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

Credit Conditions

The farm economy strengthened in 2010. However, farm income, especially net farm income, is very unevenly distributed. Much of the improvement in farm economic conditions is driven by higher commodity prices. While higher prices have been beneficial for some crop producers, they have also resulted in higher feed costs which are squeezing profits among livestock and dairy producers.

A combination of higher commodity and energy prices is significantly increasing the amount of capital required to finance agricultural production. Crop-related expenses grew 77 percent between 2002 and 2008, and are expected to rise by 9.5 percent in 2011. Livestock expenses increased by 64.4 percent between 2002 and 2008, and are forecast to increase by 6.8 percent in 2011. These higher production costs increase the demand for operating credit, increase financial leverage, and strain liquidity.

Recent Federal Reserve Surveys indicate commercial lenders in most regions are continuing to maintain stringent credit standards. Concerned that a combination of factors may be pushing farmland values quite high, the Federal Deposit Insurance Corporation has issued guidance to its examiners to scrutinize farm loans more rigorously, particularly in financial institutions with a concentration of farm lending. The combination of high feed and other input costs, increased operating capital needs, and a continued high level of loan scrutiny by lenders means some farmers are still being denied commercial credit.

FSA Farm Loan Programs. Family farmers who are denied commercial credit due to lender standards, but are otherwise creditworthy, can turn to the farm loan programs administered by FSA. The Agency assists farmers through direct and guaranteed farm loans. Direct loans are made and serviced by FSA; agency employees provide supervision and technical assistance to direct loan borrowers. Direct loans are not intended to be a permanent source of credit and borrowers agree to obtain commercial credit and refinance their FSA debts when they are able to do so.

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

Funding. FSA farm loan programs are discretionary programs funded through annual

appropriations. In accordance with the Federal Credit Reform Act of 1990 (as amended), appropriations for FSA farm loans are based on the projected total cost of loans when they are made. Federal budget resources are able to be significantly leveraged through the loan programs. In Fiscal Year (FY) 2010, for example, \$155.3 million in appropriations supported \$5.29 billion in direct and guaranteed FSA loans.

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

In early FY 2009, loan demand surged to levels that had not been seen since the early 1980s. Demand for farm loan program assistance in FY 2009 and FY 2010 reached its highest levels since FY 1985. Demand has continued at, and in some programs increased above, those near-record FY 2009 levels (Chart 1). Use of the guaranteed farm ownership program in FY 2010 reached an all-time high. FY 2010 direct operating and farm ownership obligations nearly doubled compared to FY 2008 levels. Application activity in FY 2011 reflects demand levels similar to the higher levels of FY 2009 and FY 2010. The demand for new loans in FY 2011 is in addition to the credit provided through the \$7.97 billion in direct loans and \$10.35 billion in guaranteed loans outstanding in the FSA portfolio at the beginning of the fiscal year. To manage the increase demand, FSA has proposed shifting budget authority from the guaranteed operating loan interest assistance program, where demand is down, to the direct operating loan program and the guaranteed farm ownership loan program, where a shortfall is expected. On June 27, 2011 Secretary Vilsack signed letters to the Chairmen and Ranking Members of the appropriate Appropriations Subcommittees of the House and Senate, advising them of the proposed transfer. The planned transfer will fund the approved and pending applications for direct operating loans and provide adequate guaranteed ownership funding for the remainder of FY 2011. Some, but not all of the unfunded direct ownership loans will be funded from other transfers that are required by law in August and September.

Over the past 2 years, an unusually high number of direct operating loan applications have been received from new customers. Normally, about 20 percent of direct operating loan applications in any given year are from farmers who do not have FSA loans. Since 2009, over 40 percent of direct operating loan applications have been from farmers who are not FSA borrowers. As of July 7, 2011, 44 percent of the direct operating loans made in FY 2011 were to customers who did not have existing FSA operating loans.

Performance and Portfolio Conditions

Farm loan programs continue to emphasize the importance of processing applications in a timely manner. Between FY 2001 and FY 2011, farm loan programs reduced its direct loan application processing timeframes by 11.5 days (31 percent), and reduced guaranteed loan processing timeframes by two days (10 percent). As of March 30, 2011, the average time from application receipt to final decision for direct loans was 27.8 days, and for guaranteed loans, 9.4 days. It is remarkable that even though loan demand has surged, there has not been a noticeable deterioration in application processing time. This is a testament to the dedication of FSA field staff and the effectiveness of the Information Technology (IT) solutions farm loan programs has deployed.

As of June 30, 2011, the FSA direct loan portfolio consisted of \$8.14 billion owed by 70,937 borrowers, while the guaranteed portfolio consisted of \$10.86 billion owed by 34,832 borrowers. The quality of our portfolio has continued to improve, with foreclosure and loss rates falling while borrower "graduation" to commercial loans has increased.

Loss Rates. In FY 2010, losses in the direct loan program fell to their second lowest level since 1986 -just 1.2 percent (Chart 2). Losses for FY 2010 in the guaranteed loan program were 0.6 percent, (Chart 2).

Delinquency Rates. As with losses, the direct loan delinquency rates have been at historic lows for the past two decades at 5.9 percent for FY 2010 (Chart 3). This is the result of steady and dramatic decreases, from a 23.8 percent delinquency rate in FY 1995. The decrease was facilitated by expanded authority, since 1996, to offset delinquent borrowers' loan obligations with their federal payments, salaries and income tax refunds. In the guaranteed program, the FY 2010 delinquency rate was 1.69 percent, the second lowest since 1995 (Chart 3).

Foreclosures. Foreclosure rates continue to be very low in the direct loan program. In 2010, FSA completed 64 foreclosures. This represents less than one-tenth of 1 percent of the agency's direct loan caseload of 70,905 (as of September 30, 2010). The extremely low foreclosure rate is the result of the use of all available servicing tools and a structured review process to ensure that all options to assist the borrower have been exhausted before a foreclosure action is started.

Inventory Properties. Inventory farm properties those that have come into government ownership through voluntary conveyance or foreclosure are also at historic lows, with just 86 farms totaling 10,900 acres in FY 2010 (Chart 4). In 1995, FSA held nearly 1,800 farms totaling 598,000 acres. Many of those inventory properties were sold to established and beginning farmers, providing those individuals with prime opportunities to expand or create new operations.

Graduation Rates. Federal law requires FSA to "graduate" its borrowers to commercial credit when they have made sufficient progress to be able to qualify for loans from other lenders. They are assisted by the agency in refinancing their direct loans with FSA guaranteed loans from commercial lenders. Some 2,221 direct loan borrowers were able to graduate in FY 2010.

Equitable treatment and participation

Secretary Vilsack has been extremely clear that improper and inequitable treatment of individuals the United States Department of Agriculture (USDA) and FSA serve will not be tolerated. On April 21, 2009, the Secretary announced several actions in a comprehensive approach to ensure fair and equitable treatment of USDA employees and constituents. These actions included an initiation of several improvements in processing civil rights complaints, requesting an external analysis of program delivery by USDA service center agencies, and 90 day suspension of FSA farm foreclosures, which has provided us time to ensure that all producers have received their statutory protections. In FY 2010, while FSA received more than 48,000 loan applications, more than 4,000 loan servicing requests, and tens of thousands of applications for various farm commodity, support, and disaster programs, the Assistant Secretary for Civil Rights received only 37 civil rights complaints related to FSA programs. While this is the lowest number of FSA civil rights complaints received since records have been kept, it is our goal to further reduce this number.

I, along with all members of the FSA management team, remain fully committed to providing to equal access and opportunity for all those FSA serves. I will closely monitor the operations of farm loan programs and all other FSA programs to assure that our producers, program applicants, and employees receive fair and equitable treatment. I want to update you on a few key activities dealing with these important issues.

Program participation. An examination of the composition of FSA's loan portfolio indicates that FSA finances socially disadvantaged farmers at a much higher rate than that groups' proportion of the farm population (Chart 5). FSA has significantly increased the amount of loan funds provided to socially disadvantaged applicants. Between 1995 and 2010, the FSA direct loan caseload for socially disadvantaged borrowers increased from 3,260 to 14,840. Between 1997 and 2010, the FSA guaranteed loan caseload for socially disadvantaged borrowers increased from 1,730 to 2,998.

In the 2008 Farm Bill, Congress re-affirmed the focus for FSA programs on beginning farmers and ranchers. FSA continues to strive to reach more beginning farmers and ranchers and has increased the amount of loan funds provided to beginning farmers and ranchers. The FSA direct loan caseload for beginning farmers increased from 3,474 in 1995 to 27,111 borrowers in 2010. Guaranteed caseloads for beginning farmers and ranchers were first reported in 1997. The FSA guaranteed loan caseload for beginning farmers increased from 3,617 in 1997 to 9,477 borrowers in 2010.

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

This past year we have completed the final phase of moving all automated farm loan systems to the Web. With the completion of this project, duplicate data collection is eliminated and farm loan services are being delivered even more efficiently. This project allows our employees to conduct USDA business from any location where there is broadband, WIFI or dial-up Internet access. This allows us to conduct business with producers at locations and times convenient to them. Additionally, this information is stored on a centralized server allowing employees to quickly access portfolio information and provide real time management reports. FLP staff no longer relies on antiquated operating environments for program delivery.

In addition to the business plan and loan accounting systems, other IT systems have been developed and implemented which also enhance the efficiency of FSA employees. Agency appraisers have recently been provided state of the art agricultural software that allows collateral valuations to be done more expeditiously, which facilitates faster access to capital for loan

applicants. Automated Web-based systems have been developed for program oversight, including Farm Loan Programs Risk Assessment (FLPRA) and the District Director Oversight System (DDORS), which help to ensure the integrity of FSA's farm loan programs.

Conclusion

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

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

We are experiencing a unique set of conditions in the credit and banking sectors, and to a large extent, in agriculture. These changes pose significant barriers and challenges to the groups that FSA farm loan programs are intended to assist. These issues create major challenges for the agency as well, since the success of the program depends on those whom the programs are intended to serve. To keep pace with these changes, we look forward to working with you to continue efforts to modernize our delivery systems, and to refine and adjust program requirements and operations to maximize the opportunities for our nation's small, beginning, and socially disadvantaged farmers and ranchers.

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

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

Chart 1:

**TOTAL ALL LOANS
COMPARISON OF OBLIGATIONS**
(in Billion Dollars)

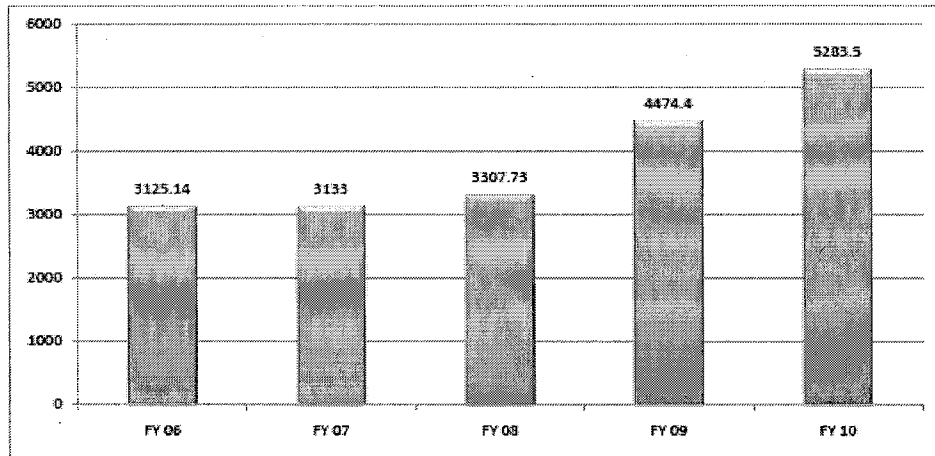


Chart 2:

FARM LOAN PROGRAMS LOSS RATES
10-Year Trend

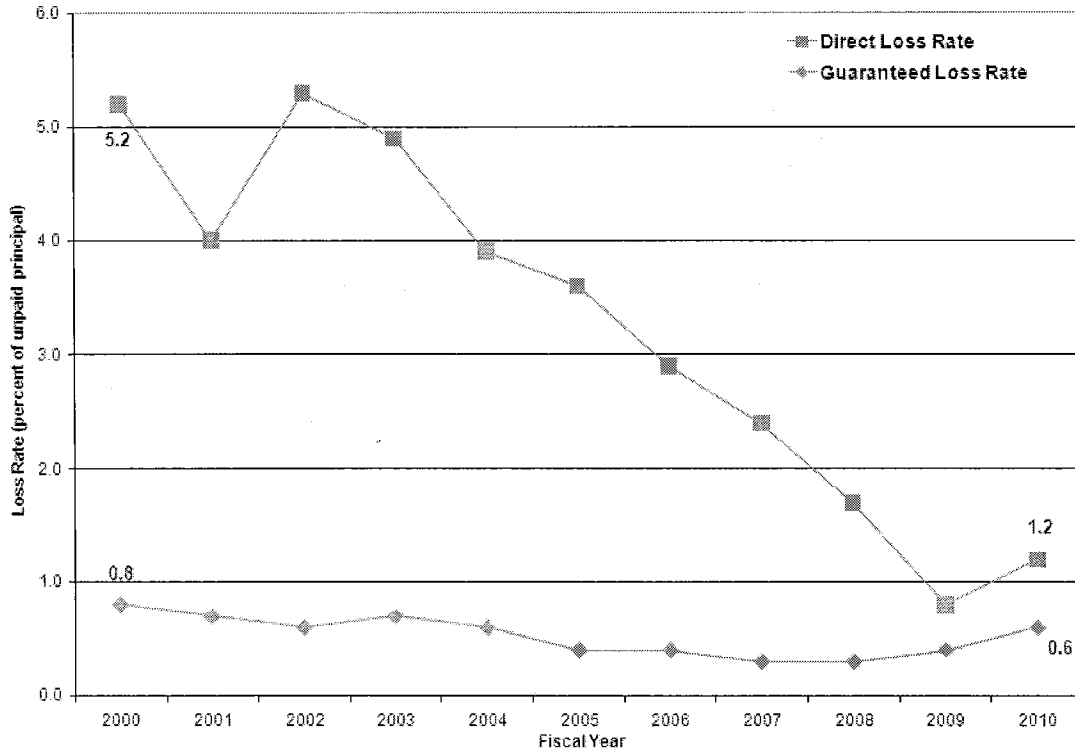


Chart 3:

FARM LOAN PROGRAMS DOLLAR DELINQUENCY RATE
10-Year Trend

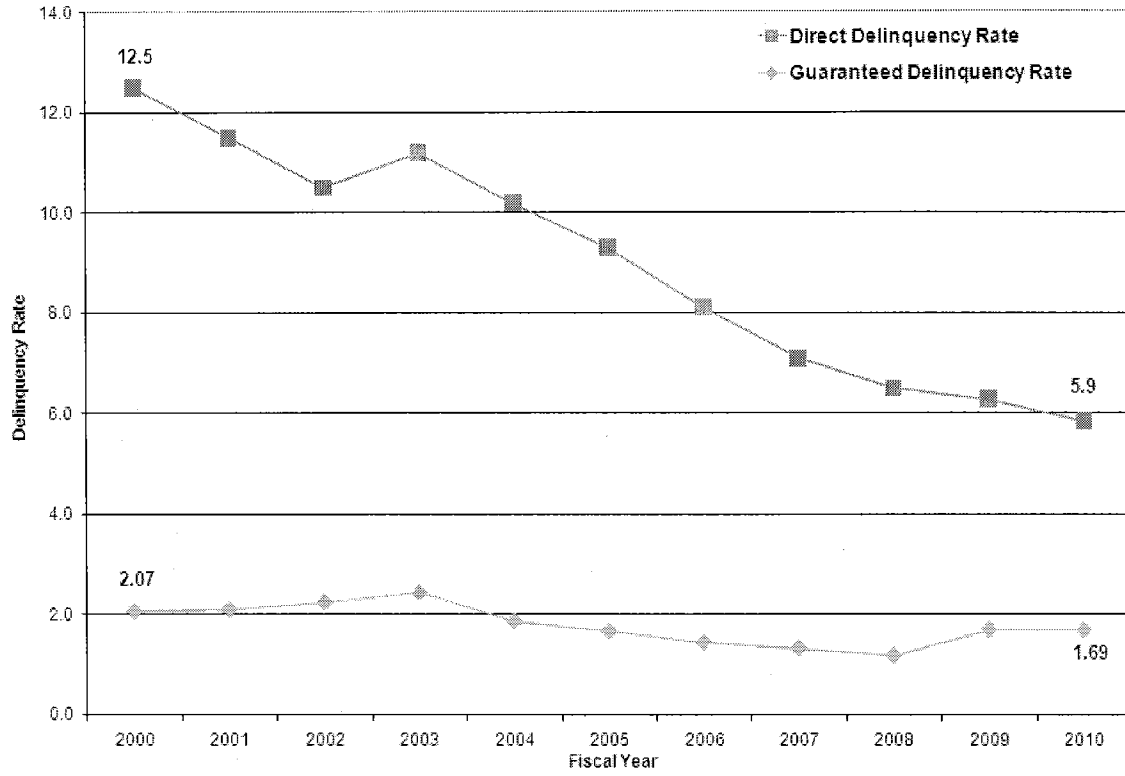


Chart 4:

FARM LOAN PROGRAMS INVENTORY PROPERTY

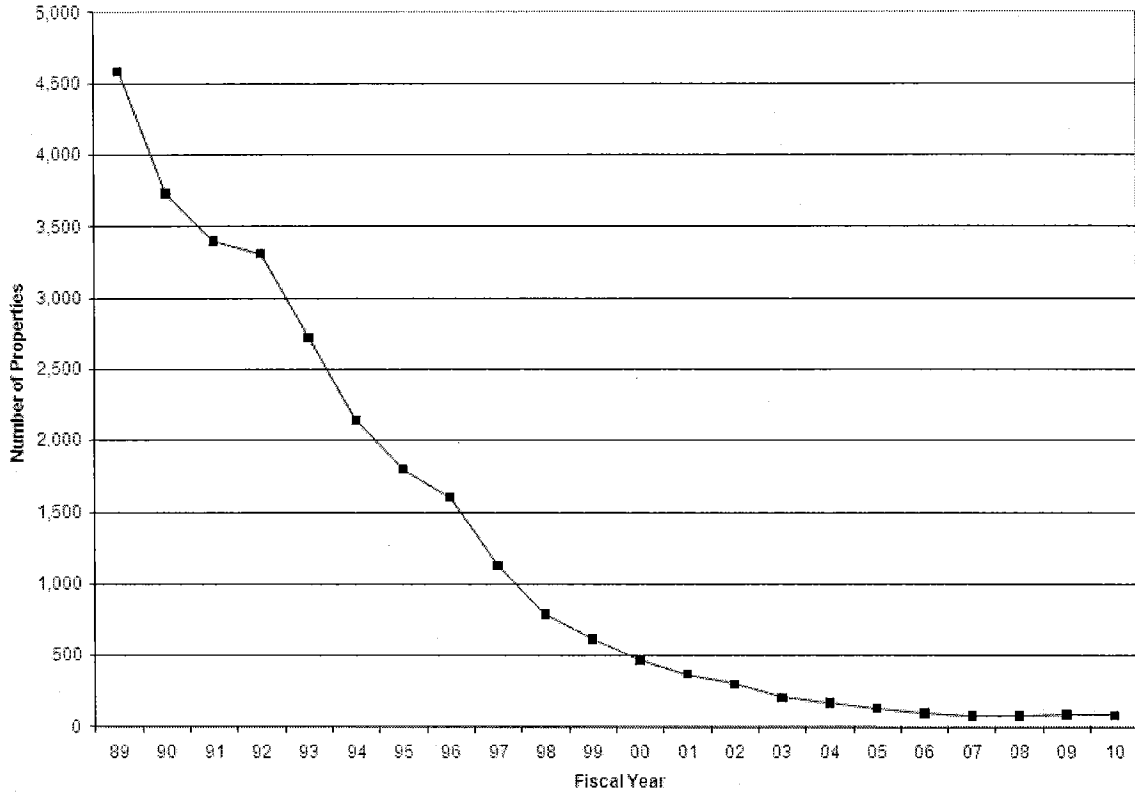


Chart 5:

FY 2010 BORROWER CASELOAD BY RACE
(As Compared to 2007 Ag Census Data)

	Percent of 2007 Ag Census Population	Percentage of FY 2010 Direct Caseload	Percent of Population being served by FSA Direct Farm Loans	Percentage of FY 2010 Guaranteed Caseload	Percent of Population being served by FSA Guaranteed Farm Loans
White	96.45	89.15	2.99	95.53	1.56
Black	1.40	3.10	7.18	0.53	0.60
Asian/Hawaiin	0.57	0.89	5.00	2.21	6.05
Amer Ind/Al Nat	1.58	3.46	7.07	1.58	1.57
* Hispanic	N/A	3.31	N/A	0.11	N/A
Other	N/A	0.10	N/A	0.04	N/A

* Hispanic Americans are not a separate category within the 2007 Census of Agriculture; therefore, no reliable comparison can be established.