

December 11, 2019

Testimony of

Shan Hanes

On behalf of the

American Bankers Association

before the

Commodity Exchanges, Energy, and Credit Subcommittee

of the

United States House of Representatives

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Chairman Scott, Ranking Member Scott, and members of the Subcommittee, my name is Shan Hanes, and I am the President and CEO of Heartland Tri-State Bank in Elkhart, KS. Heartland Tri-State Bank is a family owned and locally controlled community bank with \$125 million in assets and \$51 million in agricultural lending. We have 28 employees and have 4 locations serving Kansas.

I am also a past chairman of the American Bankers Association's Agricultural and Rural Bankers Committee. I appreciate the opportunity to present the views of rural bankers on credit issues in rural America

The American Bankers Association is the voice of the nation's \$18 trillion banking industry, which is composed of small, regional and large banks that together employ more than 2 million people, safeguard \$14 trillion in deposits and extend over \$10 trillion in loans. ABA is uniquely qualified to comment on agricultural credit issues as banks have provided credit to the agriculture industry since the founding of our country. Nearly 5,000 banks –83 percent of all banks nationwide– reported agricultural loans on their books at year-end 2018 with a total outstanding portfolio of more than \$186 billion.

The topic of today's hearing is very timely. There have been many successes within the 2018 Farm Bill that have directly affected agricultural lenders. However, the agricultural landscaped has changed considerably since the passage of the last Farm Bill. Agricultural lenders

have often been the first group to feel the effects of the changing agricultural landscape, and the role that public policy has played in shaping that landscape.

The agricultural economy has been slowing, with farm sector profitability expected to decline further in 2019. However, farm and ranch incomes have been some of the best in history. ABA would like to thank the committee for its hard work and dedication to completing the 2018 Farm Bill. With the 2018 Farm Bill in place, farmers, ranchers, and their bankers achieved a level of certainty from Washington about future agricultural policy. Interest rates continue to be at or near record lows, and the banking industry has the people, capital and liquidity to help American farmers and ranchers sustain through the turbulence in the agricultural economy.

Banks continue to be one of the first places that farmers and ranchers turn when looking for agricultural loans. Our agricultural credit portfolio is very diverse – we finance large and small farms, urban farmers, beginning farmers, women farmers and minority farmers. To bankers, agricultural lending is good business and we make credit available to all who can demonstrate they have a sound business plan and the ability to repay.

In 2018, farm banks – banks with more than 16.07 percent of their loans made to farmers or ranchers – increased lending by 5.3 percent to meet the rising needs of farmers and ranchers, and now provide over \$108 billion in total farm loans. Farm banks are an essential resource for small farmers, holding more than \$50.1 billion in small farm loans, with \$12.4 billion in micro-small farm loans (loans with origination values less than \$100,000). Farm banks are healthy, well-capitalized, and stand ready to meet the credit demands of our nation’s farmers large and small.

In addition to our commitment to farmers and ranchers, thousands of farm dependent businesses – food processors, retailers, transportation companies, storage facilities, manufacturers, etc. – receive financing from the banking industry as well. Agriculture is a vital industry to our country, and financing it is an essential business for many banks, mine included.

Banks work closely with the USDA’s Farm Service Agency (FSA) to make additional credit available by utilizing the Guaranteed Farm Loan Programs. The repeal of borrower limits on USDA’s Farm Service Agency guaranteed loans has allowed farmers to continue to access credit from banks like mine as they grow, ensuring credit access for farmers across the country.

Entities like Farmer Mac provide another avenue for banks to increase credit availability. By purchasing guaranteed loans from banks, Farmer Mac allows banks to lower interest rates for their customers and provide better loan products.

We remain concerned with certain areas of the agricultural credit market. In particular, we are worried that the Farm Credit System – a government sponsored entity – has veered away from its intended mission and now represents an unwarranted risk to taxpayers. The Farm Credit System was founded in 1916 to ensure that young, beginning, and small farmers and ranchers had access to credit. It has since grown into a \$352 billion behemoth offering complex financial services. To put this in perspective, if the Farm Credit System were a bank it would be the seventh largest in the United States, and larger than 99.9 percent of the banks in the country.

Our nation’s farmers and ranchers are a critical resource to our economy. Ensuring that they continue to have access to adequate credit to thrive is essential for the wellbeing of our whole nation. America’s banks remain well equipped to serve the borrowing needs of farmers of all sizes.

In my testimony today I would like to elaborate on the following points:

- Banks are a primary source of credit to farmers and ranchers in the United States;
- In addition to protecting crop insurance, the 2018 Farm Bill provided a much-needed change to Farm Service Agency (FSA) guaranteed loan programs, changes to ARC and PLC, and a small change to Farmer Mac;
- There are some much needed changes needed in the agricultural credit space. The most important are the passage of the Enhancing Credit Opportunities in Rural America Act (ECORA), increasing staffing within FSA loan programs, and monitoring NEPA regulations within agricultural loans
- The Farm Credit System continues to grow in size and scope, while not having to adhere to the same regulatory frameworks as banks;

I. Banks Are a Primary Source of Credit to Farmers and Ranchers in the U.S.

For my bank and for many of ABA’s members, agricultural lending is a significant component of their business activities. ABA has studied and reported on the performance of “farm banks” for decades and, we are pleased to report that the performance of these highly specialized

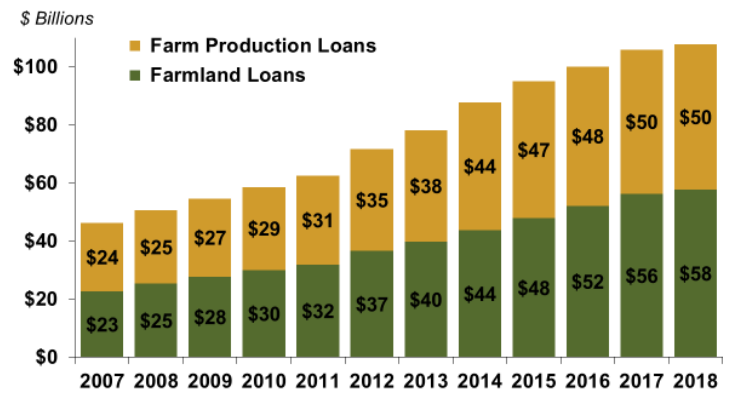
agricultural lending banks continues to be strong. ABA defines a farm bank as one with more than 16.07 percent farm or ranch loans (to all loans).

At the end of 2018, there were 1,772 banks that met this definition. Farm lending posted solid growth during 2018. Total farm loans at farm banks increased by 5.3 percent to \$108 billion in 2018 up from \$102.1 billion for these banks in 2017. Approximately one in every three dollars lent by a farm bank is an agricultural loan.

Farm real estate loans grew at a faster rate than farm production loans. Outstanding farm real estate loans grew at a pace of 2.8 percent, or \$1.6 billion, to a total of \$58 billion.

Farm production loans rose by 0.24 percent, or \$120 million, to \$50 billion. Farm banks are a major source of credit to small farmers – holding more than \$50.1 billion in small farm loans (origination value less than \$500,000) with \$12.4 billion in micro-small farm loans (origination value less than \$100,000) at the end of 2018. The number of outstanding small farm loans at farm banks totaled 771,641 with the vast majority – over 497,574 loans – with origination values less than \$100,000. Farm banks are healthy, well capitalized, and stand ready to meet the credit demands of our nation’s farmers large and small.

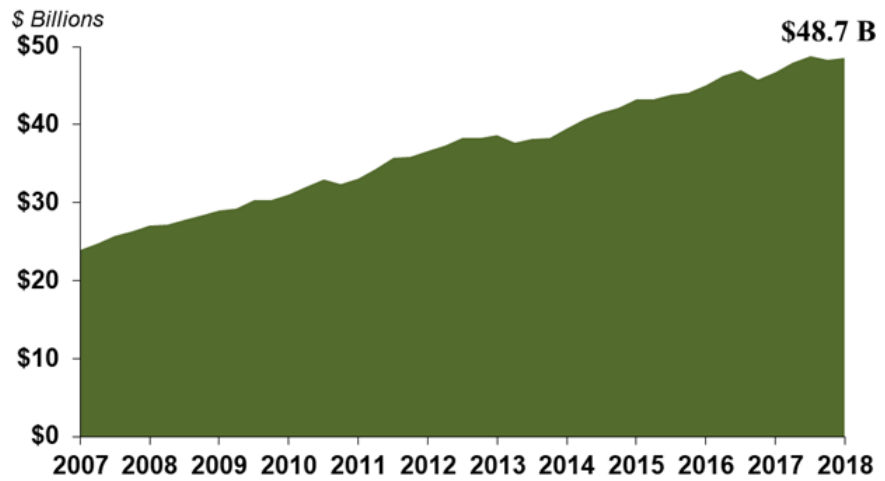
Farm Banks Exhibit Solid Farm Loan Growth



Source: Federal Deposit Insurance Corporation & American Bankers Association Analysis | American Bankers Association

Equity capital —often thought of as the strongest form of capital—at farm banks increased by 0.2 percent to \$48.7 billion in 2018. Since the end of 2008, farm banks have added \$22.2 billion in equity capital, building strong high-quality capital reserves. These capital reserves will enable flexibility amongst farm banks, as the agricultural sector adjusts to lower commodity prices — allowing bankers to work with and serve the needs of our nation’s farmers — and will also act as a buffer, proving insulation from the risks associated with any downturn in the agricultural sector.

Farm Banks Increase High-Quality Capital



Source: Federal Deposit Insurance Corporation & American Bankers Association Analysis

American Bankers Association

One area of concern for farm bankers and their customers for several years was rapid appreciation in farmland values in some areas of the country. The run up in farmland values was not a credit-driven event. Farm banks are actively managing the risks associated with agricultural lending, and underwriting standards on farm real estate loans are very conservative. The key consideration in underwriting any loan is the ability of the customer to repay regardless of the collateral position in the loan. To further manage risk, banks regularly stress test their loan portfolios to judge repayment capacity under different scenarios.

After several years of large increases in farmland values, the consensus view among bankers, through ABA surveys, is that the increase in farmland values has slowed. ABA continues to watch the farm real estate market very closely. In recent years, over four-fifths of the agriculture sector’s asset values were held in real estate. Farm land values rose slightly in 2018 and the USDA ERS projects farm land values to rise again slightly in 2019. However, in the most recent ABA Agricultural Lenders Survey, a higher segment of respondents indicated expectation that farm land values will begin to decline in coming years.

II. The Agricultural Improvement Act of 2018 Had Many Successful Components

One success of the 2018 Farm Bill was the continued support of crop insurance programs. Agricultural lenders use crop insurance as a guarantee to help secure financing for operating credit. With crop insurance, a lender has the ability to provide support based on individual producers' proven crop yields. This allows lenders to tailor a loan to a producer's operation and allow for year-to-year adjustments within that operation. Without crop insurance acting as a safety net, producers would be in a much more challenging financial situation in the event of disaster. Crop insurance has allowed lenders to provide the best possible terms for operating loans because it helps to lower the risk for the lender. ABA has been a long-time supporter of crop insurance programs and would like to see the programs expanded to help as many producers as possible, including industrial hemp.

I would like to thank Congress, especially the Agricultural Committees, for increasing borrower limits on USDA Farm Service Agency guaranteed loans in the 2018 Farm Bill. The prior borrower limits restricted farmer access to capital, and the limits did not reflect the growing cost of agriculture in the United States. The USDA's Farm Service Agency guaranteed loan program has been a remarkable success. Today, nearly \$12 billion in farm and ranch loans are made by private sector lenders like my bank and are guaranteed by the USDA. There are nearly 43,000 loans outstanding – of course some farmers have more than one guaranteed loan, so this number is not to be confused with the number of individual farmers and ranchers, but the numbers of individuals accessing credit under this program is very significant.

The loans made by banks like mine under this program are modest in size. The average outstanding guaranteed real estate loan is \$517,000 and the average outstanding guaranteed non real estate secured loan is \$289,000. Clearly, we are reaching customers who have modest-sized operations, who are in the process of starting their farm or ranch operation, or who are recovering from some sort of financial set-back. Despite the fact that these customers do not have either the earnings or collateral to qualify for conventional credit, losses in the program have been extremely small. Over the last five fiscal years losses have ranged from a high of 1.6 percent in FY19 to a low of 1.1 percent in FY15. These are extremely low losses – especially for customers who are perceived to be a higher risk than other customers, hence the need for the USDA credit enhancement. Bankers who utilize the guaranteed farm loan programs offered by USDA know what they are doing and work very closely with their farm and ranch customers to properly service these

loans. The Farm Service Agency deserves a great deal of credit for administering such a successful public/private partnership. We urge you to continue to support this very worthwhile program.

Another success of the 2018 Farm Bill are the changes to ARC and PLC programs. Being able to use Risk Management Agency data has given us a much better platform to work from when determining potential ARC and PLC payments for producers. Additionally, by changing the producer election on whether to be ARC or PLC, there is much more flexibility for producers to use the program that makes the most sense in their operation. Lastly, using the physical location of ARC County payments will provide a more accurate read on production.

Lastly, I would like to thank Congress for allowing changes to be considered within Farmer Mac. Farmer Mac is a valuable tool in the toolbox for agricultural bankers because it provides another avenue for banks to increase credit availability. By purchasing guaranteed loans from banks, Farmer Mac allows banks to lower interest rates for their customers and provide better loan products.

ABA still believes the most needed change is the removal of the current 1,000-acre limitation. The 1,000-acre limitation was put in place in the 1987 Farm Credit Act and has become outdated with the increasing size and scope of modern agriculture. Other bankers and I have been working with the Farm Credit Administration on the best possible path forward for potential changes to Farmer Mac.

III.Changes Needed in Agricultural Credit

Agricultural credit provided by the banking industry often has very different set of rules than the Farm Credit System, which serves the same customers as banks. The most striking difference is within taxation levels between the Farm Credit System and banks. When a farm real estate loan is made, the Farm Credit System will pay no tax on the income from that loan. Banks, however, will pay a 21 percent federal tax and various state and local taxes across the country. This means a farm real estate loan will cost more for a producer from a bank than the Farm Credit System. I am encouraging all Members of Congress to support H.R. 1872, the Enhancing Credit Opportunities in Rural America Act (ECORA). ECORA would allow banks like mine to provide farm real estate loans at a lower interest rate. This is good for the farmer, plain and simple.

Another example of differences between banks and the Farm Credit System is when interest only loans are made. Within the Farm Credit System, their regulator, the Farm Credit

Administration, has ruled that Farm Credit System institutions can make interest only loans without any punishment. When a bank changes a loan to interest only, it is filed as a troubled asset. This is a serious black mark on a bank and too many troubled assets can force the regulators hand on punishing a bank.

There needs to be serious consideration for increasing staff levels at FSA. As veteran staff retires, there isn't enough new staff being trained to take over their loan portfolios. This is creating a knowledge gap within FSA loan programs and is making it much harder to turn around loans in a timely fashion. When it comes to financing agriculture, especially operating loans, loans need to be made as quickly as possible so farmers can get back into the field. As the agriculture committee is aware, windows for planting or harvesting can close very quickly and our loan programs need to keep pace.

Lastly, the Agriculture Committee should examine the National Environmental Policy Act (NEPA) regulations that have been put in place for Confined Animal Feeding Operations (CAFO) for FSA loan programs. I fully understand why the regulations have been put in place, but there needs to be serious examination on potential changes to the regulations. Additionally, I have found that the regulations can vary from state to state and county to county, making it very difficult to properly put together the loan. The Agriculture Committee should consider offering changes to the NEPA regulations on CAFOs so lenders can better serve this constituency into the future.

IV. The Farm Credit System is a Large Government Entity That No Longer Serves Its Primary Mission

I mentioned earlier in my testimony that the market for agricultural credit is very competitive. I compete with several other banks in my service area, finance companies from all of the major farm equipment manufacturers, several international banks, credit unions, life insurance companies and finance companies owned by seed and other supply companies, to name a few. The most troublesome competitor I face is the taxpayer-backed and tax-advantaged federal Farm Credit System (FCS). The FCS was chartered by Congress in 1916 as a borrower-owned cooperative farm lender at a time when banks did not have the legal authority to make long-term farm real estate loans. Over the ensuing 100 years the FCS has received numerous charter enhancements and has ventured into areas that are not appropriate for a farmer-owned farm lending business.

Today *the FCS is a large and complex financial services business with \$352 billion in assets*. If it were a bank, it would be the seventh largest bank in the United States. It is tax-advantaged and enjoyed a combined local, state, and federal tax rate in 2018 of only 2.3 percent (a significant decrease from the effective tax rate of 4.5 percent just five years prior). Additionally, FCS had a net income of \$5.332 billion in 2018.

Congress created the Farm Credit System as a public option for farm finance when farmers were having trouble getting the credit they needed from non-government sources. The conditions that led to the creation of the Farm Credit System nearly 100 years ago no longer exist, and yet we continue to have a government-assisted, tax-advantaged farm lender providing credit to customers who would be able to easily borrow from taxpaying institutions like mine. In fact, the heavily subsidized credit that FCS lends goes to those who need it least. Despite amendments to the Farm Credit Act of 1980 requiring each FCS lender to have a program for furnishing credit to young, beginning and small farmers and ranchers (YBS), the share of new YBS loans to total new FCS loans continues to *be dismal*—even as the assets of the System have expanded enormously. Loans to small farmers have steadily dropped over the past several years, with small farm loans declining from a high of 30 percent of total new loan volume in 2003¹ to just 14.4 percent in 2018. Clearly, those who would benefit the most from the highly subsidized credit made available by the FCS are not receiving the benefits that Congress intended them to receive.

Conclusion

The banking industry is well positioned to meet the needs of U.S. farmers and ranchers. U.S. agriculture has begun to adjust to lower commodity prices after enjoying one of the longest periods of financial prosperity in history. However, the banking industry remains cautious as it looks forward to the next few years. There is a very real concern that declining commodity prices will negatively affect the farm economy and make credit situations tighter. This is why the banking industry will continue to offer assistance to Congress as we work through these economic times. With the changes that have been outlined earlier, the banking industry will continue to help

¹ “FCA’s Annual Report on the Farm Credit System’s Young, Beginning, and Small Farmer Mission Performance: 2013 Results”. Office of Regulatory Policy, June 12, 2014 Board Meeting

producers be strong into the future. Bankers still see great opportunities in agriculture, and they will stand with their partners in agriculture going forward.

Thank you for the opportunity to express the views of the American Bankers Association. I would be happy to answer any questions that you may have.