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TO REVIEW UNITED STATES DEPARTMENT OF AGRICULTURE FARM LOAN PROGRAMS

HEARING

BEFORE THE

COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

UNITED STATES SENATE

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TO REVIEW UNITED STATES DEPARTMENT OF AGRICULTURE FARM LOAN PROGRAMS

TUESDAY, JUNE 13, 2006

U.S. SENATE,
COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY,
Washington, DC.

The committee met at 10:05 a.m., in room SR–328A of the Russell Senate Office Building, the Honorable Saxby Chambliss, Chairman of the committee, presiding.

Senators present: Senators Chambliss, Coleman, Thomas, Talent, Crapo, Harkin, Nelson, Salazar, Baucus.

STATEMENT OF HON. SAXBY CHAMBLISS, A U.S. SENATOR FROM GEORGIA, CHAIRMAN, COMMITTEE ON AGRICULTURE, NUTRITION, AND FORESTRY

The CHAIRMAN. This hearing will now come to order. Good morning.

Our hearing is going to examine the Farm Service Agency's Farm Loan Programs. The Federal Farm Loan Programs are an important source of temporary credit to help farmers get into the business or recover from a natural disaster or other setback.

The purpose of this hearing is to ensure that programs are operating in a safe and sound manner and that FSA is providing strong financial management, all the while meeting the needs of producers. There have been $3.8 billion in lending authority each year. It's also imperative that this Committee conduct the necessary oversight to ensure the program is well managed and protects farmers.

Since 1996 Congress and the Administration have worked to improve farm loan programs. Just 5 years ago they were taken off the Government Accountability Office's high risk list.

Years of well-intentioned but financially unsound policies and practices—some directed by Congress, I admit—landed them on that list. A serious effort that began with the 1996 farm bill has been successful. I sincerely hope we never again see a time when farm loan programs are considered high risk.

I would also like to express my appreciation to the Farm Credit Council and the Independent Community Bankers of America for being willing to submit testimony for this hearing. Due to time constraints we're not able to accommodate everyone who wished to testify. Please be assured that all submitted testimony will be given the same consideration as that offered orally today.

We're going to have two panels this morning. Our first panel consists of Mr. Glen Keppy, Associate Administrator for Programs for the Farm Service Agency here in Washington. He is accompanied by ms. Carolyn Cooksie, Deputy Administrator for Farm Loan Programs.

Mr. Keppy, Ms. Cooksie, welcome to you this morning. We appreciate you coming and taking the time to shed some light on what's been happening at USDA relative to these very valuable programs. We look forward to your testimony. And I will turn the floor over to you at this time.

STATEMENT OF GLEN KEPPY, ASSOCIATE ADMINISTRATOR FOR PROGRAMS FOR THE FARM SERVICE AGENCY, ACCOMPANIED BY CAROLYN COOKSIE, DEPUTY ADMINISTRATOR FOR FARM LOAN PROGRAMS

Mr. KEPPY. Thank you, Mr. Chairman.

Members of the Committee and Staff, thank you for the opportunity to review the current state of the Farm Service Agency's Farm Loan Programs at the Department of Agriculture. This is my rookie hearing on the Hill as Associate Administrator for Programs at FSA. And unlike my playing days on the field with the Pittsburgh Steelers and Green Bay Packers, I'm pleased that we're not opponents and hope there won't be any hard hits.

The CHAIRMAN. You didn't ride a motorcycle here, did you, Mr. Keppy?

[Laughter.]

Mr. KEPPY. No, I didn't. I did learn something.

FSA's Farm Loan Program is a success story. We make direct and guaranteed farm ownership and operating loans to family size farmers and ranchers who cannot otherwise obtain commercial credit from a bank, Farm Credit System, or other lenders. Our current portfolio includes $5.4 billion in direct loans and $8.7 billion in guaranteed loans.

The quality of our portfolio has improved significantly. Here are just a few of our highlights.

Losses in our direct loan program have dropped down to 3.6 percent. That's the lowest level in 20 years. Losses in our guaranteed loan program are less than one-half of one percent. That's the lowest in 10 years. The delinquency rate for direct loans is 9.3 percent, and 1.67 percent for guaranteed loans—again the lowest in 10 years.

Last year we graduated 3,611 borrowers out of FSA loans and into commercial credit. The direct loan case load to beginning and SDA farmers has more than quadrupled from 1995 to 2005. The guaranteed loan caseload has more than doubled from 1997 to 2005.

FSA continues to help minority farmers in proportions greater than the demographic percentages of the total farming population. And we remain committed to small farmers in America.

Research at the University of Arkansas studying FSA direct loan originations during fiscal year 2000 and 2003 found that 92 percent of direct loan originations went to small farmers who had less than $250,000 in gross sales. They also determined that 78 percent of FSA's direct loans originated between 1994 and 1996 have already been paid off.

Our rear-view mirror is filled with success stories.

But our attention is clearly focused on the challenging curves up ahead.

Term limits in the present statute place quantity restrictions for direct operating loan borrowers. That means 7000 borrowers have 1 year of eligibility and 11,000 borrowers have 2 years left.

Direct farm ownership and operating loan limits were capped at $200,000 more than 20 years ago. No adjustment in two decades. Considering the rising cost of farmland, energy, and other operating expenses, can farmers fully finance their credit needs today?

The Federal work force is getting older. As many as 25 percent of the current FSA loan officers will be eligible to retire within 3 years.

Through modernization, the focus on farmers and meeting farm loan program objectives, each enhanced by the hard work and dedication of FSA employees, we have made great strides in performance improvement. Using our new farm business plan FSA borrowers are now processed through a real time web based system. We have reduced direct and guaranteed loan application processing time by almost 22 percent. And we have developed the Farm Loan Program risk assessment program, which provides risk-based oversight to the areas of potential concern within our portfolios and can now easily be identified.

Thanks to having the rural delivery system coupled with the dedication and hard work of an existing team of experienced loan officers, FSA is well positioned to continue the high quality delivery of loan program initiatives to qualified American farmers.

We look forward to working with this committee so that together we might strengthen the livelihood of family farmers while ever improving reliability of rural America.

Thank you for your attention. Because I'm a rookie and I have a veteran sitting next to me here, Carolyn, we will answer questions back and forth. Thank you.

[The prepared statement of Mr. Keppy can be found on page 38 in the appendix.]

The CHAIRMAN. We recognize the expertise in Ms. Cooksie. We're pleased to have you here.

I know you've only been on the job for a few short weeks. I'll have to say that what you just reported to us and what's in your testimony is good news, particularly for folks like me who, frankly, have been very skeptical about the ability of the Federal Government to make direct loans. We've always had a default rate that far exceeds the default rate in the private sector. And there are some valid reasons why there should be a higher rate on direct loans in the private sector.

But this is the tax-payers' money. And you tell us now that the default rate is down to 9.3 percent. That's about 3 percent better than what we saw 5 years ago. And when the loss ratio is down to 3.6 percent, that's pretty significant and it does mean that we're doing a much better job both in making the loans plus collecting the loans.

So I'm pleased to see that kind of progress.

This also says that the current farm bill is working because farmers are able to generate income from the market that allows them to pay the loans back, which obviously we're always glad to see.

First of all, in Section 5301 of the 2002 Farm Bill there was a provision that I included in that Farm Bill that requires two studies of the direct and guaranteed loan programs. Both of these studies should have been delivered to us by now. One of them was due only last month. But we haven't received either one of them. When can we expect these studies?

Ms. COOKSIE. Mr. Chairman, good morning.

We have draft copies of the studies and we can hopefully give them to you shortly. One of the problems that we had with the study, the first one covered a period of May 13, 2003 to May 13, 2004. When we started the study we realized that having only 1 year to do a study, you're not going to get any meaningful information out of 1 year because most of the loans are due on an annual basis and they would be coming due during that period of time.

And then the second study is over another year period, a couple of years, 3–year period. What was decided to do was to go out with two studies again and do a study over a 5–year period into 2005. So we started 2000 to 2004. This resulted in a longer time for completion.

The other problem we had, of course, is due to budget constraints. We've had to do that particular study in- house. So it just took longer than it should have.

But we have a draft of the two reports, the combined reports. We've seen the draft and passed the draft back and forth. We've had to go through the department clearance. Hopefully, within the next 45 days or so you should be getting a copy of the report.

The CHAIRMAN. Thank you.

Mr. Keppy, in your testimony you discussed how NSA is using or transitioning to electronic and web-based systems for loan processing and financial analysis. Would you please describe the types of internal and external controls in place to fix sensitive borrower and agency information? I don't ever want to see or hear that this agency has a problem like the Department of Veterans' Affairs. That's the reason for my question.

Mr. KEPPY. I couldn't agree more with you.

The first thing that the new technology does is does away with paper copies. And I think the safeguards are in place to make sure that the electronic transactions are safeguarded against, as much as humanly possible, against the kind of thing that we've seen happen. The loan officer will have a much better understanding of the situation that the borrower has gone through, his strengths and his weaknesses.

This will be available 24/7. So it's something that desperately is needed to make sure that we're operating in the kind of situation that we need to be today.

The CHAIRMAN. I note that you have a lot of experience in FSA today relative to the making of loans under our different programs. But I know also that there will be a drain on that experience over the next several years.

Do you have a human capital management plan in place to ensure that FSA employees receive the necessary training and the agency has a pool of talent to call upon for its management positions?

Ms. COOKSIE. We do have a human capital management plan in place. We work it every day. No. 1, we have a two- year training program for any trainee who comes into the agency as a loan officer. They have to go through the training through this training program. It takes 2 year as a matter of fact, I think many associations will tell you.

Human capital is one of our biggest issues right now. And you saw between 25 and 28 percent of our loan officers over the next few years are eligible for retirement. Our stats show they're not working much past retirement.

With the human resource budget that we've had, which has gone down, it's really a problem for us that we are able to keep our employees because it takes years to train a loan officer. We don't have the resources to put them in the pipeline as early as we need to to take care of retirement and attrition.

But under the new capital plan one of the things we're doing now under the leadership of Bill Glasser, who is the Administrator, we have 30 FTEs which we got in the appropriation bill last year. And we're going to use those as FTEs until the person gets trained; then they'll be absorbed into their ceiling, and then we will roll that back out to other states to use. That's not a lot of FTEs given the human capital needs that we have and for attrition. But it's certainly a step in the right direction.

We've got a recruiting plan for when we do have positions. We've got diversity plans for when we do have positions. We do have diversity in our hiring so we do have a pretty extensive human capital plan. The CHAIRMAN. That's the average time to complete a settled loan that goes into foreclosure? How does that compare to the private sector?

Ms. COOKSIE. I doubt that it does compare to the private sector. The 1961 statute gives the farmers tremendous appeal right. They can appeal anywhere from three to 5 years. I don't think we probably do compare to the private sector on servicing because we just have a lot of statutory requirements and rights that the farmer has, and that as far as I'm aware, nobody else in that lending market offers.

So I'd say we're a lot lengthier than the average lender out there.

The CHAIRMAN. How long has that process been in place?

Ms. COOKSIE. 1950? Before I took the job in 1996. It's been at least 20 years.

The CHAIRMAN. It's something maybe we ought to look at next year as we move into the farm bill.

Ms. COOKSIE. I think there are places where we need to look at to see if it makes sense in today's world to keep it in there.

The CHAIRMAN. While we're talking about that, I know we have a $200,000 cap. Is that something that in the opinion of USDA we're going to need to take a look at?

Ms. COOKSIE. Absolutely. That has not changed in over two decades.

Farming has changed tremendously; prices have changed tremendously. 200,000 in some of the production out there will not give very much. So there's no doubt that we need to look at that.

The CHAIRMAN. What analysis has FSA done on the proposed fee increase for the guaranteed loan program and how much more will borrowers pay on the average?

Ms. COOKSIE. We did a pretty extensive analysis on what it would mean to the farmer and how much the percentage—the half-percentage rate increase would mean. And we did it based on an average loan size, 8 percent interest.

We did a 5–year term on an operating loan and a 20–year term on a real estate loan. And for an operating loan the increased payment will be $464,000, averaged about $185 pre farmer. For real estate, based on an average loan amount of 297,000 it's going to be about $136. The line of credit which they will pay every year is slightly different. The first year it will be about $738 for 1 year, and from two to 5 years it will be a little over a thousand dollars.

So we did a pretty sensitive analysis of what that would mean as an end-result to the farmer.

The CHAIRMAN. Is it your intention that these programs be funded exclusively through fees in the future?

Ms. COOKSIE. We've been told that that is what the department thinks the result will be at some point.

The CHAIRMAN. According to media reports a recent lawsuit and settlement in Oklahoma of the interest rate charged to a farmer in violation of FSA's average agricultural loan customer rules could force commercial banks to leave the guaranteed loan program. Do you think this is a real concern?

Ms. COOKSIE. I am concerned. Any time one of our lenders has this kind of a problem we are concerned.

We think that the overwhelming majority of the more than 2400 lenders that we deal with through the guarantee program are charging the correct interest rate and are not going to have a problem. But we are concerned about what's going on in Oklahoma. I hope that the end result is that if we see that bankers are not willing to use the program I think that could be an interim result of it.

The CHAIRMAN. The University of Arkansas study that's been mentioned on the effectiveness of the direct loan program indicates that FSA is reaching beginning and socially disadvantaged farmers. Please describe the Agency's outreach effort to capture these farmers.

Ms. COOKSIE. We've really gone through a tremendous effort enrolling socially disadvantaged applicants, which is by definition women and minorities all over the country. We've done a couple of things.

One of the things we've done is we've given the states goals for SDAs. They have to reach certain goals every year, and that's part of their performance plan. Each state has a number based on national averages that they're supposed to reach. And we tie that really closely with their annual performance plan. We monitor the treatment of SDA applicants more than we do most anybody else.

The states capture at least, or report to us on 50 percent of the withdrawn and rejected applications that they get in the SDA category. We initiate responses that provide all applicants with written confirmation of all applications. We really have done an all-out effort to do outreach, and the numbers are up tremendously.

The CHAIRMAN. Very good.

Senator HARKIN.

Senator HARKIN. Mr. Chairman, thank you very much. I apologize for being a little late.

I want to welcome Mr. Keppy here, a long time friend and a great family farmer in Iowa, and one of our leaders in pork production. Of course, Iowa leads in pork production. And he's been a long-time leader in that area and I'm just delighted to see you and welcome you here to your first appearance before this Committee.

I'll just ask that my statement be made of the record.

[The prepared statement of Hon. Tom Harkin can be found on page 26 in the appendix.]

The CHAIRMAN. Without objection.

Senator HARKIN. I just want—One thing I want to bring up here with you, Glen and Ms. Cooksie, is the idea of what happened when we move more and more money—Maybe we've already asked this question—but when we move more and more into the guaranteed loans for operating lines of credit. What's going to happen? How many farmers will be unable to cash-flow these higher loan rates?

We're talking about more fees, higher fees. Has FSA estimated the number of producers who will be unable to cash-flow at these higher loan fees? And, on the other hand, in the course of that will the FSA be able to assist these borrowers through either subsidized guarantees or direct loans? In other words, how many—Do you have any estimate of how many, because of these higher fees, will not cash-flow?

Ms. COOKSIE. I don't think that we can estimate how many are not going to be able to cash-flow. As you know, the farmers come in and every year their plan changes. So it's hard to figure out until they get in and they give us a business plan for us to figure out what their cash-flow is.

But having said that, I think the first year, especially on the line of credit, it's not going to be that tremendous.

What I have a concern about is the out years on the line of credit and the fact that on the line of credit they have to pay that guaranteed fee every year, which is going to be a tremendous burden on farmers. So I think the first year they'll probably be able to make it and they'll be able—I just gave some figures before you came in on lines of credit on the average loan. The first year it will be about $738, and in the out years it will be over $1100 a year.

But in dealing with the farmers and their cash-flow and margins that we deal with, that does make a huge difference to some farmers, that amount of money. So some of them, I think this first year they'll be OK. In the out years I think some of them may have a problem. And we will have to see if the guarantee does not cash-flow if we can absorb them into the direct loan program.

The CHAIRMAN. If I can interrupt just a minute. Tell us what you mean by that. You talked earlier about the two to 5 year operating loan. How does the normal operating loan work for a farmer that comes in. Is it a 1–year loan? Does he get a loan every year? Two to five years? Explain how that works.

Ms. COOKSIE. Some of them only have to get operating loans every year. Some of them are one, five, and seven years, depending on the operation and their production cycles.

The CHAIRMAN. What you're saying to Senator Harkin is that if somebody has a 5–year operating loan, let's say, and it's $200,000 a year, even though they come in and they present basically the same plan every year or maybe some small variation of the same plan every year, they're going to pay that fee all of those years, not just the first year.

Ms. COOKSIE. If they have a continuing line of credit with us, yes.

Senator HARKIN. It wouldn't have to be a new loan; it's the same number every year.

[Pause.]

I'll have to think about that.

The other thing is I read your testimony, Glen, about the performance of the guaranteed and the direct loans. It was good. It looks very nice, very good. It raises a question.

Is FSA turning away some marginal farmers, smaller farmers, to keep losses so minimal? In other words, are we playing it too safe?

Mr. KEPPY. I'm going to turn that over to Carolyn. But my answer would be yes, we use prudent information in the discussion. But we are doing what we can to make sure that the people that need these loans are getting them.

Carolyn, you've got some facts and figures.

Ms. COOKSIE. I think the answer to that is that I'm not sure. It is a struggle because it is a balancing act between which farmers you can help and which ones you can't.

Before credit reform when we had tremendous loss rates and the interest rates were higher, there wasn't that much impact on the program itself. After credit reform our delinquency rate and our loss rate started to reflect that. So if we have high delinquency rates and high interest rates it hurts every farmer in the country who wants access to this program because we don't have the money for their loans.

On the other hand, in this program low interest rates and loan loss rates aren't the only things you have to worry about. So it's a balancing act.

I think we aren't turning away farmers who clearly need the program in connection with cash-flow. Because of the statute we can't turn them away. But it is a balancing act that we go through all the time.

Now if you think about that, quite frankly, on the one hand we see the lower number and we work toward that. On the other hand we worry that sometimes we don't reach all the farmers that we need to reach. But on the other hand, there's a margin there that you have to say no.

Senator HARKIN. What kind of data do you have to show over the last several years the percentage who have applied and are turned down?

Ms. COOKSIE. We have that data.

Senator HARKIN. Could you supply me that data? I'd certainly like to look what it's like over the last ten years or so.

Ms. COOKSIE. We have data on how many applied and how many were rejected and how many were withdrawn.

Senator HARKIN. It would be interesting if you would break that down by state.

Ms. COOKSIE. We'll do it for you.

Senator HARKIN. One last thing. We had some crop losses last year in southeast Iowa, a pretty tough drought situation down in your area and a lot of farmers applied for emergency loans and were not qualified. And a lot of them were turned away. And there was a lot of conversation about that.

Again data: Do you have data on the number of emergency loan applications that were denied over the last several years?

Ms. COOKSIE. I think we do. We have data on each application as they file it. And we can break that down into emergency loans, yes.

Senator HARKIN. One last thing. Ms. Krub's testimony—she's on the next panel—I've read her testimony. She claims that FSA has a lax attitude on borrower's rights. She states in her testimony that: "Agency decisionmakers are increasingly missing statutory deadlines for making determinations on loan applications and loan servicing requests."

I want to get your response to that.

Ms. COOKSIE. I'm a little surprised to hear that. Our application process times are overall down 22 percent.

Senator HARKIN. Are down?

Ms. COOKSIE. 22 percent overall.

The statutory deadline for processing the application is 60 days. The regulations that we put out to the field offices basically tell them they have 30 days. We're doing it in about 12 and a half right now.

So we're well below not only the statutory deadline but well below the regulatory deadline. We work on it every year. As a matter of fact, that's one of our goals that we give to the field offices at of the performance plan, how long it takes to process an application.

Senator HARKIN. You're saying you have it down to 12 days?

Ms. COOKSIE. 12 and a half days, national average.

So I think we've made great strides in that. Are there isolated instances of almost everything? Because of our portfolio, which is so large, probably so. There are anomalies out there all the time. But our national averages don't show it.

We pretty much know when people are missing deadlines and we can monitor that, and we do monitor it, not only on our application processing times but we're getting ready to do it on things like the 951(s) and all the other sorts of items out there.

I think we are getting much better at that. And I don't see overwhelmingly nationwide we're missing deadlines.

Senator HARKIN. Thank you very much.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Salazar.

Senator SALAZAR. Thank you very much, Chairman Chambliss, and Ranking Member Harkin.

Let me just say at the outset that I appreciate the work that the Farm Service Agency does. I remember a long time ago when I was a beginning farmer going to the FHA and receiving a loan that allowed me to get a 320 acre operation down in southern Colorado, and working with the agency director and going through the process of the whole application. And you continue to do good work to help people get started.

I have three questions. One is in the area of direct emergency loans, in terms of the $500,000 in direct emergency loans.

But if you look at what's happening across the country in agriculture, particularly in my state today, I think we're going to see many farmers, in large part because of the weather and related circumstances we find ourselves in in Colorado—we went through the driest year on record about 5 years ago and this year was going to be second to that year—so we've been having lots of problems, I can tell you. I was wondering where the Agency, what you expect to happen during this farming season relative to applications for direct emergency loan assistance, and whether you are prepared to respond to these requests.

Ms. COOKSIE. We are absolutely prepared. No. 1, we had a carryover from several years ago, fully enacted funding to take care of most of the ones this year.

When a state gets emergency requests and they're overwhelmed by the volume we have what we call our jump team to go into states to help process applications that they can't handle in a timely manner. So I think we're poised to handle emergency applications that we have even if we have somewhere where we have a great influx of them all at one time.

Senator SALAZAR. When you talk about the carryover from the past, what leads you to the conclusion that we have enough money?

Ms. COOKSIE. We've got right around $140 million right now, somewhere in that ballpark, that we can extend this year.

Senator SALAZAR. $140 million for emergency loans?

Ms. COOKSIE. Emergency loans nationwide.

Senator SALAZAR. And from your point of view that will be enough to cover the requests that will come in during the summer and fall?

Ms. COOKSIE. Yes. Our fiscal year ends September 30th, so we're in good shape for this fiscal year. September 30, then we start another budget year. Most of that money that is not used this year is carried over to the next fiscal year. So we'll just carry it over. I think we have adequate funds to handle the requests.

Senator SALAZAR. Following up on a question that Senator Chambliss asked on the loan limits, I think in your testimony you talked about the $200,000 ownership loan limit as well as the $200,000 direct operating loan limit.

What's your recommendation of what kind of adjustment we should make with respect to those limits?

Ms. COOKSIE. We are looking at that right now. The Secretary as you know, has spent hearing sessions on farm bill items so we're in the process right now of figuring out what those items are and what recommendations are going to be on that. We're either going to recommend that each level like OL and FO get bumped up or we will ask for some overall level.

And you don't just say you have this much for operations, this much for ownership. It's a combination of both. But I don't think a decision has been made yet on how much the recommendation is going to be.

Senator SALAZAR. In your testimony you also describe the subjectivity related to the definition of family farmer. I think you speak about it by saying that we need to move away from the more subjective definition of a family farm and develop more objective definitions related to the farmer's filing with—the annual tax return and the like.

Explain what the problem is here that you're trying to address there and what the recommendation is that you are trying to move to as a more objective determination.

Ms. COOKSIE. The simple answer is that we're just trying to figure out what the heck a family farm is so that statutorily we may call it a family farm. And we don't know what that is. It's different where I'm from in Kentucky than it would be from Georgia or Montana. It depends.

So one of the problems that we're having is to confirm a little bit figuring out what that actually is and trying to quantify that so that we can make sure that we're within our defined definition in the statute of the family farm.

But we found out about a year ago, we tried to do a proposed rule on the definition of a family farm. We got 1600 comments and they were all different in what they thought a family farm was. It was a problem and it continues to be one. Until we have a definition we'll have to struggle with that.

Senator SALAZAR. What would your proposal be relative to how we should define a family farm as we look at the rewrite?

Ms. COOKSIE. I found out from the proposed rule that I don't really have a proposal. I just know that we don't have a conclusion on what a family farm is nationwide. Senator SALAZAR. Mr. Keppy, do you have a response to that question on how we define a family farm?

Mr. KEPPY. In the pork-producing world anybody that has one more sow than I is a large farmer.

[Laughter.]

Mr. KEPPY. That's an issue that good luck on because it's going to be tough to come up with. But I am willing and we are willing as a Department to work with the people on the Hill to come up with a workable definition.

Senator SALAZAR. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Talent.

Senator TALENT. Thanks, Mr. Chairman. I appreciate your holding hearings and the ranking member, and I appreciate your service.

Let me go on a little bit on your proposed changes. Let me just say right up front, I've seen guaranteed loan programs work well in a lot of different contexts. And I'm very concerned that your proposal is going to have the effect of marginalizing the program; just basically so reducing access to it that it would defeat the purpose of it. So let me get to the heart of that.

You are proposing increases in fees of 150 percent, to I guess as much as three or four times what they now are. I sent a letter to you all signed by a number of senators pointing out the problems and asking you why you were doing that. And I got the response that you were responding to a budgetary necessity because of the problems with the operating deficit.

Are you all saying that this is a budget-driven kind of change?

Ms. COOKSIE. Absolutely we would say it's budget- driven.

Senator TALENT. Let me just say to you then, Congress determined in the last farm bill that we wanted to move in this direction to take pressure off the direct loan program to help sustain the family farming sector. The guaranteed loan program reflects I think that statutory judgment about how best to balance the needs of the farming community for a hedge against low commodity prices, disasters, et cetera, with the concerns to protect the taxpayer as well.

When you make a proposal for a change of this magnitude it seems to me that the effect of it is to defeat the balance Congress was trying to structure. Your job is to execute the laws, not to try and change the laws in the guise of a budgetary proposal.

Do you have any comment?

Ms. COOKSIE. We only charge presently a 1–percent fee. The proposed rule that's out right now changes both operating and farm ownership by half a percent. So it will go from 1 percent to one and a half percent. Then we put in a new line of credit.

Senator TALENT. It's pretty devastating, really. 75 basis points per year for operating lines of credit. I presume that this was on instruction from the Office of Management and Budget.

Let me say, Mr. Chairman, I chair the Small Business Committee. We encounter this every year. Only we have the foresight to put into the statute that they couldn't make these changes without Congressional approval. I would just strongly urge the Committee that that's a change we need to make in the next farm bill. I might also suggest, Mr. Chairman, that since it's clear to me that in this whole area of guaranteed money— not just the farms but small business—that the Office of Management and Budget is driving the policies. We ought to have them down here. These folks can't answer these questions. And they've been very honest and I appreciate their candor. It's a budget-driven thing. It's not something they would have done except they were told to d it.

We ought to get representatives from OMB down here who are driving this and ask them what they're doing to protect the American farmer because they're the ones that set the policy.

I appreciate this hearing but I think this is a great idea.

What is the default rate on guaranteed loans? The default rate is 1.4 percent. What was it last year?

Ms. COOKSIE. The default rate is 1.7.

Senator TALENT. Oh. That's the delinquency rate, which is comparable to private lenders.

This is a program that is working. Again, I'm not trying to take it out on you. You're the ones that have to be in front of us. But this program is working. And if they're going to take the safety net away from farmers I don't think there's any way they can do it by rule.

So I've seen this over and over again over the years. We ought to get OMB down here and let them explain it. We ought to find out if whoever is driving this has ever even been on a farm. Sometimes I wonder about that.

Thank you Mr. Chairman.

Thank you, guys.

The CHAIRMAN. You make a good point.

And the issue relative to the size of the loans is another policy by OMB. And I think the fact that we've had a lot of these numbers in place for a couple of decades is an indication we need to review the overall program.

Senator TALENT. I understand where these officials are coming from, Mr. Chairman. What I've said reflects my frustration that these decisions are being made by people who generally don't come before the Committee and can have a devastating effect on this program, which is working; which, frankly strikes the right balance. So I certainly will work—and we have a lot of senators who signed the letter that I sent the Department to ensure that this doesn't happen without Congressional approval.

If we can't trust the executive branch to follow the law we need to put additional safeguards in the law.

Thank you, Mr. Chairman.

The CHAIRMAN. Those decisions are also being made by folks who have no idea whether or not a peanut grows on a tree or which end the cash is on.

Thank you very much for your participation this morning. You've been very helpful. We look forward to staying in touch as we move forward over the next several months. Thank you.

Our next panel will come forward.

Dennis Everson, President, Agribusiness Division of the First Dakota National Bank in Yankton, South Dakota; Betsy Senter, National Association of Credit Specialists, FSA, and National Association of Federal Managers, from Gregory, South Dakota; and Ms. Karen Krub of the Farmers' Legal Action Group, Incorporated, in St. Paul, Minnesota.

[Pause.]

Thanks to each of you for being here this morning. We look forward to your testimony and your response to questions.

Mr. Everson, we'll start with you.

STATEMENT OF DENNIS EVERSON, PRESIDENT, AGRIBUSINESS DIVISION OF FIRST DAKOTA NATIONAL BANK

Mr. EVERSON. Thank you, Mr. Chairman, members of the Committee. I'm pleased to be here representing the American Bankers Association. Again I am Dennis Everson, president of the Agribusiness Division of the First Dakota National Bank in Yankton, South Dakota.

We're a community bank in Yankton. We have about $623 million in total assets with about 202,000 operating loans in our portfolio. In addition, we service about $333 million of loans that we actively participate in the secondary market with.

The FSA guaranteed farm loan program has enabled 46,000 farmers and ranchers to have 62,500 loans with an outstanding principal balance of $8.9 billion at the end of fiscal 1905. Every year approximately $2.2 billion of new credit is advanced under the FSA guaranteed loan program in the form of approximately 10,300 new loans. The average loan size is $212,000 in fiscal 1905.

I am pleased to report to you that banks make more loans under the FSA guaranteed loan programs than anyone else. Today there are 3,222 participants and lenders that participate in the FSA. Of that number 93 percent are banks.

Considering the fact that FSA guaranteed loans were made to those farmers and ranchers having some sort of credit deficiency, the losses incurred in the program has been very modest. This is a great success story that does not get told enough. Loan losses are low because banks make the credit decision and banks are responsible for servicing the loan from cradle to grave.

The success of guaranteed loan programs is due to the dedication of bankers and FSA personnel who are focused on constant program improvement. We are concerned about several recent proposals and other developments that we believe will negatively impact the future programs used by banks.

One, ABA opposes increasing the fees on the FSA guaranteed loan. We believe that increasing loan fees in the FSA guaranteed loan program is inconsistent with the goals of the program, which is to help those farmers and ranchers that need some additional support for their borrowing. ABA's recommendation: We oppose increasing the fees on FSA guarantees. Further, we request level funding for the FSA guaranteed loan program at a level that would allow annual guaranteed loan making in the area of 2.5 to three billion range, consistent with the annual demand over the past few years.

In addition, we support legislative language that would prohibit USDA from raising fees without Congressional authorization.

The second issue, use of the term 'average agricultural loan customer interest rate' should be abandoned. ABA's recommendation: This provision should be repealed. Market forces should determine the price of credit.

As the regulations currently stand, any bank that writes a guaranteed loan today is exposed to additional lender liability because no one can define who is an average agricultural loan customer. This provision does not protect borrowers. Instead of making more credit available, more lenders will stop using the program to avoid lender liability.

Third issue: Borrower term limits are significant obstacles to credit access for farmers and ranchers. In the mid–1990's Congress sought to limit the amount of time the borrower would be eligible for either direct or guaranteed credit from FSA. The 2002 farm bill suspended borrower term limits. The ABA supported the suspension.

When the 2002 legislation expires, term limits take effect again and the results would be devastating to those farmers and ranchers who still need additional support that an FSA guarantee provides them.

ABA's recommendation: Language imposing borrower term limits should be repealed. The last issue: The definition of family farm must be revised. FSA has attempted to define a family farm many times for purposes of determining loan eligibility. All of these attempts have failed. ABA's recommendation: FSA should adopt the definition that can be objectively measured, not subjectively measured. We recommend the definition of a family farm be limited to two criteria: One, the majority of the credit needs of the borrower are met under the FSA guaranteed loan limits; two, the entity being financed files a Federal farm tax return.

In summary, the FSA guaranteed farm loan program is an important tool that banks use to provide credit to the broadest array of farmers and ranchers. Without it a significant segment of the farm/ranch population will have a difficult time finding credit. We have made great strides in making this program work more efficiently for everyone, and we hope we can continue to make additional improvements.

Thank you for this opportunity to express the views of the American Bankers Association. I will be happy to answer any questions.

[The prepared statement of Mr. Everson can be found on page 27 in the appendix.]

The CHAIRMAN. Thank you very much.

Ms. SENTER.

STATEMENT OF ELISABETH B. SENTER, CONFERENCE CHAIR, FEDERAL MANAGERS ASSOCIATION, USDA NATIONAL ASSOCIATION OF CREDIT SPECIALISTS,—FARM SERVICE AGENCY

Ms. SENTER. Chairman Chambliss, distinguished members of the Senate Committee on Agriculture, Nutrition and Forestry, I sit before you today as a former president of the National Association of Credit Specialists of FSA and the chair of Federal Managers of USDA Policies.

On behalf of the 1700 managers and the larger Federal manager community, let me take a moment to present our organizations views today. We appreciate your leadership in assuring the stability of farm loan programs. I am currently a farm loan manager in Winner, South Dakota, where I provide making and servicing of a diverse loan portfolio serving farmers and ranchers. As loan manager I work daily with a variety of customers who do not qualify for direct loans from private lenders for legitimate reasons but still have a viable operation worthy of Federal support.

Since the passage of the 2002 farm bill the farm loan program continues to meet the needs of rural farming communities around the country. Between the authorization of bridge loans, changes to the beginning farmer down payment program, reduction in bureaucratic tape and the increase of low document loans, the agency has done well by the actions of the Congress on the 2002 farm bill.

As the measure is set to expire at the end of the year, Congress is in a critical position to address some issues we believe would strengthen the program. For starters, term limits on direct and guaranteed loans present an unrealistic timetable for customers to move away from Federal assistance.

I work with a family in South Dakota that began farming 6 years ago and has 1 year of direct operating loan eligibility remaining. As of today, it looks like they will not harvest any spring grain and will incur a significant financial setback due to dry weather in our area. With only 1 year of FSA loan eligibility remaining it is not likely they will be able to prosper enough between now and then to meet commercial lending standards. Eliminating the term limits would give this family and similar families around the country more time to get on their feet and build an economically sustainable farm or ranch.

To further assist farmers and family size farmers and ranchers, we believe the loan limit of 200,000 is outdated. This level for direct operating and farm ownership loans was established more than 20 years ago and does not meet the needs of modern day operations. By increasing the loan limits to $300,000 we will be able to offer more meaningful financing.

Earlier this year the president proposed an increase in guaranteed loan fees in his budget proposal for USDA in fiscal year 2007. These fees would be charged to the commercial lenders, who would then pass the costs directly on to the customer. This seems to contradict the purpose of the program's effort to help financially needy farmers to obtain money for their operations.

While these three reforms would help address some of our concerns with the technical aspects of the farm loan program, there are larger issues threatening the stability of our overall operations.

The impending retirement tsunami within the Federal Government threatens to rob the farm loan program of its most valuable asset: human capital. According to an FSA study 28 percent of loan officers will be retirement- eligible as of 2008, while 50 percent of the supervisory employees will be eligible in the same timeframe. What's more, it takes 18 to 24 months to train a loan officer.

In Michigan if all the employees who are currently eligible to leave retire 11 counties of the 83 counties would have no loan officer present. Within 2 years 46 percent of the State of Michigan has the potential to have no loan officer coverage for FSA.

Perhaps the most challenging obstacle our agency faces is the state of our information technology hardware and software. Outdated computers, servers and applications at times force us to send customers home without service because our operations are down. Every year budgets seem to reduce our funding for information technology and adversely impact our ability to work well with our customers.

We believe that the farm loan program portfolio is in good financial standing. However we foresee a potentially dangerous storm brewing, a combination of questionable economic conditions, unknown weather patterns, human capital deficiencies, technology failures, and bureaucratic hindrances on the horizon, a preventable scenario that could be harmful to the rural American agricultural industry.

We believe elimination of term limits, increase of loan limits, keeping the current fee structure for guaranteed loans, paying greater attention to growing attrition rates, and improved agency resources in IT could head off a potential disaster before it reaches critical mass.

We encourage you in your capacity to address these issues and help us provide the best service for farmers and ranchers in rural America.

Thank you again for the opportunity to appear before you. I'll be pleased to answer any questions you may have.

[The prepared statement of Ms. Senter can be found on page 60 in the appendix.]

The CHAIRMAN. Thank you.

Ms. KRUB.

STATEMENT OF KAREN R. KRUB, FARMERS' LEGAL ACTION GROUP, INC.

Ms. KRUB. Thank you, Mr. Chairman and Committee members. I appreciate the opportunity to testify here today and to bring to the Committee's attention concerns of farm loan program borrowers about the program's operation.

I'm a senior staff attorney with Farmers' Legal Action Group in St. Paul, Minnesota. And I'd like to take a minute to describe FLAG and explain how we come to know about borrowers' experiences in the Farm Loan Program.

FLAG is a non-profit law center that provides legal education, training, and support to family farmers and ranchers and their lawyers and advocates across the country. Over the past two decades FLAG has worked to improve the accessibility of USDA's credit and disaster programs and to help farmers understand their rights and obligations in those programs, and also the administrative review processes under those programs.

As part of this work FLAG has monitored and extensively commented on changes to the FLP. FLAG has prepared various legal education materials about the FLP and has distributed them to thousands of farmers and ranchers across the country.

FLAG attorneys also field hundreds of calls and letters from farmers and ranchers every year. Through these conversations we have learned much about farmers' actual experience with FLP and have identified serious concerns with the agency's implementation and administration of the Farm Loan Programs. And I will highlight a few of those concerns here.

The first concern is whether the Farm Loan Programs are being implemented in such way to meaningfully increase the availability of loans to credit-worthy farmers and ranchers who are otherwise unable to obtain financing. One aspect of this is the pervasive sense among borrowers that we talk with that there is simply no small money to be had, that the larger loans are consuming all of the limited program funding.

There are also concerns that banks are shifting existing borrowers to the guaranteed loan program so that the program's funding is depleted without actually increasing the number of farmers who have access to credit.

Second, the agency's current proposal to gut the Farm Loan Program regulations and rely instead on internal directives to administer the program and to return broad discretion to the local office personnel is a fundamental step backwards for the agency and for borrowers.

It is essential that clear information about the handling of loan applications and servicing requests remain part of the rule so that every applicant and borrower is treated appropriately.

Similarly, limited discretion for agency staff under the direct loan program has a historical context that must not be forgotten. Borrowers are justifiably wary of policy changes that would reopen areas of discretion that have been narrowed to address prior abuse.

Third, direct loan borrowers affected by the devastating hurricanes in 2005 are very concerned about the double- payment that will be coming January 1st.

The agency's actions in the wake of the hurricanes last fall to quickly provide debt relief to borrowers was admirable. However, rather than using the model of the successful existing program, Disaster Set Aside, through which disaster affected farmers can defer the loan payment to the end of the loan term, the agency opted to defer the borrowers' loan payments for just 1 year so that borrowers are looking at a double- payment this January 1st.

Not surprisingly, borrowers who went through the hurricanes haven't had sufficient time to recover enough to be able to handle a double-payment just 6 months from now.

There are obstacles faced by applicants and borrowers in the programs to exercise and see the benefits of the administrative appeal rights that they have. There continue to be serious problems with the agency not properly notifying applicants and borrowers of their appeal rights and not implementing the decisions when borrowers are successful.

Finally, I'd like to take a moment to address some of the comments that Ms. Cooksie made about the 951(s) aspect of loan servicing. The 12 and a half days she was talking about for the turnaround time is with respect to applications; that was not responding to loan servicing requests. She said she was still getting those numbers.

Also the 1951-Sloan restructuring was from the 1987 Ag Credit Act, that is when it came into play. It doesn't in fact require different types of servicing than a commercial lender might do. It's loan consolidation, extending the term of the loan, changes in interest rates. These are things a commercial lender might do. What the Ag Credit Act does is that it requires FSA to consider these things if the borrower asks them to before accelerating and foreclosing.

At a minimum, the Act's requirement says that the right the borrower has is that if the government would be no worse off restructuring rather than foreclosing then the agency should restructure. I wanted to clarify that.

Thank you.

[The prepared statement of Ms. Krub can be found on page 50 in the appendix.]

The CHAIRMAN. Thank each of you for your testimony.

Mr. Everson, from your perspective as a banker, how is the farm sector doing this year? Are there any parts of the country that concern ABA and your members at this point?

Mr. EVERSON. Very much so, Mr. Chairman. The Midwest, it's no secret that the drought is a huge issue for us at this point, certainly in the area my bank services loans in.

A bigger issue is all the input cost increases that we've seen this year, including fuel and fertilizer as well as escalating land prices. I had a strategic planning session with my staff just a week ago, and one of the things that is a major objective next year is, let's get geared up on the FSA guaranteed portion.

We know we have a lot of borrowers that are going to need us this year unless conditions change, both economically and weatherwise.

The CHAIRMAN. In your testimony you urge continued suspension of the term limits. Yet farm loan programs exist to provide temporary sources of credit.

Shouldn't we figure out some method by which farmers can graduate to private sources? And, of course, that's what we intended to do by the term limits. But talk to us a little more about that.

And Ms. Senter, I would ask that you address this, too, since you directly responded to that in your testimony.

Mr. EVERSON. Certainly.

First of all, the term limits that are in place, again, as I said, need to be suspended. I think it's difficult as it is many times to come up with a subjective measuring stick, if you could: How long is too long?

Because I have a lot of young borrowers and sometimes—I call the young borrower 45 years old with two sons going into the business. Consequently we do graduate a lot of borrowers. We have been involved in that in our process in our bank. But there are some borrowers with a significant increase in capital requirements in the business today that will continue to need guaranteed lending specific to their respective cases.

Again it might be a very young borrower, maybe another operator who had several children who are wishing to return to the farm. So it's very difficult to become objective in determining what that would be.

The CHAIRMAN. Ms. Senter.

Ms. SENTER. I would have to say, Senator, that I think that the graduation policy or the graduation regulations that we have in place, as Carolyn Cooksie mentioned, is working. We've graduated over 3000 borrowers. I think those rules are in place.

I don't think that the term limit should be used as a graduation tool because there are customers that maybe have some problems or have maybe a risky operation that require Federal assistance just a little longer than maybe would be on the average. But these customers are worthy customers and they need our support.

Also what we've noticed, too, is the dollars that are coming back from farm program payments are going down. Interest rates are going up, fuel costs are going up. We've had a lot more interest from the banks and from the customers also that are interested in our credit because of these risk situations. Interest rates going up at the banks makes a big difference.

The CHAIRMAN. What about loan levels, Mr. Everson? Does ABA have anything relative to what we should do with regard to loan levels?

Mr. EVERSON. With respect to the direct program, Mr. Chairman

The CHAIRMAN. Yes.

Mr. EVERSON. I don't believe that we have a recommendation in that area.

But given what we've heard this morning I agree totally that the farming sector has changed dramatically and those limits need to be increased. As of this time we have not crafted a proposal as to what that may be.

The CHAIRMAN. Ms. Senter, as an FSA credit specialist, you do have a unique perspective on farm credit issues. In your experience, what would you describe as being a typical farm loan customer?

Ms. SENTER. A typical farm loan customer in my area of South Dakota might be very different than the east coast or west coast. But I think when you're talking about sales of $250,000 or less, it might be in that vicinity in my ticular area. East coast, west coast, the scenarios might be totally different.

We found, you know, that agriculture is changing. It's diversifying into a lot of different crops and different areas that we're not familiar with in our area. We are wheat, cattle, maybe some corn area. But it's so diverse that it makes it difficult to be rock solid in your definition of what that size is in our area.

I talked to a customer recently. I said 'What is the typical cattle ranch? How many cows is that?' It might be 300 cows in a big family size operation. In order to be profitable with the cost of family living and fuel and other things it takes about that much.

The CHAIRMAN. What's the average cast load per credit specialist, and is that too much, too little, or about right?

Ms. SENTER. I think what we've seen is we've seen the case load probably 150 to 200 customers maybe. I'd say maybe more than 100, 150. This varies across the country.

What we notice, too, is that employees may be in different places, that we have shortages in one area and maybe we're a little long in other areas. But agriculture has changed where we may be dealing with maybe a little larger operator, maybe less operators than we did before.

But with our credit and the way we are structured we have to work very closely with the banks in order to make these operations successful.

The CHAIRMAN. In her written testimony Ms. Krub expresses concerns about FSA's streamlining initiative because it would not provide farmers a reliable method of accessing information and it would give more authority to the local office employees.

Would you care to comment on that?

Ms. SENTER. Like I said, Ms. Cooksie has led us into the streamlining project. And I think the intent was to reduce the regulation. A lot of our regulation was directly out of the Conn Act. It was hard for customers maybe to interpret that.

The change in regulations might be a little difficult for customers. But I do think that that information is probably accessible. Maybe it's a little hard to get to on the Internet. I haven't personally tried that. But I think that will be available to the customers.

The CHAIRMAN. Ms. Krub, some of the concerns you raise, such as providing farm loan program advice to borrowers, seem to be easily resolvable.

Is your organization working with the FSA on issues like this?

Ms. KRUB. We certainly try to.

The response that Ms. Cooksie made to Senator Harkin's question earlier about the failure of the agency to respond within their own timeframes for loan servicing requests, when she referred to the anomalies and "things happen" those seem to be the kind of responses that we get, whisch aren't terribly meaningful to the individual farmer who has any experience of it.

We have not had any luck agency-wide with getting the national office to address this, which is one reason why I wanted to bring them to the attention of this committee.

The CHAIRMAN. Regarding your concern about national appeals decisions, why does FSA appear to have trouble implementing them?

Ms. KRUB. I don't know why. I just know it's certainly not in every situation. I can give you an example.

There's a farmer in North Carolina who submitted a loan servicing request in 2003 who has since been through three National Appeals Division hearings and has been successful in every hearing. With every determination that came from NAD, the agency requested additional financial information. The farmer has within the timeframe set provided all the information and still does not have a resolution.

You know, the borrower community interpretation of that is if FSA doesn't like the decision they sometimes just won't implement it. And when NAD was created, that [NAD] staff is very explicit about this when we raised this concern with them, they don't have any enforcement authority. The farmer's only recourse is to file a Federal complaint. That's beyond the capability of almost everybody who is a direct loan borrower.

The CHAIRMAN. Senator Talent.

Senator TALENT. How would you all describe the effect of the proposed increases in the guaranteed loan program on the program? Would it be marginal, would it be substantial, devastating, or somewhere in between those?

Would you like to describe that? Mr. Everson, maybe you could start.

Mr. EVERSON. I'd be happy to.

In the calculations we have done the increase—we have talked about a lot of dollars today, but not how it might increase—but let's look at it on a percentage basis. We're going to increase the cost of that interest cost to that customer in a range of somewhere between 100 to 200 percent, depending on the type of loan that they're making application for in the guaranteed loan program. That's substantial in light of already escalating interest rates in the market.

The other thing that I think is very important to understand here is that we talk about these charges relative to the claims that are seen today within the system. What happens if there are more claims in the future? Those fees could increase substantially beyond even what we're looking at today, which would take that 1– to 200 percent, perhaps 300 percent, which again seems like we've got a really very efficient program that doesn't exist.

Senator TALENT. Would you say that the effect would be to very substantially reduce the loan portfolios and the number of farmers able to take advantage of them?

Mr. EVERSON. Yes, I would say it would be substantial.

Senator TALENT. Just to get at the purposes of the guaranteed loan program, I was jotting down a few considerations. And see if you agree with this:

It seemed to me that this information was intended by the Congress to provide capital for the younger farmers in response to the problems with aging among family farmers, given the importance of farms to the rural economy, the need to sustain the values of the land and the country, and the need which the Office of Management and Budget never seems to recognize: to sustain the system that has provided the safest and most abundant food supply in the history of mankind.

Congress made a judgment that it was worth a small subsidy every year in order to get these benefits. Would you agree that those are the benefits of the guaranteed loan?

Ms. SENTER. Yes, I would have to agree with that.

I think, speaking about the guarantee fees in general, I think the whole concept would be devastating because you have to understand that the customers that are moving—a lot are moving from direct financing from our agency to hopefully be a commercial banking customer totally. And you're charging them a 1–percent fee, which most people can ignore that. When you start charging .75 basis points on every year, I did some quick calculations—and I think some of our members did—I saw this was more than $2000 for the term of the load, more than $6000 for an average loan. That's a significant increase to customers that are struggling and trying to move to commercial credit.

The other thing is that we found that in areas that are affected by disasters, Federal Crop Insurance, the averages are working their way down, so there's no safety net there. So then you couple that with a bank that's going to charge this customer an additional fee, how are you going to pay some of these fees and continue to operate? The banker might say we can't do it without a guarantee; therefore we're not able to help you.

Senator TALENT. The thing that bothers me, the program reflects the judgment that there is a layer of prospective borrowers out there who really do have performing loans. They have loans that are good loans, but for a lot of reasons—a lot of them having to do with regulations— you guys can't make the kind of loans based on character, maybe, that 20 years ago you could have made. And this guaranteed loan program enables you to do it within the limits by which you're regulated by your agencies.

In other words, you couldn't make these loans without getting heat from your other regulators. But you can on a guaranteed basis. And the very fact that the loss rate is so low to me reflects that the program is working and accomplishing the objectives.

I know, Mr. Chairman, you think I am beating a dead horse here. But I feel strongly about this. I've seen it in other contexts. I'm glad we had the opportunity to raise this issue here.

Thank you, Mr. Chairman.

The CHAIRMAN. You raised that point, and Senator Harkin and I were talking off the record here about this. And this is something we obviously need to look at as we go through the appropriations process. I think the House has already taken some action on this issue. And we need to look at whether or not we need to do the same.

Senator TALENT. It's not for the Office of Management and Budget to overturn—we gave them authority over a piece to make sure that the program operated properly, not so they can reverse a judgment that Congress made in the last farm bill.

I really think that's what's going on here.

The CHAIRMAN. Thank you very much for being here this morning. Thanks for your valuable testimony. We look forward to continuing the dialog with you right through the next farm bill.

With that, this hearing will be adjourned.

(Whereupon, at 11:15 a.m., the hearing was adjourned.)

A P P E N D I X

June 13, 2006

Opening Statement
Senator Tom Harkin
Hearing on Farm Loan Programs
June 13, 2006

Mr. Chairman, I want to thank you for having this very timely hearing. The farm loan programs help those who otherwise would not be able to participate in production agriculture by giving them the opportunity to farm. These programs target small and beginning farmers and those who are socially disadvantaged. Direct lending by the Farm Service Agency provides only about 3 percent of the credit needs of U.S. agriculture, but for those farmers who qualify, the loans make all the difference. Without this assistance, U.S. agriculture would be less diverse.

Guaranteed loans allow family farmers who could not otherwise qualify for credit from commercial lenders to obtain needed credit. I am troubled by the Administration's decision to increase the fees on guaranteed loans. With rising interest costs and increased costs of production, I cannot imagine a worse time to ask borrowers to bear the cost of the loan program.

As we prepare for the next farm bill, we need to consider how we can improve the farm loan programs to assure that those farmers who need assistance qualify for credit and eventually develop profitable farming operations. We need to carefully consider how these programs can be improved.

I look forward to hearing the witnesses' statements, and I will have a question or two at the appropriate time.

Testimony of Dennis Everson

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

United States Senate

Committee on

Agriculture, Nutrition and Forestry

June 13, 2006

AMERICAN
BANKERS
ASSOCIATION ®

Testimony of Dennis Everson

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Committee on

Agriculture, Nutrition and Forestry

June 13, 2006

Mr. Chairman and members of the committee I am pleased to be here today representing the American Bankers Association (ABA) to discuss the agricultural credit programs offered by the United States Department of Agriculture, Farm Service Agency (FSA) and to give you our industry's recommendations on how these programs can be improved to allow the banking industry to better meet the credit needs of more farmers and ranchers.

My name is Dennis Everson and I am President of the Agri-Business Division at First Dakota National Bank in Yankton, South Dakota. I am a former Chairman of the American Bankers Association's Agricultural and Rural Bankers Committee (ABA). I am currently a member of the board of directors of the South Dakota Bankers Association, and I serve on the board of directors of the Federal Agricultural Mortgage Corporation (Farmer Mac). My bank, First Dakota National Bank, is the oldest bank in what was the Dakota Territory, and my bank is also the oldest Farm Service Agency Preferred Lender (PLP) in the United States. First Dakota National bank has $623 million in total assets, $203 million in agricultural loans, and we service total agricultural loans of $333 million.

ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

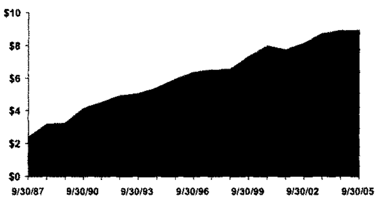
The Banking Industry Works Closely With USDA To Meet the Credit Needs of Farmers and Ranchers

I am pleased to report to you that the relationship between the banking industry and FSA is strong and that we are all working together to provide credit to farmers and ranchers who would not be able to get credit without the guaranteed loan program. Thanks to the determination of my peers around the country, and the willingness of FSA to constantly make adjustments and improvements to their programs, the FSA guaranteed farm loan programs enabled 46,000 farmers and ranchers to have 62,500 loans with an outstanding principal balance of $8.9 billion at the end of FY 05.

Every year approximately $2.2 billion of new credit is advanced under the FSA guaranteed loan program, in the form of approximately 10,300 new loans. Loans are made to purchase and improve farm real estate, build new farm buildings, make conservation improvements, purchase machinery, livestock, and crop inputs, and refinance debt.

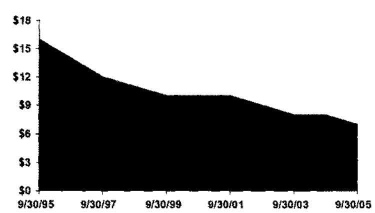
The credit made available under these programs is going to modest sized farms and ranches as the average guaranteed loan in FY 05 was $212,000. Twenty-six percent of all FSA guaranteed loans made in FY 05 went to farmers and ranchers who FSA defines as beginning farmers, and nearly twelve percent of all guaranteed loans were made to farmers and ranchers who FSA classifies as socially disadvantaged farmers.

FSA Guaranteed Principal Outstanding
($ in Billions)



Source USDA

FSA Direct Loan Principal Outstanding
($ in Billions)



Source USDA

The Transition from Direct USDA Lending to Credit Guarantees Has Gone Well

For the last 30 years Congress and succeeding administrations have supported the transition from direct USDA loans to providing credit guarantees to private sector lenders (and government backed lenders like the Farm Credit System). Private sector lenders do a better job of underwriting and servicing agricultural credits, and FSA's role is to oversee the lenders. In addition, instead of hiring a large field staff to administer a direct loan portfolio, the guaranteed loan programs leverage the assets of the commercial lenders to do the field work. However, guaranteed loans do not work for every farmer and rancher. Even with a 90% guarantee against potential loan losses, not all producers can qualify for this type of credit. Congress and succeeding administrations have continued to fund a direct loan program to meet the needs of these very limited resource farmers.

Banks Make the Most Guaranteed Loans

I am pleased to report to you that banks make more loans under the FSA guaranteed loan programs than anyone else. Today, there are 3,222 lenders that participate and of that number, 93% or 2,987 are banks.

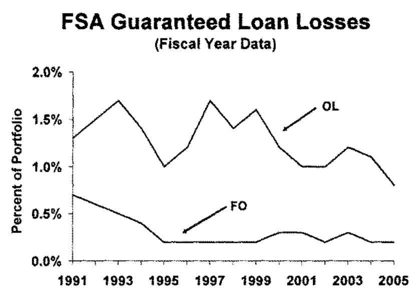
Banks provide the overwhelming number of farm loans that are guaranteed by FSA

Source. USDA

The Preferred Lenders Program

Earlier I mentioned that First Dakota National Bank is the oldest FSA Preferred Lender in the country. This program, long championed by the American Bankers Association, and implemented by FSA in the late 1990s allows banks like mine to assume more responsibility for the loan making and loan servicing functions once FSA approves the process under which we manage agricultural credit making. Once we have achieved PLP status, we can process loans faster than ever before. Today, as a PLP lender I can get an approval from FSA within three days. This process has allowed me to work with my customers much more efficiently. There are currently 160 PLP lenders throughout the country.

FSA Guaranteed Loan Losses Have Been Very Modest



Source USDA

Considering the fact that FSA guaranteed loans are made to those farmers and ranchers who have some sort of credit deficiency, the losses incurred under the program have been very modest and have been comparable to non guaranteed lending by banks and other lenders. This is a great success story that does not get told enough. Loan losses are low because banks make the initial credit decision, and are responsible for servicing the loan from cradle to grave. In addition, private sector lenders know that FSA will not pay on the guarantee until the lender liquidates and accounts for all of the collateral that was pledged for the loan. Private lenders must strictly adhere to FSA policies and procedures in order to ensure that the guarantee will be honored in case of a loan loss. Any bank that has had experience with guaranteed loan liquidations knows that FSA is very thorough in their settlement procedures. Over the years, led by the American Bankers Association, the banking industry has worked closely with FSA to ensure that bankers understand the unique responsibilities that come with the credit guarantee.

The Banking Industry and FSA Are Committed to Constant Program Refinement to Continually Improve Program Delivery

The relationship has not always gone swimmingly between FSA and private sector lenders over the past thirty years. FSA personnel, who were trained to be very focused on providing supervised credit directly to farmers and ranchers, were skeptical about changing their focus from direct lending to providing credit guarantees to banks and others. Banks and their regulators questioned if FSA would honor the guarantee if there was a loan loss. The lack of understanding between the two sides resulted in some early program delivery problems that at times seemed insurmountable. By the 1990s, it was clear to everyone that things had to change in order for the program to meet the expectations of policy makers, and of the farmers and ranchers who would benefit the most if program delivery issues were resolved. In 1992, Congress authorized the Preferred Lenders Program, but rollout was delayed as USDA reorganized Farmers Home Administration and the Agricultural Stabilization and Conservation Service into a new agency, the Farm Service Agency.

In the middle 1990s bankers began a series of discussions with FSA personnel that has resulted in many positive improvements to the program. These "stake holder" meetings are designed to bring bankers and FSA personnel together to talk about how things can be done better, and to gather ideas for future program enhancements. These meetings have been phenomenally successful as can be seen in the growth of the program from the late 1990s to today. In addition, a group of bankers who specialize in guaranteed loan making and servicing have been meeting together annually for the last seven years to discuss how the program is working and to share process improvements. No one makes these people travel from all over the country to get together annually; they do it because they are helping their farm and ranch customers by making the program a success.

A robust secondary market for FSA guarantees has developed during the same period. Many banks now sell their FSA guarantees to Farmer Mac so the banks can re-liquefy, and make more credit available. The customer benefits because banks are able to offer more fixed rate financing since, by selling the loan the interest rate risk is shifted from the customer and the bank to the secondary market.

More recently, FSA has adopted loan analysis software that is the same that is used by thousands of banks, thus further aiding constructive conversations every day between FSA personnel and private sector lenders.

All of this progress has created a large and dedicated national affinity group composed of bankers and FSA personnel who are focused on constant program improvement, with an eye on better serving those farmers and ranchers who need some additional financial help. The success of the FSA guaranteed loan programs over the years is due to the willingness of all parties to openly express what is good for future program development.

We are concerned about several recent proposals and developments that we believe will negatively impact future program use.

ABA Opposes Increased Fees on FSA Guaranteed Loans.

We believe that increasing loan fees on the FSA guaranteed loan program is inconsistent with the goals of the program, which is to help those farmers and ranchers that need some additional support for their borrowing, but that could qualify for commercial credit if they had some additional support.

As we understand the Administration's proposal, the guaranteed loan program administered by FSA would stop being an appropriated program, and would be transformed into a fee based program. FSA plans to implement the new fee structure starting on October 1, 2006.

According to the proposed rule published by FSA in the *Federal Register* on May 15, fees are to increase across the board from 90 basis points (bps) to 150 bps on all loans, with an annual maintenance fee of 75 bps on guaranteed operating lines of credit. The public has until July 14, 2007 to review and comment on the proposed rule.

What does the proposed fee increase mean in costs to an average borrower? The following two scenarios outline what the fee is under existing regulations, followed by what the same producer could expect to pay under the new FSA proposal:

Current Regulation

A farmer borrows $150,000 to finance equipment and $75,000 to plant crops.

The banker structures the credit request in the form of 2 separate loans:

- A $150,000 term loan amortized over 7 years
- A $75,000 line of credit that can be paid back and re-advanced over a 5 year period

USDA requires a fee of .90% (90 bps) on the entire package:

$225,000 X .90%= **$2,025.** If the customer does not change their credit package during the term of the loans; this is the entire cost to acquire the credit.

Proposed Fee Structure

USDA is proposing the following fee structure:

$150,000 term loan X 1.50%= **$2,250**

$75,000 line of credit X 1.50%= **$1,125** ***plus*** an annual fee of .75% each year just to have the line of credit available.

- Year 1 $75,000X..75%= $563
- Year 2 $75,000X..75%= $563
- Year 3 $75,000X..75%= $563
- Year 4 $75,000X..75%= $563
- Year 5 $75,000X..75%= <u>$563</u>

Total for line of credit = **$2,815**

Total cost of the <u>same credit package</u> under FSA's new proposal = **$6,190. This is a 167% increase.**

A fee increase of this magnitude will have a negative effect on the program, because it will impact those farmers and ranchers that can least afford an increase in their costs. We are also concerned that the increased fee could result in some farmers and ranchers being disqualified for guaranteed loans altogether, which would place additional demands on the already limited direct loan program.

Finally, without an annual appropriation to support the guaranteed farm loan programs future fees could range widely year to year, a fact that USDA acknowledges in the proposed rule. The federal government calculates what the cost of providing a credit program like the FSA guaranteed loan program by annually calculating the "subsidy rate". The subsidy rate varies by loan program and is based, in part, on the previous year's loss experience for the particular loan program. If there were a drought in one part of the country that caused the loss rate for the guaranteed line of credit to increase, for example, the subsidy rate the following year would be increased, meaning that there would be less loan funding available because the government's cost of providing credit had gone up under that program. In order for FSA to continue to be able to provide the same level of funding, FSA would have to increase fees again.

Recommendation: The ABA opposes increasing the fees on FSA guarantees. Further, we request level funding for the FSA guaranteed loan program, at a level that would allow annual guaranteed loan making in the $2.5 to $3.0 billion range, which is consistent with annual demand over the past few years. In addition, we support legislative language that would prohibit USDA from raising the fee without Congressional authorization.

Use of the Term, "Average Agricultural Loan Customer Interest Rate", Should be Abandoned

Banks and other lenders that make loans using FSA guarantees are supposed to price guaranteed loans based on a concept that is impossible to define. Due to the inability of anyone to objectively define the concept, banks that make guaranteed loans have been exposed to increased lender liability. This month, for example, a small bank in Oklahoma was forced to pay $2.127 million to settle a lawsuit based on the claim that the bank charged the customer an interest rate that was higher than the "average agricultural loan customer rate".

The statute authorizing the guaranteed loan program, for loans sold into the secondary market (7 USC Sec. 1929(h) (2)) states the following:

> "The interest rate payable by a borrower on the portion of a guaranteed loan that is sold to the secondary market under this chapter may be lower than the interest rate charged on the portion retained by the lender, but shall not exceed the average interest rate charged by the lender on loans made to farm and ranch borrowers."

The Farm Service Agency has taken this definition from the federal statute and has applied it to all FSA guaranteed loans. FSA's handbook, "Guaranteed Loan Making and Servicing" (2-FLP) requires that each lender comply with the following:

> "Neither the interest rate on the guaranteed portion nor the unguaranteed portion may exceed the rate the lender charges its average agricultural loan customer."

We do not believe that FSA has done an adequate job of objectively defining "average agricultural loan customer" because they do not know what it is. Is that an average rate on all loans that are currently outstanding at a particular institution? Is it on loans of the same duration? Is it for all types of loans made to anyone who is a farmer or rancher? The statute is unclear, and FSA's regulation is equally problematic. Essentially both the statute and the regulation attempt to define what cannot be clearly and objectively defined.

Market forces should determine the rate of interest charged on loans guaranteed by FSA just as market forces determine the interest rate charged on all other financial products offered by banks. The agricultural credit marketplace is very competitive. The internet has created a great deal of transparency about interest rates, loan terms, and collateral requirements. The marketplace is transparent. Attempts to impose an artificial cap on interest rates have backfired. Instead of it being a protection to the borrower, it has exposed the lending community to additional lender liability, resulting in a reduction in the number of banks and other lenders that are willing to use the program. The net result will be that fewer farmers and ranchers will get the credit they need. The small bank in Oklahoma I spoke about earlier will no longer use the program.

Recommendation: The provision in statute should be repealed, and FSA should eliminate all references to pricing from their regulation. Market forces should determine the price of credit. As the regulations currently stand, any bank that writes a guaranteed loan is exposed to additional lender liability because no one can consistently define who is an average agricultural loan customer. The statute and the regulation does not protect borrowers. Instead of making more credit available, more lenders will not use the program.

The Resumption of Borrower Term Limits Will Represent a Significant Obstacle to Credit Access for Farmers and Ranchers

In the mid 1990s Congress sought to limit the amount of time that a borrower would be eligible for either direct or guaranteed credit from FSA. *The Farm Security & Rural Investment Act of 2002* suspended what is commonly referred to as borrower term limits. ABA supported the suspension. When the 2002 legislation expires, term limits again take effect and the result could be devastating to those farmers and ranchers who still need the additional support that an FSA guarantee provides them in meeting their credit needs.

While we strongly support the idea that all farm and ranch businesses should be able to stand entirely on the strength of their individual balance sheet and earnings statements, we recognize the reality that there will always be a number of farms and ranches who will require some type of credit enhancement in order to continue to fund their operations. Requiring these firms to meet an arbitrary deadline for eligibility is inconsistent with the program.

Recommendation: Language imposing borrower term limits on FSA direct and guaranteed loans should be repealed.

The Family Farm Definition Needs to Be Based on Fact, Not Subjective Factors

Over the years FSA has attempted to define a family farm, for purposes of determining eligibility, in many different ways. These attempts, no matter how well intended, have failed.

For example, the current definition requires lenders to subjectively determine if the farm is "***recognized*** in the community as a farm", and that it "has a ***substantial*** amount of the labor requirements for the farm and non-farm provided by the borrower's immediate family", and that it "may use a ***reasonable amount*** of full-time labor and seasonal labor during peak loan periods". (2-FLP pages 6 and 7, emphasis added)

We are concerned that some legitimate family farms do not qualify for a guaranteed loan because of the subjective nature of the definition. Approval officials differ based on their interpretation of the regulation. Without a definition that can be objectively defined and clearly documented, there will continue to be uneven application of the definition around the country.

Recommendation: FSA should adopt a definition that can be objectively measured and documented. We recommend the definition of a family farm be limited to two objective criteria; the majority of the credit needs of the borrower are met under the FSA guaranteed loan limit (currently $852,000 and adjusted annually for inflation) and the entity being financed files a federal farm tax return (1040 Schedule F or appropriate corporate form).

Recommendations to Improve the Interest Assist Program

Perhaps one of the most useful, but scarce resources USDA has available to assist farmers and ranchers who need some additional financial assistance is Interest Assist (IA). A farmer or rancher who can not meet cash flow requirements under commercial interest rates may qualify for IA if his lender is willing to continue financing the operation. Under the program, FSA buys down the lender's interest rate by 4% by paying the lender the 4% that is shaved off the borrower's loan rate. The borrower benefits because they pay a greatly reduced interest rate. The lender benefits because they are able to continue the credit relationship and are made whole for the reduction in the interest rate. We believe that IA fills an important gap between those borrowers who can only qualify for direct loans from FSA and those who could qualify for a guaranteed loan if they did not have to pay full market rate. Interest Assist has been criticized for being expensive because it is a direct payment, but the loans are still made and serviced by private sector lenders, which presents a far lower cost structure to the government than if the loans were made and serviced directly by FSA.

Interest Assist provides lenders with additional tools that can be used to provide a greater range of customers with access to capital. The program continues to be relevant and important to financing a segment of producers that could not be reached without it. We believe that IA should be better defined and targeted so the maximum number of qualifying farmers and ranchers benefit.

In late 2005 FSA published a proposed rule seeking to revise some aspects of the Interest Assist program. The Agency has not yet finalized the proposed rule. We would like to restate and amplify several of our recommendations from that comment letter:

Who Should Benefit From Interest Assist?

Every year the IA program is over subscribed. Current regulations allow any farm or ranch borrower to receive IA if their cash flow indicates they have a need for it. Given the scarcity of Interest Assist, we believe who benefits from IA should be better targeted so that the limited funding is used to meet a clearly defined set of criteria. We believe that a discussion between the lending community and FSA would be the best forum for deciding how to establish better targeted and more objective criteria for who should benefit.

Maximum Interest Assistance Payment

FSA proposed to reduce the maximum amount of debt on which an applicant may receive IA from $852,000 (at the present time) to $400,000. We disagreed with FSA about placing a limit of $400,000 on the amount of debt eligible for IA. We are concerned that the proposed rule would limit a benefit that Congress intended to be available across the board. Based on this concern we opposed reducing the debt level upon which an applicant may receive Interest Assist.

Summary

The guaranteed farm loan programs administered by FSA and extended to producers by the banking industry have worked well. The commitment by the banking industry and by FSA to constantly seek ways to improve the program has created an effective and cost efficient public-private partnership. Fifty thousand farmers and ranchers have credit because over 3,000 private sector lenders understand, support, and use the program.

The program is efficiently administered and serviced because banks deploy their resources to service the loans which have resulted in minimal loan losses. In FY 05, for example, loan losses were only .2% on loans secured by farm real estate, and .8% on non real estate secured loans. Given all of the uncertainties of farming and ranching, and the fact that these borrowers require a credit enhancement to qualify for commercial credit, it is a remarkable achievement.

The FSA guaranteed farm loan program is an important tool that we use to provide credit to the broadest array of farmers and ranchers. Without it, a significant segment of the borrowing population would have a much more difficult time finding capital. We have made great strides in making this program work more efficiently for everyone, and we hope that we can continue to make additional improvements.

Thank you for the opportunity to express the views of the American Bankers Association. I would be happy to answer any of your questions at this time.

Testimony of Glen Keppy
Associate Administrator for Programs
Farm Service Agency
United States Department of Agriculture

before the

Committee on Agriculture, Nutrition, and Forestry
United States Senate
June 13, 2006

Mr. Chairman, and members of the committee, thank you for the opportunity to appear before you to review the current state of Farm Loan Programs (FLP) at the Department of Agriculture. I am pleased to be able to share vital administrative and FLP accomplishments by the Farm Service Agency (FSA) over the past several years. We will provide a brief overview of our key programs, a comparative analysis of current trends versus where we were ten years ago, and perspectives of ongoing implementation challenges we face as we continue to administer FLP.

Farm Loan Programs Overview
FSA makes direct and guaranteed farm ownership (FO) and operating loans (OL) to family-size farmers and ranchers who cannot obtain commercial credit from a bank, Farm Credit System, or other lenders (Chart 1). FSA loans can be used to purchase land, livestock, equipment, feed, seed, and supplies. Our loans can also be used to construct buildings or make farm improvements.

Under its Farm Ownership and Farm Operating Loan programs, FSA has the following amounts outstanding:

- Direct Farm Ownership: $2.928 billion
- Guaranteed Farm Ownership: $5.311 billion
- Direct Operating Loan: $2.524 billion
- Guaranteed Operating Loan: $3.428 billion

Emergency loans are also available to help producers recover from losses in counties declared or designated as disaster areas or plant and animal quarantine areas and contiguous counties. Other programs include the Indian Tribal Land Acquisitions Loan Program (ITLAP) and the Boll Weevil Eradication Loan Program.

FSA loans are often provided to beginning farmers, ranchers and applicants designated by the Congress as socially disadvantaged (SDA) who cannot qualify for conventional loans because they have insufficient financial resources. FSA provides temporary assistance to established farmers who have suffered financial setbacks from natural disasters, or whose resources are too limited to maintain profitable farming operations at commercial lending rates and terms. FSA guaranteed loans provide conventional agricultural lenders with up to a 95 percent guarantee of the principal and/or interest losses should the borrower default. The lender is responsible for servicing a borrower's account for the life of the loan. All loans must meet certain qualifying criteria to be eligible for guarantees, and FSA has the responsibility to monitor the lender's servicing activities. Farmers first apply to a conventional lender, which then arranges for the FSA guarantee.

FSA makes and services direct FO and OL loans. We provide direct loan customers with credit counseling and supervision so they have a better chance of success in their farming operation. To qualify for a direct loan, the applicant must meet the eligibility criterion as well as show sufficient repayment ability and pledge collateral to fully secure the loan.

Modernization Trends
Agriculture is a very dynamic industry. Recent changes in the operating environment have been enormous. This requires that FSA also must be aggressive in keeping pace and must modernize our operations.

Briefly, our recent accomplishments include:

Farm Business Plan. Business plans for FSA borrowers are now processed through a Web based system. This provides access to "real time" data on our portfolio while sharing data among our automated systems. This system also provides a reporting option. We have established some standard reports that reveal the financial status of our portfolio. In the future, we will be developing additional reports that will allow us to assess the impact of economic changes in the agricultural sector so that we can anticipate their impact on our borrowers. This also allows lenders to provide information to FSA on guaranteed loans electronically. In the future, we expect that borrowers and applicants using this software will be able to provide their financial information to us via the Web.

This system has allowed our loan officers to conduct more extensive and meaningful financial analysis of our borrower's portfolios thus enhancing their opportunities for success and graduation to commercial lending.

Currently, we are moving all of our automated systems to the Web. When this project is completed we will eliminate duplicate data collection and farm loan services will be delivered more efficiently. Our employees will be able to conduct USDA business from any location where there is broadband, WIFI or dial-up Internet access. This will allow us to conduct business with producers at locations and times convenient to them. Additionally, this information will be stored on a centralized server allowing employees to quickly access portfolio information and provide real time management reports.

Guaranteed Loans are processed under the Guaranteed Loan System (GLS), an integrated software system shared between USDA's Rural Development and FSA. GLS has been Web enabled since May 2001, with ongoing refinements to make it more efficient and user-friendly. Lenders will soon have access to the system to report their loan closings, which will further reduce the time of finalizing the guarantee transaction.

FLP Streamlining. FLP is in the final stages of streamlining regulations on its direct loan programs (guaranteed loan regulations were streamlined in 1999). This streamlining effort will provide FSA employees with additional time to devote to servicing other customer needs. Once implemented, it will deliver three key benefits:

1) Consolidate and reorganize 13 CFR parts into five parts and 42 instruction manuals into four handbooks;
2) Modify loan making and servicing processes within current statutory authorities; and
3) Improve, rather than eliminate, existing program processes.

Farm Loan Programs Risk Assessment (FLPRA). FSA developed a risk based oversight program to identify areas for potential risk in our portfolios. State reviews are conducted by national FLP staff once every five years and by state office staffs who must review one-third of their service centers each year. Potential risk areas are separated into three broad categories:

1) Program Management;
2) Program Objectives; and
3) Financial Integrity.

Data is obtained from the FLP automation sources. This process was piloted in FY 2005 and implemented in FY 2006.

800-Number. In February 2006, FSA introduced a new 24-hour, toll-free line that borrowers can call to get information on their accounts. They can check their current account status, loan balance, due date of the next installment, historical data on their various loans, and general information – such as the amount of interest paid – to help them in calculating their income taxes.

To date, the 800-number has received more than 1,200 calls. FSA will be expanding awareness of this resource by highlighting its availability on year-end statements sent to each borrower, as well as on all courtesy reminder notices that are sent 60 days before payments are due.

Comparative Framework: That Was Then – This Is Now
The quality of our portfolio has improved significantly due in large part to our modernization efforts, better customer service and the dedication of FSA employees, as well as the much improved farm financial environment of the past six years.

FLP continues to emphasize the importance of processing applications in a timely manner. Between FY 2001 and FY 2005, FLP reduced its direct application processing timeframes by nine days (20 percent), and reduced guaranteed processing timeframes by four days (22 percent).

Loss Rates. In FY 2005, losses in the direct loan program fell to their lowest level in nearly twenty years – just 3.6 percent. FSA has experienced a steady decrease in direct losses over the past decade, from a high of 11 percent in FY 1996 (Chart 2).

Losses for FY 2005 in the guaranteed loan program were 0.4 percent, the lowest level in at least 10 years (Chart 3).

Delinquency Rates. As with losses, the direct loan delinquency rates are at historic lows for the past two decades at 9.3 percent for FY 2005 (Chart 4). 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 federal payments, salaries and income tax refunds to delinquent borrowers.

In the guaranteed program, the FY 2005 delinquency rate was 1.67 percent, the lowest since 1995 (Chart 5).

Foreclosures. Foreclosure rates continue to be very low in the direct loan program. In 2005, FSA participated in 229 foreclosures, including cases initiated by other lenders against individuals who also had loans with FSA. This represents less than one-third of 1 percent of the agency's direct loan caseload, and is a slight decrease from the previous two years, when the rate was just over the one-third of 1 percent level.

Inventory Properties. Inventory farm properties – those that have come into government ownership through voluntary conveyance or foreclosure – are also at historic lows with just 133 farms covering 25,000 acres in FY 2005. Just a decade ago, FSA held nearly 1,800 farms covering 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 3,611 direct loan borrowers (4.63 percent) were able to graduate in FY 2005, a percentage comparable to the rates over the past ten years.

Beginning and SDA Farmer Participation. FSA has annual performance goals in place for field offices that reflect the Government Performance and Results Act requirements. These goals include increasing lending to beginning and SDA farmers and ranchers.

FSA continues to provide assistance to minority farmers in greater proportions than their demographic percentage of the total farming population (Chart 6 / Table 1).

FSA has increased the amount of loan funds obligated to beginning farmers and ranchers and to SDA applicants. The FSA direct loan beginning farmer caseload increased from 3,474 in 1995 to 15,704 in 2005. During this same period the FSA direct SDA caseload increased from 3,260 to 14,238. Guaranteed caseloads for beginning farmers and ranchers and SDAs were first reported in 1997. The FSA guaranteed beginning farmer caseload increased from 3,617 in 1997 to 7,910 in 2005. During this same period, the FSA guaranteed SDA caseload increased from 1,730 to 3,015.

Independent Study Results

Now, these improvements just cited are not our only assessments. Independent research verifies that FSA direct loan programs are operating effectively, and make a significant, positive impact on the groups they are intended to serve. Researchers at the University of Arkansas recently conducted a comprehensive review of FSA direct loan programs. In one facet of their research, they studied loan originations in fiscal years 2000-2003 and found that 92 percent of the direct loans originated in those years went to small farmers, that is, farmers with less than $250,000 in gross sales. They found that although FSA farm loans assist only 4 percent of all farmers, because FSA farm loans are targeted to family farmers, an estimated 18 percent of all non-hobby family farmers depend on FSA for at least a portion of their financing.

The researchers also examined longer term outcomes of FSAs FLP. They reviewed the status of farmers who received loans between 1994 and 1996. The research found that 78 percent of the loans made during this period had been satisfied. They also found that of all the loan recipients during that period, only 11 percent left farming involuntarily. Bear in mind that all of these farmers cannot get commercial financing when they come to FSA for a direct loan.

In one key finding, the researcher concluded that given that direct loan recipients typically have weakness in their financial profiles and would likely have difficulty qualifying for commercial credit, the direct FLPs are largely servicing the intended clientele based on the agency's mission. Study findings, and other indicators in this testimony, clearly show that FSA's FLPs are doing a remarkable job of accomplishing what can only be described as challenging program objectives, and controlling operating costs and losses, as well.

Ongoing Challenges

As we look ahead in the ever-changing environment, FSA will face significant and ongoing challenges in the years to come. Some of the most prominent are term limits, loan limits, staffing constraints, and finding ways to help beginning farmers overcome the barriers to enter production agriculture.

Term Limits. The statute presently limits a borrower to direct OL loans in each of seven years, with an additional one-time, two-year waiver on an individual case basis:

- There are more than 7,000 FSA borrowers who can only receive direct operating loan assistance one more year from the agency; and
- There are more than 11,000 FSA borrowers who can only receive direct operating loan assistance two more years from the agency.

Without FSA direct loan assistance, many of these borrowers may be forced out of farming as they may not have access to the capital necessary for them to conduct their farming operations.

The statute presently limits borrowers with guaranteed OL loans to 15 years of eligibility, with receipt of a direct OL loan also counting as a year of eligibility for guaranteed OL loans. The 2002 Farm Bill suspended enforcement of this provision, but the suspension expires on December 31, 2006. Once the statutory suspension expires, more than 500 borrowers will be ineligible for any further assistance. An additional 1,200 borrowers will become ineligible for further assistance during 2007.

Loan Limits. The direct farm ownership loan limit ($200,000) was last adjusted in 1978. The direct operating loan limit ($200,000) was last adjusted in 1984. These limits are not adjusted annually for inflation. Due to a statutory change in 1998, guaranteed loans are adjusted annually.

With the rising costs of farmland and operating expenses, these direct limits restrict the ability of direct loan borrowers to sustain their family operation and make it difficult for a beginning farmer to get started in farming.

Staffing Challenges. We estimate that as many as 25 percent of FSA's current loan officers will be eligible to retire by the year 2009.

On average, it requires about two years to hire and train a loan officer in order to provide the level of effective supervision, expertise and customer service needed to maximize every opportunity for success for FSA borrowers. The two year training window for new loan officers complicates an already cloudy staffing forecast.

FSA's portfolio and borrowers could be exposed to financial risk if retirement attrition projections for loan officers are even marginally accurate. A large percentage of FSA borrowers are either beginning farmers or financially stressed borrowers who need financial supervision. FSA loan officers provide this supervised credit which requires a complete knowledge of FSA programs, finances, and agriculture enterprises.

Barriers for Entry Level Farmers and Ranchers. There are some obstacles that make it difficult for entry level farmers and ranchers to launch production agriculture operations. There are several underlying factors that create barriers, including:

1) Initial capital investment;
2) High land values;
3) Inability to access credit;
4) Lack of farm succession planning;
5) Increasing interest rates; and
6) Higher energy costs.

Conclusions

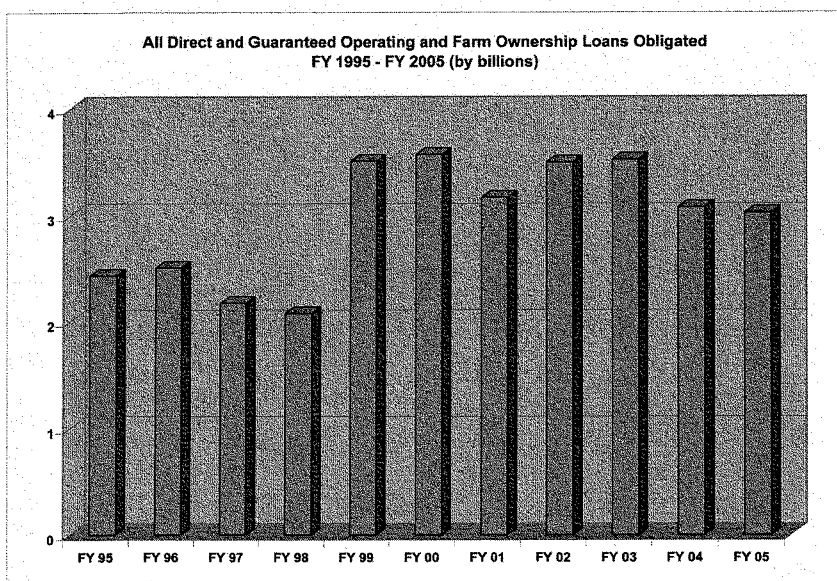
Through modernization efforts, maintaining focus on program objectives, and the hard work and dedication of FSA employees, FSA farm loan programs have made great strides in improving program performance. Loan failures and losses have declined which is a strong indication that the program mission of helping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

However, more challenges lie ahead. Government resources are increasingly limited and the agriculture production landscape is changing. The structure of agriculture continues to change as most farms become larger and increasingly more reliant on technology, resulting in increased capital needed to gain entry. The cost of assets required to operate a farm continue to increase as well. 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 will continue efforts to modernize the delivery system, 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, the FSA farm loan programs staff is well positioned to continue the high quality delivery of existing programs and new initiatives to assist small, beginning, and minority family farmers. We look forward to working with this Committee to address the challenges we face in accomplishing this worthwhile mission to strengthen family farmers and rural America.

APPENDIX

Chart 1



$ Billions

Chart 2

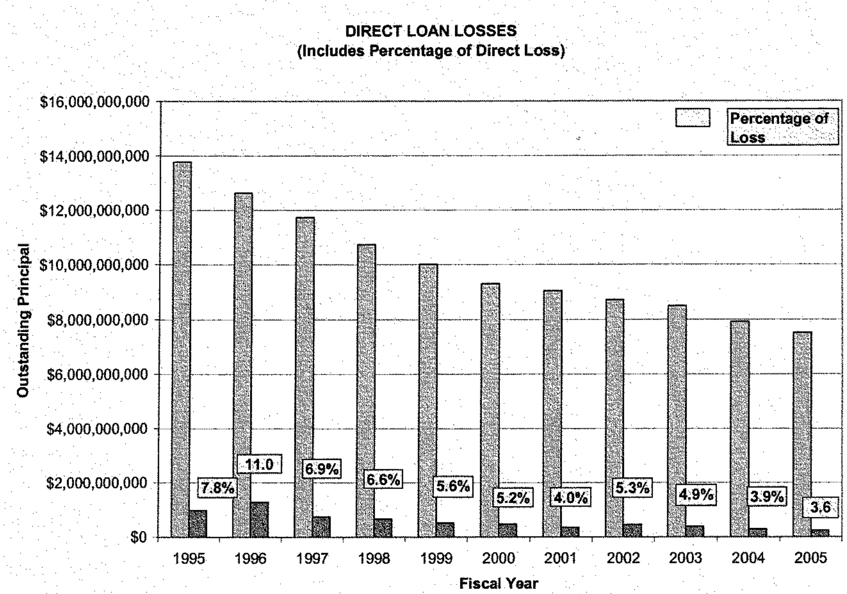


Chart 3

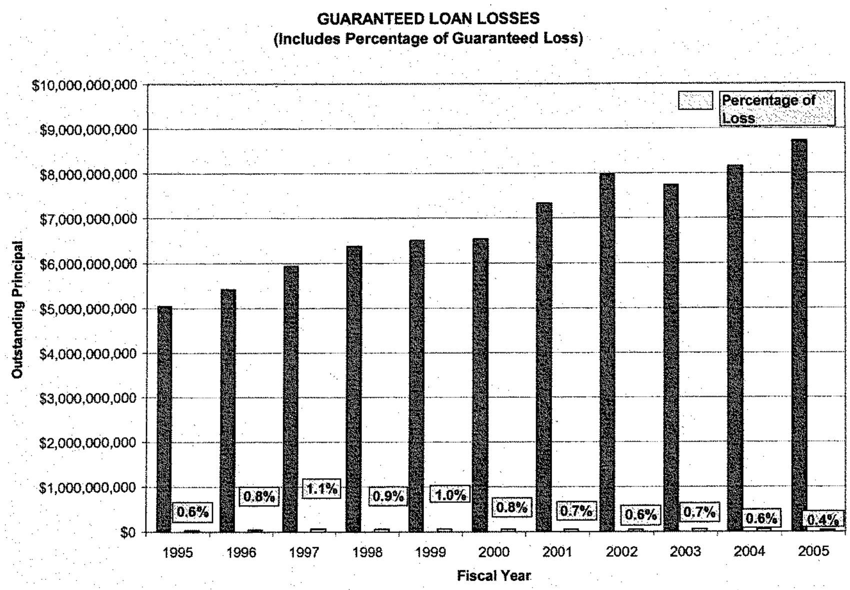


Chart 4

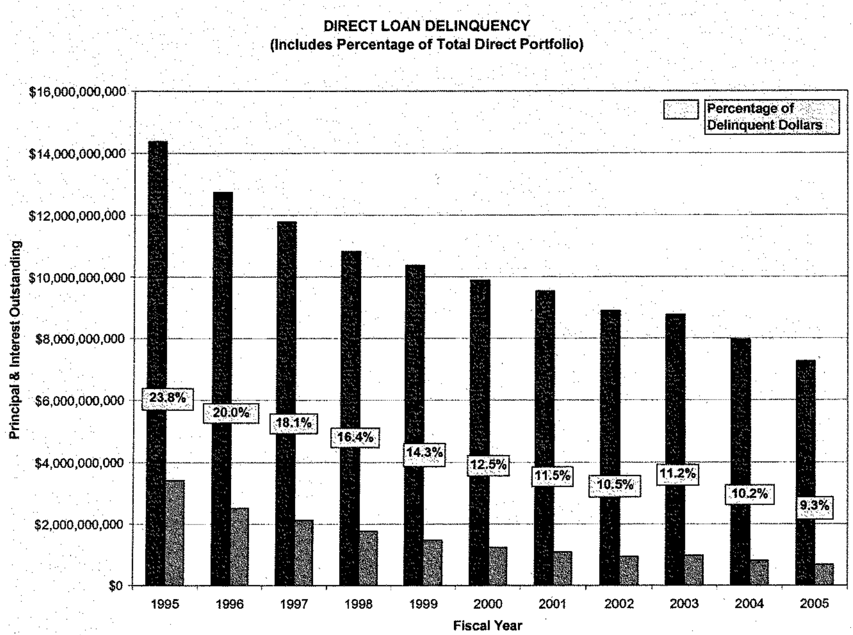


Chart 5

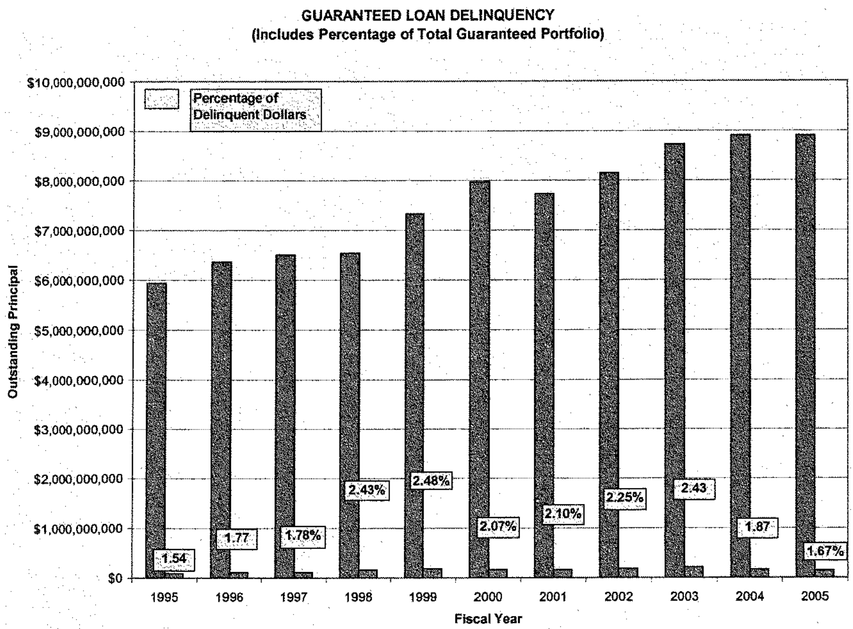
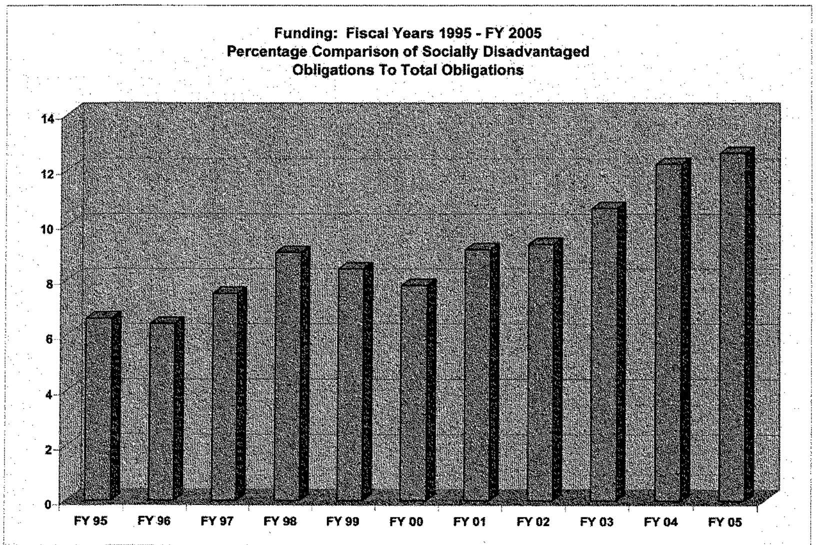

GUARANTEED LOAN DELINQUENCY
(Includes Percentage of Total Guaranteed Portfolio)
Percentage of Delinquent Dollars
Outstanding Principal
$10,000,000,000
$9,000,000,000
$8,000,000,000
$7,000,000,000
$6,000,000,000
$5,000,000,000
$4,000,000,000
$3,000,000,000
$2,000,000,000
$1,000,000,000
$0
1.54
1.77
1.78%
2.43%
2.48%
2.07%
2.10%
2.25%
2.43
1.87
1.67%
1995
1996
1997
1998
1999
2000
2001
2002
2003
2004
2005
Fiscal Year

Chart 6



Percentage of Obligations to Total Obligations

Chart 6 / Table 1

FY 2005 BORROWER CASELOAD BY RACE
(As Compared to 2002 Census Data)

	Percent of 2002 Census Population	Percent of FY 2005 Direct Caseload	Percent of Population being served by FSA Direct Farm Loans	Percentage of FY 2005 Guaranteed Caseload	Percent of Population being served by FSA Guaranteed Farm Loans
White	97.46	88.13	3.16	95.38	1.77
Black	1.37	3.74	9.53	0.59	0.78
Asian/Hawaiin	0.44	0.92	7.30	2.09	8.56
Amer Ind/Al Nat	0.73	2.77	13.24	1.46	3.61
* Hispanic	N/A	4.27	N/A	0.37	N/A
Other	N/A	0.17	N/A	0.12	N/A

* Hispanic Americans are not a separate race category within the 2002 Census of Agriculture, therefore no reliable comparison can be established.

FLAG

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My name is Karen R. Krub. I am a Senior Staff Attorney with Farmer's Legal Action Group (FLAG) in Saint Paul, Minnesota. Thank you for the opportunity to present this testimony regarding the USDA Farm Loan Programs (FLP). I appreciate the opportunity to give a voice to the programs' farmer and rancher borrowers. The concerns I raise here today have been developed in coordination with the National Family Farm Coalition and others dedicated to improving access to credit for family farmers and ranchers.

FLAG's Work on Behalf of FLP Borrowers

Farmers' Legal Action Group, Inc. (FLAG) is a nonprofit, public interest law center that provides legal education, training, and support to family farmers and ranchers and their lawyers and advocates across the country. Over the past two decades, FLAG has provided legal assistance to thousands of small and mid-sized family farmers throughout the nation who participate in USDA's agricultural credit programs and the administrative review processes for these programs.

FLAG has worked for 20 years to improve the accessibility of the USDA credit and disaster assistance programs and help farmers understand their rights and obligations under those programs. FLAG attorneys have traveled all over the country conducting training sessions for farmers and ranchers and their advocates about the USDA credit and disaster programs. FLAG has also produced many volumes of farmer-friendly legal education materials that analyze and explain these programs and distributed them nationwide. These include: four editions of Farmers' Guide to FmHA; Farm Survival Handbook; Farmers' Guide to Getting a Guaranteed Loan; five editions of Farmers' Guide to Disaster Assistance; and scores of articles in our quarterly newsletter, Farmers' Legal Action Report.

As part of this effort, FLAG has monitored changes to the FLP programs over the past 20 years and has submitted extensive comments to the Farm Service Agency (FSA) (formerly the Farmers Home Administration, or FmHA) regarding the Agency's implementation of statutory changes and adoption of regulatory and policy changes. In recent years, FLAG's comments related to the Farm Loan Programs have addressed:[1]

- Several proposed rules affecting the Guaranteed Loan Program, including extensive proposed changes to the Interest Assistance Program.
- Changes to FSA's internal appeal procedures and required notice to program participants, including FLP applicants and borrowers.
- Proposed "streamlining" of the direct loan component of FLP, involving a comprehensive rewriting of program regulations and elimination of more than 90 percent of the regulatory language.
- Appraisal requirements for direct FLP loans.
- Implementation of the credit provisions of the 2002 Farm Bill.

FLAG attorneys also field hundreds of calls, letters, and email messages every year from farmers and ranchers and their attorneys and advocates across the country. Through these conversations we receive a great deal of information about how FSA is implementing its loan programs in various parts of the country.

The USDA Farm Loan Programs

Through the Farm Loan Programs, USDA acts as the lender of last resort for creditworthy family farmers and ranchers who are unable to obtain financing from commercial sources at reasonable rates and terms.[2] Despite the clearly articulated congressional policy of supporting the family farm system of agriculture through these credit programs, FSA (like its predecessor, FmHA) has a history of implementing the programs in such a way as to unduly limit their effectiveness and the benefits the programs are intended to bring to farmers and ranchers and their rural communities.

In the 1980s, administration of the USDA agricultural credit programs reached its nadir, seeing tens of thousands of borrowers forced to liquidate and federal courts around the country ruling that FmHA's procedures were unlawful. During this period, FLAG attorneys were counsel to FmHA borrowers in Coleman v. Block, representing a nationwide class of almost 250,000 farmers. In that lawsuit, the court found that FmHA's foreclosure and liquidation procedures violated the statutory directives and borrowers' due process rights. Congress addressed many of the issues raised in that litigation through the passage of the Agricultural Credit Act of 1987.

In the most general terms, the mandates of the 1987 Act reflect a few core principles related to the USDA loan programs: borrowers must receive full, timely information about the loan programs they participate in; it is in everyone's best interest for a financially distressed farmer to continue farming if a restructuring would leave the government no worse off than liquidation; decisions in individual

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1 The full text of FLAG comments on agency rulemaking can be found on FLAG's Web site at www.flaginc.org/topics/fedreg/comments/index.php.

2 See 7 U.S.C. §§ 1922, 1941, 2001.

cases must reflect uniform criteria; and borrowers must be treated fairly by the Agency. 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 loan applications and loan servicing requests; and a duty on the Agency's part to provide assistance to any farmer or rancher who seeks to make a loan application or servicing request.

Systemic Problems Continue to Pervade the Farm Loan Programs

Based on the observations FLAG has made in the work described above, we have identified several continuing problems with FSA's implementation and administration of the Farm Loan Programs. Some are legal problems embedded in the regulations and Agency policies that ignore or contradict statutory directives; some are guiding principles, not made explicit but nonetheless shaping Agency actions; and some are local problems resulting from confusion and/or bias.

In summary, these concerns are:

(1) A general disregard for borrowers' interests. The Agency's attitude about borrowers manifests itself in efforts to limit borrower and public input into the programs, interpreting policies as narrowly as possible against borrowers (sometimes narrower than even arguably permissible), behaving as if the Agency is not accountable for meeting program requirements, treating borrowers as a necessary evil rather than the ones for whom the programs exist, abdicating oversight duty in the guaranteed loan program, and delaying implementation of statutory and policy changes that benefit borrowers while implementing restrictions almost immediately.

Examples:

Agency decision-makers are increasingly missing statutory deadlines for making determinations on loan applications and loan servicing requests. There are many instances where farmers have spent a decade or more in limbo because of Agency delays, and delays often cause people to lose rights as the rules change. At the same time, farmers are held to rigid timeframes, without exception.

We are hearing reports that local offices are increasingly failing to issue written decisions on loan applications and servicing requests, despite a statutory mandate to do so within 10 days of making a decision. If there is no written notice, borrowers don't learn of appeal rights.

The Agency has issued terse rejections of requests to clarify proposed rule language, even when commenters point out that local FSA office personnel are confused and are telling farmers the wrong information.

The Agency uses atypically short public comments for proposed and interim FLP rules, even for massive regulatory initiatives. In at least one case, the Agency refused to reopen or extend the comment period even when the original notice contained an error in the Agency contact information.

It sometimes takes years for the Agency to implement statutory changes that enhance eligibility or otherwise benefit borrowers. For example, the "debt forgiveness" restriction on eligibility for new FLP loans generally covers all forms of reducing or terminating a loan that cause a loss to USDA. The 2002 Farm Bill, however, provides that debt forgiveness specifically does not include any write-down of FSA debt received as part of the resolution of a discrimination complaint against the Secretary of Agriculture. FSA has not yet implemented this change by rule, though other 2002 Farm Bill changes were implemented in 2003; and the Agency omitted this exception from the 2004 proposed recodification of the direct loan program.

There is an increasing marginalization of borrowers in the Guaranteed Loan Program, made evident in an August 15, 2005, proposed rule where the Agency refers to guaranteed lenders as its "customers."[3] In that rule, the Agency proposed to relax a lender's maximum loss ratio for events beyond the lender's control.[4] The prefatory remarks to the proposed rule state that, in the six-year period that the Preferred Lender classification has been used, "an average of less than one lender a year" has had its PLP status revoked due to excessive loss ratio. Thus, based on the experience of what can be no more than five lenders, the Agency took the initiative to propose a rule change. There is nothing objectionable for borrowers about this proposal, but it reveals the lengths the Agency will go to on behalf of a handful of lenders while placing no obligation on lenders to provide similar leeway for borrowers. All of the exculpatory examples in the proposed change are events that would increase losses for lenders because they would threaten borrowers' viability. But where, borrowers reasonably ask, is the parallel language directing lenders to allow borrowers a grace period after a local freeze or economic downturn, a drop in local land values, a change in area industries, loss of market access, or biological or chemical damage?

Guaranteed loan borrowers and their advocates have repeatedly urged FSA, as part of the on-going effort to improve the guaranteed loan program, to consider more consistent and definite requirements for guaranteed loan servicing that ensure lenders have an incentive to make full use of their tools to avoid liquidation and losses, whether to borrowers or the government. When lenders unreasonably shift costs to borrowers or reject viable restructuring opportunities, the result is reduced program participation, higher default and liquidation rates, higher costs to the government, and more expensive credit for family farmers and ranchers—all of which are directly contrary to the purpose of the program. These changes could affect hundreds of borrowers every year and would further the fundamental purpose of the program, yet there has been no suggestion of consideration on the Agency's part. Instead, we see a proposed change that the Agency acknowledges would affect "an average of less than one lender a year."

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3 70 Fed. Reg. 47,730-47,733 (August 15, 2005).

4 Proposed § 762.106(g)(2)(ii)(A) provides examples of events which would be considered beyond the control of the lender and could therefore excuse exceeding the maximum loss ratio. These examples are: "a freeze with only local impact, economic downturn in a local area, drop in local land values, industries moving into or out of an area, loss of access to a market, and biological or chemical damage." 70 Fed. Reg. 47,732 (2005).

Another aspect of FSA personnel having lost perspective about the Farm Loan Programs is the extent to which borrowers report local personnel "taking things personally." This is manifested in experiences where borrowers are told by local personnel "you'll never get a loan here, quit trying," or where, instead of working with a borrower in financial distress to avoid liquidation and minimize losses to the borrower and the government, the local Agency personnel become focused on forcing a borrower out to "teach them a lesson."

Changes to Shared Appreciation Agreement (SAA) valuations, subtracting the value of capital improvements made during the SAA term from the calculation of "appreciation," were not implemented until eight months after the policy change was announced and after many, if not most, borrowers were unable to benefit from the change.[5]

(2) Removal of substantive provisions from regulations to internal handbooks. The Agency's current initiative to move program provisions from regulations to internal handbooks violates the Administrative Procedures Act mandate that rules affecting program rights be subject to notice-and-comment rulemaking, marks a return to the pre-1987 Act system where farmers lack a reliable method of knowing what that applicable program requirements are, and forces farmers in a potentially adversarial relationship with FSA to nonetheless rely on FSA to provide all applicable information when asked, and to be right about the answer.

FSA local offices also need clear direction to implement FSA loan programs. It is essential for clear information about the handling of loan applications and servicing requests to remain part of the rule so that each applicant and borrower is treated appropriately. For a farmer facing a hostile local office and no place else to go for the credit needed to keep an operation going, it is absolutely necessary that there be clear, objective regulations setting out the terms of the interaction between the two sides in the lending relationship. The reality is that some farmers still have to rely on regulatory language to get a fair consideration of their credit requests.

FSA's 2004 FLP "streamlining" proposal would replace some 1500 pages of current regulations with less than 100 pages. The stated intent of the proposed rule – to allow the general public, including loan applicants and borrowers, to "more easily find needed information" – is belied by the removal of significant substantive provisions from the rule language and the Agency's overt plan to rely heavily on internal handbooks for program administration. Although the Agency's prefatory remarks state that only procedures having "no impact on loan applicants and borrowers" were removed from the reorganized rule, this is simply not true. The reality is that the proposal removes and leaves unaddressed several areas of program administration that involve critical, substantive provisions.

Understanding that borrowers are generally unfamiliar with administrative processes and need assistance from FSA regarding information and procedural issues, it is imperative that FSA provide adequate information in the regulations to facilitate a good working relationship with

[5] The final rule on deduction of capital improvements, issued by FSA and effective on August 18, 2000, was based on a proposed rule published in the Federal Register in November 1999 and implemented a policy first announced by Secretary Glickman in March 1999. 65 Fed. Reg. 50,401 (2000).

borrowers and assure that borrowers are treated fairly. Removing important information from the regulations is counterproductive to these goals and will result in confusion and poor working relationships with borrowers, and leaves applicants and borrowers subject to the vagaries of presumptions, politics, and personality.

(3) Reintroducing broad Agency personnel discretion in loan decisions. The Agency's 2004 proposed rule for FLP "streamlining" would vest broad discretion with local office employees. In particular, language in the proposed eligibility requirements for loan servicing is subjective, susceptible to abuse, and likely to be the subject of many challenges. The history of abuse of such discretion in the Agency should make it unnecessary to point out why this is bad policy. Borrowers already report widespread disparity among who gets treated well and who gets pushed around or excluded; the intent to introduce still more subjective criteria is very troubling. This is particularly true given that there is still no meaningful process for investigation and resolution of allegations of discrimination made by applicants and borrowers about FSA decision-makers.

Like the detail of the current direct loan program regulations, a lack of discretion for Agency staff under the direct loan program has a historical context, which must not be forgotten: chronic abuses of discretion resulting in extensive litigation and the need for recurring congressional action.[6] Borrowers and loan applicants are justifiably wary of policy changes that would reopen areas of discretion that have been narrowed due to prior abuse. It is imperative that the Agency set meaningful parameters on any discretion. The Agency should be concerned with perceived differences as well as actual inconsistencies and should set out objective standards against which an employee's exercise of discretion in the direct loan programs can be measured. As the court in Harris v. Marsh observed,[7]

> Particularly when vague, subjective standards are given to a large number of individuals to be applied in a wholly discretionary manner, with no systematic review to ensure fairness, the chances are substantial that conscious or unconscious racial bias on the part of some of those individuals will infect the selection process.

Concerns about unfettered discretion on the part of local office employees also relate to the fact that African-American farmers who prevailed in the Pigford claims process and who were supposed to see a new opportunity to participate in the FLP credit programs have not seen that opportunity realized because they are back at the offices where the problems occurred.

(4) Refusal to implement National Appeals Division (NAD) determinations that are favorable to farmers. The Agency has a long history of attempting to insulate its FLP decisions from review and refusing to implement review determinations that find Agency error.

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6 See, e.g., Coleman v. Block, 580 F. Supp. 194, 200 (D.N.D. 1984) ("The FmHA concedes that the liquidation decision rarely turns on whether the farmer is delinquent...Instead, the decision rests on a host of highly subjective factors....").

7 679 F. Supp. 1204, 1299 n. 154 (E.D.N.C. 1987).

The creation of an independent NAD as part of the Department of Agriculture Reorganization Act of 1994 was a product of failings in the internal appeals processes of FSA's predecessors – FmHA and ASCS. One of the most problematic issues for program participants was obtaining implementation of a favorable appeal decision. Aware of this problem, Congress included language in the new NAD statute specifically addressing implementation, requiring that

> [o]n the return of a case to an agency pursuant to the final determination of [NAD], the head of the agency shall implement the final determination not later than 30 days after the effective date of the notice of the final determination.[8]

The NAD statute defines "implement" to mean

> those actions necessary to effectuate fully and promptly a final determination of [NAD] not later than 30 calendar days after the effective date of the final determination.[9]

Furthermore, the law requires that "[i]f an application for a loan ... is disapproved by the Secretary" but the disapproval is reversed or revised in an administrative appeal or lawsuit, "the Secretary shall act on the application...within 15 days."[10] Within those same 15 days, the Secretary must provide the loan applicant with "notice of the action." FLP applicants by definition have no other source of credit and are requesting credit that is necessary for their operations. Congress was clearly concerned that wrongfully denied loan applicants should not face further delays after a successful loan denial appeal and intended for these applicants to have essentially immediate relief.

Agency regulations ignore these statutory mandates and purport to allow the Agency to demand what is in effect a new application when an Agency's FLP decision is reversed. The Agency also believes that it need merely initiate implementation within the 30 days after an appeal determination is made. These positions are simply not permitted under the statutes.

One example of this is a farmer who submitted a loan servicing request in 2002, has since won three NAD appeals related to the request, and who is still awaiting implementation by the Agency. Each time a NAD appeal determination is rendered, the Agency insists on having new information. The farmer has met every deadline and provided all requested information and still cannot get any relief.

Because NAD lacks enforcement authority, when the Agency refuses to implement a NAD determination favorable to a borrower, the borrower's only recourse is the cost and delay of federal litigation (no small expense for the government, either) in order to obtain benefits that should be available as a matter of course. Those who cannot afford to litigate must accept the Agency's unlawful behavior, and so the Agency's "policy" of ignoring NAD determinations that it doesn't like succeeds by attrition.

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8 7 U.S.C. § 7000 (emphasis added).
9 7 U.S.C. § 6991(8) (emphasis added).
10 7 U.S.C. § 1983a(c).

In addition to implementation problems, the Agency's failure to provide adequate notice of appeal rights is a continuing problem. In some instances this is a failure at the local level and represents a training or management issue, in other instances, this is a national policy of thwarting appeal rights. For example, in the proposed FLP "streamlining" rule, FSA proposed to omit notice of appeal rights from restructuring offers and to instead "consolidate" the borrower's appeal rights in the subsequent notice of intent to accelerate. This proposal is contrary to law and reflects an innate disregard on the Agency's part for borrowers' rights to prompt, clear notice of appeal options.

Yet another way FSA attempts to insulate its decisions from review is by adopting an unreasonably narrow view of what of its decisions are appealable. Although NAD ultimately has the authority to decide what adverse decisions can be appealed, and takes a much broader view than FSA does, borrowers are informed of their appeal rights by FSA, not by NAD. Some NAD officials have estimated that non-appealability pronouncements by the Agency reduce appeals by 90 percent.

(5) Unduly restrictive criteria without a reasonable policy justification.

By requiring a lien on all property owned by borrowers whose direct FLP loans are restructured, FSA cripples these borrowers' ability to obtain future credit and improve their financial circumstances. Not only is the requirement excessive by any reasonable financial standards, it is burdensome and demeaning to the borrower to have to "beg FSA to subordinate" in order to obtain any other credit. In the words of a long-time advocate, "It's not right." The Emergency Loan program policy of requiring security valued at up to 150% of the loan amount should be more than adequate in these cases.

Another example of overreaching to the detriment of broad federal policy is the Agency's insistence on using "highest and best use" appraisals in loan servicing, rather than agricultural use appraisals. In the SAA context, FSA took a policy position not mandated by statute which actually forced otherwise successful operations to liquidate and convert to nonagricultural use, in violation of statutory mandates to utilize loan servicing programs "to the maximum extent possible" to facilitate keeping borrowers on the farm or ranch[11] and to avoid federal policies which drive the conversion of farmland to other uses.[12]

(6) Refusal to make program information available.

Borrowers continue to report difficulty obtaining access to and/or copies of their FLP files. Sometimes a borrower is given only one document and told "that's the whole file"; sometimes borrowers are told they can't have anyone with them when they look at their file. For guaranteed loans, borrowers often find themselves caught between the lender's and FSA's assertions that the file information can only be obtained from the other party.

[11] 7 U.S.C. § 2001(a).
[12] 7 U.S.C. §§ 4201 et seq.

Local FSA personnel often resist or even refuse to make Agency policies, handbooks, and other information available to borrowers, or any member of the public, though there is an explicit national policy, as there must be, that these are to be provided upon request.

The Agency has refused to make available to the public the comments submitted in response to the FLP "streamlining" proposal, telling one requester that the comments cannot be released until a final rule is issued. This is counter to the E-Government Act of 2002, which requires that agencies "shall make publicly available online…all submissions" under APA notice-and-comment rule making, to the extent practicable.[13] Several other agencies within USDA, for example, the Agricultural Marketing Service and Natural Resources Conservation Service, have concluded that it is practicable to post comments received during the rulemaking process on their Web sites, and have in fact posted public comments. NRCS posted the literally thousands of comments it received on the proposed rule for the Conservation Security Program.

FSA also routinely refuses to provide public access to proposed forms that are the subject of information collection notices published in the Federal Register as required under the Paperwork Reduction Act. Although comments on the forms are requested, meaningful comment is impossible without access to the form language itself, and so the purpose of the Act is thwarted.

(7) Inability or refusal to recognize that successful agriculture can have many faces, sizes, etc. Farmers have experienced that there is little if any recognition by the Agency of the value of a diversity of agriculture, the value of allowing farmers to differentiate their operations to find a niche and be successful in different ways, despite the need for farmers to create new opportunities for themselves and adjust their expenses in the face of consistently low prices for the major commodities.

Smaller farmers continually report being told that they can only get financing if they expand their operations. Farmers wanting relatively small loans can't get them. The Agency and guaranteed lenders seem convinced that only big operations are desirable borrowers, whatever an applicant's actual financial situation. This is particularly a concern when the bigger loans quickly consume available funding. Paired with this are continuing concerns that the guaranteed loan funds are being used by lenders to move their existing borrower base to "safer" loans, while not providing any new credit availability in the marketplace. In particular, there are concerns that the "family farm" eligibility requirement is not enforced for guaranteed loans, so that the funds are used up by large-sum borrowers whose eligibility is questionable at best.

FSA seems to be making little effort to promote the guaranteed loan program and Interest Assistance Program among lenders in underserved areas, particularly lenders with high numbers of borrowers who would be considered "socially disadvantaged applicants," and helping those lenders to understand and participate in the programs.

(8) Lack of program information. There has been no real implementation of the transparency and reporting provisions of the 2002 Farm Bill that were intended to show who is benefiting from

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13 107 Pub. L. No. 347, § 206(d)(2)(A); 116 Stat. 2899 (2002) (codified at 44 U.S.C. § 3501 note).

the FLP programs. If the information doesn't get out, it becomes almost impossible to know whether the Agency is really serving the people the programs are intended to benefit.

Thank you again for the invitation to testify and for your concern for proper implementation of the Farm Loan Programs. At a time when increasing interest rates, high fuel and other input costs, and stagnant or dropping prices are impacting access to agricultural credit across the country, it is important for oversight by this Committee and action by the Agency to ensure loan availability and proper servicing under USDA's Farm Loan Programs.

Respectfully submitted,

FARMERS' LEGAL ACTION GROUP, INC.

s/Karen R. Krub

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Senior Staff Attorney
Email: kkrub@flaginc.org

Federal Managers Association

Testimony
Before the United States Senate
Committee on Agriculture
June 13, 2006
United States Department of Agriculture Farm Loan Programs

Preventing the Perfect Storm: Assessing the State of the USDA Farm Loan Program

Statement of
Elisabeth B. Senter
Conference Chair
Federal Managers Association
USDA National Association of Credit Specialists– Farm Service Agency

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Chairman Chambliss, Ranking Member Harkin and distinguished members of the Senate Committee on Agriculture, Nutrition and Forestry:

My name is Betsy Senter, and I am here today representing the Federal Managers Association (FMA) and the National Association of Credit Specialists of the Farm Service Agency (NACS-FSA). On behalf of the 1700 managers in the Farm Service Agency and the nearly 200,000 managers, supervisors and executives in the federal government, please allow me to take a moment and thank you for this opportunity to present our views before your Committee. As federal managers, we are committed to carrying out the mission of our agency in the most efficient and cost effective manner while providing those necessary services to needy farmers and ranchers. We truly appreciate your interest and leadership in ensuring our stability by assessing the state of our Farm Loan Program today.

I come before you as the former two-term President of the NACS-FSA and am presently serving as Chair of FMA's USDA Conference. I grew up in Raleigh, North Carolina, graduated with a Bachelor of Science degree in both Animal Science and Wildlife Biology from North Carolina State University and have been a USDA Farm Service Agency/Farmers Home Administration employee in South Dakota for more than 28 years. I am currently a Farm Loan Manager in Winner, South Dakota where I supervise the making and servicing of a diverse loan portfolio to family-sized farmers and ranchers in the rural south central part of the state. Please keep in mind that I am here on my own time and of my own volition representing the views of the FMA and the NACS-FSA organizations. I do not speak on behalf of the USDA either officially or unofficially.

The mission of the Farm Service Agency is to "administer farm commodity, credit, environmental, conservation, and emergency assistance programs for farmers and ranchers." As a Loan Manager, I work daily with farmers and ranchers who, for a variety of legitimate reasons, do not qualify for direct loans from private lenders. In such cases, we offer both direct and guarantee loans to assist farmers and ranchers in getting started on a family-sized agriculture endeavor or expanding an existing operation. To meet our mission, the agency provides direct loans of up to $200,000 or guarantee loans from a private lender to assure repayment and minimize the commodity lenders risk. Ideally, the goal for these small loans is for farmers and ranchers to graduate through the process from receiving direct loans from the government, to having the government guarantee a loan from a private lender, to establishing their own sustainable line of direct private loans.

The effective and capable leadership of Deputy Administrator Carolyn Cooksie in conjunction with recent years of positive economic fortunes allows me to report that, from our perspective, the FSA's farm loan programs are in good standing. The agency has highlighted that loan funds are in high demand and loan default and loss rates are low. The Office of Management and Budget (OMB) Program Assessment Rating Tool (PART) scores and the "Farm Service Agency Direct Loan Program Effectiveness Study" performed by the University of Arkansas Department of Agricultural Economics and Agribusiness confirm that the loan programs are meeting objectives, being managed effectively, and sit in good standing.

With few exceptions, the program changes made with the passage of the 2002 Farm Bill have pleased its customers, the commercial lenders, farmers and ranchers. The bill authorized the Farm Loan Program to modernize its delivery tools, regulatory rules and resource infrastructure to better serve rural Americans. Despite budget shortfalls and a growing disparity in information technology resources, significant enhancements have been achieved in the use of existing modern technology and expansion into Web-based programs. We are in the final stages of streamlining loan program regulations and updating our forms. This effort should result in the elimination of approximately 38 regulation manuals. Any remaining documents in use will be automated to improve cost savings, enhanced efficiency and easy access for internal and external customers. Ms. Cooksie is to be complimented for her accomplishments in modernizing the programs given the limited resources, improving customer service, improving program efficiency and for maintaining a loan portfolio that is worthy of our continued support.

We do not wish to overshadow the many accomplishments of the Agency and the incredible work being conducted by the dedicated managers and employees of its workforce. However, as responsible stewards of the taxpayers' dollars we find it necessary to express some concerns for the future economic well being of rural America and the continued effectiveness of the programs that we administer. Somewhat like the fishermen at sea looking into the horizon at the bourgeoning storm, there seems to be a number of warning signs that indicate an impending perfect storm could hit the shores of the FSA and threaten the stability of rural America.

Rising interest rates, high agricultural production costs, high capital investment costs, increasing costs of living, the probability of less generous commodity program benefits, shrinking agricultural profit margins, a declining number of lenders offering credit to family-size farm operations, outdated information technology resources and a "human capital crisis" of increasing attrition rates at the Agency are all indications that a potentially devastating scenario could cripple the strength and stability of the farm loan program. We recognize the inherent risks of the cyclical agriculture industry that we are in and understand that no degree of preparation will allow us to save every family farm, rural business, rural school or rural community from market conditions. Yet, as responsible stewards of the program it is our opinion that we must seize this opportunity to stave off the detrimental effects of preventable problems and secure the tools that will be necessary for us to weather the storm and save as many family farms as possible. In saving family-size farms and ranches we will help preserve the economic stability of rural America. The continued effectiveness of farm loan programs depends on our ability to retool and prepare for the storm.

POSITIVES AND MISSED OPPORTUNITIES IN THE 2002 FARM BILL

During the 2002 Farm Bill debate, NACS-FSA and FMA supported many of the changes that were eventually adopted by Congress and implemented in the field. The most critical of issues that Congress supported and we believe has significantly improved the programs and services for rural Americans were:

- The "bridge loans" that allowed loan applicants to secure approval for real estate purchases from FSA and then to refinance a temporary source of credit to purchase farm real estate at times when loan funds are not available;
- Changes in the beginning farmer down payment loan program, which increased FSA's participation level from 30 percent to 40 percent and increased the amortization period from 10 years to 15 years;
- The passage of an amendment that required an annual rather than a semiannual assessment of each direct loan borrower's operation to reduce the amount of paper work and unburden managers with an more effective assessment timeframe;
- The increase in the "Lo-Doc" benchmark allowed more loan applicants to use the streamlined loan processing provisions; and,
- The continuation of interest assistance on guaranteed farm operating loans.

These changes have allowed the farm loan program to develop into the robust government service it is today. However, there were a number of other issues which we believed would further improve the program and allow it to maintain its stability that were overlooked. We proposed some of these reforms in 2001 and 2002 during the consideration of the 2002 Farm Bill. More specifically, addressing term limits on direct and guaranteed loans, increasing loan limits, blanket assignment authority on FSA program payments, and allowing FSA to guarantee "aggie" or tax exempt bond loans made by commercial lenders are a few issues that we recommended as further improving the effectiveness of the program, but were ultimately omitted from the 2002 Farm Bill. As we face the expiration of the 2002 Farm Bill, this seems like an opportune time for Congress to act on reforming these important issues during the reauthorization of the Agriculture, Conservation and Rural Enhancement Act.

REFORMS TO THE FARM LOAN PROGRAM

End the Term Limits

The phrase "term limit" is used to describe rules limiting the number of years that a customer can be enrolled in the FSA direct and guarantee loan programs. The term limits for direct loan programs are seven to ten years depending on the type of loan received. A customer who is unable to obtain credit from commercial sources can only receive loans from the agency for seven to ten years at which point the farmer or rancher must either have built up a strong enough credit to go to a private lender or face the alternative of being unable to sustain their operations. Term limits do not have any caveats or exclusions for natural disasters, falling prices or random occurrences such as a ban imposed on the American beef industry by the Japanese government. Term limits are hard and fast dates that set forth a get lucky or get out mandate seemingly unsuitable for a need based federal farm loan program. The reality is many needy farmers and ranchers are unable to apply for loans because of these arbitrary term limits.

In our line of work, these are not just theoretical examples. Day in and day out, we encounter good, hard working people who just need a little more assistance or a little more time to stay afloat. For instance, a Wisconsin dairy farmer who cannot apply for credit to rebuild his dairy barn that burned down, or the Texas farmer with a terminally ill wife who suffered two consecutive years of crop failures as a result of a severe drought is unable to secure credit to continue a farm operation that has traditionally been profitable. As a farm loan manager, these arbitrary standards put us in the unenviable position of turning away otherwise qualified applicants such as a forty year old apple orchard farmer from Washington forced to sell a third-generation farm after 20 years of ownership because three consecutive years of low apple prices eroded her financial condition and prevented her from securing commercial credit or more than 375 Indiana farmers who will not be eligible for FSA loans unless the term limits are not removed. These are real scenarios collected from our members across the country that reflect the reality of a farm loan program established to aid people in these situations, but are rendered useless due to the unfortunate bureaucracy.

I work with a family from South Dakota that began farming six years ago. They have scrimped and saved and now have a herd of 100 cows. The family has one year of FSA direct operating loan eligibility remaining. As of today, it looks like they will not harvest any spring grain and will incur a significant financial setback due to dry weather in our area. Unfortunately, federal crop insurance does little to assist farmers in areas that suffer multiple crop failures. For example, in our area we lost the majority of three spring grain crops over the past four of five years. Our corn yield has plummeted from around 76 bushels per acre to 47 bushels per acre during the past 10 years. With only one year of FSA loan eligibility remaining, it is not likely that they will be able to prosper enough to meet commercial lending standards within the next 12 months. The family will lose their safety net and their source of financing within one year. Simply allowing an extension of the term limits would give this family more time to get on their feet and build an economically sustainable farm.

The amount of capital required to maintain a viable farming operation is staggering. In the best of times the profit margins are slim, often requiring more than seven to ten years to build the equity and profitability that commercial lenders require. FSA loan programs are a critical part of the safety net that was created to assist viable family-size farmers and ranchers who are unable to secure commercial credit at affordable rates and terms. By neglecting this issue, we are hindering the sustainable development of rural farmers and ranchers by forcing term limits instead of working with the fluctuating markets and unique agricultural environments.

Provisions contained in the 2002 Farm Bill allowed for a two-year waiver of direct operating loan term limits on a case-by-case basis. Although it was appreciated, this band-aid did not fix the problem and the agency must then deny essential services to a large number of farmers and ranchers. One farm loan manager from Texas reports that a prolonged drought and term limits will force 23 of his customers to seek a new line of work within twelve months with approximately 80 percent of the 130 direct loan borrowers in that area to follow within a few years, since they do not meet today's "chain bank underwriting standards." A loan manager in Wisconsin reported that 63 of 103 direct loan borrowers in his area will become ineligible for direct loans before the next Farm Bill is signed. As these families exit the farming business, liquidate their assets and move to the city to find work, the rural community and rural economy will suffer a devastating blow. It is possible to prevent this and help encourage sustainable rural agricultural development.

Term limits also apply to loans made by commercial lenders that are guaranteed by FSA. Term limits on guarantee loans were waived through the end of the 2002 Farm Bill and will become effective again on January 1, 2007. Waiving the term limit rule on FSA guaranteed loans did not jeopardize the integrity or effectiveness of the program in any way, and guaranteed loan activity remained healthy while loan default and loss rates remained low. However, it is our recommendation that the 2007 Farm Bill should permanently eliminate term limits on guarantee loans.

If it wasn't clear, we strongly recommend that the Committee support Farm Bill provisions to eliminate term limit rules on FSA direct and guaranteed farm loan programs. By failing to address the elimination of this bureaucratic matter, we are denying the Agency a tool that will be essential in our efforts to save viable farm operations and provide stability to rural economies when the seas get rough and rural America needs us most. The get lucky or get out term limit rules should be eliminated in favor of agency graduation, market placement and credit elsewhere provisions that are already in existence. When properly applied, graduation, market placement and credit elsewhere rules are effective in assuring that FSA is not competing with private industry in providing essential credit to farmers and ranchers.

As loan managers, it takes extensive training and experience to become a manager or an officer. The decisions that we render are not done without proper oversight, review, consideration and reconsideration. It is in our interest as managers to provide economically sound loans to qualified seekers. We are not recommending this modification as a way to impair the loan making structure or create an unbalanced risk for the federal government. Rather, it is a way to use government resources as they were intended to be used in a profoundly helpful program such as this.

INCREASE THE FARM LOAN LIMITS

Loan limits describe the maximum amount of dollars that an applicant can borrow from FSA. As managers, we also struggle with the hindrance of the limits placed on the level of loan we may make at a given time. FSA's direct operating loan (OL), which is used to finance production expenses, machinery, equipment, vehicles, livestock or other short and intermediate term farm business ventures, has a limit of $200,000. Direct farm ownership (FO) loans, which are used to finance the purchase or improvement of real estate, also have a $200,000 loan limit. These loan limits were established more than 20 years ago and do not meet the needs of modern day operations. Production and capital costs increased significantly over the past 20 years. Direct OL and direct FO loan limits need to be adjusted to allow FSA to effectively serve family-size farmers and ranchers in all areas of this great nation.

A farm loan official from Wisconsin reported to us that a farmstead costing less than $200,000 20 years ago is currently selling for at least $650,000 and they are lucky if a $200,000 loan is enough to purchase a ten acre farmstead. East and West coast states are realizing an even larger spread between our current loan limit and the amount of funds needed to finance the purchase a modest family-size farm.

Of greater concern is that our operating loan limit is preventing FSA from meeting the needs of customers. A loan manager from Washington reports that a typical 50 acre fruit production operation in his area requires $150,000 operating capital annually, and they do not sell their crop from one year before needing funds to produce the following year's crop. This means this customer will need $300,000 of operating credit for a short period of time when only $200,000 is available from FSA. This also does not take into consideration his credit needs for machinery and equipment with the agency on a term loan. The Washington loan official, with just reason, claims that we are setting beginning farmers up and "directly participating in their demise" because our loan limits are not sufficient to meet the needs of the customers that we are attempting to assist. Similar stories may be heard from loan officials in Georgia, Florida, California, Iowa, Minnesota or any other state in the country. Agricultural production, start up and capital costs 20 years ago are not a reasonable baseline for use in establishing loan limits today.

We urge the Committee to consider raising the loan limits for direct operating loans to at least $300,000 along with the direct farm ownership loan limit. As an alternative we may suggest that the Committee eliminate provisions setting forth a separate loan limit for each type of loan – operating and farm ownership – and authorize individuals to receive any combination of direct operating and farm ownership loans for a total amount not to exceed $500,000 to $600,000 as the Committee may see fit. A combined loan limit may help customers who need FSA operating or farm ownership loans, but are able to secure their other credit needs from a commercial lender.

Prevent The Increase of Guarantee Loan Fees

The President recently proposed a 150 to 450 percent increase in fees charged to commercial lenders who work with FSA in offering guaranteed loans. According to the American Bankers Association (ABA), the FSA guaranteed loan programs are a remarkable success story representing a supreme example of a true public-private partnership that will suffer considerably if the new fees are incurred. We agree with ABA's assessment of the resulting problems from increasing the guarantee fees. At present, the fees are modest and the guaranteed loan programs are performing as intended. Program usage has been strong. Loan default and loss rates have been low. ABA's concern that an increase in fees will have a significant adverse affect on FSA guaranteed loan programs is valid. However, we believe that the impact of such an action will be much greater than ABA has reported.

Family-size farmers and ranchers use guaranteed loans because their credit represents more risk than a commercial lender is able to incur without the backing of a guarantee from FSA. Guaranteed loan customers generally fail to meet commercial lending standards due to a lack of repayment margin or a lack of owner equity; therefore, assessing larger guarantee fees will add to the already sizeable financial burdens of the customers that we are attempting to serve.

In understanding the relationship that exists between the FSA direct and guaranteed loan programs one will recognize what we believe to be an even greater reason for concern regarding the proposed increase in fees. Guaranteed loans are used to help direct loan borrowers secure credit from commercial lenders, otherwise known as graduating; to help loan applicants secure all or part of their credit needs from a commercial lender, or market placement; and to serve those who do not quite meet commercial lending standards but can prosper without having to rely on FSA direct loans. Increasing guaranteed loan fees will reduce guaranteed loan demand and increase demand for direct loan funds, thus, shift loan making and loan servicing responsibilities from commercial lenders to FSA. FSA does not have sufficient resources in terms of loan funds or human capital to meet a significant increase in direct loan demand.

In an effort to preserve program effectiveness and prevent administrative fee increases in future years, we ask that the committee add a provision to the 2007 Farm Bill that will require Congressional approval of any future USDA guaranteed loan fee increases.

LIABILITY INSURANCE FOR FARM LOAN MANAGERS

In 1998, Congress mandated that agencies cover 50 percent of the professional liability insurance premiums for management officials in supervisory roles. This applied to managers across the federal government. As it is an inherent hazard of their job, the government, like most private employers, covers a percentage of the cost for managers to maintain liability insurance should a claim be brought forth that names them as one of the defendants. The professional liability insurance offered in affiliation with FMA costs roughly $300 per year, and would be an obligation of $150 for the Agency. This protects against a supervisor or manager being named in a lawsuit or other kind of legal action.

A limitation in the law stipulates that the employee must be a supervisor in order for the government to cover 50 percent of the insurance premiums for liability coverage. The reality is that many other management officials who are in decision-making positions, such as farm loan officials and contracting officials, may be subject to legal action even though they do not meet the definition of manager under the law. In their case, they do not have the same support from the Federal government that Federal supervisors do in recognition of the hazards of the job. We recommend that Congress amend the 1998 law to require agencies, including the Farm Service Agency, to extend coverage of 50% of the professional liability insurance premiums to non-supervisory federal managers.

ADDRESSING THE HUMAN CAPITAL CRISIS

The Office of Personnel Management Director Linda Springer recently unveiled a four-year operational plan to address both internal and government-wide human capital needs in order to prevent what she called the impending "retirement tsunami" in the federal government. Over the next few years, more than 50 percent of the entire federal workforce and more than 60 percent of all managers will be eligible for retirement. FSA is not immune to the potentially disastrous impact of the baby boomer retirement wave on the agencies most valuable commodity, the human capital workforce.

In an effort to develop a strategic plan for managing human capital, FSA performed a study identifying mission critical positions, evaluating retirement eligibility trends, and assessing the amount of time required to train personnel to perform mission critical tasks. Results of the study are alarming. The study looked at mission critical positions in the 1165 FSA classification series including: Farm Loan Officers, Farm Loan Managers, Farm Loan Specialists, and Farm Loan Chiefs. Of the 1165 employees studied, 28 percent of the employees will be retirement eligible as of 2008, while 50 percent of the supervisory employees will be eligible in the same timeframe.

Agency officials reported that the average 1165 job series employee is retiring within three months of becoming eligible to retire as compared with the average federal employee who works for three years beyond the date that they become eligible to retire. FSA also determined that it requires 18 to 24 months to train an employee to perform entry-level Farm Loan Officer's duties. The concern is compounded by the realization that FSA farm loan program personnel, after multiple consolidation and streamlining efforts, are delivering loans from fewer than eight hundred FSA field office locations often covering very large geographic regions. Farm loan program staffing levels in many states are few in number and sparsely scattered leaving no fully trained loan personnel within a reasonable commuting distance to fill field office loan official or loan technician positions that become vacant for any length of time. Customer service is suffering at an increasing number of locations.

Poor credit decisions made by inexperienced or inadequately trained loan officials during good economic times often go unnoticed. In good times, above normal income and/or increasing asset values allow customers to get by and allow the agency to avoid a loss. In less favorable economic times, poor credit decisions often result in costly loan losses and the failure of farm operations that may have been avoided by a more experienced loan official armed with the knowledge, skills and ability to address the complexities of the job. As family-size farms fail, rural businesses, rural communities and rural economies suffer. Delayed action could prove to be hazardous to the economic well being of rural communities as we embark on less favorable times with too little experience, too little training and too few personnel in mission critical loan official and loan technician positions.

The state of Michigan is a great example of a potential human capital problem. Currently, there are 52 loan officers working in the farm loan program area. Of the staff in the field, four managers are eligible for retirement as we speak 6 more within the next two years, and five additional employees over the next five years for a total of 15 farm loan managers. The sad part is there are only 20 farm loan managers in Michigan and it takes a minimum of two years to train a new managers. Should the employees that are eligible to leave today retire; there will be 11 counties of the 83 counties in Michigan with no loan officers present. Within 2 years the potential counties increases to 38. Presently, there are no additional loan officers in the pipeline. In simple terms, 46% of the state of Michigan has the potential to have no loan officer coverage for FSA within the next two years.

We would be remiss if we failed to compliment FSA Administrator Teresa Lasseter for the positive first steps that she took towards addressing our concerns. Administrator Lasseter set aside 30 full time equivalents (FTEs) for Farm Loan Officer Trainee (FLOT) positions in 2006 and is proposing to allocate 15 additional FTEs for FLOT positions in 2007. Administrator Lasseter's actions, while extremely positive and possibly the best that she can do within current budget constraints, may prove to be too little too late unless Congress provides additional resources to assist her efforts.

In order to preserve program efficiency and effectiveness we would like to encourage the Committee to work with appropriators in providing additional funding and FTEs to allow the Administrator to hire and begin training Farm Loan Officers and Farm Loan Program Technicians 18 to 24 months before the trainer walks out the door leaving no-one to train a new hire and no-one to efficiently and effectively carry out fulfill program objectives. Furthermore, we would ask that Congress approve an allocation for training and travel funds targeted at assuring that the Farm Loan Officers and Farm Loan Program Technicians are properly trained during their 18 to 24 month apprenticeship.

INFORMATION TECHNOLOGY FUNDING AND CAPITAL NEEDS

One of the five pillars of the President's Management Agenda is to bring Agency's up-to-par when it comes to e-government. The expansion of electronic government programs seeks to meet the high demand of government services while reducing the cost to the federal government. Farm Loan Programs moved expeditiously into an e-government compliant organization and to achieve enhanced levels of efficiency through better use of automation tools. With a reasonable amount of budgetary support, we anticipate that a majority of the FLP information technology (IT) systems will be converted to Web-based applications later this summer. However, if we do not continue supporting investments in hardware and software to complete the modernization process we can not achieve desired results. We made a commitment, we are mid stream and we can not turn back.

From an employee's perspective, the most frustrating part of working with Web-based applications is the connectivity and the down time. Providing quality customer service depends on maintaining an efficient work force depends on our ability to access and use Web-based systems every hour of the day and night. Sending customers home without service because the FSA servers are down is simply not acceptable. Even more unacceptable is employees staring into a computer monitor waiting for the next screen to come up because connectivity is woefully inadequate. This is not a model of government efficiency. Rather this forces employees to modify his or her business practices because they can not depend on infrastructure to support the Web-based applications to work properly. Appointments cancelled or work deferred because computer systems are not working, can not be replaced and are awaiting repair should not become common place.

Reduced funding for information technology has had and will continue to have a significantly adverse impact on agency employees and on the quality of service provided. We ask that information technology funding levels be maintained, at minimum, or improved to allow the Agency to attain Congressional objectives for providing efficient, effective, quality services to rural Americans.

Several years ago, the USDA established an equipment replacement plan that would allow for the timely replacement of computer equipment. Budget reductions, however, forced the Department to amend their plan, and with fewer information technology personnel available to repair the machines, the Department must attempt to keep the average computer in service forty percent longer than was outlined in the original plan.

Cuts in personnel coupled with cuts in information technology expenditures are a double-edged sword. We need the efficiencies from better software and hardware to achieve agency objectives with fewer employees. However, information technology budget items are routinely cut in order to meet short-term obligations. We recommend that information technology objectives be adequately funded and departments be held accountable for achieving objectives within budget. Information technology enhancements are an investment in our future. Funds that are intended for information technology enhancements must not be diverted to pay rent, utilities and similar short-term obligations.

CONCLUSION

It is our contention that the Farm Service Agency's Farm Loan Program loan portfolio is in good financial standing. However, we have grave concerns that a number of pending issues on the horizon that could place at risk the taxpayer's investment in the agency's loan portfolio. The USDA Farm Loan Program makes it possible for beginning, financially strapped or multi-generational family farmers and ranchers to compete in the market place. The 2002 Farm Bill aided the efforts of the FSA in achieving its mission, but more must be done.

We are standing on the precipice of what could be a disastrous storm. The combination of questionable economic conditions, unknown weather patterns, human capital deficiencies, technology failures, and bureaucratic hindrances rests on the horizon in a preventable scenario that could be harmful to rural America and the agriculture industry. Congress and this Committee is in the pivotal position to address some of these pending disruptions, and there is no better time than now as the 2002 Farm Bill is set to expire at the end of this year.

We recommend the elimination of term limits as a means to free up farm loan managers to make sound financial decisions in offering loans to qualified recipients who otherwise would be ineligible because of the current regulations. It also means preventing scenarios like a Georgia family of five –a farming father, and a stay at home mom – from defaulting on their loan because they reached the term limit and could not find a private lender to take on the small farm as an investment. As the cost of living goes up, so goes the cost of maintaining and establishing farms and ranches. Rural America has not been immune to the cost increases of a growing national economy, and the federal government farm loan program limits should keep up with the growth. In order to reap rewards of investment, it is important to provide loans that will adequately assist in the cost of farm and ranch maintenance. It is time to increase the loan limit from $200,000 to at least $300,000. Additionally, charging substantial increases in guarantee fees to commercial lenders only adds to the financial burden of the farmer or rancher seeking private loans from the same commercial lenders. Congress must also work to protect the workforce of America from often frivolous lawsuits by supporting the inclusion of loan officials and contracting officers into the liability insurance reimbursement program.

These reform recommendations, however, can only be effective if the Agency is provided the necessary resources to administer the program services and its reforms. The Administration must offer budget proposals that take into account the impending brain drain in human capital, proper succession planning, information technology upgrades and overall adequate funding, and Congress must authorize and appropriate funds that meet those resource needs. With so much pending on the horizon, however, it is critical that Congress and the Administration invest in a successful federal program before it falls apart and wreaks havoc on rural America.

We are the men and women who work with the American farmer and rancher everyday. We see the potential of so many worthwhile applicants, and take to heart the work we do. We are dedicated and committed members of the federal workforce serving rural America. I'd like thank you for the opportunity to present our perspective on the state of the farm loan program and would be pleased to answer any questions you might have. Thank you for your time and consideration of our views.

Questions for the Record

Senator Norm Coleman

U.S. Senate Committee on Agriculture, Nutrition and Forestry
Hearing on Farm Loan Programs
Tuesday, June 13, 2006

Panel I

Question #1
My understanding is that the proposed regulation announcing new user fees on USDA guaranteed farm loan programs represents a major cost that would be passed down to producers. As weather-related disasters are wreaking havoc on farmers in northern Minnesota and energy costs are hurting farmers across the country, this is a terrible time to add another cost to producers' balance sheets. These loans are meant to be loans of last resort to farmers facing tough times, and the program has been quite efficient – a few million dollars can guarantee a billion dollars in loans to keep farmers going.

Why would USDA take money from what is an efficient loan program to farmers at a time when some farmers are really hurting?

Question #2
I realize the Farm Storage Facility Loan program isn't part of FSA's farm ownership (FO) or operating loans (OL) programs, but it is a loan program FSA oversees that is important to my producers. This is a program FSA operates under it's CCC authority, and it has the potential to make a big difference in Minnesota, but my folks have recognized a couple of stumbling blocks you might be able to help me with.

First of all, my farmers contend the loan payoff period of seven years for this program is not economically feasible because it makes the payment too high, and it doesn't make sense given the fact that a grain storage structure has a useful lifespan of up to 50 years. Is there a reason why a repayment plan of, say, 20 years wouldn't work?

Secondly, on grain bin loans up to $100,000, the USDA requires a first mortgage, which often ends the application process. Would it be possible to replace this requirement with either an egress or separation easement that would allow USDA protection without putting a burden on the landowner?

Finally, as producers send more of their crops to renewable fuel production, it becomes more and more important for there to be more storage facilities in order to ensure a stable supply – instead of having to pile high quality crops on the ground for temporary storage when we run out of storage space. Accordingly, do you think USDA would be willing to take a look at replacing the $100,000 cap on the program with a cap based on, say, a three year average of bushel production?

Panel II

Question #3
Everson and Ms. Senter, I know the Guaranteed Loan fee increase proposed by USDA is a real concern for both of your organizations, and I share your concern.

My understanding is that the proposed regulation announcing new user fees on USDA guaranteed farm loan programs represents a major cost that would be passed down to producers. As weather-related disasters are wreaking havoc on farmers in northern Minnesota and energy costs are hurting farmers across the country, this is a terrible time to add another cost to producers' balance sheets. These loans are meant to be loans of last resort to farmers facing tough times, and the program has been quite efficient – a few million dollars can guarantee a billion dollars in loans to keep farmers going. Would both of you explain what sort of impact you believe this fee increase will have on the guaranteed loan program? Also, how will the fee affect which farmers and ranchers are eligible for the program?

Question #4
Mr. Everson and Ms. Senter, both of you have expressed great concern over the expiration of the 2002 Farm Bill's suspension of term limits for the direct and guaranteed loan programs. The FSA loan programs are meant to serve as a lender of last resort for farmers trying desperately to keep their operations running, yet these loan program's aren't meant to offer permanent assistance. I think it's important for the American public to understand that farmers face unique challenges and unique situations that

make it difficult for them to work within these term limits. Will you explain, for the record, why term limits just don't function for farmers and what effect they would have on the farming community if reinstituted?