Remarks of the
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Thank you for the invitation to participate in this conference and discuss the topic of “Access to Capital.”

Capital is a key ingredient for growth and prosperity. But for many in rural America it is a scarce commodity. … And while there are many obstacles that impede rural America’s access to capital, I believe new opportunities may arise as economic conditions improve and information technology helps us hurdle the physical distances that separate us.

This issue has been the topic of study and research for a number of years. Countless hours of research have produced scores of publications and reports. Policy options have been considered and tested, but no single solution has emerged for all communities and segments of rural markets.

In particular, I would like to recognize Mark Drabenstott and the extensive work of the Center for the Study of Rural America for their efforts on continuing to spotlight the growing financing needs of rural communities, businesses and entrepreneurs.

Rural America’s potential should not be dismissed or diminished. This is because rural America comprises 2,052 counties, contains 75 percent of the nation's land, and is home to 17 percent (49 million) of the U.S. population. Indeed, rural America is a force unto itself.

Rural America and agriculture currently face new and unique challenges. These challenges require innovative solutions. We have seen varying degrees of success with the many Federal, state and local programs directed at increasing access to credit and capital in rural areas.

As Chairman and Chief Executive Officer of the Farm Credit Administration (FCA), I am committed to helping farmers and other rural residents, including businesses and communities flourish in a period of rapid technological advancement and economic change.

Today, I will present some of my views on rural America's access to capital in a broad context. And, in doing so, I will talk about the:

- Needs and challenges of rural residents, businesses and communities;
- FCA's role in advancing access to capital in rural America;
- Farm Credit System and Farmer Mac's role in providing financing to agriculture, related rural businesses, and rural communities;
- Efficiencies of rural debt and equity markets;
- FCA programs, initiatives, and strategies to increase the availability of funds to agriculture and rural areas; and
- Need for legislative change.

With the cost of doing business going up, farmers, ranchers, rural businesses and residents need financing today more than ever. Similarly, the need for greater private capital investment in rural areas is well established and ever increasing too. Rural and agricultural businesses, however, do not enjoy the same access, competitive rates or flexible financing terms or the ability to raise equity as easily as their urban counterparts. Policy experts generally agree on the reasons capital in rural areas is scarce, including:

- Distance to capital markets;
- Inflexible or outdated financial regulations;
- Inability or unwillingness of lenders to provide financing
- Lack of a secondary market for all types rural lending (i.e., business, infrastructure, low income housing);
- Absence of high-quality infrastructure, including high-speed internet connections
- Fewer capital providers;
- Limited pool of highly skilled workers and individuals with management expertise, and
- Globalization, which has created alternative low cost business sites around the world making it more difficult and competitive for rural areas to attract capital.

There is less agreement, however, on the solutions that are needed to help rural areas obtain access to the debt and equity markets, so they can build their infrastructures, local talent, services and economic bases.

Rural community and commercial banks have traditionally originated most of the agricultural and business loans in rural America. Historically, banks used to obtain the bulk of their loanable funds from low-cost deposits, such as passbook savings and no-interest checking accounts. But rural investors—like their city cousins—have discovered mutual funds and are placing much less of their savings into bank deposits. This has sent banks searching for new ways to fund loans. Furthermore, small- and medium-sized rural business loans often pose the greatest funding challenge for traditional credit providers.

Despite several recent legislative and regulatory remedies, rural banks still lack reliable sources of funding and capital investment for agricultural and rural businesses. Moreover, bank regulatory agencies generally frown on high concentrations of risk thereby limiting the flexibility of some local loan officers.

Obstacles to adequate and flexible sources of capital to rural businesses must be identified and removed in order to foster growth and development in our rural communities. The formation of new partnerships or alliances among agriculture and other rural businesses, community banks and Farm Credit institutions could help alleviate inefficiencies and bridge funding gaps. It is these partnerships that will help rural America over come obstacles to growth and prosperity.

FCA plays a unique role in advancing access to capital in rural America. The fundamental mission of the agency is to ensure a dependable source of credit for agriculture and rural America. FCA is the independent federal financial regulatory agency that is responsible for overseeing the mission and safety and soundness of two related government-sponsored enterprises (GSEs)—The Farm Credit System (System) and the Federal Agricultural Mortgage Corporation (known as Farmer Mac.) We achieve our congressional mandate by conducting periodic financial safety and soundness examinations and by issuing regulations that promote the efficient credit delivery. … And, "efficient credit efficient credit delivery. … And, "efficient credit delivery" is particularly critical to the flow of capital to agriculture and rural areas and the System's continued safe and sound operations.

Our role includes monitoring the System's ability to access the capital markets. In the post 9/11 era, the significance of this role has become more evident. Helping secure a stable source of funds for U.S. agricultural production and related rural credit needs during market disruptions, credit events and other crisis situations is critical to the safety of the U.S. food supply and well-being of all Americans.

The Farm Credit System plays a prominent role in financing American agriculture and rural areas. The System is a nationwide cooperative network of borrower-owned financial institutions that lend to agriculture and rural areas. Created by Congress in 1916, it is the oldest of the five GSEs in the United States and the only one that engages in lending at the retail level.

When Congress established the Farm Credit System as a GSE, its purpose was to provide a permanent, reliable source of credit and related services to agriculture, their cooperatives, and related businesses in rural America. The System is also a key source of credit for agricultural processing and marketing activities, rural housing, rural utilities, and foreign and domestic entities that participate in international agricultural trade.

Congress further intended the System to improve the income and well being of American farmers, ranchers and rural residents. The System meets this broad public need by preserving liquidity and competition in rural credit markets. The accomplishment of this public policy goal significantly benefits rural areas and their residents, including young, beginning, small, family, minority, female, and socially disadvantaged farmers, as well as rural home purchasers. As has been said before, "a stronger rural America, means a stronger America."

Today, Farm Credit institutions serve all 50 states and the Commonwealth of Puerto Rico. As of January 1, 2004, the System consisted of 110 institutions and had assets of $120 billion. The Farm Credit Banks also fund and discount loans that 29 non-System "Other Financing Institutions" (OFIs), such as commercial and community banks and their affiliates, make to farmers, ranchers, and other eligible borrowers.

As a GSE, the System enjoys a secure source of funds, relatively low interest rates and liquidity. Through collaboration and partnering, it also has the ability to share these benefits with community and commercial lenders, and other credit providers that serve rural areas. System institutions and their borrowers have access to the capital markets through the Federal Farm Credit System Banks Funding Corporation, which is wholly owned by all five System banks. Proceeds from the sale of debts securities are channeled to agriculture and rural residents through loans Farm Credit institutions make to their eligible and creditworthy borrowers.

Farmer Mac plays a vital and growing role in increasing the liquidity and efficiency of rural credit markets as well. In 1987, Congress established Farmer Mac to facilitate the securitization of agricultural and rural home mortgages for sale into the secondary market. Congress's creation of Farmer Mac was part of its efforts to resolve the agricultural crisis of the mid-1980s and to provide a more efficient means of financing agricultural and rural housing mortgages.

The legislative intent in developing a secondary mortgage market for agricultural loans was to increase the availability of long-term credit to farmers and ranchers at stable interest rates, increase liquidity to agricultural lenders, provide new capital for agricultural investments, and enhance the ability of individuals in rural communities to obtain financing for moderately priced homes.

Through its Farmer Mac I and Farmer Mac II programs, Farmer Mac creates greater liquidity and lending capacity by providing rural lenders an avenue to sell qualifying agricultural real estate loans and guaranteed portions of USDA guaranteed farm ownership and operating loans and rural business and community development loans into the secondary market.

Farmer Mac is also developing new programs that will benefit rural lenders and their borrowers. For example, Farmer Mac introduced its Long-Term Standby Purchase Commitment (Standby) program in 1999. Under Farmer Mac's Standby program, a financial institution pays an annual fee for Farmer Mac's commitment to purchase loans in a specific pool under conditions at the option of the institution.

And in 2003, Farmer Mac introduced the Agricultural Mortgage Backed Security (AMBS) Participation Swap. Under this program, Farmer Mac purchases a 100 percent participation in a pool of loans and, in return, provides the institution with an AMBS that it guarantees. These new programs also help lenders manage their credit risk exposure and free up capital to make additional loans to agriculture and rural businesses and residents.

Access to the capital markets is improving for some segments of rural markets. However, many other rural areas continue to struggle for equal access.

As part of the Federal Agricultural Improvement and Reform Act of 1996, Congress directed the USDA to complete a study of the availability of credit in rural areas for agriculture, housing, and rural development. FCA staff also participated in this significant study. In general, the study concluded that rural financial markets worked reasonably well in serving the financial needs of major groups of borrowers in rural communities.

The study, however, also found that rural markets and market segments do not all have equal access. The report indicated some borrowers and some rural communities face higher costs for their credit or limitations on credit availability that are unrelated to creditworthiness.

In the summer of 2001, FCA held a public meeting in Des Moines, Iowa, and surveyed a number of small community bankers participating in the OFI lending program. We did this to seek input on strategies to improve the availability of the funds to agriculture and rural communities through the OFI lending program. While less scientific in our approach, we heard anecdotal evidence that supported the USDA study.

Specifically, these sessions suggested that lending institutions had difficulty funding certain segments of their portfolios, including young, beginning and small farmers, start-up agribusinesses, and rural economic development). While recent legislative changes allowed commercial lenders to use agricultural and rural development loans as collateral for FHLB advances, … survey participants indicated there were a number of program hurdles, such collateral and pricing, that reduced their ability to utilize the Federal Home Loan Bank (FHLB) system as a source of liquidity. They also believed that the lack of understanding of agriculture and rural markets adversely affected their ability to obtain funds at competitive rates.

Other community lenders indicated that Farmer Mac programs offered them a valuable source of liquidity and the ability to diversify their funding sources and risks. However, they noted that strict underwriting standards made it difficult for them to obtain Farmer Mac funding for certain segments of their portfolio, such as YBS and disadvantaged farmers and for farming operations with unique features.

Some lending institutions also indicated they had limited capacity to fund large loans, and felt they would benefit from greater use of participation and risk-sharing arrangements with other lenders.

As a result of these sessions and other public meetings and discussions, the FCA has focused several of its initiatives on fulfilling the credit needs of underserved segments of rural markets. But, before I discuss these strategies in greater detail, I would like to briefly talk about the benefits of securitization and access to equity capital in rural areas.

Asset securitization and structured financial transactions provide financial institutions an efficient mechanism to buy and sell loan assets and diversify their credit risk exposures. Financial institutions accrue many benefits through asset securitization programs. Some of the more significant benefits include:

- Increased liquidity and lending capacity;
- Improved access to the capital markets at more favorable rates;
- Increased risk-adjusted return on capital, and
- Improved balance sheet risk management.

Market innovation and integration have changed how financial assets are funded. Asset securitization is now a prominent tool that financial institutions use to fund assets and manage financial risks. Although Farmer Mac programs have made the benefits of securitization available for certain segments of rural markets, I believe rural credit delivery systems have not fully participated in this financial advancement and greater participation by financial institutions serving rural markets would increase the efficiency of rural debt markets and availability of funds to rural areas.

There is large body of evidence that indicates that rural equity markets are poorly developed and less efficient than urban equity markets. Research studies indicate that traditional venture capitalists have limited investment activity in rural areas because of the high cost of finding and managing good investment opportunities and limited "deal" flow.

There are a number of federal, state, local and privately sponsored programs focused on bridging the equity gap in rural areas. These programs include state and federal tax credits, state-assisted angel networks, management and technical assistance programs, state-sponsored venture capital funds, private venture capital funds and community development corporations. Each of these programs has met with varying degrees of success.

I would like to focus my discussion on two new efforts recently created by Congress that I believe offer rural America much promise. The first is the New Markets Tax Credits (NMTC), which was a key element of the Community Renewal Tax Relief Act of 2000. This program provides additional equity investment for businesses in economically distressed areas through the availability of tax credits to private investors. The NMTC program is authorized to provide $15 billion in investments for which tax credits can be claimed. I believe incentive-based programs, such as the NMTC, will help rural communities attract much needed equity investment.

The second program I would like to address relates to rural business investment companies (RBICs). RBICs were authorized through the Farm Security and Rural Investment Act of 2002 (or as more commonly referred to the "2002 Farm Bill"). This program provides $44 million in grants and $280 million in debt guarantees to assist the RBICs to make equity investments in rural businesses.

RBICs are similar to Small Business Investment Companies (SBICs), which provide equity investments to qualifying small businesses. RBICs are for-profit entities with management experienced in venture capital or community development. A RBIC must raise a minimum of $5 million in private capital. This capital can be leveraged 3 to 1 by USDA loan programs.

Both commercial and System lenders can establish and own RBICs -- with some constraints of course. Another important aspect of the RBIC program is the availability of grants to assist RBICs and their portfolio of companies, with technical, managerial or networking assistance.

As a safety and soundness regulator, I appreciate the value of a skilled management team and a well-executed business plan. Profitability, performance and success require more than an investment in a good idea in today's global marketplace.

From our experience with agricultural credit, during times of stress, the difference between success and failure is often management and planning. Therefore, I believe it is crucial, and equally as important, to invest in human capital — that is, education, management expertise, and leadership skills — as it is to invest equity capital. One cannot succeed without the other. Programs that provide both, are much needed in rural areas.

While the RBIC program offers a lot of promise, unfortunately its implementation has been slow.

Financial institutions need greater flexibility and new tools to help meet the financing needs of agriculture and rural America in the 21st century. At the FCA, we are developing and studying a number of strategies that would:

- Provide new and dependable sources of funding for agricultural producers, agribusinesses, and rural communities that currently have limited access to capital markets;
- Allow Farm Credit institutions greater flexibility to make debt and equity investments that offer agricultural producers, agribusinesses, and rural communities new financing options that best meet their needs;

- Encourage FCS institutions and other financial service providers to form partnerships and alliances that increase funding for young, beginning, small, and minority farmers, start-up agribusinesses, and rural communities; and
- Establish strong safety and soundness controls to ensure that FCS institutions have appropriate policies, management expertise, internal controls, and evaluation systems to maintain a secure and stable source of liquidity for agriculture and rural needs.

At this time, I would like to highlight a few efforts and initiatives that my agency has undertaken in recent years to create new tools and greater flexibility including, Participation loans, OFI lending, improved access to capital for young, beginning and small farmers and ranchers, and investments in rural America.

In early 2002, the FCA issued a final rule on loan participations. This rule eliminated a number of unnecessary regulatory restrictions that impeded effective participation relationships between System and non-system lenders. This rule better enables System institutions to partner with local credit providers to provide the type of credit at the flexible terms and competitive rates that agriculture and ag-related businesses need.

The System's legislative charter dedicates the System to agricultural and rural lending, which allows the System to accept the concentration risks that other lenders are unable to accept. The new rule allows FCS institutions to purchase and sell 100 percent loan participations. This benefits both FCS System and non-System lenders by allowing them to share and better manage risks in their portfolios. Risk sharing is essential for enhancing the efficiency of rural credit markets and increasing access and availability of funds at reliable and competitive rates.

Recently, the FCA Board approved a final regulation governing other financing institutions. The rule is intended to make affordable credit more available to agriculture and rural America by increasing cooperation between System and non-System lenders. The rule would remove provisions in the existing regulations that impede the flow of credit, but are not required by law, or do not enhance safe and sound operations. This rule would also reduce FCS bank capital requirements on loans to certain OFIs, allowing banks to discount loans to OFIs at more competitive rates.

This rule, in combination with other powers, would give the Farm Credit System more avenues to meet the varied funding needs of a wide variety of non-System lenders that finance agriculture. The rule would also enhance the ability of non-System lenders to access any one or a combination of the System's funding programs, depending on their individual needs. Further, the rule would enhance the System's ability to fulfill its mission to finance agriculture and other specified credit needs in rural America by serving as a steady source of funding and liquidity for other lenders. Most notably, the new rule could lower credit costs and provide more credit options for farmers and ranchers.

Providing financially sound and constructive credit and related services to borrowers identified as young, beginning, and small farmers and ranchers is a legislated mandate and a high priority for the System and FCA. Loans to YBS borrowers help ensure a smooth transition of agribusiness to the next generation and a continued strong and diversified customer base for the FCS.

The percentage of retirement age farm operators has risen during the last two decades, suggesting an increased importance for the Farm Credit System's role in helping young and beginning farmers finance the purchase of land sold by those who are exiting the business. USDA estimates that more than one-fourth of U.S. farmers and one-half of farm landlords are at least 65 years old, much higher percentages than for the overall U.S. labor force.

Transitions out of and into the capital-intensive farming business involve credit decisions that are compounded by the volatile nature of agricultural production and markets. Congress and the FCA see the System as being in a unique position to develop YBS programs that coordinate with other governmental programs, spread risks, and take a longer-term perspective in lending to YBS borrowers. Many borrowers are assisted by the various state and federal programs that provide interest rate reductions and or guarantees to help commercial lenders and FCS institutions reduce credit risks for borrowers. Without such concessions and guarantees, credit to some YBS borrowers would not be extended due to repayment risks.

In November 2002, we held a public meeting in Kansas City, Missouri, to seek input on whether regulatory changes were needed to enhance the Farm Credit System's service to YBS farmers and ranchers. This public meeting was another step in the agency's efforts to obtain public input, which will help us ensure that the System accommodates the current and evolving needs of YBS farmers and ranchers for credit and related services.

Among other things, we specifically sought input on the types of marketing and outreach activities and the types of System partnerships, alliances, or other joint efforts that would enhance the YBS programs. Additionally, we sought information on the programs and services non-System lenders offer to YBS farmers and ranchers that the System should offer as well.

Subsequent to the public meeting, we proposed a rule that amended our YBS regulations. The proposed rule attempts to balance the needs for additional guidance while allowing System direct-lender associations the flexibility to design YBS programs unique to the needs of their territories and within their risk-bearing capacities.

Another aspect of our YBS initiatives is to use awards and recognition to reward successes. For the last few years, I have presented awards to those System institutions with the most effective programs for serving the needs of YBS borrowers. I believe it is critical and absolutely important for our credibility as an objective arms-length financial regulator, to be fair and balanced in our regulatory approach. The bottom-line is that while we are sometimes called upon to criticize the activities of the institutions we regulate, we should never hesitate to compliment them on a job well done.

Recognition was based on a number of criteria, including the extent to which the institution offers an education component; provides for extensive outreach; makes effective use of financial incentives, such as differential loan underwriting standards and lower fees or interest rates; year-over-year increase in program activity; overall YBS program effectiveness; and participation with government-guaranteed lending programs, including those sponsored by USDA's Farm Service Agency.

Through public input meetings, comments on our proposals, and in other forums we have also heard that investments in rural America would help meet the changing financing needs of rural America. We believe that the FCS cannot meet the growing and rapidly changing financial needs of agriculture and related rural businesses unless we develop a more comprehensive and flexible regulatory framework for investments in rural America. We envision that this new regulatory framework would give the FCS greater latitude to hold investments in rural America, so long as System institutions apply appropriate risk management controls and hold sufficient capital to cover their risks.

The Act authorizes Farm Credit banks to "buy and sell obligations of, or insured by, the United States or of any agency thereof, or securities backed by the full faith and credit of any such agency, and make such other investments as may be authorized under regulations issued by the Farm Credit Administration."

We are currently evaluating a number of options that would enable System institutions to more fully use their investment powers to help fill financing gaps in rural America. We are also reviewing regulatory limits and restrictions that might impede the FCS's ability to serve agriculture and rural communities. I would like to briefly mention a few investment options under review at the agency.

The FCA actively encourages System lenders to use government guarantee farm lending programs to help expand YBS lending and to meet the needs of other eligible borrowers in the agricultural community. USDA's guaranteed farm loan programs, administered by the Farm Service Agency, have been increasing among System institutions. However, I believe more can be accomplished for YBS and rural communities through investments. Currently, we are evaluating regulatory obstacles, such as portfolio limits, which might prevent FCS lenders from making greater use of their existing statutory authorities to make additional investments in loans, notes, and bonds that are guaranteed.

Further investments in obligations that are issued or guaranteed by the Federal government could help increase the availability of long-term credit to farmers, ranchers, agribusiness, and other rural residents at stable interest rates. They would also improve the liquidity of agricultural lenders, provide new capital for agricultural investments, and enhance the ability of individuals in rural communities to obtain financing for farmland and moderately priced homes. Investments in pools of guaranteed loans, notes, and bonds could also provide Farm Credit institutions with an important tool to reduce and diversify their credit risk exposure. Such investments might include:

- FSA guaranteed farm ownership and operating loans
- USDA rural business and community development loans
- Rural Housing Service guaranteed loans
- SBA guaranteed obligations to small rural businesses
- Export-Import Bank guaranteed obligations

Investments in aggie bonds are another possible avenue to improve the availability of credit to YBS farmers. Aggie bonds are tax-exempt debt obligations issued by state authorities that allow banks to use bond proceeds to make low-interest loans to farmers. Under aggie bond programs, the state establishes a program to help beginning farmers or promote agricultural development and sells bonds to private investors.

Greater participation in the funding of general obligations and revenue bonds of municipalities can provide significant benefits to rural communities that have limited access to capital markets.

I believe Farm Credit institutions are uniquely positioned to help bridge many of the financing gaps in rural America because they operate at the grass root level in rural communities where they can identify local needs. Investments in these obligations are consistent with the System's Congressional mandate:

> To . . . provide for an adequate and flexible flow of money into rural areas, and to modernize and consolidate existing farm credit law to meet current and future rural credit needs, and for other purposes.

Additional investment sources can help underserved rural communities in many ways. Rural development investments help rural communities build needed infrastructure, such as schools, fire stations, hospitals, and other health care facilities. Additionally, investments in these obligations can also help build or extend utilities, including water, electricity, and telecommunications services in rural areas.

Mortgage revenue bond programs sponsored by state and local housing finance agencies are another example of investments that provide funding for underserved rural markets. Mortgage revenue bonds are tax-exempt bonds issued by these agencies to finance low-income borrowers, special housing needs, home rehabilitation projects, and rural housing.

As I indicated earlier in my presentation, RBICs hold a lot of promise for increasing the access and availability of equity financing in rural areas. However, until this RBIC program is up and functioning, we are evaluating how investments by FCS institutions in SBIC could serve as a viable alterative to the RBIC program.

Although there is a widespread geographic distribution of SBICs, rural businesses have limited access to SBIC funding. Most SBICs are owned by traditional venture capitalists or commercial banks, which focus their investments in high-growth, high-tech businesses. Thus, most rural businesses are not in their target market. Further, few SBICs are located outside non-metropolitan areas.

FCS institutions, which are located in rural areas across the nation, however, are well positioned to serve rural entrepreneurs through either the RBIC or SBIC program. Thus, in the absence of a viable RBIC program, the FCA is now examining how FCS investments in SBICs can be used as an interim step to help fill the equity gap in rural areas.

During my tenure of over five and one-half years, we have made considerable progress in creating an updated and flexible regulatory environment for financing the current and future needs of agriculture and rural areas. However, the regulatory efforts, some of which that I discussed today, are only a part of the solution to increasing rural America's access to capital. Legislative changes are also essential.

The Farm Credit Act is woefully outdated. The last significant overhaul of the Act was over 30 years ago. Since then, a lot has changed. America's agricultural and rural economy has been restructured through changing demographics, globalization, vertical integration which adds value to agricultural products, technological advances in agricultural production, and improved communications and transportation systems.

These changes demand that we revisit the existing statutory framework for financing the needs of agriculture and rural areas. And, as I mentioned before, I believe that updating and clarifying the provisions of the Act would allow FCS institutions to better serve the credit needs of today's rural America.

In closing, I would like to thank Texas A&M University Real Estate Center for the opportunity to speak at your conference today.

Capital is critical to growth and prosperity … and, please know that I am committed to creating a useful and flexible regulatory framework that will help ensure an adequate and dependable supply of capital to agriculture and rural areas.

By working together, I believe we can create and find the right solutions to meet the growing financing needs of agriculture, rural residents, rural businesses and their communities.

I look forward to listening to more of your ideas and strategies on how to advance access to capital in rural America this afternoon.

Again, thank you. God bless you … and God bless rural America.