.¹¹⁵

The terms of FSA guaranteed loans must be negotiated between the lender (either a commercial bank or an FCS institution) and the borrower, though interest rates may not exceed the rate the institution charges its average farm customer.¹¹⁶ The type of collateral used to secure FSA guaranteed loans mirrors that needed to secure direct loans; FSA determines whether the collateral being proposed by the commercial lender is adequate for the loan to receive an FSA guarantee.¹¹⁷

¹¹⁰ U.S. Department of Agriculture, Farm Service Agency, *Direct Loan Program* (online at www.fsa.usda.gov/Internet/FSA_File/flp_direct_farm_loans.pdf) (accessed July 8, 2009) (hereinafter "FSA Direct Loan Information").

¹¹¹ *Id.*

¹¹² U.S. Department of Agriculture, Farm Service Agency, *Farm Loan Programs: Interest Rates* (online at www.fsa.usda.gov/FSA/webapp?area=home&subject=fmlp&topic=dfi-ir) (accessed July 8, 2009).

¹¹³ FSA Direct Loan Information, *supra* note 110.

¹¹⁴ FSA Direct Loan Information, *supra* note 110.

¹¹⁵ FSA Direct Loan Information, *supra* note 110.

¹¹⁶ U.S. Department of Agriculture, Farm Service Agency, *Guaranteed Loan Program* (online at www.fsa.usda.gov/Internet/FSA_File/guaranteed_farm_loans.pdf) (accessed July 8, 2009).

¹¹⁷ *Id.*

FSA-guaranteed loans remain with the lender; however, through Farmer Mac II, one of Farmer Mac's programs¹¹⁸ for the secondary market for agriculture loans, the government-guaranteed portion of FSA-guaranteed loans can be resold (although the original commercial lender retains the responsibility for servicing the loan).¹¹⁹

In 2007, FSA held 2.33 percent of the total debt in the farm sector, totaling \$4.93 billion, including 1.91 percent of farm real estate debt and 2.77 percent of non-real estate farm debt.¹²⁰ FSA's overall share of farm debt peaked at 17 percent during the 1980s farm crisis, but it has declined precipitously over the past two decades, indicative of the strength of the agriculture sector and the reduced need for farmers to turn to the lender-of-last resort for credit.¹²¹ While, as mentioned earlier, demand for FSA's programs has spiked in recent quarters, it remains unclear how or if this increased demand will impact the overall share of farm debt held by FSA, because the volume of FSA loans made is limited by congressional appropriations regardless of demand.

c. Life Insurance Companies

Life insurance companies often hold mortgages among the assets backing their life, annuity, and health liabilities, and these companies are an additional source of credit to farmers, specializing in providing larger, farm real estate loans.¹²² In 2007, life insurance companies held \$11.2 billion of farm real estate debt, or 10.35 percent of farm real estate debt outstanding.¹²³ The share of farm real estate debt held by insurance companies has held steady in recent decades, comprising between ten and 13 percent of farm real estate debt every year since 1980.¹²⁴

d. Individuals and Others (including Equipment and Input Suppliers)

Not unlike the population of small businesses on the whole, many small, family farms rely on financing from family, friends, and neighbors to finance their operations and real estate purchases. In 2007, individuals and others held 10.18 percent of all farm debt, including 7.79 percent of real estate debt and 12.66 percent of non-real estate debt.¹²⁵ These figures include lending by niche lenders such as equipment and input suppliers (so-called "captive finance companies.")

¹¹⁸ Farmer Mac and its programs are discussed *infra*, Section 2, Part (C)(2)(g).

¹¹⁹ *Id.*

¹²⁰ USDA Farm Sector Income Forecast, *supra* note 69.

¹²¹ USDA Farm Sector Income Forecast, *supra* note 69.

¹²² American Council of Life Insurers, *ACLI Life Insurers Fact Book 2008*, at 7 (Oct. 31, 2009) (online at www.acli.com/ACLI/Tools/Industry+Facts/Life+Insurers+Fact+Book/GR08-108.htm).

¹²³ USDA Farm Sector Income Forecast, *supra* note 69.

¹²⁴ USDA Farm Sector Income Forecast, *supra* note 69.

¹²⁵ USDA Farm Sector Income Forecast, *supra* note 69; *See also* USDA Finance Outlook, *supra* note 5, at 49.

Captive finance companies, such as John Deere (in the case of equipment) or seed and fertilizer suppliers, make credit available to farmers to finance the purchase of their products and, therefore, often enter into competition with commercial banks and other sources of farm credit. These companies sometimes offer direct lines of credit to farmers, but often credit is extended by smaller wholesalers and dealers selling supplier products to local or regional markets around the country. Recent data are lacking, but according to a 2004 survey these smaller dealers typically receive financing from FCS institutions or commercial banks and then extend unsecured lines of credit for a year or less. Larger equipment and input suppliers typically utilize a completely different financing scheme. They have the ability to directly access the commercial paper markets or even to pursue securitization.¹²⁶

The percentage of overall farm debt held by these miscellaneous individuals and entities has progressively eroded over time, from its peak of 40 percent, in 1960, the first year for which data are available.¹²⁷ This long-term trend is a result of the declining use of friend and family networks to finance farm real estate and operating expenses, as the years since 1960 have seen the American credit system become more developed and commercial bank and FCS credit become available to more people in all regions of the country. But nonetheless, certain subsectors of this category remain substantial credit providers, and niche lenders continue to make financing available to farmers. In 2008, total agriculture equipment sales reached \$28.3 billion.¹²⁸ \$24.7 billion of this amount is estimated to be financed.¹²⁹ The most recent historical data (comparing 2007 and 2008) showed 15.1 percent growth in agricultural equipment financing.¹³⁰

e. Farm Credit System

The FCS was established in 1916 and its stated purpose is “to provide sound, dependable funding for agriculture and rural America.”¹³¹ While the FCS is considered a Government

¹²⁶ See Section C(4)(c), *infra*, for an analysis of credit availability in the captive finance sector.

¹²⁷ USDA Farm Sector Income Forecast, *supra* note 69.

¹²⁸ U.S. Department of Commerce, Bureau of Economic Analysis, *Table 5.5.5U Private Fixed Investment in Equipment and Software by Type* (June 26, 2009) (online at bea.doc.gov/national/nipaweb/NIPA_Underlying/TableView.asp?SelectedTable=39&FirstYear=2008&LastYear=2009&Freq=Qtr).

¹²⁹ This estimate is calculated by multiplying total agriculture equipment sales by a propensity to finance percentage derived through research conducted by Global Insight. Equipment Leasing and Finance Foundation, *Propensity to Finance Study* (October 2007).

¹³⁰ Equipment Leasing and Finance Association, *2009 Survey of Equipment Finance Activity* (July 14, 2009) (online at www.elfaonline.org/pub/news/press/pressreleases_report.cfm?ID=9873).

¹³¹ Federal Farm Credit Banks Funding Corporation, *The Farm Credit System Investor Presentation*, at 3 (July 2009) (online at www.farmcredit-ffcb.com/farmcredit/serve/public/invest/present/report.pdf?assetId=135941) (hereinafter “July FCS Investor Presentation”).

Sponsored Enterprise (GSE), it is not explicitly guaranteed by the government and it is not a lender-of-last-resort but, rather, a for-profit lender that directly competes with commercial banks (though FCS does receive federal tax benefits). The system consists of five funding banks and 90 lending associations, which are cooperatively owned by borrowers (including farmers, ranchers, agriculture cooperatives, rural utilities, and others).¹³² The FCS maintains its operations by selling system-wide debt securities into the capital markets, and the system banks and lending associations are regulated by FCA.

FCS institutions provide a variety of loan products to meet the credit needs of farmers and those in rural areas, and the purposes for which loans can be made, as well as guidelines for the terms of FCS loans, are defined by the Farm Credit Act of 1971.¹³³ Short-term production loans (generally for twelve months or less) are made to finance farmers' operating costs – including inputs such as labor, feed, and fertilizer – during the farmers' typical production and marketing cycle. Intermediate-term loans, made for a specific term (generally ten years or less), are typically used to finance depreciable capital assets, such as farm machinery, vehicles, or breeding livestock. Finally, farm real estate loans are made for a term that ranges from five to 40 years.

FCS loans may be made with either a fixed or floating interest rate, and, among floating interest rate loans, there are two types: administered-rate loans (which may be adjusted periodically at the discretion of the lending institution) and indexed loans (which are adjusted periodically based on changes in specified indices). At the close of 2008, roughly 45 percent of the loan volume in the FCS consisted of floating rate loans, with the remaining 55 percent having fixed rates.¹³⁴ FCS loans often have interest-rate caps that prevent the interest rate from rising above a certain level.

With the exception of short-term operating loans, FCS loans are generally secured (though intermediate-term loans can be made on a secured or unsecured basis). Long-term real estate loans must be secured by first liens on the real estate, and the loans may be made only up to 85 percent of the appraised value of the property (97 percent of the appraised value if the loan is government-guaranteed).¹³⁵ However, FCS has indicated that the actual loan-to-value ratio for farm real estate loans “is generally lower than the statutory maximum percentage.”¹³⁶

¹³² U.S. House Committee on Agriculture, Subcommittee on Conservation, Credit, Energy, and Research, Testimony of President of Mid-Atlantic Farm Credit Bob Frazee, *To Review Credit Conditions in Rural America*, 111th Cong., at 1 (June 11, 2009) (online at agriculture.house.gov/testimony/111/h061109sc/Frazee.doc) (hereinafter “Bob Frazee House Agriculture Testimony”).

¹³³ Farm Credit Act of 1971, as amended through Pub. L. No. 110-246 (codified at 12 U.S.C. § 23).

¹³⁴ Federal Farm Credit Banks Funding Corporation, *Farm Credit System Annual Information Statement 2008*, at 52 (Feb. 27, 2009) (online at www.farmcredit-ffcb.com/farmcredit/financials/statement.jsp) (hereinafter “FCS 2008 Annual Information Statement”).

¹³⁵ *Id.*, at 8.

¹³⁶ *Id.*, at 8.

The FCA requires that system institutions adopt written standards for prudent lending and effective collateral evaluation.¹³⁷ In order to manage credit risk, FCS institutions consider the following in underwriting loans: borrower integrity, credit history, cash flows, equity, and collateral, as well as any off-farm sources of income that may affect or enhance the ability of the borrower to repay the farm loan.¹³⁸ Each FCS institution must establish a “lending limit,” representing the maximum amount of credit that can be extended to one borrower or industry.

Last, FCS institutions further manage risk by entering into agreements that provide long-term standby commitments to purchase FCS loans, such as agreements with Farmer Mac. As of December 31, 2008, \$2.165 billion worth of FCS loans were under guarantees with Farmer Mac.¹³⁹ Additionally, \$1.447 billion in FCS loans were securitized (via exchanging them for mortgage backed securities issued by Farmer Mac) at the close of last year, though this figure represented a mere 0.90 percent of total FCS loans and leases outstanding at that time.¹⁴⁰

As of 2007, the FCS held 36.69 percent of total farm debt in the United States, including 42.08 percent of farm real estate debt and 31.09 percent of non-real estate farm debt.¹⁴¹ The FCS’ overall share of farm debt has edged upward this decade, after a sustained period during which it held roughly 25 percent of farm debt – historically low for the FCS – in the aftermath of problems in the FCS during the 1980s farm crisis.¹⁴²

f. Commercial Banks

While the credit needs of American farmers are served by two separate entities with specific mandates to extend credit to the agriculture sector –FSA and FCS – and life insurance companies, individuals, and captive finance companies also provide a significant share of farm loans, commercial banks – large and small – remain a major source of farm credit. At the close of 2007, commercial banks held 45.42 percent of total farm debt – a larger share than any other source of credit.¹⁴³ Commercial banks held 37.67 percent of farm real estate debt and a majority of non-real estate farm debt – 53.47 percent.¹⁴⁴ The overall share of farm debt held by

¹³⁷ *Id.*, at 10.

¹³⁸ *Id.*, at 10.

¹³⁹ *Id.*, at 12.

¹⁴⁰ *Id.*, at 12.

¹⁴¹ USDA Farm Sector Income Forecast, *supra* note 69.

¹⁴² USDA Farm Sector Income Forecast, *supra* note 69; For a discussion of problems in the FCS during the 1980s, see Roland E. Smith, Chief Examiner, Farm Credit System, *Conditions in the Farm Credit System*, Presented to the Farm Credit Administration Board (May 14, 1998) (online at docs.google.com/gview?a=v&q=cache:cLJ3fB2L9QcJ:www.fca.gov/PDFs/FCS_Conditions_Report.pdf+Farm+Credit+System+1980s&hl=en&gl=us).

¹⁴³ USDA Farm Sector Income Forecast, *supra* note 69.

¹⁴⁴ USDA Farm Sector Income Forecast, *supra* note 69.

commercial banks has stayed fairly constant this decade, but it is up considerably from the roughly 25 percent share held by banks in the mid-1980s.¹⁴⁵

However, less is known about characteristics of farm loans at commercial banks and trends in commercial bank lending to the agriculture sector because of a lack of standardized data and reporting. While the government tracks and collects certain information about the farm sector and its programs (and, as a GSE, the FCS is required to collect certain information as well), bank lending to farmers does not abide by rigid constraints, and the existence of fewer farm-specific reporting requirements for commercial banks than FSA and FCS makes the interface of banks with the farm sector much more opaque.

Further, the unique nature of the farm sector makes it difficult to describe any characteristics of farm loans made by commercial banks as “typical.” Indeed, the variety in the terms of credit extended to farmers mirrors the variety in the credit needs of farmers more generally, with farmers requiring credit for short-term operating expenses, intermediate-term equipment and livestock purchases, and long-term real estate costs. However, several distinguishing characteristics generally hold true across the industry.

On the whole, farm loans share more similarities with commercial loans than they do with residential mortgages, with banks extending credit on terms and with amortizations that tailor to the unique needs of individual borrowers, and providing financing that matches the useful life of what it is that is being financed (whether for a yearly cycle of corn, a dairy cow, or a piece of farm equipment). Also unlike the residential mortgage market, farm loan products have remained quite traditional, not seeing exotic loan products in recent years – though the trend has been away from fixed rate financing and toward loans with floating rates.¹⁴⁶

Banks traditionally seek an abundance of collateral when extending credit to farmers, and they will cross-collateralize, using real estate as collateral to secure loans for operating and production purposes, and seeking additional collateral on short-term operating loans whenever possible. Additionally, banks require a relatively high equity cushion when making farm loans, with loan-to-value ratios in excess of 60-70 percent of the appraised value of the property a rarity for farm real estate loans. Testimony at the Panel’s field hearing in Greeley, CO, confirmed the conservative nature of farm lenders, who, knowing the vicissitudes of the agriculture sector, are generally reluctant to lend to those not in a relatively strong debt-to-equity position and thus tend to create a “larger buffer, or margin,” between the loan and the value of the of the land, equipment, or products being financed.¹⁴⁷

¹⁴⁵ USDA Farm Sector Income Forecast, *supra* note 69.

¹⁴⁶ Second Quarter Fed Databook, *supra* note 2, at 19 (A.6 Share of Non-Real-Estate Bank Loans with a Floating Interest Rate Made to Farmers).

¹⁴⁷ Congressional Oversight Panel, Testimony of Senior Vice President of New West Bank Lonnie Ochsner, *COP Field Hearing in Greeley, CO on Farm Credit* (July 7, 2009) (online at cop.senate.gov/hearings/library/hearing-070709-farmcredit.cfm) (“However, in the ag[riculture] industry, it is

Beyond looking at collateral and requiring high equity cushions when making loans to farmers – and in keeping with the idea that farms are not merely properties but often businesses – banks typically conduct a financial statement analysis of prospective borrowers when making loans, including looking at the balance sheet, income statement, statement of cash flows, and statement of owner equity.¹⁴⁸

i. Bank Size. The farm credit market is served by all sizes of commercial banks, though very large and very small banks play a disproportionate role in extending credit to farmers. As of March 31, 2009, 8,256 commercial banks held farm loans, and the top 16 lenders to farmers – representing less than two-tenths of one percent of banks making loans to farmers – held 21.67 percent of total agriculture loans, including 16.91 percent of farm real estate loans and 27.15 percent of non-real estate farm loans.¹⁴⁹ For their part, the 71 banks with total assets exceeding \$10 billion as of March 3, 2009, held 20.38 percent of farm loans (also demonstrating that several of the largest farm lenders are not among the largest banks in the country).¹⁵⁰

On the other hand, 5,547 commercial banks with total assets under \$1 billion held 64.25 percent of loans to farmers – 65.98 percent of real estate and 62.26 percent of non-real estate loans – and 5,043 banks with total assets under \$500 million held 53.88 percent of loans to farmers – 54.04 percent of real estate and 53.69 percent of non-real estate loans.¹⁵¹ These 5,043 banks with total assets under \$500 million represent a mere 6.65 percent of the total assets of all banks extending credit to the agriculture sector – demonstrating the critical role that small, community banks across the country play in the farm credit markets.¹⁵²

Figure 20: Percent of Agricultural Loans by Bank Size¹⁵³

cyclical and good, prudent ag[riculture] lenders have created a larger buffer, if you will, or margin. In other words, if a cow is worth \$1,500, they would loan 70 percent of that cow, knowing full well that cycles will occur where that cow may be worth \$1,800, but still leaving that margin in place and utilizing a more stabilized value over time rather than wagging the tail up to a \$2,500 value and then loaning 80 or 90 percent because the industry is experiencing great times.”).

¹⁴⁸ Farm Financial Standards Council, *Financial Guidelines for Agricultural Producers* (accessed July 8, 2009) (online at www.ffsc.org/cd_news_release.pdf).

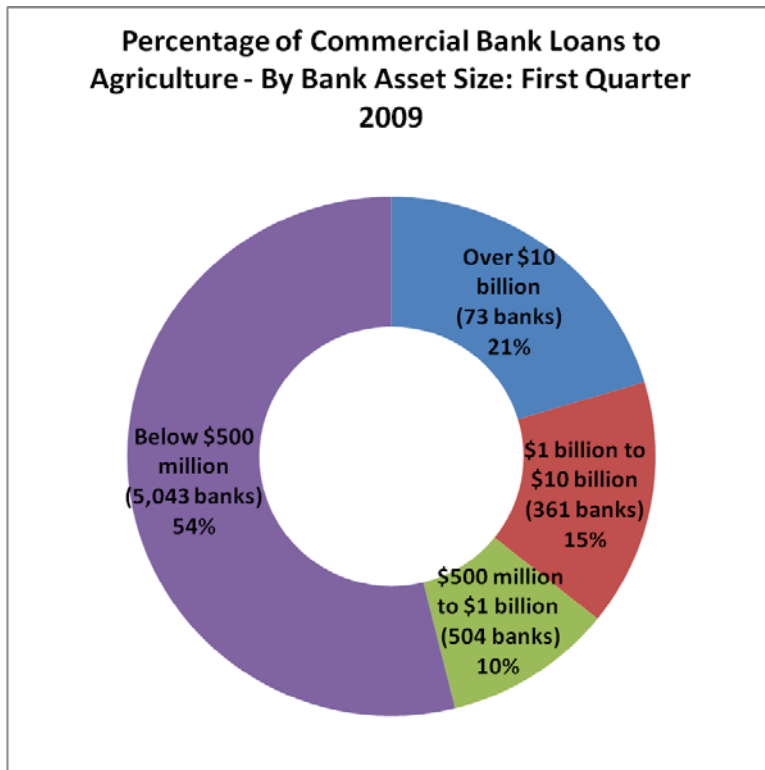
¹⁴⁹ Federal Deposit Insurance Corporation, *Statistics on Depository Institutions from Quarterly Reports of Condition and Income for the Quarter Ending March 31, 2009* (accessed July 8, 2009) (online at www2.fdic.gov/sdi/index.asp) (hereinafter “FDIC First Quarter Call Report Data”).

¹⁵⁰ *Id.*

¹⁵¹ *Id.*

¹⁵² *Id.*

¹⁵³ *Id.*

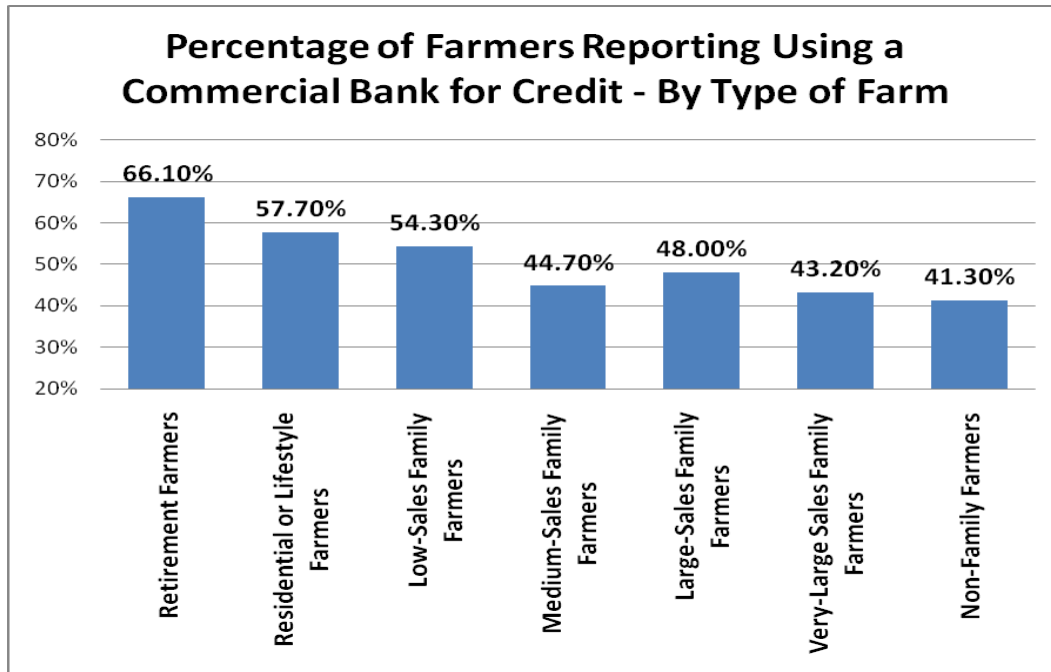


ii. Farm Size. The diversity of the American agriculture sector makes for diverse credit needs for farms large and small, specializing in products ranging from commodity crops to livestock. Further, some agricultural lenders are generally more suited to the specific needs of a certain type of farm or farmer than others. For instance, while an FSA direct or guaranteed loan may be a suitable credit source of last resort for a small, family farm, the size limits on those loans often preclude larger farms from turning to FSA to fulfill their credit needs. Moreover, the specialized FCS, with its government mandate to serve the needs of farmers and rural America, may be a better option for larger farmers, while smaller farmers – with a higher percentage of non-farm income – may find it more practical to obtain a loan from the local bank that they use for their non-farm banking and credit needs.

Data confirm that, taken on the whole, small, family farmers are more likely to use commercial banks as their principal source of credit than larger and nonfamily farmers. Specifically, according to USDA data, 66.1 percent of “retirement” farmers, 57.7 percent of “residential or lifestyle” farmers, and 54.3 percent of low-sales family farmers report using commercial banks for credit, while 44.7 percent of medium-sales family farmers, 48.0 percent of large-sale family farmers, 43.2 percent of very large-sale family farmers, and 41.4 percent of nonfamily farmers report using commercial banks for credit.¹⁵⁴

¹⁵⁴ U.S. Department of Agriculture, Economic Research Service, *Structure and Finances of U.S. Farms: Family Farms Report*, at 20 (June 2007) (online at www.ers.usda.gov/publications/eib24/eib24.pdf).

Figure 21: Percent of Farmers Reporting Using a Commercial Bank for Credit¹⁵⁵



iii. TARP and Non-TARP Banks. A critical aspect of determining the potential effectiveness of any loan restructuring program to be carried out by TARP-recipient banks – the congressional mandate underlying this report – is determining the percentage of farm loans held by TARP banks. As of March 31, 2009, commercial banks that have received TARP dollars held 28.76 percent of the slice of total farm loans held by commercial banks.¹⁵⁶ Breaking it down by types of farm loans, TARP-recipient banks held 27.46 percent of the portion of farm real estate loans made by commercial banks and 30.26 percent of non-real estate farm loans made by banks.¹⁵⁷ Banks receiving funding through the TARP were responsible for 71 percent of the total assets in the U.S. banking system as of March 31, 2009; therefore, relative to their assets, TARP-recipient banks are generally less involved in agriculture lending.¹⁵⁸

At that time, the top 21 recipients of TARP dollars (the institutions for which Treasury tracks detailed lending statistics in its Monthly Lending and Intermediation Snapshot), held 16.95 percent of the portion of farm debt held by commercial banks – 13.10 percent of bank-held

¹⁵⁵ *Id.*

¹⁵⁶ FDIC First Quarter Call Report Data, *supra* note 149; U.S. Department of the Treasury, *Troubled Asset Relief Program Transactions Report for Period Ending June 26, 2009* (June 30, 2009) (online at www.financialstability.gov/docs/transaction-reports/transactions-report_063009.pdf) (hereinafter “TARP Transactions Report”).

¹⁵⁷ *Id.*

¹⁵⁸ *Id.*

farm real estate debt and 21.36 percent of bank-held non-real estate farm debt.¹⁵⁹ The largest TARP-recipient lender to the agriculture sector – and, indeed, the largest commercial bank farm lender – is Wells Fargo, whose holding company alone (which includes Wachovia Bank), held 7.68 percent of commercial bank farm debt – 4.86 percent of real estate and 10.93 percent of non-real estate bank farm debt.¹⁶⁰

iv. Foreign Owned Banks. Given that foreign owned banks hold approximately ten percent of total loans and leases outstanding in the U.S. banking system, it deserves mention that the share of farm loans held by foreign owned banks – which are ineligible for funding through the TARP – cuts into the pool of farm loans that could potentially be affected by any TARP-based loan restructuring mandate.¹⁶¹ Indeed, two of the five largest commercial bank agricultural lenders in the United States are headquartered abroad – Bank of the West and Rabobank. These two foreign owned banks alone account for slightly less than 4 percent of all commercial bank agriculture lending.¹⁶²

g. Other Players in the Farm Credit Markets

Although they do not provide credit directly to farm borrowers, Farmer Mac and the Federal Home Loan Banks play an important role in making credit available to key agricultural lenders.

i. Farmer Mac. The Federal Agricultural Mortgage Corporation (Farmer Mac) was created by Congress in 1987 via passage of the Agricultural Credit Act. Farmer Mac is a GSE whose mission is to provide liquidity in the “secondary market for agriculture real estate and rural housing mortgage loans.”¹⁶³ Congress expanded Farmer Mac’s mission in 2008 via passage of the Food, Conservation, and Energy Act (commonly known as the 2008 Farm Bill) “to purchase, and to guarantee securities backed by, loans made by cooperative lenders to cooperative borrowers to finance electrification and telecommunications systems in rural areas.”¹⁶⁴

Very simply, Farmer Mac purchases qualified agriculture loans, pools them into securities, and then either holds those securities in its portfolio or sells them to investors in the secondary market, much like Fannie Mae and Freddie Mac do for qualified home mortgage

¹⁵⁹ *Id.*

¹⁶⁰ *Id.*

¹⁶¹ Board of Governors of the Federal Reserve System, *Statistical Release H.8 Assets and Liabilities of Commercial Banks in the United States* (July 2, 2009) (online at www.federalreserve.gov/releases/h8/Current/).

¹⁶² FDIC First Quarter Call Report Data, *supra* note 149.

¹⁶³ Federal Agricultural Mortgage Corporation, *2008 Annual Report* (accessed July 7, 2009) (online at www.farmermac.com/investors/pdf/ar/annual_2008.pdf) (hereinafter “Farmer Mac 2008 Annual Report”).

¹⁶⁴ *Id.*

loans.¹⁶⁵ In addition to purchasing loans, Farmer Mac issues long-term standby purchase agreements, whereby it promises to purchase a certain number of loans from the lender. Farmer Mac provides these services through three main programs: Farmer Mac I (loans not guaranteed by USDA); Farmer Mac II (USDA guaranteed loans); and Rural Utilities (rural utilities loans). The total volume in these three programs stands at over \$9.9 billion.

Farmer Mac is part of the FCS and regulated by the FCA. It is not liable for the debt of any other institution within the FCS and, therefore, is also considered its own GSE. As a GSE, Farmer Mac enjoys having an implicit government guarantee, and the debt that Farmer Mac issues to raise funding for its operations is priced as such. As of March 31, 2009, Farmer Mac had total liabilities of \$4.566 billion. It also had core capital of \$250 million, which is \$67 million above its minimum statutory capital requirement of \$183 million.¹⁶⁶

As mentioned above, Farmer Mac securitizes and issues purchase commitments on over \$9.9 billion in agricultural loans. Of these assets, the GSE holds roughly \$3.1 billion in mission-related assets (Farmer Mac guaranteed securities and loans) on its portfolio.¹⁶⁷ Comparatively, Fannie Mae and Freddie Mac securitize and guarantee over \$5.4 trillion in mortgage loans. These two GSEs combined hold over \$1.5 trillion in mission related assets (mortgage loans and securities) on their portfolios.¹⁶⁸ Farmer Mac lost \$106 million in 2008 due to its investments in Fannie Mae and Lehman Brothers. These losses, among other pressures, spurred it to raise new capital and replace its CEO. As Farmer Mac works to shore up its capital position, it can be expected to sell off assets, including loans, on its balance sheet.¹⁶⁹ Thus, its secondary market function may be less than it has been. Yet the agricultural loan secondary market has never been as robust nor as large as the secondary market for home loans. This moderates the impact on credit availability of any financial difficulties faced by Farmer Mac.

ii. Federal Home Loan Banks. Congress created the Federal Home Loan Bank System (FHLB System) in 1932 through the Federal Home Loan Bank Act. The FHLB system is made up of 12 cooperative banks or Federal Home Loan Banks (FHLBs), each representing a district

¹⁶⁵ Federal Agricultural Mortgage Corporation, *Farmer Mac Programs* (accessed July 7, 2009) (online at www.farmermac.com/lenders/fmacprograms/farmermacprograms.aspx).

¹⁶⁶ Federal Agricultural Mortgage Corporation, *Form 10-Q for the Quarterly Period Ended March 31, 2009*, at 30 (May 12, 2009) (online at www.farmermac.com/investors/pdf/10Q/Q1-2009-10-Q.pdf).

¹⁶⁷ *Id.*

¹⁶⁸ Federal Housing Finance Agency, *Report to Congress 2008* (May 18, 2009) (online at www.fhfa.gov/webfiles/2331/FHFAReporToCongress2008final.pdf).

¹⁶⁹ On March 31, 2009, Rabobank announced plans to purchase a \$354 million portfolio of agricultural loans from Farmer Mac. Rabobank, *Rabobank to Acquire \$354 Million Portfolio from Farmer Mac* (Mar. 30, 2009) (online at www.rabobankamerica.com/content/documents/news/2009/rabobank_to_acquire_354_million_portfolio_from_farmer_mac.pdf).

within the United States. The system is a GSE and all 12 FHLBs have joint and several liability for each other. The FHLB's primary purpose is to provide liquidity to its member institutions. The FHLB System has over 8,100 member institutions, comprising 5,861 commercial banks, 1,217 thrifts, 896 credit unions, and 145 insurance companies.¹⁷⁰ To become a member, an institution must own stock within its particular district FHLB.

FHLBs provide liquidity to their member institutions by offering short-term loans called advances. In order to qualify for the advances, member institutions must offer in exchange certain types of pledged assets or collateral. Previously, pledged collateral had to be in the form of mortgage loans or government securities. However, the Federal Home Loan Bank System Modernization Act of 1999, which was Title VI of the Gramm-Leach-Bliley Act, expanded the type of pledged collateral small member institutions could offer and allowed the FHLBs to make advances secured by agricultural, small business, and community development loans, as well.¹⁷¹ The amount of FHLB outstanding advances has increased steadily throughout the years, rising from \$581.2 billion in 2004 to \$619.9 billion in 2006, \$640.7 billion in 2006, \$875 billion in 2007, and \$928.64 billion in 2008.¹⁷² However, the number dropped by nearly 12 percent to \$817.4 billion in the first quarter of 2009, which is likely indicative of the overall tightening of credit availability in the banking system.¹⁷³

3. Effect of the Broader Financial Crisis on Farm Credit Markets

In the fall of 2008, much of the world plunged into arguably the worst economic crisis since the Great Depression. While the U.S. agricultural credit sector remains stronger than the overall credit system,¹⁷⁴ it is not immune from turbulence in the broader economy. For example, in the first quarter 2009, the overall commercial bank delinquency rate was 5.60 percent, compared to an agricultural loan delinquency rate of 1.71 percent during the same period.¹⁷⁵ Also in the first quarter 2009, the percentage of banks reporting at least the same availability of funds for farm operating loans as last year remained steady.¹⁷⁶ In other credit sectors, first

¹⁷⁰ Council of Federal Home Loan Banks, *The Federal Home Loan Banks* (accessed July 17, 2009) (online at www.fhlbanks.com/assets/pdfs/sidebar/FHLBanksWhitePaper.pdf).

¹⁷¹ Gramm-Leach-Bliley Act of 1999, Pub. L. No. 106-102.

¹⁷² Federal Home Loan Bank System, Office of Finance, *Quarterly Combined Financial Report for the Six Months Ended June 30, 2008* (Aug. 13, 2008) (online at www.fhlb-of.com/specialinterest/finreportframe.html).

¹⁷³ *Id.*

¹⁷⁴ See, e.g., Paul N. Ellinger, *Financial Markets and Agricultural Credit at a Time of Uncertainty*, Choices: The Magazine of Food, Farm, and Resource Issues, at 33 (First Quarter 2009) (online at www.choicesmagazine.org/magazine/article.php?article=61) ("Relative to other financial intermediaries, agricultural lenders generally remain healthy.").

¹⁷⁵ Board of Governors of the Federal Reserve System, *Charge-off and Delinquency Rates on Loans and Leases at Commercial Banks* (accessed July 8, 2009) (online at www.federalreserve.gov/releases/chargeoff/delallsa.htm).

¹⁷⁶ Second Quarter Fed Databook, *supra* note 2.

quarter 2009 was much worse. During that quarter, 79.2 percent (net) of senior lending officers reported tightening standards for commercial real estate loans and 58.8 percent reported doing the same for household credit cards.¹⁷⁷

However, since the beginning of the year, surveys of agricultural credit institutions show indications of both more repayment problems for existing loans and tighter lending standards on new originations.¹⁷⁸ Delinquency rates for commercial bank farm real estate loans jumped from 1.7 percent in first quarter 2008 to 2.8 percent in first quarter 2009, their highest level since first quarter 2003. There was double digit growth in the percent of banks reporting higher collateral requirements for non-real estate farm loans in three surveying Federal Reserve Districts (12 percent, 15 percent, and 13 percent, respectively) between the first quarters of 2008 and 2009.¹⁷⁹

The financial crisis and recession weakened virtually every part of the overall credit market. As indicated above, the farm credit market is in a weaker state as compared to one year ago. Thus, the U.S. farm credit market currently faces a crucial transition moment: Agriculture lenders in most regions enjoyed strong performances over the past few years, with historically low delinquency rates and ample credit availability. The agriculture credit markets now face rising delinquency and tighter lending standards, although today's situation remains within historical parameters. The key question is whether the global financial crisis will continue to prompt, and even possibly accelerate, these downward trends beyond historical averages within the sector.

a. Commodity Prices

Farm product prices declined 15 percent in June 2009 from their June 2008 index values.¹⁸⁰ Certain individual commodities have seen prices fall even faster and even farther.¹⁸¹ Consequently, commodity price declines are one of the significant factors contributing toward the projected 20 percent decline in net farm income in 2009, a steep drop off for farmers to bear even though it would still leave net income above a running ten-year average.¹⁸² Lower net income restricts a farmer's cash flow and thus both increases the risk of non-performance on current debt and makes it harder to obtain new credit. While the economy remains in recession, the U.S. agriculture industry can expect the continued possibility of weak demand and downward

¹⁷⁷ Board of Governors of the Federal Reserve System, *Senior Loan Officer Opinion Survey on Bank Lending Practices* (May 4, 2009) (online at www.federalreserve.gov/BoardDocs/SnLoanSurvey/200905/chartdata.htm).

¹⁷⁸ Second Quarter Fed Databook, *supra* note 2.

¹⁷⁹ Second Quarter Fed Databook, *supra* note 2.

¹⁸⁰ USDA June Agricultural Prices, *supra* note 68.

¹⁸¹ This is particularly true in the livestock sector where the dairy industry has been particularly hard hit (prices in June plunged 41 percent from their position a year ago) along with, to a lesser extent, the hog, poultry, and cattle industries.

¹⁸² See Section B(1), *supra*, for a complete discussion of farm income.

pressure on prices.¹⁸³ Over the long-term, the outlook is equally unsettled. A growing global population needs to eat, so a lack of demand is unlikely to be a problem.¹⁸⁴ However, other factors (chief among them the value of the dollar, as discussed earlier) may limit how much U.S. farmers can take advantage of rising prices should demand rise as expected.¹⁸⁵ Thus, lower commodity prices are very likely to negatively impact farm credit in the near-term while the long-term trend remains uncertain.

The agriculture economy is far from a monolithic area, both in terms of commodity and geography. The Panel recognizes that due to the cyclical and counterbalanced nature of the agriculture market, certain commodities may be in greater distress at any particular time compared to the sector as a whole. It is quite common for one or more sub-sectors or geographic regions, even in good times, to experience problems even while the overall industry remains generally healthy. This can result in credit pressures for lenders with portfolios concentrated on one sub-sector or region.

b. Longer-Term Fixed-Rate Financing Availability

Due to tightening credit conditions, farmers face greater difficulty in obtaining desirable long-term, fixed-rate term loans, according to representatives of the FCS and its regulator.¹⁸⁶ However, at the moment, Federal Reserve data offer only lukewarm support for extending these statements to commercial banks. The floating interest rate share of total farm operating loans is elevated, with the implication that the fixed interest rate loan share would be lower, but not above historical levels. Further, average maturity on farm operating loans actually rose for the second quarter of 2009, although it is lower than it has been since 2006.¹⁸⁷

If there is a trend away from long-term fixed-rate financing, two negative implications for agricultural operators should be noted. First, it keeps farmers from locking in currently low

¹⁸³ Thus short-term predictions for commodity prices depend heavily on the accuracy of assumptions as to the duration and severity of the economic crisis. See OECD-FAO Outlook, *supra* note 53.

¹⁸⁴ OECD-FAO Outlook, *supra* note 53. The OECD-FAO report argues that the worldwide agriculture sector is poised for renewed growth assuming economic recovery occurs within 2-3 years. The USDA's own income projections also show a short-term dip in income followed by renewed growth through the rest of the time frame. See USDA Economic Research Service, *USDA Agricultural Projections to 2018* (Feb. 12, 2009) (online at www.ers.usda.gov/publications/oce091/).

¹⁸⁵ U.S. Department of Agriculture, Economic Research Service, *The 2008/2009 World Economic Crisis: What It Means for U.S. Agriculture*, at 27 (Mar. 2009) (online at www.ers.usda.gov/Publications/WRS0902/WRS0902.pdf).

¹⁸⁶ Bob Frazee House Agriculture Testimony, *supra* note 132, at 8; House Agriculture Committee, Subcommittee on Conservation, Credit, Energy, and Research, Testimony of Chairman and Chief Executive Officer of the Farm Credit Administration Leland A. Strom, *To Review Credit Conditions in Rural America*, at 2 (online at agriculture.house.gov/hearings/statements.html) ("Fixed-rate term loans are more difficult to obtain.") (hereinafter "Leland Strom House Agriculture Testimony").

¹⁸⁷ Second Quarter Fed Databook, *supra* note 2, A.4 Average Maturity of Non-real-estate Bank Loans and A.6 Share of Non-real-estate Bank Loans with a Floating Interest Rate. Considering these tables together, one possibility is a trend toward more long-term variable rate loans.

interest rates, which are generally as low as at any point in the past two decades.¹⁸⁸ Second, it places more pressure on current cash flow, as farmers are forced to use shorter maturity debt that takes up a relatively larger portion of resources at any given time. As noted above, decreased cash flow makes new credit more expensive to obtain and increases the risk of repayment problems.

c. Loan Underwriting and Documentation

Both observers and lenders themselves agree that commercial lending standards are tighter as a result of the financial crisis.¹⁸⁹ However, it is unclear whether this trend extends to all parts of the farm credit market. FSA is the lender of last resort and has statutory lending standards designed to support those unable to obtain credit elsewhere.¹⁹⁰ In May, its then-Administrator noted much higher demand for its loans so far in 2009: 81 percent higher for direct operating loans and 132 percent higher for direct real estate loans.¹⁹¹ FCS members report unchanged lending standards despite the financial crisis, although their regulator has testified that weak debt markets will force FCS institutions into more conservative lending.¹⁹² News reports offer anecdotal examples of farmers draining retirement savings or accumulating credit card debt in the face of fewer available long-term loans.¹⁹³

¹⁸⁸ Second Quarter Fed Databook, *supra* note 2, C.4 Average Fixed Interest Rates on Farm Loans. Variable rates are also low at the moment. *See* Second Quarter Fed Databook, *supra* note 2, C.5 Average Variable Interest Rates on Farm Loans. Thus, this problem may only gradually become more apparent in the future, when farmers excluded from fixed-rate loans now are forced to face higher variable rates later, assuming interest rates eventually begin to climb again.

¹⁸⁹ *See, e.g.*, House Agriculture Committee, Subcommittee on Conservation, Credit, Energy and Research, Testimony of President and CEO of Farmers Bank Fred Bauer on behalf of the Independent Community Bankers of America, *To Review Credit Conditions in Rural America*, 111th Cong., at 3 (June 11, 2009) (online at agriculture.house.gov/hearings/statements.html) (“81 percent [of community banks] have tightened their credit standards since the start of the crisis.”) (hereinafter “Fred Bauer House Agriculture Testimony”).

¹⁹⁰ *See* 7 U.S.C. § 1922 for statutory lending requirements.

¹⁹¹ FSA June Testimony, *supra* note 41, at 2. In discussions with FSA economists and farm groups, other contributing factors for increased demand were discussed beyond less credit availability in the wider market. They include: higher application volume in anticipation of increased Congressional appropriations and the 2008 Farm Bill’s increase in the maximum direct loan size from \$200,000 to \$300,000.

¹⁹² Congressional Oversight Panel, Testimony of Senior Vice President and Corporate Secretary of Farm Credit Services of the Mountain Plains Mike Flesher, *COP Field Hearing in Greeley, CO on Farm Credit*, at 3 (July 7, 2009) (online at cop.senate.gov/documents/testimony-070709-flesher.pdf) (“Mountain Plains...has not changed its lending standards in response to the current financial and economic disruption.”) (hereinafter “Mike Flesher COP Testimony”); The FCS representative testifying before the House Agriculture Committee on June 11, 2009 made a similar statement. *See* Leland Strom House Agriculture Testimony, *supra* note 186 (“Lenders are naturally becoming more cautious and conservative on the extension of credit.”); Federal Farm Credit Banks Funding Corporation, *Farm Credit System Quarterly Information Statement – First Quarter 2009*, at 15 (May 7, 2009) (online at www.farmcredit-ffcb.com/farmcredit/serve/public/finin/quarin/report.pdf?assetId=132506) (“System managements have made a decision to slow loan growth.”) (hereinafter “FCS First Quarter 2009 Statement”).

¹⁹³ Lauren Etter, *Farmers Start to Feel Credit Pinch*, Wall Street Journal (May 19, 2009) (online at online.wsj.com/article/SB124268924963032355.html).

Increased demand for FSA loans might suggest tougher standards at commercial banks and FCS institutions, as FSA borrowers must be unable to obtain a loan from another source.¹⁹⁴ Likewise, Federal Reserve data indirectly support the conclusion that underwriting and documentation standards are tighter. Collateral requirements for lending are higher and referrals to non-bank lenders (such as FSA) are up.¹⁹⁵ Even putting aside the pressure the overall economic situation places on lending standards, loan officers faced with reduced farm cash flows are likely to continue tightening their standards and asking for additional documentation.

Market participants express mixed views with regard to why underwriting standards are elevated. Community banks, who often carry sizeable agriculture portfolios, argue that overly cautious bank regulators have pressured them to unnecessarily restrict new lending.¹⁹⁶ On the other hand, agricultural economists at the Federal Reserve report banks tightening credit standards on their own, exhibiting caution due to turbulent economic events and their own increased costs in obtaining funding from the bond markets.¹⁹⁷ Whether the cause is direct decision-making or nervous supervisors applying pressure, clearly tighter farm credit can be at least partially attributable to turmoil in the economy away from the farm.

d. Unemployment

U.S. unemployment reached 9.5 percent by June 2009.¹⁹⁸ Seventy percent of farm households have an operator or a spouse engaged in off-farm employment.¹⁹⁹ Especially for smaller family farms, the trend is toward ever greater reliance on non-farm income sources. In fact, only the eight percent of farms with sales greater than \$250,000 a year derive more income from the farm, on average, than from off-farm sources.²⁰⁰ Thus, despite the recent strength of the U.S. farm economy, problems in the larger rural economy certainly affect the agriculture sector, and especially smaller producers.

Given the farm sector's increasing reliance on off-farm employment, regional employment market stability becomes a key factor in predicting the direction of farm credit. When a town's central business district faces higher unemployment, these troubles radiate out to its surrounding farmland and increase the risk of loan repayment issues. In the modern,

¹⁹⁴ However, it need not mechanically show tighter standards at these institutions. There are other possible reasons for increased FSA applications. See note 191, *supra*.

¹⁹⁵ Second Quarter Fed Databook, *supra* note 2, C.1 Non-real-estate Farm Lending Compared with a Year Earlier and C.3 Indicators of Relative Credit Availability.

¹⁹⁶ Fred Bauer House Agriculture Testimony, *supra* note 189, at 3 ("They also feel the government is dissuading them from lending by putting them through overzealous regulatory exams.").

¹⁹⁷ Henderson Article, *supra* note 27, at 73-74.

¹⁹⁸ U.S. Department of Labor, Bureau of Labor Statistics, *Employment Situation Summary June 2009* (July 2, 2009) (online at www.bls.gov/news.release/empisit.nr0.htm).

¹⁹⁹ USDA Finance Outlook, *supra* note 5, at 31.

²⁰⁰ USDA Finance Outlook, *supra* note 5, at 31.

interconnected economy, the farm sector cannot escape larger employment troubles. However, as of this spring, USDA noted that 39 percent of farm operators and 71 percent of spouses are employed in retail, services, government, education, or health, which in USDA's opinion, represent employment sectors that are more stable than hard-hit industries like construction and manufacturing, as well as many of the more volatile agriculture sectors, as well.²⁰¹ Given that, according to USDA, 95 percent of the average farm family's income is from off-farm sources. If this employment stability is real, then off-farm employment could actually function as a means of limiting delinquency in the event of farm net cash flow issues. Close attention should also be paid to farmland values; a significant decline in real estate equity could further expose non-farm unemployment issues by removing a current cushion against problems like unemployment or a decline in wages.

4. Credit Availability Moving Forward

The different providers of farm credit face differing challenges in determining the availability of credit going forward. Three key factors inevitably influence how much credit they will extend. One is the state of both the agricultural and general economy. Even government appropriators indirectly set loan funding based on external economic conditions. The other major players, the FCS, commercial banks, and life insurance companies, must respond to market conditions in a way that allows them to maximize return on investment. With respect to commercial banks in particular, stresses on bank capital due to market conditions also could play a role in the availability of credit for farmers, as discussed later in the report. The second factor is farmland real estate prices. Up to the present, appreciating land values have been a substantial countervailing force for maintaining a relatively robust farm credit market in the face of larger economic storm clouds. Rising equity helps to make up for declining net cash income and rising off-farm unemployment. If real estate values fall substantially in the future, credit availability would likely tighten. The final factor is the capital strength of the lending institution. A weakly capitalized commercial bank or FCS institution will not have the capacity to maintain or expand credit availability moving forward.²⁰²

a. Government Programs

FSA loan funding levels depend on congressional appropriations. Of course, in times of agricultural or general market problems, Congress faces pressure to increase its appropriations to the direct and guaranteed loan programs as a backstop against decreases in commercial or FCS lending. Thus, FSA credit availability is at least indirectly affected by external credit conditions. Recently, Agriculture Secretary Vilsack announced the availability of over \$760 million in

²⁰¹ USDA Crisis Impact Report, *supra* note 6, at 20.

²⁰² See section C.4.d.ii, *infra*, for further discussion of commercial bank capital strength and its impact on credit availability.

additional funds this year for direct real estate and operating loans.²⁰³ The funding was made available through the Supplemental Appropriations Act of 2009²⁰⁴ and is designed to both remove a backlog of approved but unfunded loans as well as allow for new originations. FSA reports demand for agency loans reaching its highest level in two decades.²⁰⁵ The increased loan demand likely comes from a loss of credit availability, as well as the additional funding for FSA loans, expansions of the maximum loan levels, or increased refinancing activity.²⁰⁶

In the end, credit availability from FSA is in some senses both the most predictable and least predictable of the major sources. It is highly predictable for three reasons: it cannot withdraw from the market nor can it shift resources to another industry without violating its mandate. Strong political support for agriculture makes it unlikely that its credit funding would ever drastically decline, outside of a fundamental reorganization of farm support programs. Finally, as the governmental lender of last resort, underwriting standards are much less volatile and susceptible to changes in market conditions. Increased credit availability, however, only results from congressional action or an intra-agency discretionary funding transfer, always a difficult process to predict.²⁰⁷ Borrowers could end up waiting in an application queue if the level of funding does not equal demand.

b. Farm Credit System

FCS funding availability over the near-term is likely to contract, but individual FCS institutions may be able to maintain pre-crisis credit availability.²⁰⁸ Despite modest improvements in the availability of funding through the debt markets, spreads relative to Treasuries remain double their levels before the financial crisis and it remains extremely difficult to issue long-term debt.²⁰⁹ When combined with greater regulatory scrutiny, tighter underwriting standards, and increased delinquency on existing loans, this suggests credit availability will remain tighter than the norm of the past few years. FCS notes in its first quarter 2009 statement,

²⁰³ U.S. Department of Agriculture, *Agriculture Secretary Vilsack Announces Availability of \$760 million in Direct Loans to Farmers and Producers* (July 16, 2009) (online at www.usda.gov/wps/portal/!ut/p/_s.7_0_A/7_0_1RD?printable=true&contentidonly=true&contentid=2009/07/0313.xml).

²⁰⁴ Pub. L. No. 111-32.

²⁰⁵ FSA June Testimony, *supra* note 41; Scuse Testimony, *supra* note 64.

²⁰⁶ See FSA June Testimony, *supra* note 41 at 1 (“Activity in FSA’s loan programs certainly indicates that less commercial credit is available to farmers at the present time.”). The possible alternative explanations for the sharp rise in demand were brought to the Panel’s attention during Panel staff discussions with FSA economists.

²⁰⁷ See 7 U.S.C. § 1988 for the relevant statutory language on the appropriations process for FSA’s loan programs.

²⁰⁸ Mike Flesher COP Hearing Testimony, *supra* note 192, at 3; Bob Frazee House Agriculture Testimony, *supra* note 132, at 3.

²⁰⁹ Leland Strom House Agriculture Testimony, *supra* note 186, at 4.

“System managements have made a decision to slow loan growth.”²¹⁰ Furthermore, FCS’ regulator, FCA, testified that “lenders are naturally becoming more cautious and conservative on the extension of credit to farmers, ranchers, and other agricultural producers.”²¹¹ More definitive data will provide clarity on the availability of credit from FCS.

FCS’ charter restricts its lending activities to agriculture-related activities. Thus, there is little chance of its members shifting their lending allocations to other industries. In fact, at the end of the first quarter of 2009, gross loan volume was \$1 billion higher than it was on March 31, 2008.²¹² With a mandatory borrowers’ rights scheme already in place, but never tested during a significant general financial downturn, it is unclear whether a surge in modification requests would cause FCS members to further restrict credit availability as a precaution. Finally, the Panel again notes the regional and commodity-specific nature of any agriculture sector survey. FCS member associations tend to be regionally focused. An FCS member whose portfolio tilts heavily toward a particularly hard-hit product or region (such as the dairy sector) may make different credit availability decisions as compared to the System as a whole.²¹³

c. Insurance Companies and Captive Finance Suppliers

Both insurance companies and captive finance suppliers represent a small, yet relatively stable portion of the overall farm credit market.²¹⁴ Life insurers provide loans secured by the real estate of larger farmers.²¹⁵ As such, some experts see signs that insurers are scaling back lending in the face of reduced access to working capital on the part of their borrowers.²¹⁶

Likewise, the captive finance supplier lending market will continue to face challenges from an only slightly thawed asset-backed finance market and a still limited commercial paper market. Furthermore, input suppliers such as seed and fertilizer companies must deal with the diminished cash flows of farmers involved in certain commodity sectors.²¹⁷ Those smaller dealers and suppliers extending unsecured lines of credit face the possibility of non-recovery in

²¹⁰ FCS First Quarter 2009 Statement, *supra* note 192, at 15.

²¹¹ Leland Strom House Agriculture Testimony, *supra* note 186, at 2.

²¹² FCS First Quarter 2009 Statement, *supra* note 192, at 15.

²¹³ FCS First Quarter 2009 Statement, *supra* note 192, at 10 (“Most institutions have higher geographic, borrower and commodity concentrations than the System as a whole.”).

²¹⁴ See sections 2.c and 2.d, *supra* for background on these market players.

²¹⁵ See, e.g., Prudential Agricultural Investments, *Agricultural Lending* (accessed July 14, 2009) (online at www3.prudential.com/businesscenter/realestate/pmcc/whowere/agricultural.html). Prudential’s minimum loan size is \$500,000.

²¹⁶ Paul Ellinger, *Financial Crisis’s Impact on Producer’s and Agriculture’s Long-term Forecast* Presentation to the Independent Community Bankers of America, at 43 (2009) (hereinafter “Paul Ellinger ICBA Presentation”).

²¹⁷ *Id.*

the event of farm failures.²¹⁸ Larger input suppliers may be impacted by the recent problems in the commercial paper market as well. John Deere reports lower revenue from financing and operating loans extended.²¹⁹ Monsanto, the largest U.S.-based seed company, noted in its third quarter financial statement that it was ending its customer lending operation that had been conducted through a securitization vehicle of its creation.²²⁰

On the other hand, healthy equipment and input companies, perhaps strengthened by other corporate units or the vitality of certain agriculture sectors and regions, may look to fill any gaps in credit availability left by other market players, such as commercial banks. For example, witnesses at the Panel's field hearing in Greeley, CO, indicated that some input suppliers in their region may have increased their credit offerings in recent months, perhaps in an effort to "pick up the slack" from other lenders.²²¹ John Deere has publicly expressed an interest in continuing to grow its loan portfolio, and its volume of operating loans to customers (many of whom are farmers) increased 58 percent from 2007 to 2008.²²² Data from the Equipment Leasing and Financing Association show that credit approvals for the three agriculture equipment financing companies in its economic index dropped sharply from 95 percent in November 2008 to just over 70 percent in January 2009 but have since recovered to 85 percent in May 2009.²²³ This percentage is roughly 20 percentage points higher than the overall credit approval figure for all companies in the index.²²⁴

d. Commercial Banks

²¹⁸ See Agricultural Retailers Association, *Customer Financing Survey Results* (May 4, 2004). According to the survey, most wholesalers and dealers do not have insurance covering their unsecured lending. One way they combat this risk is through the farmer's assignment of a payment, such as USDA subsidy payment, to the supplier.

²¹⁹ See Deere & Company, *Deere Announces Second-Quarter Earnings* (May 20, 2009) (online at www.deere.com/en_US/ir/media/pdf/financialdata/reports/2009/2009_secondquarter.pdf). John Deere Credit Corporation, the Deere lending arm, also saw lower profits last year as its charge-off rate rose and interest rates declined.

²²⁰ See Monsanto Company, *Form 10-Q for the period ending May 31, 2009*, at 36 (June 26, 2009) (online at www.monsanto.com/investors/financial_reports/sec_html.asp?ipage=6394612&repo=tenk).

²²¹ Congressional Oversight Panel, Testimony of Marc Arnusch, Owner, Marc Arnusch Farms, *COP Field Hearing in Greeley, CO, on Farm Credit* (July 7, 2009) (audio available online at cop.senate.gov/hearings/library/hearing-070709-farmcredit.cfm).

²²² See Deere & Company, *Annual Report 2008*, at 16 (Dec. 18, 2008) (online at www.deere.com/en_US/ir/media/pdf/financialdata/reports/2009/2008annualreport.pdf).

²²³ This data was provided by Bill Choi, Director for Information and Research Services, Equipment Leasing and Finance Association. Choi disaggregated the index data cited in note 218, *infra*.

²²⁴ Equipment Leasing and Finance Association, *MLFI-25 and Beige Book Review First Quarter 09*, at 14 (April 2009).

Commercial bank credit availability will continue to be driven by both agricultural producer demand for loan products and credit availability from lenders on the supply side. However, the extraordinary economic events of the past year and the extensive government response to those events means that events external to the agriculture industry will also cause disruptions. In its June report, the Panel noted the impact that continued stresses on bank capital could have on overall credit availability, which would include availability in the agriculture sector.

According to the bank supervisors, and in some cases only after very large infusions of capital by the U.S. taxpayer, most U.S. banks now have capital levels in excess of the amounts required under banking rules. Nonetheless, the realized and prospective losses created by the financial crisis and the impact of the country's economic condition on banks' revenues have substantially reduced, and are expected to further reduce, the capital of some major banks. Falling capital levels at major banks can lead to a broad loss of confidence in bank solvency, particularly if there is a lack of clear information as to the financial condition of the major banks. Loss of confidence can become a self-fulfilling prophecy, leading to the reluctance of banks to lend to one another (a key component of the banking system's operation), causing individual banks to tighten credit by cutting back on lending in general, and forcing regulators to pump funds into one bank or BHC after another on an ad hoc basis.²²⁵

i. Demand. Buoyed by appreciating land values and record product prices, farm credit at commercial farm banks²²⁶ increased to \$55.1 billion in 2008.²²⁷ Demand for farm credit remains relatively strong, the likely result of farmers using credit as a means to ride out the recent volatility in certain sectors and the general economic crisis. In five Federal Reserve District first quarter agricultural lending surveys, approximately 70 percent of banks reported either the same or higher demand for farm operating loans as compared to a year earlier.²²⁸ However, in one District (Richmond) 48 percent of its bank respondents said demand for such loans was lower compared to a year ago.²²⁹ FDIC aggregated call report data indicate a four percent rise in farm

²²⁵ Congressional Oversight Panel, *June Oversight Report: Stress Testing and Shoring Up Bank Capital* (June 9, 2009) (online at cop.senate.gov/documents/cop-060909-report.pdf).

²²⁶ As defined by the American Bankers Association, a farm bank has assets of less than \$1 billion whose ratio of domestic farm loans to total domestic loans is greater than or equal to 14.20 percent. There are also 21 banks with more than \$1 billion in assets which meet the farm loans to total loans ratio requirement.

²²⁷ American Bankers Association. *2008 Farm Bank Performance*, at 3.

²²⁸ Second Quarter Fed Databook, *supra* note 2, C.1 Non-real-estate Farm Lending Compared with a Year Earlier.

²²⁹ Second Quarter Fed Databook, *supra* note 2, C.1 Non-real-estate Farm Lending Compared with a Year Earlier.

loans from the first quarter of 2008 to the first quarter of 2009.²³⁰ The Chicago, Richmond, and Dallas District surveys show 80 percent, 60 percent, and 61 percent of banks expecting the same or higher volume of real estate loans in the next quarter as compared to a year earlier.²³¹ On the other hand, many farmers used the strong earnings and farmland values of the past few years to instead decrease their reliance on debt. This trend is especially noticeable among small farmers, while larger farmers remain relatively more reliant on debt to finance their operations.²³²

ii. Availability. On the supply side, in all six Federal Reserve Districts conducting agriculture surveys at least 70 percent of banks responding had the same funds available for farm lending as they did a year earlier.²³³ Nevertheless, two prominent agricultural credit experts expect the gloomy economic picture to likely dampen farm credit availability: “Even if loan demand rebounds, tighter credit standards and increased collateral requirements could limit loan originations.”²³⁴ Some data seem to bear out this gloomier assessment. Four districts reported a rise in the percentage of banks referring loan applicants to non-bank agencies (for example, FSA) as compared to a year earlier.²³⁵ The verdict is still out as to whether tighter underwriting standards and deteriorating farmer financial conditions will make credit harder to come by in the next few years.

iii. Other Factors. While the overall farm credit market offers mixed signals, certain locales have clearly seen declines. New Frontier Bank’s April 2009 failure left farmers searching for new lenders to pick up the bank’s \$700 million agriculture portfolio, the eighth largest in the nation. As the dust continues to settle, credit in the area remains lacking relative to this demand.²³⁶ However, reports of possibly lax lending standards raise questions as to whether analogous localized credit contractions would result if other farm banks become insolvent.²³⁷

²³⁰ Federal Deposit Insurance Corporation, *Quarterly Banking Profile All Institutions Performance First Quarter 2009*, Table 11-A (accessed July 7, 2009) (online at www2.fdic.gov/qbp/2009mar/qbpall.html).

²³¹ Second Quarter Fed Databook, *supra* note 2, Table C.6. The most recent data available compiles the results of the first quarter 2009 survey, asking about expectations regarding the second quarter of 2009.

²³² USDA Finance Outlook, *supra* note 5, at 49.

²³³ Second Quarter Fed Databook, *supra* note 2, Table C.1 Non-real-estate Farm Lending Compared with a Year Earlier.

²³⁴ Jason Henderson and Maria Akers, *Recession Catches Rural America*, Federal Reserve of Kansas City Economic Review, at 80 (First Quarter 2009) (online at www.kc.frb.org/PUBLICAT/ECONREV/PDF/09q1Henderson.pdf).

²³⁵ Second Quarter Fed Databook, *supra* note 2, Table C.3 Indicators of Relative Credit Availability.

²³⁶ It is unclear whether a lack of new entrants into the northeastern Colorado farm credit market is due to borrowers with weak balance sheets or the capacity of commercial lenders. *See* Congressional Oversight Panel, Transcript of *COP Field Hearing in Greeley, CO on Farm Credit*, at 71-73 (July 7, 2009); *See also* Larry Dreiling, *Bank Failure Fallout is Topic of Vilsack Stop*, High Plains/Midwest Ag Journal (May 25, 2009) (online at www.hpj.com/archives/2009/may09/may25/Bankfailurefalloutistopicof.cfm).

²³⁷ Stephanie Simon, *Town’s Friendly Bank Left Nasty Mess*, Wall Street Journal (June 16, 2009) (online at online.wsj.com/article/SB124510107619616409.html).

Nonetheless, the situation provides an example of the pressures that can occur in a locality when credit supply and demand become significantly imbalanced through any number of reasons, such as a bank failure, a major lender shifting its portfolio from agriculture, a natural disaster, or other reasons.

D. Farm Loan Restructuring

1. Statistics and Trends in Delinquencies and Foreclosures

Any analysis of statistics and trends in farm loan delinquencies and foreclosures is necessarily limited by the lack of hard data available on farm loan foreclosures. The Panel noted a similarly frustrating lack of adequate delinquency, foreclosure, and restructuring data in its March report on residential mortgage foreclosure mitigation.²³⁸

With the exception of FSA – which tracks foreclosure rates for its direct loan programs – there is no existing source that tracks foreclosures on farm loans held by commercial banks or FCS institutions. However, a review of data that are available – such as data on farm loan delinquencies, nonaccrual loans, and loan charge-offs, for the various sources of farm credit – provides a reasonably good picture of the current performance of loans made to American farmers.

On the whole, observable trends in the performance of farm loans mirror trends in agriculture markets generally, which have seen modest stress in recent quarters on the heels of several historically strong years. Similarly, delinquency, nonaccrual, and loan charge-off rates began to tick upward starting in the fourth quarter of 2008 and continuing in the first quarter of 2009; however, these upticks are from historically low rates – and they remain well below the

²³⁸ “In every area of policy, Congress and the Administration need quality information in order to make informed decisions....The first step for understanding the foreclosure crisis and evaluating responses is to have an accurate empirical picture of the mortgage market. For example, how many loans are not performing, what loss mitigation efforts have lenders undertaken, how many foreclosures have occurred, how many are in the process of occurring, and how many more are likely to occur? How many of these foreclosures are preventable, meaning that another loss mitigation option would result in a smaller loss to the lender? What is driving mortgage loan defaults? Are there any salient characteristics of the loans that are defaulting and for which successful modifications are not feasible? What relationship does foreclosure have to loan type, to loan-to-value ratios, to geographic factors, and to borrower characteristics? And crucially, what obstacles stand in the way of loss mitigation efforts? These are some of the questions for which the Congressional Oversight Panel believes the Congress and the Administration need to know the answers in order to make informed policy decisions.

“Unfortunately, this essential information is lacking. The failure of banks and housing regulatory agencies to gather and analyze quality market intelligence is striking. The United States is now two years into a foreclosure crisis that has brought economic collapse, and federal banking and housing regulators still know surprisingly little about the number of foreclosures, what is driving the foreclosures, and the efficacy of mitigation efforts.”

Congressional Oversight Panel, *Foreclosure Crisis: Working Toward a Solution: March Oversight Report*, at 11 (Mar. 6, 2009) (online at cop.senate.gov/documents/cop-030609-report.pdf).

rates seen during previous times of stress in the agriculture sector. Notwithstanding this caveat, the first quarter of 2009 did see some measures of credit quality rise to levels of stress not seen in the better part of a decade, and it remains to be seen whether these levels will continue to escalate to match the crisis conditions in other sectors of the economy or whether they will plateau at levels that, while above the excellent levels seen the past few years, are more in-line with historical agricultural loan performance.

a. The Farm Service Agency

As the lender-of-last-resort for the American agriculture sector – exclusively serving borrowers who are unable to obtain credit at reasonable rates from other sources of farm credit – it would stand to reason that signs of stress among farm borrowers would first begin to appear within the loan portfolio of FSA. However, fiscal year 2008 was a historically strong year for FSA loan performance, with loan loss rates in FSA’s direct and guaranteed loan programs falling to their lowest levels since FSA began to track the data in 1985 – 1.7 percent for the direct loan program and 0.3 percent for the guaranteed loan program.²³⁹

Figure 22: FSA Direct Loan Losses: FY 1998 – FY 2008²⁴⁰

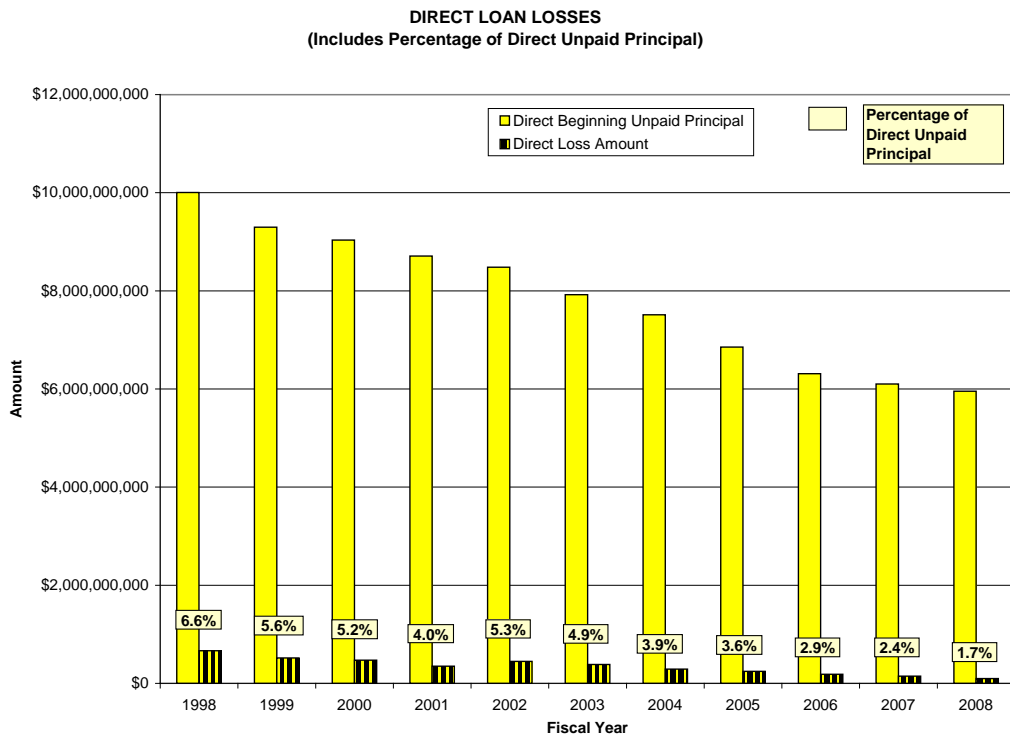
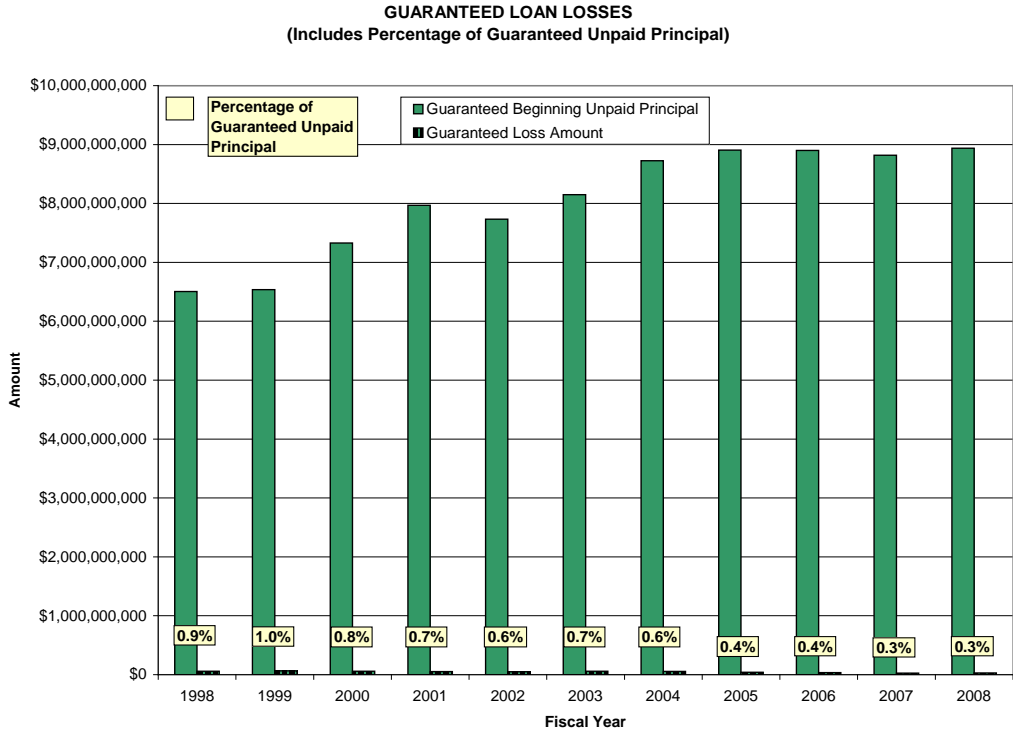


Figure 23: FSA Guaranteed Loan Losses: FY 1998 – FY 2008²⁴¹

²³⁹ FSA June Testimony, *supra* note 41.

²⁴⁰ FSA June Testimony, *supra* note 41.



Likewise, FSA loan delinquency rates indicated continued strength in the farm sector. The direct loan delinquency rate of 6.5 percent was the lowest rate on record and the guaranteed loan delinquency rate of 1.18 percent was the lowest rate since 1995.²⁴²

Figure 24: FSA Direct Loan Delinquency: FY 1998 – FY 2008²⁴³

²⁴¹ FSA June Testimony, *supra* note 41.

²⁴² FSA June Testimony, *supra* note 41.

²⁴³ FSA June Testimony, *supra* note 41.

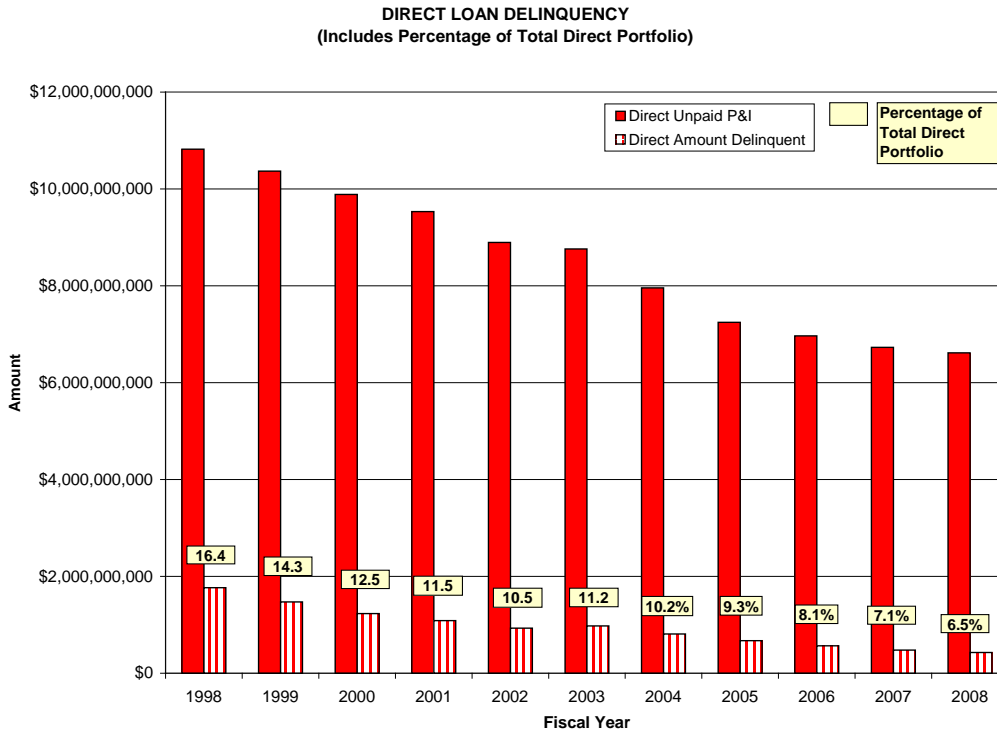
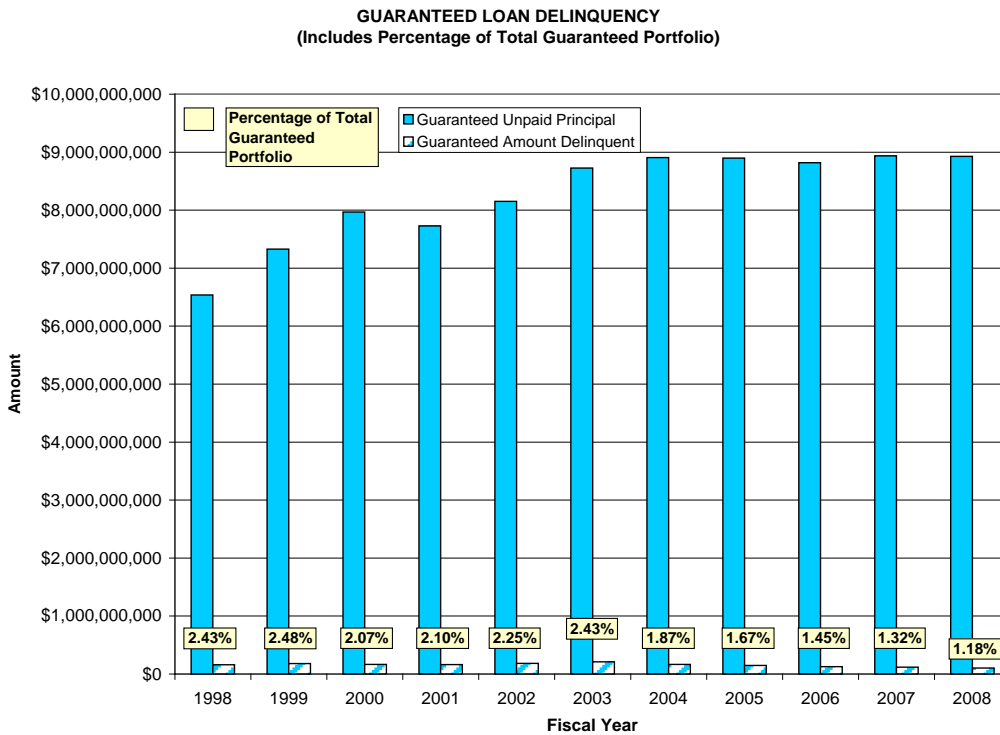


Figure 25: FSA Guaranteed Loan Delinquency: FY 1998 – FY 2008²⁴⁴



²⁴⁴ FSA June Testimony, *supra* note 41.

Foreclosure rates for FSA's direct loan program were also "very low" in fiscal year 2008, as FSA participated in 169 foreclosures, down from 311 foreclosures five years earlier.²⁴⁵ However, then-FSA Administrator Doug Caruso testified that he expects farm loan performance to "deteriorate somewhat" this year "given the increased financial stress in the agriculture economy."²⁴⁶ USDA testimony provided at the Panel's field hearing in Greeley, CO, described such deterioration as "almost inevitable" given the challenging economic times, increased stress in the dairy, hog, and poultry industries, and the fact that delinquencies and losses have been at all-time lows in recent years.²⁴⁷

FSA tracks the number of its guaranteed loans that are restructured by the lender. Thus far in the Fiscal Year ending September 30, 2009, 736 loans totaling \$139 million have been restructured. At this pace, total restructurings have already nearly eclipsed last year's final numbers (853 restructurings totaling \$141 million) and may exceed the highest volume seen since Fiscal Year 2003 (853 restructurings in 2007).²⁴⁸ However, FSA's guaranteed loan portfolio increased from 53,000 to 65,000 loans during this time period. Thus, while the number of restructurings rose this year as the farm economy weakened, this number saw an uptick as early as 2006 while still remaining a small percentage of total loans. FSA does not track the type of lender, such as a commercial bank or FCS institution, involved in the restructuring.

b. The Farm Credit System

The quality of loans held by FCS institutions began to deteriorate a bit in the fourth quarter of 2008; however, this uptick in nonperforming loans was from historically low levels. Nonaccrual loans as a percentage of gross loan volume reached 1.41 percent as of December 31, 2008, up from 0.36 percent one year earlier and 0.43, 0.49, and 0.67 percent at the close of 2006, 2005, and 2004, respectively.²⁴⁹ Overall, nonperforming loans as a percentage of gross loan volume followed a similar trend, hitting 1.50 percent at the close of 2008, up from 0.43, 0.50, 0.56, and 0.77 percent in the four preceding years.²⁵⁰ Nonaccrual and nonperforming loans have edged up further in 2009, hitting 1.70 percent and 1.80 percent, respectively, as of March 31, 2009.²⁵¹

²⁴⁵ FSA June Testimony, *supra* note 41.

²⁴⁶ FSA June Testimony, *supra* note 41.

²⁴⁷ Scuse Testimony, *supra* note 64.

²⁴⁸ FSA loan servicing officials provided the Panel with data on restructurings through a data request to their internal loan tracking system.

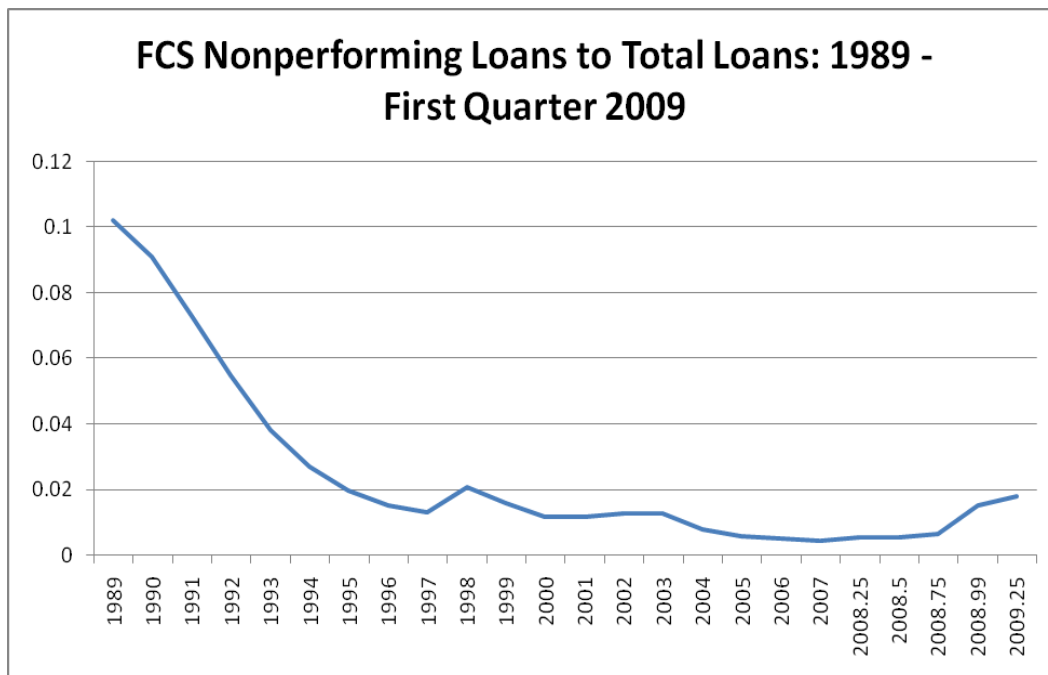
²⁴⁹ Farm Credit Administration, *FCS Major Financial Indicators* (June 16, 2009) (online at www.fca.gov/reports/fcsindicators.html) (hereinafter "FCS First Quarter 2009 Indicators").

²⁵⁰ *Id.*

²⁵¹ *Id.*

While FCS reports that “the current level of [nonperforming] loans has moved more in line with historical levels,” following an extraordinarily strong couple of years, the fact is that these nonaccrual and nonperforming loan rates are the highest such rates seen this decade, and thus should be carefully monitored moving forward.²⁵² However, these rates would have to increase dramatically to come close to rivaling rates seen during previous periods of stress in the farm sector. For a point of reference, nonperforming loans as a percentage of gross loan volume exceeded ten percent in 1989, at the tail end of the 1980s farm crisis.²⁵³ The chart below tracks the percentage of nonperforming FCS loans over the past two decades.

Figure 26: FCS Nonperforming Loans to Total Loans: 1989 – First Quarter 2009²⁵⁴



c. Commercial Banks

Trends in delinquencies and nonperforming loans at commercial banks likewise reveal a modest uptick beginning in the fourth quarter of 2008, and a continued upswing in the first quarter of 2009, following a number of years of extraordinarily high farm credit quality. The share of total farm real estate loans delinquent at the close of the first quarter of 2009 hit 2.76 percent, up from 1.66 percent one year earlier, with loans past due 30-89 days up from 0.87 to

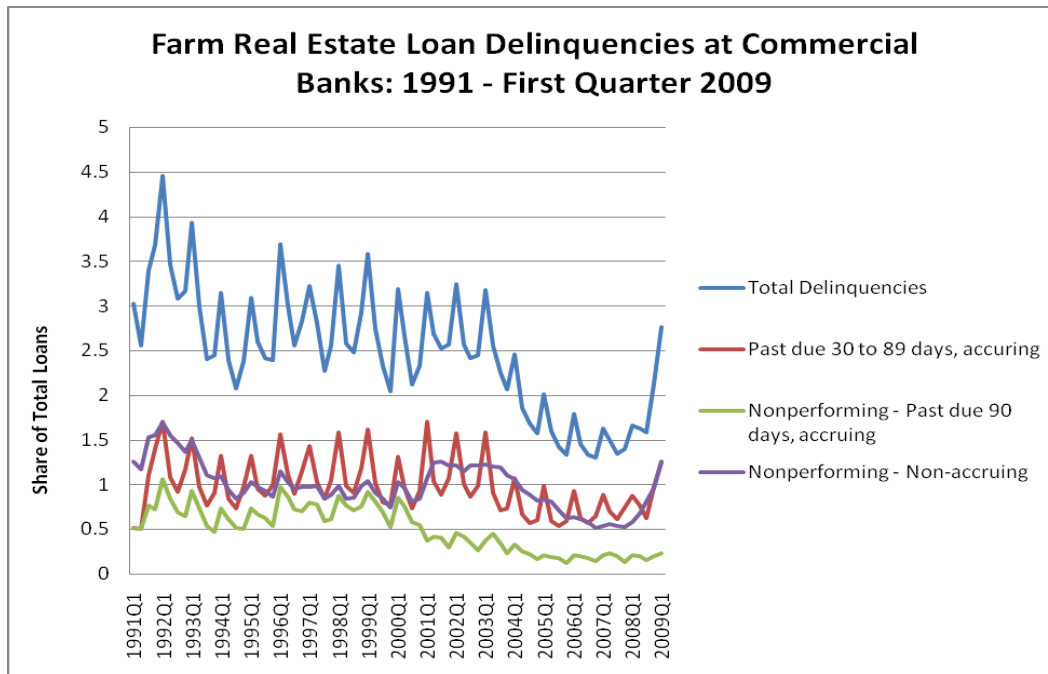
²⁵² FCS 2008 Annual Information Statement, *supra* note 134, at 9.

²⁵³ July FCS Investor Presentation, *supra* note 131.

²⁵⁴ July FCS Investor Presentation, *supra* note 131.

1.26 percent, loans past-due over 90 days yet still accruing interest up from 0.21 to 0.23 percent, and nonaccruing loans rising from 0.58 percent to 1.26 percent.²⁵⁵

Figure 27: Farm Real Estate Loan Delinquencies at Commercial Banks²⁵⁶



The net share of farm real estate loans charged off rose from 0.008 percent in the first quarter of 2008 to 0.051 in the first quarter of 2009.²⁵⁷ While all of these figures remain at or below typical levels seen in the 1990s and even earlier this decade, the jumps seen over the past two quarters may be reason for concern should delinquencies continue to rise at this rate in future quarters.

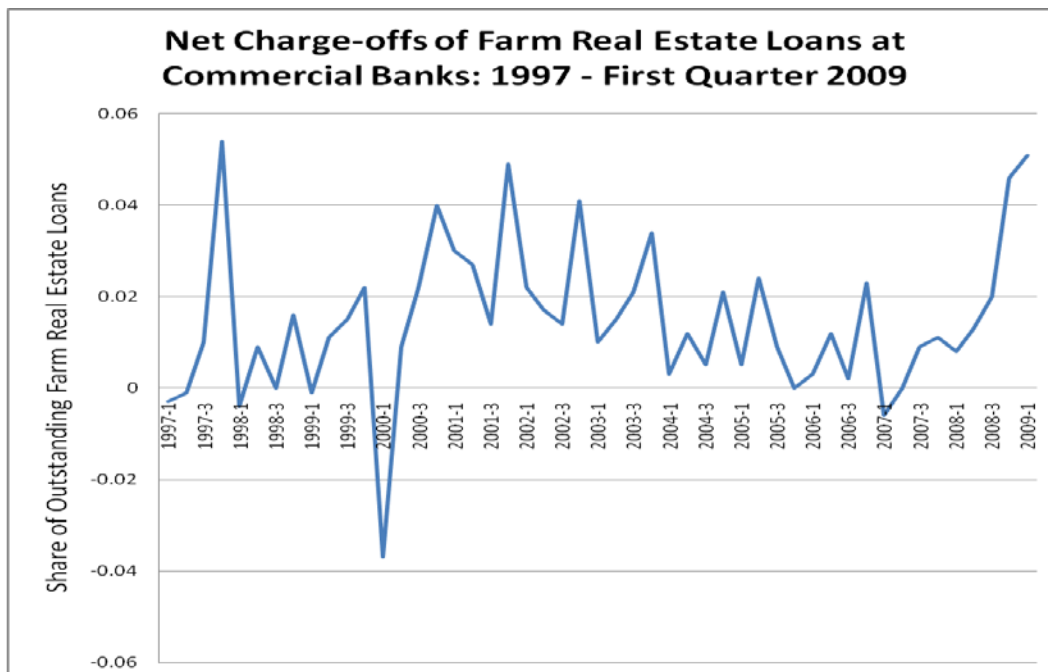
Figure 28: Net Charge-offs of Farm Real Estate Loans at Commercial Banks²⁵⁸

²⁵⁵ Second Quarter Fed Databook, *supra* note 2, at 24 (B.4 Delinquent Real Estate Farm Loans Held by Insured Commercial Banks).

²⁵⁶ Second Quarter Fed Databook, *supra* note 2, at 24 (B.4 Delinquent Real Estate Farm Loans Held by Insured Commercial Banks).

²⁵⁷ Second Quarter Fed Databook, *supra* note 2, at 25 (B.5 Net Charge-Offs of Real Estate Farm Loans Held by Insured Commercial Banks).

²⁵⁸ Second Quarter Fed Databook, *supra* note 2, at 22 (B.2 Delinquent Non-Real Estate Farm Loans Held by Insured Commercial Banks).



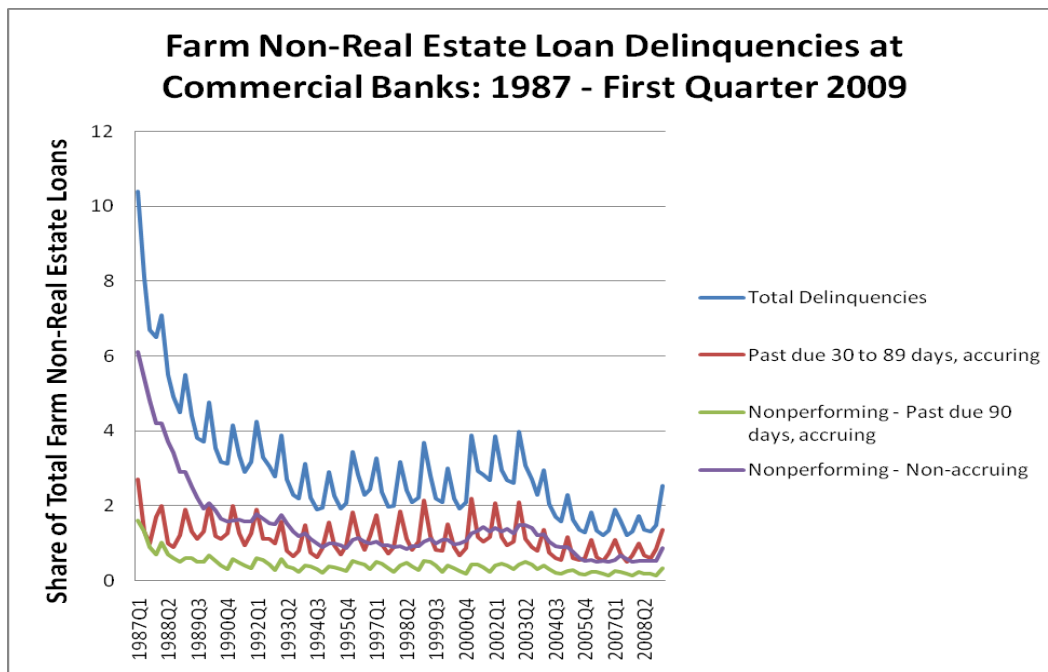
The performance of non-real estate farm loans followed a similar trend, with the total share of delinquent non-real estate farm loans rising from 1.72 percent in the first quarter of 2008 to 2.53 percent in the first quarter of 2009.²⁵⁹ From year-to-year, the share of non-real estate farm loans past-due 30-89 days rose from 0.98 percent to 1.36 percent, loans past-due over 90 days yet still accruing interest went up from 0.22 to 0.32 percent, and nonaccruing loans rose from 0.52 percent to 0.85 percent.²⁶⁰

Figure 29: Farm Non-Real Estate Loan Delinquencies at Commercial Banks²⁶¹

²⁵⁹ Second Quarter Fed Databook, *supra* note 2, at 22 (B.2 Delinquent Non-Real Estate Farm Loans Held by Insured Commercial Banks).

²⁶⁰ Second Quarter Fed Databook, *supra* note 2, at 22 (B.2 Delinquent Non-Real Estate Farm Loans Held by Insured Commercial Banks).

²⁶¹ Second Quarter Fed Databook, *supra* note 2, at 22 (B.2 Delinquent Non-Real Estate Farm Loans Held by Insured Commercial Banks).

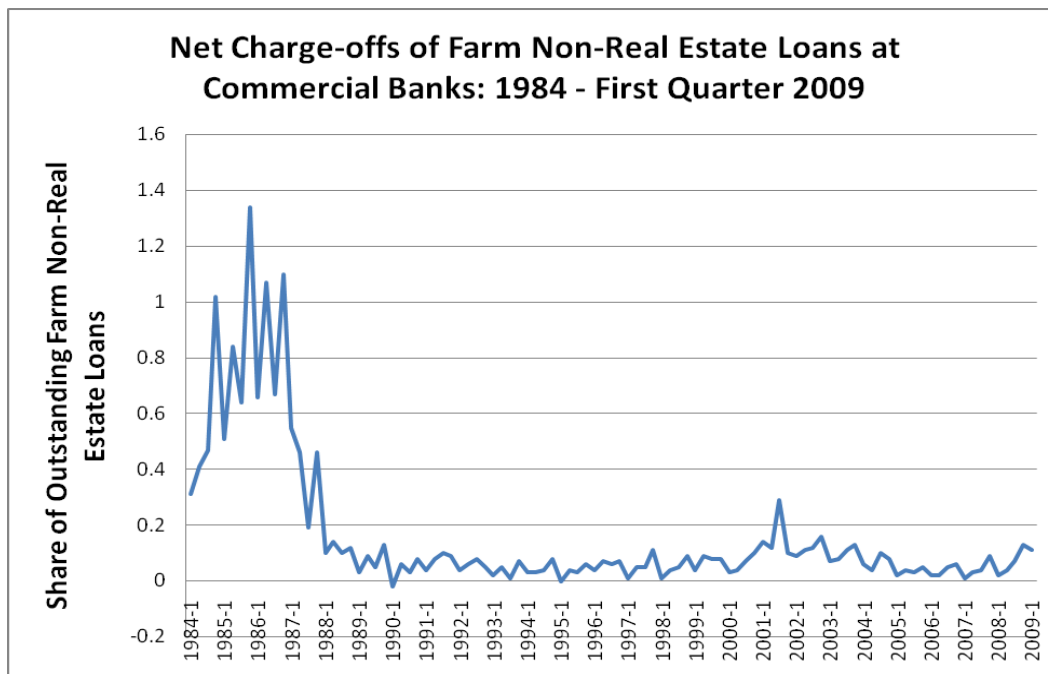


Net charge-offs of non-real estate farm loans increased from 0.02 percent to 0.11 percent from the first quarter of 2008 to the first quarter of 2009.²⁶² Again, while these numbers are up from the historically low levels seen in recent years, they are below loan delinquency rates from earlier this decade, and well below delinquency and charge-off rates from the 1980s.

Figure 30: Net Charge-offs of Farm Non-Real Estate Loans at Commercial Banks²⁶³

²⁶² Second Quarter Fed Databook, *supra* note 2, at 23 (B.3 Net Charge-Offs of Non-Real Estate Farm Loans Held by Insured Commercial Banks).

²⁶³ Second Quarter Fed Databook, *supra* note 2, at 23 (B.3 Net Charge-Offs of Non-Real Estate Farm Loans Held by Insured Commercial Banks).



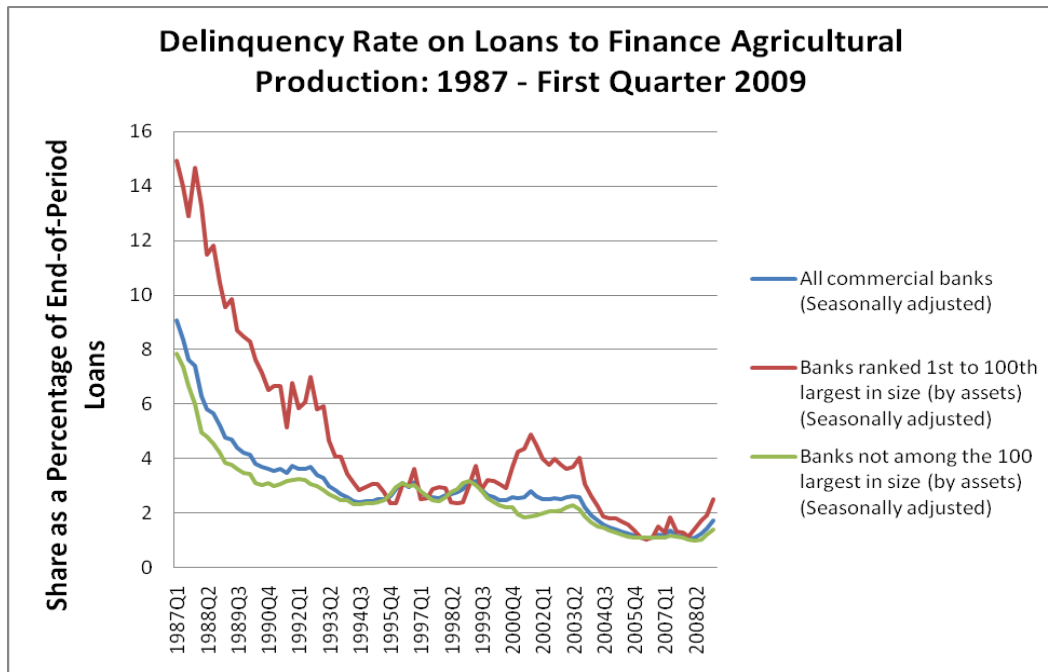
Additional Federal Reserve data that capture a somewhat different universe of loans to finance agricultural production show the same uptick in charge-offs and delinquencies.²⁶⁴ Specifically, the delinquency rate on agricultural production loans rose from 1.06 percent (seasonally adjusted) in the first quarter of 2008 to 1.71 percent (seasonally adjusted) in the first quarter of 2009, with the delinquency rate at the 100 largest banks in the United States (by assets) rising from 1.14 percent to 2.52 percent and the delinquency rate at the remainder of commercial banks going from 1.01 percent to 1.38 percent over that time period.²⁶⁵

Figure 31: Delinquency Rate on Loans to Finance Agricultural Production²⁶⁶

²⁶⁴ Data on charge-offs and delinquencies on agricultural loans are compiled in two quarterly Federal Reserve statistical releases, the E.15 Agricultural Finance Databook (discussed throughout this report) and the *Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks* release. The two releases differ somewhat in their methodology and the universe of agricultural loans that they include. While the E.15 Databook includes delinquency and charge-off rates for both agricultural production and farm real estate loans, the *Charge-Offs and Delinquencies* release only includes a figure for agricultural production loans. The E.15 Databook also manipulates the data to provide an estimate for delinquency and charge-off rates on non-real estate farm loans at banks with under \$300 million in assets at which farm production loans account for fewer than five percent of total loans and leases (these small banks not concentrated in agriculture are not required to report this data on their call reports). The E.15 also adjusts the data to exclude foreign results for large banks that report farm delinquencies and charge-offs on a consolidated basis. For its part, the *Charge-Offs and Delinquencies* release seasonally adjusts its data, and it provides an annualized figure for charge-offs (thus accounting for the higher charge-off rates in the *Charge-Offs and Delinquencies* release compared to the E.15 Databook.)

²⁶⁵ Board of Governors of the Federal Reserve System, *Charge-Off and Delinquency Rates on Loans and Leases at Commercial Banks* (First Quarter 2009) (online at www.federalreserve.gov/releases/chargeoff/default.htm) (hereinafter “Fed Charge-Off and Delinquency Rates”).

²⁶⁶ *Id.*

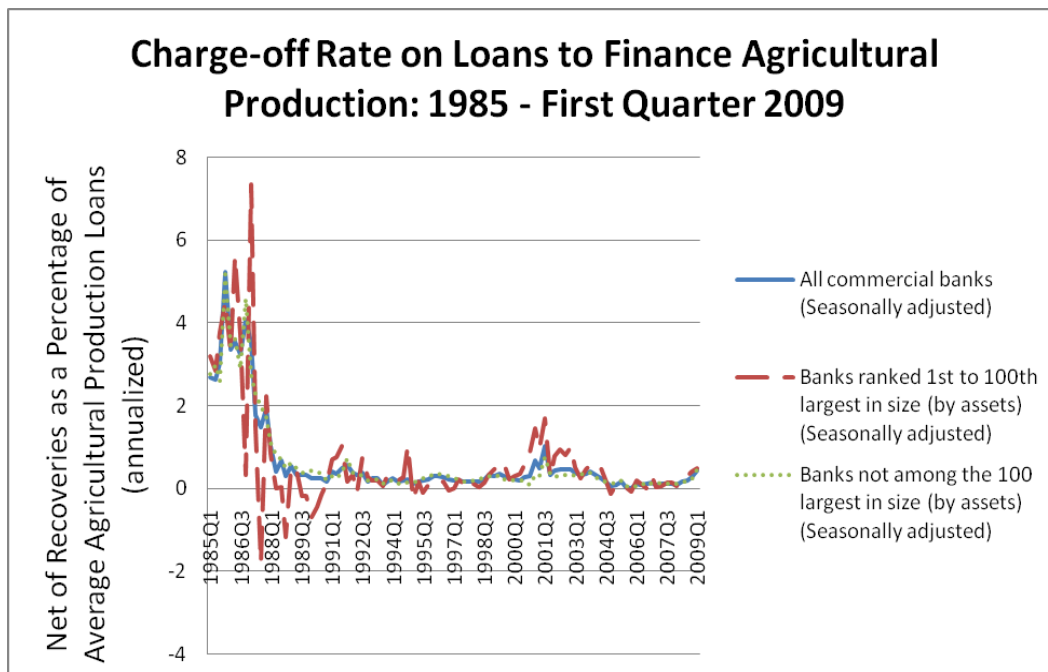


Annualized charge-off rates on agriculture production loans likewise went up from the first quarter of 2008 to the first quarter of 2009, going from 0.08 percent to 0.42 percent overall (seasonally adjusted) – 0.04 percent to 0.47 percent at the largest 100 banks and 0.11 percent to 0.45 percent at the remainder of commercial banks.²⁶⁷ Tracking these data from the height of the 1980s farm crisis – when delinquency rates topped nine percent and charge-off rates exceeded four percent – puts this current upswing into perspective.

Figure 32: Charge-off Rate on Loans to Finance Agricultural Production²⁶⁸

²⁶⁷ *Id.*

²⁶⁸ *Id.*



A look at the distribution of agriculture banks – defined by the Federal Reserve as those that have a proportion of farm loans (real estate plus non-real estate) to total loans that is greater than the unweighted average at all banks – according to the proportion of their loans that are nonperforming provides an alternative measure of the performance of farm loans. The share of agriculture banks with more than five percent of their loans nonperforming increased from 3.4 percent in the first quarter of 2008 to 6.6 percent in the first quarter of 2009.²⁶⁹ This proportion was 31.5 percent during the first quarter of 1987.²⁷⁰

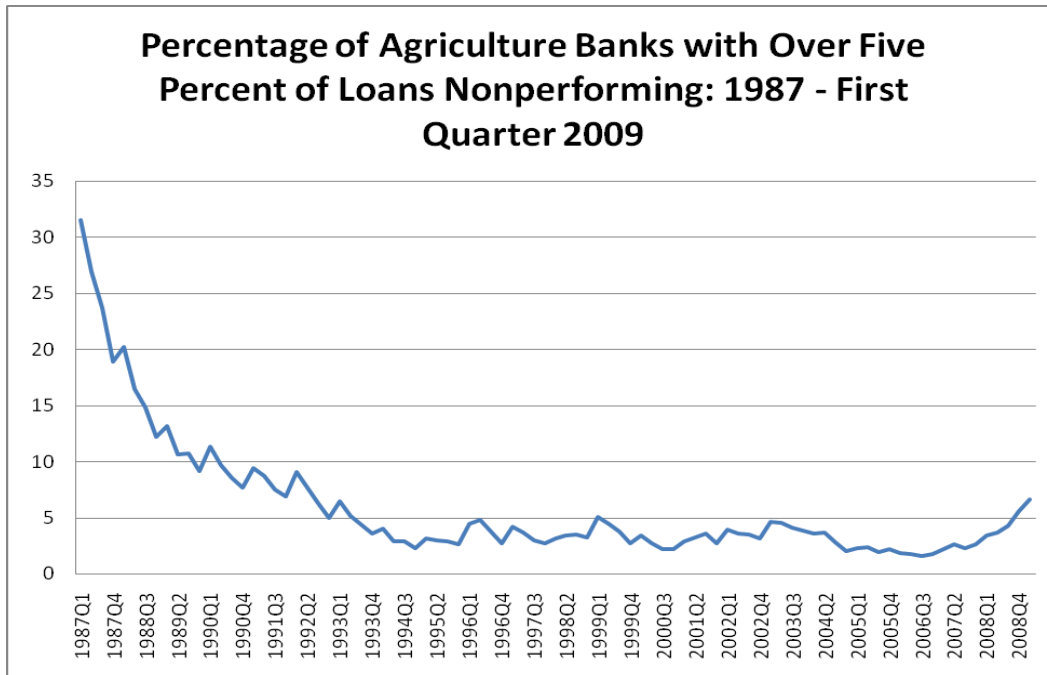
However, the proportion of agricultural banks in the next tier down – those with 2.0 and 4.9 percent of total loans nonperforming – rose from 15.5 percent to 23.6 percent between the first quarters of 2008 and 2009, while the proportion of agriculture banks with fewer than 2.0 percent of total loans nonperforming fell from 81.0 percent to 69.9 percent over that time period.²⁷¹ This proportion of banks with under 2.0 percent of loans nonperforming is at its lowest level since 1992, though it should be emphasized that these proportions are based on the performance of all loans and leases – not merely agricultural loans.

²⁶⁹ Second Quarter Fed Databook, *supra* note 2, at 26 (B.6 Distribution of Agricultural Banks by the Share of Their Total Loans that are Nonperforming).

²⁷⁰ Second Quarter Fed Databook, *supra* note 2, at 26 (B.6 Distribution of Agricultural Banks by the Share of Their Total Loans that are Nonperforming).

²⁷¹ Second Quarter Fed Databook, *supra* note 2, at 26 (B.6 Distribution of Agricultural Banks by the Share of Their Total Loans that are Nonperforming)..

Figure 33: Agriculture Banks with Nonperforming Loans Exceeding 5 Percent²⁷²



Also useful to consider when attempting to track the performance of farm loans is the amount of farmland held by commercial banks – a rough gauge of foreclosure activity. The value of farmland in bank possession more than doubled between the first quarter of 2008 and the first quarter of 2009 – going from \$60.7 million to \$122.4 million.²⁷³ While this figure is well below the value of farmland held in the early 1990s, in the aftermath of the farm crisis (farmland in bank possession exceeded \$424 million in 1992), this jump does provide reason for concern, and a continued upswing could be an indication of more difficult times than anticipated for the farm sector.²⁷⁴

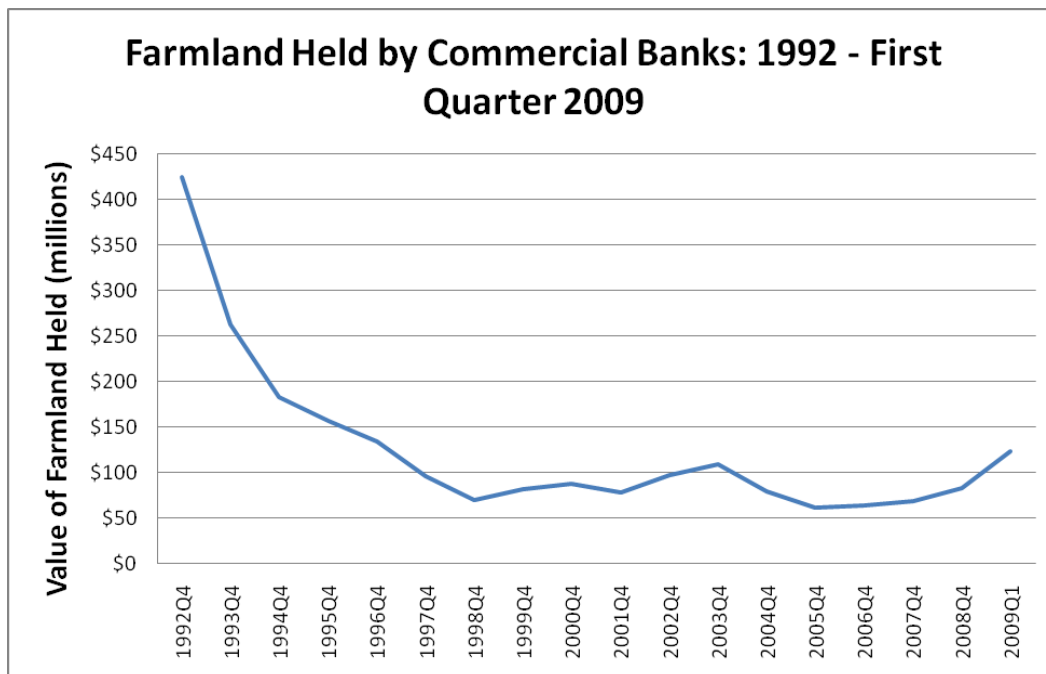
Figure 34: Farmland Held by Commercial Banks²⁷⁵

²⁷² Second Quarter Fed Databook, *supra* note 2, at 26 (B.6 Distribution of Agricultural Banks by the Share of Their Total Loans that are Nonperforming).

²⁷³ FDIC First Quarter Call Report Data, *supra* note 149.

²⁷⁴ FDIC First Quarter Call Report Data, *supra* note 149.

²⁷⁵ FDIC First Quarter Call Report Data, *supra* note 149.



Finally, the Federal Reserve’s survey of farm lenders provides information on repayment rates for farm loans. Recent surveys conducted in the Federal Reserve’s Kansas City, Dallas, and Minneapolis regions indicate that between five and 20 percent more bankers have found farm loan repayment rates to have decreased in the first quarter of 2009 compared to the first quarter of 2008 than have found that rate to have increased over that time period.²⁷⁶ As with other indicators, this rate should be tracked moving forward, as continued spikes in loan nonpayment would likely give rise to increased rates of farm foreclosures.

2. Loan restructuring policies in place at major credit sources

a. Farm Service Agency

i. FSA Direct Loans. The Agricultural Credit Act of 1987 instituted a number of reforms to USDA’s Farm Loan Programs (FLP) that aimed to enhance several core principles of FSA, including timely and comprehensive disclosure of loan programs and loan status; preservation of operating farms whenever feasible; uniform criteria for credit decisions; and fair and equitable treatment by FSA. These principles are reflected in specific mandates, such as required notice of loan servicing programs and a period to consider the options before the agency can accelerate a delinquent loan; a range of loan servicing tools; specific timeframes for the agency to respond to

²⁷⁶ Second Quarter Fed Databook, *supra* note 2, at 31 (C.1 Non-Real Estate Farm Lending Compared with a Year Earlier).

loan applications and loan servicing requests; and a duty on the agency's part to provide assistance to any farmer who seeks to make a loan application or servicing request.²⁷⁷

FSA is required by law to attempt to restructure loans issued by its FLP when borrowers are unable to make scheduled payments due to reasons beyond their control.²⁷⁸ The law also provides a process by which FSA loans are to be serviced in order to avoid foreclosure and liquidation. FSA's responsibilities under the law are triggered when a borrower becomes 90 days past due on an FSA loan account. The agency must provide a servicing packet to the borrower presenting the available options for avoiding foreclosure on the loan. Borrowers who are not delinquent, but anticipate that they will not be able to make their next payment, may request the servicing packet at any time. Borrowers have 60 days from the receipt of the packet to respond to FSA and express their desire to pursue an alternative to foreclosure.²⁷⁹ The guiding principle in the exploration of foreclosure alternatives is to keep borrowers on their land and operating their farms under restructured loans whenever the government would receive an equal or greater net return than it would otherwise realize through foreclosure.

FSA determines the net recovery value of a given loan security retrieved through liquidation by adding (1) the current appraised value of the borrower's interest in the security property, and (2) the value of the borrower's interests in all other assets that are neither exempt from judgment nor essential for farm living or farm operating expenses, and then subtracting the government's costs of acquiring, holding, maintaining, and disposing of the property. These costs include prior liens on the property, taxes and assessments, depreciation, lost interest income, resale expenses (including necessary repairs), and other administrative and legal expenses. If FSA determines that the present value of payments that the borrower would make under a restructured loan would be of equal or greater value than the calculated net recovery value of the security for the original loan, under the law a loan modification must be offered. The appropriate restructuring option is calculated by the Debt and Loan Restructuring System (DALRS), an automated software program using inputs provided by the borrower. Each loan servicing alternative generated by DALRS is considered with the goal of developing a feasible plan that allows the borrower to meet necessary family living and farm operating expenses and service all debts, including restructured loans. A feasible plan must cover up to 110 percent of the borrower's projected expenses and debt service obligations.²⁸⁰

²⁷⁷ Jerome Stam, Steven Koenig, Susan Bentley, and H. Frederick Gale, Jr. *Farm Financial Stress, Farm Exits, and Public Sector Assistance to the Farm Sector in the 1980s*, USDA Economic Research Service (Agriculture Economic Report Number 645).

²⁷⁸ 7 U.S.C. § 2001.

²⁷⁹ 17 C.F.R. § 766.1 *et seq* (2004).

²⁸⁰ U.S. Department of Agriculture, *Direct Loan Servicing – Special and Inventory Property Management*, Farm Service Agency Handbook (Oct. 9, 2008) (online at www.fsa.usda.gov/Internet/FSA_File/2-flp.pdf).

FSA has four “primary loan servicing” options at its disposal under the restructuring program. The options include:²⁸¹

1. Consolidation, Reamortization, and Rescheduling

General operating loans can be rescheduled for up to 15 years from the date of their restructure. Principal and unpaid interest can be combined and rescheduled for up to 15 years. Line of credit loans can be rescheduled for up to seven years from the date of the restructure. Real estate loans may be reamortized over a period of up to 40 years from the date of the original loan.

2. Deferral

The deferral option allows the borrower to make no payments or only partial payments for up to five years. All of the principal and a portion of the interest may be deferred but a partial interest payment must always be received. To be eligible for a deferral, borrowers must obtain FSA approval of a feasible first-year deferral and post-deferral farm operating plan that does not create excessive net cash reserves.

3. Interest Rate Reduction

FSA may also complement the restructuring mechanisms in options one and two by reducing the interest rate on a loan.

4. Writedown

If consolidation, rescheduling, reamortization, deferral, or some combination thereof does not result in a feasible plan with 110 percent debt service margin, FSA may consider a writedown, a reduction in the total debt. This option is only available to borrowers who are currently delinquent on their loans and have not previously received debt forgiveness on any FSA direct loan. The size of the writedown is generally calculated to require the borrower to pay the most he or she can afford, including the value of any nonexempt, nonessential assets. The debt cannot be written down below the net recovery value of the loan collateral. Federal law limits debt forgiveness to one instance of no more than \$300,000.²⁸²

In circumstances where a loan is restructured via writedown, FSA is required by law to enter into a Shared Appreciation Agreement (SAA) providing for the government to share any appreciation in value of the security property that occurs over a specified time period. SAAs are designed to protect taxpayers, ensuring that farmers who benefit from a government writedown and subsequently enjoy a reversal of fortune must repay at least a portion of the public

²⁸¹ *Loan Restructuring in the USDA Farm Loan Program*, Farmers’ Legal Action Group, Inc. Briefing Paper (hereinafter “FLAG Loan Restructuring”).

²⁸² 7 U.S.C. § 2001.

assistance. SAAs issued after August 18, 2000, have a maximum term of five years and may be triggered by either a conveyance of the security property (other than to a spouse upon the borrower's death); full payment or other satisfaction of the underlying loan; cessation of farming by the borrower; or acceleration of the underlying loan. If none of these triggers occur during the life of the contract, recapture will be triggered upon expiration of the contract. The amount of appreciation that USDA is entitled to depends upon when the trigger event occurs. If the trigger event occurs in the first four years of the agreement, USDA will claim 75 percent of the increase in value of the security. If the trigger occurs in the fifth year, or at the expiration of the SAA, USDA may claim 50 percent of the increase in the value of the security. Under no circumstances may FSA recapture more than the amount of principal and interest that was written down.²⁸³

If DALRS indicates that no feasible plan is possible under any of the available restructuring options, state-sponsored mediation or a meeting of creditors may be offered. If restructuring is not possible after mediation, the borrower may have the opportunity to buy out the debt at the current market value of the security and any non-essential assets. The remainder of the debt is written off when the buyout is accomplished. If the borrower is unable to take advantage of the buyout option, FSA is required to proceed with foreclosure in an effort to recover as much value as possible. In certain situations, borrowers may avoid foreclosure by voluntarily conveying the security property to the government in full satisfaction of the debt.²⁸⁴

An individual receiving notification of an adverse decision from USDA has the right to appeal. The USDA appeals process has two stages. The borrower must first participate in a hearing in his or her state or jurisdiction of residence with an FSA officer. Following this hearing, either the borrower or FSA may petition the National Appeals Division of the USDA (NAD) to reconsider the finding of the local hearing officer. The NAD Director then decides if the case will be heard and either finds the case to be not appealable or schedules a final hearing. The vast majority of these petitions are found to be appealable.²⁸⁵

ii. FSA Guaranteed Loans. While FSA guaranteed loans are made by private lenders and only guaranteed by the government, federal law requires that the Secretary of Agriculture ensure that the programs are designed to be responsive to the needs of borrowers and lenders, and that all viable options are explored before the lender initiates foreclosure proceedings.²⁸⁶ USDA

²⁸³ FLAG Loan Restructuring, *supra* note 281.

²⁸⁴ U.S. Department of Agriculture, *Fact Sheet: Primary and Preservation Loan Servicing for Delinquent FSA Borrowers* (July 2008) (online at www.fsa.usda.gov/FSA/newsReleases?area=home&subject=empl&topic=pfs&newstype=prfactsheet&type=detail&item=pf_20080710_farln_en_ppls08.html) (hereinafter "Delinquent FSA Borrower Factsheet").

²⁸⁵ Of the 266 cases brought before the NAD Director in 2008, 242 of those cases were found to be appealable. U.S. Department of Agriculture, National Appeals Division, *FY 2008 NAD Appeal abilities* (online at www.nad.usda.gov/Forms/FY%202008%20NAD%20Appealabilities.pdf).

²⁸⁶ 7 U.S.C. § 1998.

regulations provide thorough instructions on the steps that lenders are expected to take to keep borrowers out of foreclosure via loan restructuring.²⁸⁷ However, ultimately it is solely the lender's prerogative to accept or reject a borrower's plan for resolution of a default or offer another alternative for restructuring debt. FSA credit officers play an advisory role, helping to maximize the outcome for all concerned stakeholders.²⁸⁸

A guaranteed loan is considered in default if a loan payment is outstanding 30 calendar days after its due date. Within 15 days of default, the lender should arrange a meeting with the borrower to identify the nature of the delinquency and develop a course of action that will resolve the issue and preclude the loan from going to foreclosure. An FSA credit officer may be brought into the process at the request of either the lender or the borrower to help facilitate a solution. Similar to direct loans, the restructuring options for guaranteed loans include rescheduling, reamortization, deferral, debt writedown, or some combination thereof. However, unlike the direct loan program, the burden of identifying the appropriate restructuring option lies with the borrower, not the lender. In addition, holders of distressed guaranteed operating loans may also be eligible for relief through FSA's Interest Assistance Program (IAP). Under IAP, FSA agrees to subsidize four percent of the interest rate in the form of a payment from FSA to the lender.²⁸⁹ If a borrower qualifies for IAP assistance, the lender may not initiate foreclosure action on the loan until 60 days after the date that eligibility is determined, affording the borrower time to present a viable restructuring plan with IAP as a component.²⁹⁰

Institutions that guarantee FSA loans are categorized according to their experience and performance in the program. Junior lenders, known as standard eligible lenders, must seek approval of restructuring plans, whereas the more senior certified and preferred lenders have greater leverage to restructure loans without FSA approval. Certain restrictions apply to all lenders. Loans secured by real estate and/or equipment may be restructured using a balloon payment, equal installments, or unequal installments, but the projected value of the security must indicate that the loan will be fully secured when the balloon payment is due. These loans must have a minimum term of five years. Loans secured solely by livestock or crops are not eligible for rescheduling using a balloon payment.²⁹¹ All debt writedowns require prior approval from FSA. The present value of the loan to be written down, based on the interest rate of the rescheduled loan, must be equal to or exceed the net recovery value of the loan collateral. FSA

²⁸⁷ 7 C.F.R. § 762.101 *et seq* (2007).

²⁸⁸ U.S. Department of Agriculture, *Guaranteed Loan Making and Servicing*, Farm Service Agency Handbook (Oct. 9, 2008) (online at www.fsa.usda.gov/Internet/FSA_File/2-flp.pdf) (hereinafter "FSA Guaranteed Loans Handbook").

²⁸⁹ American Bankers Association, *Industry Issues: USDA, Farm Service Agency Guaranteed Loan Servicing Options* (June 30, 2009) (online at www.aba.com/Industry+Issues/GR_AG_FSAGuarLoan.htm) (hereinafter "ABA Guaranteed Loans").

²⁹⁰ FSA Guaranteed Loans Handbook, *supra* note 288.

²⁹¹ FSA Guaranteed Loans Handbook, *supra* note 288.

will compensate the lender for the loss incurred as a result of the writedown in proportion to the guaranteed percentage of the loan.²⁹² On loans secured by real estate, lenders must execute a shared appreciation agreement under the same terms as direct loans that are written down by FSA.

Since USDA guaranteed loans are neither owned nor serviced by USDA, USDA maintains that its role is as a guarantor.²⁹³ The borrower and lender must jointly petition for an appeal. The only exception is when a lender is appealing the amount of a final loss payment from USDA, in which case only the lender may appeal. USDA does not allow appeals to lender decisions by borrowers.²⁹⁴

b. Farm Credit System

The Agricultural Credit Act of 1987 required the FCS to implement mandatory protections for its customers, a set of provisions known as “borrower rights.”²⁹⁵ The provisions are designed to ensure that FCS lenders provide borrowers with full disclosure of their loan status and the opportunity to pursue a viable alternative to foreclosure. The borrower rights provisions are enumerated in the statute and are enforced by the FCA.²⁹⁶ In addition, each FCS lending institution is required to maintain a formal policy governing loan restructuring that is consistent with the law and approved by the FCA.²⁹⁷

Borrower rights entitle FCS customers to certain disclosures on all loans, whether the loan is distressed or not. These basic disclosure requirements on non-distressed loans include:²⁹⁸

- the current effective rate of interest on a loan by the date it closes;
- any borrower requirement to purchase at-risk stock in the FCS institution;
- copies of all the documents signed by the borrower prior to closure of the loan;
- prompt notification of whether a loan application has been accepted, reduced, or denied.

With respect to distressed loans, FCS lenders are required to notify borrowers at least 45 days in advance of the initiation of a foreclosure proceeding that they may qualify for a

²⁹² ABA Guaranteed Loans Handbook, *supra* note 289.

²⁹³ In this way, USDA guarantees serve a purpose analogous to the role played by TARP in agriculture lending by TARP-recipient banks: both are federal backstops to commercial bank risk taking.

²⁹⁴ 12 C.F.R. § 762.104 (2007).

²⁹⁵ Agricultural Credit Act of 1987, Pub. L. No. 100-233.

²⁹⁶ 12 U.S.C. § 2202(a).

²⁹⁷ 12 C.F.R. § 616 (1999).

²⁹⁸ Farm Credit Administration, *Borrower Rights* (accessed July 17, 2009) (online at www.fca.gov/about/borrower_rights.html).

restructuring. At that time, the borrower is entitled to an opportunity to review the status of the loan and respond to the institution with an acceptable plan for restructuring the loan. Restructuring may include rescheduling, reamortization, renewal, deferral of principal or interest, debt forgiveness, or any other action to modify a loan so as to make it probable that the borrower will recover and become financially viable. As in the case of FSA loans, if a restructuring alternative can be identified which is less than or equal to the estimated cost of foreclosure and liquidation, the lender is required to enter a restructuring agreement with the borrower.²⁹⁹ The key difference is that the burden of developing a feasible alternative on an FCS loan lies with the borrower, not the lender.

FCS institutions are required to consider several factors when evaluating the borrower's proposal and conducting a least-cost analysis of restructuring versus foreclosure. The net recovery value of foreclosure must take into consideration the outstanding balance due on a loan and the liquidation value of the loan, including the borrower's repayment capacity and the liquidation value of the collateral. This includes estimates of maintaining a loan as a nonperforming asset or incurring the administrative and legal fees associated with foreclosing on the loan and disposing of the acquired property. The calculation of the cost of restructuring the loan must account for the present value of interest income and principal forgone by the lender in carrying out the restructuring plan; the reasonable and necessary administrative expenses involved in working with the borrower to finalize and implement the restructuring plan; whether the borrower has presented a preliminary restructuring plan and cash-flow analysis taking into account income from all sources to be applied to the debt and all assets to be pledged, showing a reasonable probability that orderly debt retirement will occur as a result of the proposed restructuring; and whether the borrower has furnished or is willing to furnish complete and current financial statements in a form acceptable to the institution.

Ultimately, the decision of what is the least cost alternative, and therefore of whether or not to restructure a loan, lies with the lending institution. Provided that it has done the proper due diligence and conducted a fair comparative assessment of the cost of a loan restructuring versus foreclosure, the institution may deny the application and pursue foreclosure. If restructuring is denied, an FCS borrower may request a review by a credit review committee (CRC). The board of directors of each FCS institution must establish a CRC to review an adverse credit decision and that CRC must include at least one of the institution's farmer-elected board members and exclude any loan officers involved in making the initial decision. The CRC has the ultimate decision-making authority on all credit decision reviews.³⁰⁰

As the regulator of the FCS, FCA receives any complaints regarding loan restructuring applications. FCA also examines for compliance with borrower rights provisions as part of its regular examination process. If the FCA determines that an FCS institution has failed to

²⁹⁹ 12 U.S.C. § 2202(a).

³⁰⁰ Delinquent FSA Borrower Factsheet, *supra* note 284.

properly comply with the borrower rights requirements, FCA may issue a directive instructing the institution to take corrective action. Failure to comply with the directive may result in FCA assessing monetary penalties or seeking a court order. Borrowers are afforded no private right of action under the borrower rights provisions. Borrower rights do not attach to loans that are sold into the secondary market.

c. Commercial Banks

i. Options for Restructuring. There is no across-the-board agricultural loan restructuring policy for commercial banks. Each institution, be it a smaller, community bank or a large, national lender, determines its modification policy based on its own risk tolerance, the borrower assets involved, and other considerations. At the moment, due to strong farmland values and historically low farm debt-to-asset ratios (as discussed *infra*) greater options may exist for flexible modifications.³⁰¹

The variability of commercial bank policies creates difficulties for data analysis of current farm loan restructuring activities. No statutorily mandated or industry-adopted policies are in place. Due to the lack of standardization and reporting requirements, no data are available concerning the frequency or types of farm loan modifications conducted by commercial banks.

While lacking any sort of enforcement mechanism, some regional associations representing larger institutions develop best practices to serve as a framework for making restructuring decisions, particularly when the region is dealing with problems in prominent local product sectors.³⁰² For example, the Wisconsin Bankers Association has developed a set of principles of farm debt restructuring:

- Customer success is the overriding principle: bankers want to see their farm customers thrive and will work with their customers during good times and bad.
- Customer equity considerations: sometimes the best option for a financially troubled borrower is for them to preserve their equity by liquidating the business. The decision to liquidate is not easy, but many times is the best solution in a number of situations. Bankers will work with their customers to help them decide the best course of action
- Honesty: Customers must make a good faith effort to abide by any existing loan agreements that were executed when the credit was first obtained. For example, they must not sell collateral out of trust. If a customer violates the basic business

³⁰¹ See sections B(2) and B(3), *supra*, for a detailed discussion of farmland values and debt-to-asset ratios.

³⁰² See, e.g., Wisconsin Bankers Association, *Principles of Farm Debt Restructuring*, Letter from Kurt Bauer, President and Chief Executive Officer of the Wisconsin Bankers Association, to Senator Feingold (June 19, 2009).

security agreement(s) and sells assets that are collateral for the loan in question, and does not apply the proceeds from the sale of the assets to the outstanding loan, this action will limit the bank's ability to do problem mitigation with the borrower.

- **Communication:** Every borrower and lender relationship demands open and honest communication. The identification of distress in a loan relationship should not change the communication process. Timeliness and the expectations for both the borrower and the bank need to be clearly communicated on a regular and ongoing basis.
- **Responsibility for problem identification:** In most distressed loan situations, insufficient repayment capacity is the root cause of the problem. As the owner of the farm business, the borrower is primarily responsible for developing a plan to cure the problem. The lender's responsibility is to review the borrower's plan and to advise the borrower on the feasibility of the plan, and if the plan fits within the underwriting standards of the bank.
- **Plan development:** The borrower typically identifies potential expense reductions, any potential for additional farm income, considers the potential for non-farm income, identifies excess assets to sell, or decides to liquidate the entire business. The borrower may ask for time to allow him or her to refinance his or her debt with another credit source.
- **Evaluation of the plan:** The feasibility of the business plan completed by the borrower must be evaluated by the bank to determine the farm management's ability to succeed, the adequacy of collateral for the loan, and the ability of the operation to meet debt service requirements. Deadlines for the execution of asset sales, expense reductions, refinancing of debt by another source, or the acquisition of non-farm employment are set and are mutually agreed to by the borrower and the banker. Once a plan is agreed to, the bank typically notifies the borrower in writing.
- **Plan execution:** Once the plan is completed and approved, bankers may use several tools to assist distressed borrower. Not all banks will offer the same options. What each individual bank will do is dependent upon the risk tolerance of management, the loan policy of the individual bank, regulatory circumstances, and other factors (such as whether or not the loan has been sold or participated).
- **Monitoring the plan:** When a plan is agreed to by a borrower and the bank, it must be monitored by both parties for performance compliance. Mutually agreeing to a

set of objectives to be met on an agreed upon schedule is of the utmost importance.

- Resolution of the problem: Once the problem period has passed, and the business has recovered, the borrower is expected to return to the original repayment plan unless otherwise agreed to.
- Bankruptcy: *At all times*, farm business owners have the option to try to restructure their business debt through bankruptcy, including Chapter 12 which is reserved for family farmers who are defined in the statute. In addition to Chapter 12, farmers have Chapter 11, 7, and 13 available to them depending upon their individual circumstances.³⁰³

Because FSA guarantees loans made by both FCS and commercial banks, it is possible to obtain limited data on commercial bank loan write-offs through FSA data. It is important to note, though, that FSA is the lender of last resort; therefore, commercial bank loans guaranteed by FSA are by definition to borrowers who were unable to get a regular commercial bank loan. As noted earlier in this section, USDA does have regulations instructing lenders whose loans it guarantees to take steps to keep borrowers out of foreclosure through restructuring. However, the provisions appear to have little enforcement. Therefore, commercial banks' willingness and ability to restructure FSA guaranteed loans may provide information on their ability and willingness to restructure regular loans held by the bank.

Out of all FSA guaranteed loans made in the past seven years, loans made by commercial lenders had a delinquency rate of 1.97 percent, while loans made by FCS institutions had a rate of 1.14 percent. For guaranteed loans that eventually had to be written off as unrecoverable over the same time span, FSA data show a loss rate of 0.61 percent for commercial banks versus 0.20 percent for FCS institutions.³⁰⁴ The commercial bank delinquency rate above is less than two times that of FCS institutions. By the time troubled loans must be written off, the loss rate gap has widened to three times higher for commercial credit.

Here again though, insufficient and missing data prevent drawing any solid conclusions from these data. FSA staff notes that the above delinquency rate was gathered through self-reporting by institutions. Thus, what one lender reports as delinquent 30 days after a missed payment, another lender may consider a loan that is in essence still current and only delinquent in form. More importantly, since FSA does not track the lender type engaging in a restructuring, the Panel is unable to conclude whether commercial banks' higher write-off rate is a

³⁰³ *Id.*

³⁰⁴ FSA loan servicing officials provided the Panel with loan loss rate statistics through a data request to their internal loan tracking system. The data is accurate as of June 30, 2009.

consequence of conducting fewer restructurings or due to another cause, such as higher-risk lending.

ii. Home Affordable Modification Program. While commercial banks do not have a requirement to restructure farm loans, the residential mortgage restructuring program provides insight into the effectiveness of a requirement on TARP recipient banks to restructure a specific type of loan. On March 4, 2009, Treasury announced the *Home Affordable Modification Program* (HAMP) as part of its *Making Home Affordable* (“MHA”) initiative. Treasury estimates that three to four million potentially at-risk homeowners could benefit from HAMP through mortgage modification. HAMP is funded by a government commitment of \$75 billion, which is comprised of \$50 billion of TARP funds and \$25 billion from the Housing and Economic Recovery Act. The \$50 billion of TARP funds is directed toward modifying private-label mortgages, and the \$25 billion from the Housing and Economic Recovery Act is dedicated to the modification of Fannie Mae and Freddie Mac mortgages.

The goal of HAMP is to prevent foreclosures by creating a partnership between Treasury and private institutions in order to reduce borrowers’ monthly payments to an affordable level. In addition to creating monetary incentives for the modification of at-risk mortgages, HAMP standardizes loan modification guidelines in order to create an industry paradigm. Also, all TARP recipients will be required to use these guidelines for loan modifications going forward.

Eligibility Requirements – The loan must have originated on or prior to January 1, 2009. The mortgage must be a first lien on an owner-occupied property with an unpaid balance up to \$729,750.³⁰⁵ There is no maximum or minimum loan-to-value (LTV) requirement to participate in HAMP. Borrowers in bankruptcy or in active litigation regarding their mortgage can participate in the program without waiving their legal rights.

Incentives – There are a number of incentives aimed at both encouraging participation of borrowers, servicers, and investors and at maintaining a focus on successful results. First, servicers receive an up-front fee of \$1,000 for each completed modification. Second, servicers receive “Pay-for-Success” fees of up to \$1,000 each year for up to three years. These fees will be paid monthly and are predicated on the borrower staying current on the loan. Borrowers are eligible for “Pay-for-Performance Success Payments” of up to \$1,000 each year for up to five years, as long as they stay current on their payment. This payment is applied directly to the principal of their mortgage. The “Responsible Modification Incentive Payment” is a one-time bonus payment of \$1,500 to the lender/investor and \$500 to servicers that will be awarded for modifications made while a borrower is still current on payments. Finally, Treasury estimates

³⁰⁵ The unpaid balance ceiling increases in relation to number of units on the property (2 units - \$934,200; 3 units - \$1,129,250; 4 units - \$1,403,400).

that up to 50 percent of at-risk mortgages have second liens.³⁰⁶ In order to address second lien debts, such as home equity lines of credit or second mortgages, HAMP encourages servicers to contact second lien holders and negotiate the extinguishment of the second lien. The servicers will receive a payment of \$500 per second lien modification, as well as success payments of \$250 per year for three years, as long as the modified first loan remains current.

Debt Ratios -The front end debt-to-income (DTI) target is 31 percent. The lender will first have to reduce the borrower's mortgage payments to no greater than a 38 percent front end DTI ratio. Treasury will then match the investor/lender dollar-for-dollar in any further reductions, down to a 31 percent front end DTI ratio for the borrower. Treasury has established a two percent floor below which it will not subsidize interest rates. Lenders and servicers could reduce principal rather than interest and would receive the same funds available for an interest rate reduction. Servicers must follow a strict step-by-step standardized formula known as the "Standard Waterfall" to achieve the 31 percent front-end DTI ratio.³⁰⁷

Counseling – If the borrower has a back-end DTI ratio of 55 percent or more, he or she must enter a debt counseling program.

Cost assessment of foreclosure versus modification – A Net Present Value (NPV) test is required for each loan that is in "Imminent Default" or is at least 60 days delinquent. First, servicers should determine the NPV of the proceeds from the liquidation and sale of a mortgaged property. Variables to take into account are:

1. The current market value of the property as established by a broker's price opinion, automated valuation methodology, or appraisal;
2. The cost of foreclosure proceedings, repair and maintenance of the property;
3. The time to dispose of the property if not sold at foreclosure auction;

³⁰⁶ U.S. Department of the Treasury, *Making Home Affordable: Program Update* (Apr. 28, 2009) (online at www.financialstability.gov/docs/042809SecondLienFactSheet.pdf).

³⁰⁷ Step 1a: Request Monthly Gross Income of borrower. Step 1b: Validate first lien debt and monthly payments. This information is used to calculate a provisional modification for the trial period. Step 2: Capitalize arrearage. Step 3: Target front end DTI of 31 percent and follow steps 4,5,6 in order to reduce borrower's monthly payment. Step 4: Reduce the interest rate to achieve target (two percent floor). The guidelines specify reductions in increments of 0.125 percent that should bring the monthly payments as close to the target without going below 31 percent. If the modified interest rate is above the Interest Rate Cap as defined by Treasury, then the modified interest rate will remain in effect for the remainder of the loan. If the modified interest rate is below the Interest Rate Cap, it will remain in effect for five years followed by annual increases of 1 percent until the interest rate reaches the Interest Rate Cap. The modified interest rate will then be in effect for the remainder of the loan. Step 5: If the Front end DTI target has not been reached, the term or the amortization of the loan may be extended up to 40 years. Step 6: If the Front end DTI target has still not been reached, it is recommended that the servicer forbear principal. If there is principle forbearance then a balloon payment of that amount is due upon the maturity of the loan, the sale of the property, or the payoff of the interest bearing balance.

4. Costs associated with the marketing and sale of the property as real estate owned; and
5. The net sales proceeds.³⁰⁸

Second, servicers should determine the proceeds from a loan modification. Treasury has established parameters for running the NPV for modification test.³⁰⁹ The NPV of the foreclosure scenario is then compared to an NPV for a modification scenario. If the NPV of the modification scenario is greater, then the servicer must modify the loan.

Home Price Depreciation Payments – Lender compensation will be provided to partially offset losses from home price declines. The payment is linked to declines in the home price index. The Administration, working with the FDIC, will provide up to \$10 billion for this program. The goal is to discourage servicers and lenders from pursuing foreclosure at the present due to weakening home prices.

Monitoring – Servicers are required to maintain records for verification/compliance reviews. All borrowers must fully document income, including a signed IRS 4506-T form, their two most recent pay stubs, and their most recent tax return. In addition, borrowers must also sign an affidavit of financial hardship. Property owner occupancy status will be verified through a borrower credit report and other documentation; no investor-owned, vacant, or condemned properties are eligible.

3. Issues Raised by Restructuring Models

The Helping Families Save Their Homes Act directed the Panel to produce a special report on farm loan restructuring. As part of the report, the Panel was asked to examine “any programs for direct loan restructuring or modification carried out by the Farm Service Agency of the Department of Agriculture, the Farm Credit System, and the Making Home Affordable Program of the Department of the Treasury.”

The Panel’s analysis of each of the three restructuring models first considers key factors that differentiate the lenders, the type of loans they offer, and the type of borrowers that they serve from the commercial bank farm credit market that would be affected by a potential TARP-based loan restructuring requirement. The analysis then proceeds to a discussion of the

³⁰⁸ Jordan D. Dorchuck. *Net Present Value Analysis and Loan Modifications*, Mortgage Bankers Association (Sept. 15, 2008) (online at www.mortgagebankers.org/files/Conferences/2008/RegulatoryComplianceConference08/RC08SEPT24ServicingJordanDorchuck.pdf).

³⁰⁹ The servicer may choose the discount rate for the calculation, although there is a ceiling set by the Freddie Mac Primary Mortgage Survey rate (PMMS), plus a spread of 2.5 percentage points. The servicer may apply different discount rates to loans in investor pools versus loans in portfolio. Cure rates and redefault rates must be based on GSE analytics. Servicers having at least a \$40 billion servicing book have the option to substitute GSE established cure rates and redefault rates with the experience of their own aggregate portfolios.

restructuring models themselves, issues raised by each model's inherent structure and operation, and possible challenges that could shape the effectiveness of the model should it be applied to commercial bank farm loans.

One general issue to consider when analyzing the applicability of any of the three models to the commercial bank farm credit market is the presence or lack thereof of junior liens. As evidenced by the residential mortgage market, junior liens can significantly complicate the restructuring process, because the junior lien holder has little incentive to extinguish the lien, but a primary mortgage cannot be restructured without such consent.³¹⁰ While it is not uncommon for farmers to have multiple lines of credit, not all farm loans are secured by real estate, and data are not available regarding the prevalence of second liens on farms. However, it should be noted that the extent to which second liens are present could ease or complicate the application of any of the loan restructuring models.

Finally, while within each model it is clearly paramount to compare the cost of loan restructuring with the cost of foreclosure to come to a rational decision on the direction in which to proceed, in comparing the restructuring models to each other, it can be expected that the cost of foreclosure in each case would be virtually the same. Therefore, it is important to consider the resources that restructuring loans through each of these processes would consume relative to each model's potential benefits. Data are not available on the relative value for the lender of farm loan restructuring compared to farm foreclosures, though bank and FCS witnesses at the Panel's field hearing indicated that they can often get better value via a loan restructuring than by prosecuting a foreclosure.³¹¹

a. FSA

Any attempt to transfer FSA's loan restructuring model to a wider group of borrowers must first keep in mind the unique nature of FSA and of those who utilize its loan products. First, given that FSA is the lender-of-last resort for the agriculture sector, FSA borrowers are

³¹⁰ As noted in the Panel's March report, *Foreclosure Crisis: Working Toward a Solution*, "Junior mortgages pose a significant obstacle to restructurings of first mortgages because of junior mortgagees' ability to free ride on modifications and hold up refinancings. Any modification that reduces payments on the first mortgage benefits the junior mortgagee because the modification frees up income that is available to service the junior mortgage. Because of this free riding problem, first mortgagees may be reluctant to engage in modifications."

It goes on to note "Junior mortgagees are able to stymie refinancings of first mortgages. Unless the junior mortgagee's consent is gained, the junior mortgage gains priority over the refinancer. As a result, refinancing is extremely difficult unless the junior mortgagee agrees to remain subordinated, and junior mortgagees often seek a payment for this. The problem is particularly acute with totally underwater junior mortgages, who only have hold-up value in their mortgage." Congressional Oversight Panel, *Foreclosure Crisis: Working Toward a Solution*, at 50 (Mar. 6, 2009) (online at cop.senate.gov/documents/cop-030609-report.pdf) (hereinafter "March COP Report").

³¹¹ See Congressional Oversight Panel, *COP Field Hearing in Greeley, CO, on Farm Credit* (July 7, 2009) (audio available online at cop.senate.gov/hearings/library/hearing-070709-farmcredit.cfm).

necessarily less creditworthy than borrowers at commercial banks and FCS (perhaps increasing the likelihood that foreclosure would be a rational option for FSA loans, but above all making FSA loans and borrowers distinct from those of other farm lenders). FSA, therefore, as a specialized institution, has programs designed specifically to meet the needs of the type of farmers that it serves, and the fact that FSA holds a small slice of overall farm debt – less than 2.5 percent – means that its model has never been attempted on a larger, sector-wide scale. The dollar amounts confronted by FSA in modifying loans are also a key difference between FSA and other lenders, as FSA loans must fall below statutory limits.

Of the various models examined in the previous section, restructuring based on FSA direct loan model would clearly be the most involved. The onus of taking action for a restructuring under this program falls on FSA, rather than the borrower. FSA is not only required by statute to notify the borrower of a potential default, but it is also required to lay out and present all of the options for restructuring a loan to the borrower. Under the FSA loan guarantee model, the lender must notify the borrower of a potential default; however, it is the borrower who must present the various options for restructuring to the lender. Representatives from FSA estimated that for each direct loan that FSA restructures, it spends about 40 hours of staff time processing and completing that restructuring.³¹² However, FSA currently uses a streamlined substitute process for loans that will be modified via reamortization or a deferral as opposed to an interest rate or principal reduction.³¹³ This process takes approximately 10 hours.

The time and individual attention that each loan receives, consequently, as well as USDA's knowledge of the agriculture sector that FSA brings to the process, is paramount to ensuring that the borrowers whose loans are modified do not become delinquent once again (FSA discussed the low re-default rate of modified FSA loans in its testimony at the Panel's Greeley, CO, field hearing).³¹⁴ This approach is only possible because roughly half of FSA's

³¹² These time estimates were provided to Panel staff by staff of the FSA, and the estimates are based on a Delphi study undertaken by the FSA in 2000 in an effort to determine staffing needs. In conducting the study, the FSA sampled county offices in regions across the country to estimate the amount of time required to complete different tasks, including loan restructuring.

³¹³ The regulations that guide the implementation of the FSA's loan restructuring program require that reamortization, rescheduling, and consolidation be considered prior to a deferral, and that all of these options be considered prior to moving to the more labor-intensive process of considering interest rate reduction or principal write down. See U.S. Department of Agriculture, Farm Service Agency, *FSA Handbook: Direct Loan Servicing – Special and Inventory Property Management*, at 4-51 and 4-71 (Dec. 31, 2007) (online at www.fsa.usda.gov/Internet/FSA_File/5-flp_r00_a06.pdf).

³¹⁴ See Congressional Oversight Panel, Testimony of Acting State Executive Director for Colorado, Farm Service Agency, Gary Wall, *COP Field Hearing in Greeley, CO, on Farm Credit* (July 7, 2009) (audio available online at cop.senate.gov/hearings/library/hearing-070709-farmcredit.cfm) (“After the loan is restructured, there are not a lot of accounts that go delinquent again because it is based on cash flow and history. We look at the history of that operation to determine what the history has been over the past and their yields and their income and their expenses. So after you work through those numbers and get it down to debt, defer, or whatever, they seem to continue on after you do it”).

mortgage modification administrative costs are paid for through direct appropriation (rather than a self-funding mechanism).³¹⁵

The involved nature of the process, as well as the specialized knowledge of the USDA farm loan officers who carry out the responsibilities of the restructuring process, offer a unique benefit to the FSA model. However, that involved process and specialized knowledge also make the process more difficult to replicate. Moreover, fundamental differences between FSA loans and borrowers and commercial loans and borrowers – and the share of farm debt held by FSA versus commercial banks – call into question the ease with which the FSA model could be applied.

b. Farm Credit System

The FCS holds a significantly larger share of total farm debt than FSA (indeed, a comparable amount to commercial banks), perhaps increasing the likelihood that its loan modification program could serve as a reasonable model for banks. However, there are several key aspects of the FCS model – and FCS itself – that could complicate the model's implementation at commercial banks.

The most important distinguishing factor for FCS is a general one: the FCS has a specific mandate to lend to farmers and those in rural America. Further, it is a relatively cohesive entity – 5 funding banks and 90 associations that make loans, and it is owned by the members who utilize the cooperatives. On the other hand, farm loans are a small portion of total loans and leases at the vast majority of commercial banks.³¹⁶ Consequently – as with FSA – when FCS modifies farm loans, it is doing so with a unique knowledge of the farm industry and its ebbs and flows, and the detailed list of items that FCS institutions must take into account when evaluating borrowers' proposals to modify their loans (to determine if the NPV of modifying the loan exceeds the NPV of foreclosure) requires knowledge of the peculiarities of the industry.

Further, the unique nature of the Credit Review Committee – to which borrowers may appeal if their proposal to restructure their loan is rejected by their FCS institution – including the requirement that a farmer-elected board member serve on the review committee, could complicate the application of the FCS model to commercial banks.

c. Making Home Affordable

There are a number of issues raised by the Home Affordable Modification Program that must be considered in analyzing the potential applicability of this loan restructuring model to distressed farm loans.

³¹⁵ See Omnibus Appropriations Act of 2009, Pub. L. No. 111-8, Title I.

³¹⁶ Farm loans (real estate and non-real estate) make up less than 2 percent of total loans and leases in the U.S. banking system. See FDIC First Quarter Call Report Data, *supra* note 149.

While both the HAMP loan modification program and any potential TARP-based loan modification for farm loans would be carried out by commercial banks, there are several critical differences between the residential mortgage sector and farm credit markets that deserve mention. First and foremost, problems in the housing sector – though particularly acute in some regions as opposed to others – are deep and pervasive, with sharply declining property values combining with high levels of exotic, adjustable-rate and subprime mortgages to wreak havoc on homeowners across America. Conversely, current or future stresses in the agriculture sector can be expected to be scattered and the result of challenges unique to specific regions, sectors, or, indeed, individual borrowers. Further, the farm sector did not see widespread use of the type of nontraditional loan products that amplified the crisis in the housing sector, nor did securitization – and the accompanying failure of some banks to maintain appropriate underwriting standards that so often resulted – ever take root to any great extent in the farm sector.

Considering the severe nature of the challenges in the housing sector, the HAMP loan modification program was, therefore, created with the goal of reaching a large number of homeowners, and the program’s guidelines for mortgage services are standardized so as to facilitate widespread implementation of the program. However, FSA and FCS officials, commercial banking groups, and representatives of the farm sector have all stressed that modifying farm loans is an inherently nuanced and labor-intensive process, not suited to rigid models. Unlike residential mortgage modifications, which examine more straightforward items such as debts, income, and asset value, farm loan restructurings must also examine business plans, cash flows, and market conditions. Therefore, the feasibility of providing standardized guidelines for modifying farm loans that would be effective industry-wide – or the necessity of doing so on anything near the scale of the HAMP – would need to be considered. This is particularly true given that farm loans do not merely cover a farmer’s home (if it is on his farm property) but are effectively business loans as well, and the ability of a farmer to repay is dependent on the idiosyncrasies of farm markets, volatile commodity prices, the farmer’s business plan and, ultimately, cash flow. Because of this additional complexity, scrutiny would need to be given to how the tools, mechanisms, and procedures for dealing with distressed home loans through the HAMP could also be modified before attempting to apply the model to farm loans.

In considering the impact of various loan restructuring models, policymakers should also consider the differing implications of whether a loan is more likely to be securitized or held on a bank’s books. While over two-thirds of residential mortgages originated since 2001 are securitized,³¹⁷ the percentage of farm loans securitized and sold into the secondary market remains quite low. This difference is important because lenders have different incentives to modify loans they hold in portfolio (and thus for which the lender would still hold all the risk) as compared to loans they merely service. It can also be easier to restructure portfolio loans,

³¹⁷ March COP Report, *supra* note 310, at 40.

because for securitized loans there are competing interests within segments of MBS owners, adding another layer of complexity.³¹⁸ This complexity can also impede foreclosure mitigation efforts, and it has been found that the foreclosure rate for securitized loans is higher than the rate for loans held on banks' balance sheets.³¹⁹ While the fact that farm loans are generally not securitized could work to make it easier to implement a farm loan restructuring program, in considering the usefulness of HAMP as a model, it important to keep in mind that HAMP was designed to be used principally in the highly securitized residential mortgage market, and thus includes incentives to overcome barriers that may not exist in the farm sector.

Additional considerations when contemplating applying the HAMP model to troubled farm loans are the effectiveness of the HAMP model itself in reducing preventable foreclosures and the incentive system that guides HAMP's implementation. With regard to the former, since HAMP is still in its early stages, its record is incomplete to assess its success fully (and thus incomplete to determine whether this would be an appropriate model to apply). While Treasury has reported contacting numerous borrowers and extending modification offers,³²⁰ it also acknowledges problems.³²¹

Finally, it should be noted that HAMP is an incentive based system, providing payments for various participants, and not requiring those banks that received TARP dollars prior to its implementation to participate in the program. In total, \$75 billion has been set aside for incentive payments. It is unclear what level of subsidization would be required for farm restructuring incentives. Nevertheless, it should be noted that, in the HAMP model, when compared with the others, the administrative costs are borne more directly by taxpayers.

4. General Issues for Policymakers to Consider

³¹⁸ March COP Report, *supra* note 310, at 46.

³¹⁹ Tomasz Piskorski et al., *Securitization and Distressed Loan Renegotiation: Evidence from the Subprime Mortgage Crisis*, University of Chicago Booth School of Business Working Paper, at 3 (Dec. 2008) (No. 09-02) (online at papers.ssrn.com/abstract=1321646) (finding a 19-33 percent decrease in the relative mean foreclosure rate among portfolio loans).

³²⁰ Congressional Oversight Panel, Testimony of Assistant Treasury Secretary for Financial Stability Herbert Allison, Jr., *Hearing with Assistant Treasury Secretary Herbert Allison* (June 24, 2009) (online at cop.senate.gov/hearings/library/hearing-062409-allison.cfm) ("We have now over 200,000 offers for modifications out there"). *See also* U.S. Department of the Treasury, *Making Home Affordable Progress Report* (May 14, 2009) (online at <http://www.ustreas.gov/press/releases/docs/05142009ProgressReport.pdf>) ("The 14 participating servicers have... mailed out over 300,000 letters with information about trial modifications to borrowers").

³²¹ Congressional Oversight Panel, Testimony of Assistant Treasury Secretary for Financial Stability Herbert Allison, Jr., *Hearing with Assistant Treasury Secretary Herbert Allison* (June 24, 2009) (online at cop.senate.gov/hearings/library/hearing-062409-allison.cfm) (In reply to Mr. Neiman's assertion that the HAMP program was plagued by confusion and delays, Assistant Secretary Allison replied: "We certainly are concerned...I think we need to keep in mind that this is a massive program of a size never before attempted.") (In reply to questions regarding fraud-prevention policies, Secretary Allison stated: "we're doing our best with a system that wasn't designed for this type of a crisis and trying to make the best of it as it exists.").

a. Need

In assessing the state of the farm credit markets and considering the use of loan restructuring as an alternative to foreclosure by TARP recipients, policymakers must first determine whether there is a need. To make such a determination, the Panel's analysis examined a number of factors including: the demand for and availability of credit in the agriculture sector, charge-offs and delinquencies of agricultural loans, values of farm real estate and bank holdings of farmland, debt-to-asset ratios of farmers, and farm income and profitability.

At the Panel's July 7th field hearing in Greeley, CO, Michael Scuse, Deputy Undersecretary of USDA's Farm and Foreign Agricultural Services (FFAS), noted the following:

Reports from the Federal Reserve and other sources indicate there is a tightening of credit for farmers and ranchers around the country. A combination of limited or negative returns in much of the livestock industry, reduced profit margins in crop production, and increased sensitivity to credit risk has caused many farm lenders to raise their credit standards, reduce the amount they are willing to lend in agriculture, or both. Many lenders report that increased scrutiny from regulators has caused them to raise credit standards significantly. Activity in FSA's farm loan programs certainly indicates that less commercial credit is available to farmers at the present time.³²²

While Federal Reserve data may indicate some tightening of credit in agricultural lending, the data are mixed, and the actual availability of credit in the months ahead remains unclear. Five of the six Federal Reserve district first quarter agricultural lending surveys show that approximately 70 percent of banks reported either the same or higher demand for farm operating loans as compared to a year earlier. However, in one district (Richmond) 48 percent of its bank respondents said demand for such loans was lower compared to a year ago.³²³ Three district surveys (Chicago, Richmond, and Dallas) show 80 percent, 60 percent, and 61 percent of banks expecting the same or higher volume of real estate loans in the next quarter as compared to a year earlier.³²⁴ However, four districts also reported a rise in the percentage of banks referring loan applicants to non-bank agencies (for example, FSA) as compared to a year earlier.³²⁵ Overall, the survey results are mixed, and this is an area that merits further monitoring.

Deputy Undersecretary Scuse's testimony before the Panel also highlights the increased demand for FSA's direct and guaranteed operating loan programs. Of particular note, "45 percent of the direct operating loans approved in FY2009 were for customers who did not have

³²² Scuse Testimony, *supra* note 64.

³²³ Second Quarter Fed Databook, *supra* note 2, Table C.1.

³²⁴ Second Quarter Fed Databook, *supra* note 2, Table C.1.

³²⁵ Second Quarter Fed Databook, *supra* note 2, Table C.1.

existing FSA operating loans,” which according to Secretary Scuse is normally “about 20 percent.”³²⁶ There are a number of factors that could explain the increase in demand in addition to a tightening of credit in the commercial credit markets. The increase could also be due in part to recent expansions in the FSA direct operating loan program itself. The program received an additional \$173 million in authority under the American Recovery and Reinvestment Act signed into law earlier this year. Moreover, the 2008 Farm Bill raised the lending limit for FSA direct loans from \$200,000 to \$300,000.³²⁷

Federal Reserve data on commercial bank delinquencies and charge-offs on loans to finance agricultural production show a steady uptick in each of the last four quarters. The delinquency rates on agricultural loans (seasonally adjusted) were 1.06 percent in the first quarter of 2008; 1.11 percent in the second quarter of 2008; 1.23 percent in the third quarter of 2008; 1.43 percent in the fourth quarter of 2008; and 1.71 percent in the first quarter of 2009. Charge-off rates for agricultural loans (seasonally adjusted) were .08 percent in the first quarter of 2008; .16 percent for the second quarter of 2008; .18 percent in the third quarter of 2008; .28 percent in the fourth quarter of 2008; and .42 percent in the first quarter of 2009.³²⁸ Despite a steady increase, commercial bank delinquency rates and charge-offs put into the context of the last 20-25 years are still quite low. Commercial bank delinquency rates (seasonally adjusted) peaked at 9.08 percent in the first quarter of 1987, and have not risen above 2 percent since the fourth quarter of 2003. Commercial bank charge-off rates (seasonally adjusted) peaked at 5.23 percent in the fourth quarter of 1985, but have only once topped 1 percent (1.03 percent in the third quarter of 2001) since the second quarter of 1988.³²⁹

Of concern to the Panel is the increase in the value of commercial bank holdings of farmland, which may indicate an increase in farm loan foreclosures. The value of farmland in bank possession more than doubled last year, increasing from \$60.7 million in the first quarter of 2008 to \$122.4 million in the first quarter of 2009. While the average value per acre of farmland in the U.S. reached a record high of \$2,170 per acre in 2008 (an increase of 7.96 percent from 2007), the overall increase in farmland value alone cannot explain the increase in the value of farmland held by banks. The current value of farmland held in bank possession is still well below the level reached in 1992 (when it exceeded \$424 million), however, the increase in the first quarter of 2009 is significant and merits careful observation by Congress.

Finally, on a more positive note, the Panel notes that the national debt-to-asset ratio for farmers is at a historically low level, and that the average U.S. farm operator household income,

³²⁶ Second Quarter Fed Databook, *supra* note 2, Table C.1.

³²⁷ Food, Conservation, and Energy Act of 2008, Pub. L. No. 110-246 (codified at 7 U.S.C § 1925 (a)).

³²⁸ See Board of Governors of the Federal Reserve System, *Federal Reserve Statistical Release: Charge-Offs and Delinquency Rates on Loans and Leases at Commercial Banks* (online at www.federalreserve.gov/releases/chargeoff/chgallsa.htm).

³²⁹ *Id.*

which has surpassed overall average U.S. household income every year since 1996, appears strong. However, the Panel also notes the increasing reliance of farmers on non-farm sources of income, which in 2009 is expected to exceed 95 percent for the first time in history³³⁰. While it is unclear how this increasing reliance on non-farm sources of income will affect farmers' future ability to pay off their agricultural loans, this is an area that also bears watching. As stated earlier, the rising dependence on off-farm income could make small farms increasingly vulnerable to outside economic conditions.

In determining the immediate need for a restructuring mandate of agricultural loans by TARP recipients, the Panel's analysis is inconclusive. Several factors such as generally low delinquency and charge-off rates, a historically low farmer debt-to-asset ratio, and record U.S. farm operating income levels suggest that an agricultural restructuring requirement may be premature. However, other factors such as a possible tightening of the farm credit markets, an uptick in the delinquency and charge-off rates, an increase in the value of commercial bank holdings of farmland, and a growing reliance of farmers on non-farm sources of income remain areas of concern for the Panel and deserve further monitoring. If trends in these areas continue, the need for a restructuring mandate may be clearer.

b. Other Options for Farmers

Congress has other tools available that may provide indirect relief for distressed farm loans. Most troubled loan situations arise from insufficient repayment capacity. Therefore, other programs providing assistance to farmers have the potential to ease a distressed loan situation

Congress has established a variety of programs to assist struggling farmers, whether they specialize in some type of commodity crop or livestock production. This assistance is provided through a wide array of government initiatives, including fixed direct payments, counter cyclical payments, marketing loan benefits, conservation grants, emergency relief, and income loss contract payments. According to USDA, 40 percent of farms received government payments in 2007, averaging \$9,792 per operation.³³¹ The current recession has, however, affected all sectors of the economy, including agriculture. Net farm income and farmer net cash income, which reached record levels in 2008, are expected to decline dramatically in 2009.³³² It is noteworthy that government assistance through direct payments is also expected to decline in 2009.³³³ Direct government payments are forecast at \$11.4 billion in 2009 (comprising over 16 percent of

³³⁰ U.S. Department of Agriculture, *The 2008/2009 World Economic Crisis: What It Means for U.S. Agriculture* (Mar. 2009) (online at www.ers.usda.gov/Publications/WRS0902/WRS0902.pdf).

³³¹ U.S. Department of Agriculture, Economic Research Service, *Farm Income and Costs: 2009 Farm Sector Income Forecast* (online at www.ers.usda.gov/Briefing/FarmIncome/nationalestimates.htm) (accessed July 20, 2009).

³³² *Id.*

³³³ *Id.*

total net farm income expected for 2009), which is down about 8 percent from \$12.4 billion in 2008, and well below the record of \$24.4 billion in 2005.³³⁴ The decline can be explained in large part due to a \$2.4 billion decrease in emergency disaster assistance expected for 2009. Emergency disaster assistance is projected to be only \$0.26 billion in 2009.³³⁵ While the 2008 Farm Bill created a permanent fund for disaster assistance, many agricultural producers will not receive payments until 2010.³³⁶

Other payments are projected to increase. The lower market prices forecast for 2009 are expected to generate moderate increases in payments under two major price contingent programs, counter-cyclical payments (CPP) and marketing loan benefits.

As mentioned earlier in the report, dairy has been the hardest hit of all farm sectors. There are two federal programs that assist dairy farmers by providing price supports for dairy products: the Milk Income Loss Contract Program (MILC) and the Dairy Product Price Support Program (DPPSP). Payments under both programs have already been triggered. Under the DPPSP, the Commodity Credit Corporation (CCC) purchases surpluses of nonfat dry milk, cheese, and butter from dairy processors. CCC expects to remove 234 million pounds of dry nonfat dry milk this year; it removed 111 million pounds of nonfat dry milk in 2008.³³⁷ In addition, in February of this year, USDA started making payments to participating dairy farmers under MILC, another federally sponsored price support system. Federal MILC payments are expected to amount to \$700 million in 2009.³³⁸

In testimony before the Panel, Les Hardesty, Chairman of the Dairy Farmers of America Mountain Area Council, suggested that dairy farmers might best be helped through the Commodity Credit Corporation (CCC). Mr. Hardesty testified that “if TARP funding was used temporarily to increase the CCC [Commodity Credit Corporation] purchase price for cheese and nonfat dry milk, all of those products could go back immediately into food assistance programs.”³³⁹

Crop growers also have various options for assistance. Crop insurance policies cover many major crops in most areas of the country. In total, crop insurance is available for more than 100 crops. Four major crops – corn, cotton, soybeans, and wheat – account for more than

³³⁴ *Id.*

³³⁵ *Id.*

³³⁶ Public Law No. 110-246.

³³⁷ U.S. Department of Agriculture, Economic Research Service, *Livestock, Dairy, and Poultry Outlook* (January 2009) (See online at: <http://www.ers.usda.gov/publications/ldp/2009/06Jun/ldpm180.pdf>).

³³⁸ U.S. Department of Agriculture, Economic Research Service, *Farm Income and Costs: 2009 Farm Sector Income Forecast* (See online at: <http://www.ers.usda.gov/Briefing/FarmIncome/nationalestimates.htm>).

³³⁹ Hardesty Testimony, *supra* note 65

two-thirds of sectors covered by crop insurance.³⁴⁰ Certain livestock and dairy producers are also covered under various pilot programs designed to protect producers from loss of gross margin or price declines. Another potential avenue of assistance for crop farmers is the Average Crop Revenue Election (ACRE) program, which was created in the 2008 Farm Bill. According to the Food and Policy Research Institute, “ACRE is a voluntary program that makes payments to producers when state per acre revenues for a particular commodity fall below a trigger tied to a moving average of national prices and state level yields.” The FPRI predicts that “ACRE is likely to be attractive to grain and oilseed producers, providing more payments on average than the traditional payments that program participants must agree to forgo.”³⁴¹

While these options incur a cost for taxpayers, some loan restructuring models, such as the housing foreclosure mitigation program, also require taxpayer funding. These programs provide Congress with possible alternatives, but could allow more specific targeting, thereby matching assistance to the sectors and areas of greatest need.

c. Effect on TARP Participation

Congress must also consider the possible effect on TARP, and what changing the rules could mean for both current and future participants of either TARP or any other federal effort to address the financial crisis. In its July oversight report on TARP repayments, the Panel noted that a “motivation for prompt repayment of TARP investments has to do with the specific rules or conditions to which TARP recipients are subject.”³⁴² “Changing of rules” was a concern specifically addressed in a memo dated March 30, 2009, from the American Bankers Association to Members of Congress regarding legislation that would have further restricted compensation of employees at TARP recipient banks.

Beyond this unfairness to these institutions and bank employees, there is a much broader concern about how banks can be involved with the government in stimulating the economy when the rules keep changing. The intention of the CPP [Capital Purchase Program] was to stimulate new lending and to provide healthy, well-run banks with capital to weather the economic storm. The changes proposed send the opposite message. They signal to any strong, viable bank that any involvement by the government in the business of private enterprise brings with it

³⁴⁰ Congressional Research Services, *Federal Crop Insurance: Background and Issue* (April 17, 2009) (See online at: <http://www.nationalaglawcenter.org/assets/crs/R40532.pdf>).

³⁴¹ Food and Policy Research Institute (FPRI) 2009 U.S. and World Agricultural Outlook, (January 2009).

³⁴² Congressional Oversight Panel, *July Oversight Report: TARP Repayments, Including the Repurchases of Stock Warrants* (July 2009).

significant risk and costs, not the least of which is the unilateral changing of rules at any time.³⁴³

In its May report, the Panel noted that investors had questions as to whether or not investors of the Term Asset-Backed Securities Loan Facility (TALF) would be subject to conditions placed on participants in the TARP generally.³⁴⁴ In fact, the prime reason cited for modest participation in TALF was uncertainty regarding the political risks of participation. TALF participants desired clear and unambiguous statements from both executive and congressional officials. In an April 18th speech, William Dudley, President of the Federal Reserve Bank of New York, said the following: “the effectiveness of some of the Fed facilities have been undercut by stigma... or by worries about what other strings are or might be attached to the use of the facilities...”

One reason why the TALF has gotten off to a relatively slow start is the reluctance of investors to participate... Some investors are apparently reluctant not because the economics of the program are unattractive, but because of worries about what participation might lead to. The TARP loans to banks led to intense scrutiny of bank compensation practices given that TALF loans are ultimately secured by TARP funds, investor anxiety about using the program has risen.³⁴⁵

Unlike FSA and FCS, a TARP recipient bank could choose to avoid a loan restructuring mandate by repaying its loan and exiting the TARP program. Other banks could choose to avoid a TARP recipient bank restructuring mandate by declining to participate in TARP in the first place. Yet, Treasury has made repeated efforts to improve participation. On May 13, Treasury tried to bolster the participation of smaller community banks by extending their application deadline for the Capital Purchase Program by another six months.³⁴⁶ Later that month, Treasury also tried to encourage all financial institutions in need of further capital from Treasury to seek such capital by extending the application deadline for the Capital Assistance Program by another

³⁴³ See Memorandum from Floyd Stoner, American Bankers Associations to Members of the House of Representatives (March 30, 2009) (online at www.aba.com/NR/rdonlyres/76DCD307-2D7E-48A6-A10F-623175F0AEAD/59034/ExecComp_ABAHouseLetter_033009.pdf).

³⁴⁴ Congressional Oversight Panel, *May Oversight Report, Reviving Lending to Small Businesses and Families and the Impact of TALF* (May 2009).

³⁴⁵ See Federal Reserve Bank of New York, *Prepared Remarks by William C. Dudley, President and Chief Executive Officer, at Vanderbilt University: The Federal Reserve's Liquidity Facilities* (Apr. 18 2009) (online at www.newyorkfed.org/newsevents/speeches/2009/dud090418.html) (characterizing fears expressed by some investors that participation in TALF may lead to increased regulation of investor practices as “misplaced” but “understand[able]... given the political discourse” and the “intense scrutiny of bank compensation practices” that arose from TARP investments in financial institutions).

³⁴⁶ U.S. Department of the Treasury, *Frequently Asked Questions Regarding the Capital Purchase Program for Small Banks* (online at www.financialstability.gov/docs/CP/FAQonCPPforsmallbanks.pdf) (accessed July 17, 2009).

six months as well.³⁴⁷ However, Congress must consider whether conditionality would run counter to Treasury's objective by impacting participation in these and other TARP-related programs. Ultimately, Congress will have to weigh the potential cost of creating a mandate against the potential benefits of an agricultural loan restructuring requirement.

d. Effect on Farm Credit Availability

Policymakers must also consider the potential impact of a restructuring mandate for TARP recipient banks on farm credit availability. Commercial banks are for-profit businesses; therefore, any mandate affecting their cost of doing business will likely have some influence on their lending decisions. Unlike FSA and FCS, commercial banks have no exclusive mandate to serve farm markets. Should banks perceive the cost of providing farm loans as too high, they are free to shift their resources to other markets.

Lenders, particularly large lenders for whom agricultural lending is a small piece of their portfolios, may simply exit the farm credit market if the cost of doing business becomes too onerous. Yet, while farm loans may be a small percentage of their portfolio, large banks are an important source of farm loans, providing 36 percent of commercial bank farm credit. The loss of a large lender could diminish farm credit availability.

When a commercial bank withdraws from the local farm credit market, the results can be quite harsh, as demonstrated by New Frontier Bank in Greeley, CO. The absence of this commercial bank farm credit provider has left a dearth of farm credit. There is not sufficient credit capacity with the remaining credit providers to fill the void quickly or easily.

The three possible loan restructuring mandate models have differing approaches to administrative costs. The Making Home Affordable program offers numerous incentives, designed to help offset the administrative costs of a restructuring. By contrast, the FSA and FCS models would leave the administrative costs with the banks, possibly to be passed through to the borrowers.

e. Benefits to the Taxpayer

Finally, Congress may also consider taxpayer fairness in determining the use of a loan restructuring requirement, and whether TARP-recipient banks that lend to agriculture should have to conform to the practices of other federally subsidized agricultural lenders. FSA is a government agency and is directly subsidized by the federal government. FCS is a quasi-government entity or GSE that is also subsidized by the federal government, albeit to a lesser extent. Both are lenders of agricultural loans and both have a loan restructuring requirement. Comparatively, a commercial bank that is a recipient of billions of dollars in TARP funds is also

³⁴⁷ U.S. Department of the Treasury, *FAQs on Capital Purchase Program Repayment and Capital Assistance Program* (online at www.financialstability.gov/docs/FAQ_CPP-CAP.pdf) (accessed July 17, 2009).

subsidized by the federal government. However, taxpayers, who are providing the funding for TARP, do not enjoy the option of a loan restructuring requirement from TARP-recipient banks like they enjoy from FSA and FCS.

E. Conclusion

Unlike many other sectors, over the last few years farm lending has featured positive signs, both for borrowers and lenders. The agriculture sector posted record profits and had historically low debt to asset ratios. Farm loan delinquency rates were also at historic lows. Even as farm news has been generally positive in recent years, the news has not been universally good. Some sectors, such as dairy, have faced tough economic times brought on by high input costs and low milk prices.

It now appears that some of the stresses in the rest of the economy may be catching up to the farm sector. While still within historic averages, recent quarters have revealed deeply worrisome trends. Credit availability appears to be tightening, and demand for loans from USDA, the lender of last resort, has increased notably. Lenders have reported a steady rise in loan delinquencies and charge-offs. Of particular concern is the projection that farm income will fall by 20 percent this year and that farm families have an increasing reliance on non-farm income.

Unfortunately, farm credit data are incomplete. While the available data reveal some troubling trends, the existing data make it extremely difficult to predict the potential length and depth of these trends with any certainty. Without definitive data, it is difficult to draw definitive conclusions or to make definitive recommendations at this time. Thus, the Panel's first recommendation is that all available data should be closely monitored going forward. It is critical to track the direction of these trends.

As noted in the Panel's March report on residential mortgage foreclosure mitigation, in order for Congress and regulators to respond properly and promptly to issues in the market, better information is needed. Congress should create a farm loan performance reporting requirement to provide a source of comprehensive intelligence about loan performance, loss mitigation efforts and foreclosure. Banking regulators, USDA, and FCS could be required to analyze these data and to make the data and their analysis public. To the extent that lenders already report delinquency and foreclosure data to credit reporting bureaus, the additional cost of federal reporting would be quite modest, but the better information could be very valuable both in identifying problems and in working out policy responses.

It is possible that the current negative economic trends in agriculture may level out or even reverse. In its ten-year projection released in February 2009, USDA projected that net farm income would decline in the near term from the high levels of 2007 and 2008, but remain

historically strong and rebound to near record levels by the end of the projections (2018).³⁴⁸ Like all projections, however, this is based on critical long-term assumptions based on a number of factors. If the situation in the farm sector improves, Congress could determine that no action to mitigate farm loan foreclosures is necessary. On the other hand, it is possible that current trends may continue or even worsen. If the situation deteriorates, Congress has a range of possible responses:

One possibility, and the topic of this report, is a farm loan restructuring mandate for TARP recipient banks. Congress could impose a restructuring mandate on TARP banks, following the pattern of the obligations imposed on lenders by FSA, FCS, or the Making Home Affordable program. Each model offers one possible means to require restructuring, but would require some amount of adaptation to fit the TARP recipient banks' loan model.

While it is an option, mandatory modifications might not be the most effective policy choice because of the limited number of farm loans held by TARP recipient banks. Commercial banks hold only 45.42 percent of overall farm debt. When considering real estate debt, the form of debt most likely to be collateralized by real estate, commercial banks hold an even smaller piece of total farm debt, only 37.67 percent. Further, TARP recipient banks only hold 27.46 percent of the commercial bank portion of total farm real estate bank loans or ten percent of all farm debt. Thus, a restructuring mandate for TARP recipient banks would have limited reach. Over time, TARP recipient banks are likely to play a diminishing role in the farm credit arena as banks continue to return their TARP funding to the government. Already, banks holding 2.54 percent of total commercial farm bank debt have returned their TARP funding.³⁴⁹ With Wells Fargo, the nation's largest agricultural lender, seeking to return its TARP dollars at the "earliest practicable date," the share of farm loans held by TARP institutions is likely to dwindle further.³⁵⁰

Congress and Treasury have other options within TARP to protect farm homes, just as they have embraced the principle of using TARP to protect non-farm homes. They could apply this principle in different ways. One possibility would be to devote some portion of the remaining TARP funding to a farm mortgage foreclosure mitigation program, patterned on the incentive-based program developed to protect homes, but focusing on bank participation that extends beyond current TARP recipients. Unlike residential mortgage restructurings, farm loan restructurings must also consider business plans, cash flows, and market factors. Therefore, the model would need to be adapted to provide the necessary flexibility. Another option for utilizing

³⁴⁸ USDA Long-Term Projections, *supra* note 16.

³⁴⁹ FDIC First Quarter Call Report Data, *supra* note 149; TARP Transactions Report, *supra* note 156.

³⁵⁰ Tom Petruno, *Wells Fargo Says It Will Hold on to TARP Money for Now* (June 9, 2009) (online at latimesblogs.latimes.com/money_co/2009/06/wells-fargo-co-didnt-want-a-federal-capital-infusion-last-fall-but-got-one-anyway-now-despite-its-earlier-objection.html).

TARP money is to create a loan guarantee program for restructured farm loans. Both FCS and banks have indicated that FSA's loan guarantees are important to their ability to restructure troubled farm loans, yet the demand for such loans nearly always exceeds the supply. TARP could help ensure that guarantees are available to help lenders conduct successful restructurings.

If the farm sector continues to decline, Congress has options outside the TARP program. The U.S. government has a longstanding commitment to farmers. This is embodied through the numerous existing programs designed to assist the farm industry, many of which are targeted toward different needs or sectors. If Congress determines that the farm sector in part or in whole needs assistance, then such assistance could be delivered through existing programs. While having a potentially wider impact than a TARP bank mandate, this alternative could also allow assistance to be narrowly targeted, such as to the struggling dairy industry.

While most people now live in cities rather than on a farm or ranch and most people earn a living at an office rather than in the fields, agriculture remains central to our nation. We rely on our nation's farmers and ranchers to provide us with a steady, safe food supply. Congress has a long history of acting to help maintain a robust agriculture sector while also ensuring the survival of the family farm. We offer this analysis of the current farm credit situation in that spirit.

Section Two: Additional Views

A. Damon Silvers

I wish to make the following additional points:

As is the case in housing, foreclosure is usually a mutually destructive option in farm lending. This was confirmed in our hearing in Greeley, CO, by witnesses from the banking industry and the Farm Credit System.

In other instances where federal money or guarantees are injected into the farm credit system, the Congress has required various forms of foreclosure mitigation policies to be adopted by lenders.

It is clearly the policy of the Treasury Department in administering TARP to seek to prevent home foreclosures, and properly so, given the explicit mandate in the EESA to do so.

It should be the policy of the Treasury Department to administer TARP in such a manner to encourage TARP recipient banks to pursue options other than foreclosure in dealing with troubled loans to family farmers.

B. Rep. Jeb Hensarling and Senator John E. Sununu

Although we commend the Panel and its staff for their efforts in producing the Special Report on Farm Loan Restructuring under a tight time frame, we do not concur with the all of the analysis and conclusions presented in the report.

We do agree with the Panel's conclusion that agriculture is a vital part of our nation's economy. However, we think a retroactive restructuring mandate would burden TARP recipients unduly and amplify the overall risk of extending credit to borrowers, causing adverse ripple effects to the farm industry it intends to assist.³⁵¹ In addition, such action would send the wrong message to the private sector and enhance the uncertainty associated with participation in public sector programs. The tepid response to the TALF program and the protracted start-up period for the PPIP program are attributable in part to the concern that private sector participants may be subjected to burdensome rules and regulations on a retroactive basis. Private sector participants have taken a circumspect and guarded approach to public sector programs, and the Panel's suggestion that Congress sanction a retroactive restructuring mandate for TARP recipients is clearly counterproductive.³⁵²

More significantly, we are troubled that the private sector must now incorporate the concept of "political risk" into its due diligence analysis before engaging in any transaction with the United States government.³⁵³ While private sector participants are accustomed to operating

³⁵¹ In this regard, we refer only to TARP recipients that have not repaid all amounts owed to the United States government. It is our understanding that no member of the Panel advocates the imposition of any restructuring mandate on any TARP recipient that has repaid all such amounts.

³⁵² Many recipients have been stigmatized by their association with TARP and wish to leave the program as soon as their regulators permit. Some of the adverse consequences that have arisen for TARP recipients include, without limitation, executive compensation restrictions, corporate governance and conflict of interest issues, employee retention difficulties, and the distinct possibility that TARP recipients (including those who have repaid all Capital Purchase Program advances but have warrants outstanding to Treasury) may be subjected to future adverse rules and regulations. In our opinion, the TARP program should be terminated due to, among other reasons: (1) the clear desire of the American taxpayers for the TARP recipients to repay all TARP related investments sooner rather than later; (2) the troublesome corporate governance and regulatory conflict of interest issues raised by Treasury's ownership of equity interests in the TARP recipients; (3) the stigma associated with continued participation in the TARP program by the recipients; and (4) the demonstrated ability of the current Administration to use the program to promote its economic, social, and political agenda. Rep. Hensarling introduced legislation (H.R. 2745) to end the TARP program on December 31, 2009. In addition, the legislation (1) requires Treasury to accept TARP repayment requests from well capitalized banks; (2) requires Treasury to divest its warrants in each TARP recipient following the redemption of all outstanding TARP-related preferred shares issued by such recipient and the payment of all accrued dividends on such preferred shares; (3) provides incentives for private banks to repurchase their warrant preferred shares from Treasury; and (4) reduces spending authority under the TARP program for each dollar repaid.

³⁵³ While scholars have not agreed on a single definition of "political risk," the term generally refers to the inappropriate interference of the public sector in the affairs of the private sector.

within a complex legal and regulatory environment, many are unfamiliar with the emerging trend of public sector participants to bend or restructure rules and regulations so as to promote their economic, social, and political agenda. The realm of political risk is generally reserved for business transactions undertaken in developing countries and not interactions between private sector participants and the United States government. Private sector participants are beginning to view interactions with the United States government through the same jaundiced eye they are accustomed to directing toward third-world governments. It appears somewhat ironic that the Panel champions transparency and accountability for the private sector but fails to note that retroactive mandates are their public sector antithesis. How is it possible for directors and managers of private sector enterprises to discharge their fiduciary duties and responsibilities when policy makers legislate and regulate without respect for precedent and without thoughtfully vetting the unintended consequences of their actions?

The business community is sorting through this sea change and may appear intimidated by the Administration. The public sector should not, however, view the reticence of the private sector to challenge the Administration and Congress as acquiesce to their policies. Time will tell, but the private sector has no doubt learned much from the circuitous and unpredictable nature of the TARP, TALF, and PPIP programs, as well as from the treatment of the non-UAW creditors in the Chrysler and GM bankruptcies.³⁵⁴ Any suggestion by the Panel that Congress should consider the imposition of a retroactive restructuring mandate on TARP recipients is not helpful in restoring a sense of confidence between the private and public sectors.

³⁵⁴ It will be interesting to note if the cost of capital of business enterprises with large unionized workforces increases after the treatment of the private sector secured and unsecured creditors in the Chrysler and GM bankruptcies.

Section Three: About the Congressional Oversight Panel

In response to the escalating crisis, on October 3, 2008, Congress provided Treasury with the authority to spend \$700 billion to stabilize the U.S. economy, preserve home ownership, and promote economic growth. Congress created the Office of Financial Stabilization (OFS) within Treasury to implement a Troubled Asset Relief Program. At the same time, Congress created the Congressional Oversight Panel to “review the current state of financial markets and the regulatory system.” The Panel is empowered to hold hearings, review official data, and write reports on actions taken by Treasury and financial institutions and their effect on the economy. Through regular reports, the Panel must oversee Treasury’s actions, assess the impact of spending to stabilize the economy, evaluate market transparency, ensure effective foreclosure mitigation efforts, and guarantee that Treasury’s actions are in the best interests of the American people. In addition, Congress instructed the Panel to produce a special report on regulatory reform that analyzes “the current state of the regulatory system and its effectiveness at overseeing the participants in the financial system and protecting consumers.” The Panel issued this report in January 2009.

On November 14, 2008, Senate Majority Leader Harry Reid and the Speaker of the House Nancy Pelosi appointed Richard H. Neiman, Superintendent of Banks for the State of New York, Damon Silvers, Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL-CIO), and Elizabeth Warren, Leo Gottlieb Professor of Law at Harvard Law School to the Panel. With the appointment on November 19 of Congressman Jeb Hensarling to the Panel by House Minority Leader John Boehner, the Panel had a quorum and met for the first time on November 26, 2008, electing Professor Warren as its chair. On December 16, 2008, Senate Minority Leader Mitch McConnell named Senator John E. Sununu to the Panel, completing the Panel’s membership.