Senate Ag Committee Field Hearing Testimony by Dave Armstrong, CEO, GreenStone Farm Credit Services - April 9, 2011 - Michigan State University, East Lansing, MI

Madame Chairman – Thank you for the opportunity to participate in today's hearing and allowing me to share some of the great things that GreenStone Farm Credit Services is doing for farmers and rural residents in Michigan and northeast Wisconsin, provide you with a brief overview on credit conditions in our local service area, and touch on a couple of areas that are important for the Farm System to carry out its mission in a very rapidly changing marketplace. As you have already heard today, Michigan agriculture has a great story to tell and we are very proud to be part of our collective industry's success.

GreenStone Farm Credit Services is the largest agricultural lender throughout the state of Michigan and northeast Wisconsin.

We are a financial services cooperative, which means our stockholders are the more than 21,000 farmers and rural residents that do business with us.

GreenStone is part of the national Farm Credit System, which was established by Congress in 1916 as a means to provide farmers and ranchers with a stable, secure source of credit. Some 95 years later, GreenStone is a $5.6 billion financial institution, placing it 7th in the nation in terms of asset size among the 86 Farm Credit associations, with a market share of 65 percent of the agriculture debt when compared to selected commercial banks active in agricultural lending within its territory.

We are headquartered right here in East Lansing, Michigan, and have more than 450 employees working out of our 37 locations throughout our service area.

GreenStone is primarily a lending institution, with credit made available for any agricultural need including land, buildings, equipment, livestock and operations. In addition, GreenStone finances rural properties, such as recreational land, home sites and home construction. We also offer a variety of ancillary services above and beyond our loan products, such as tax and accounting services, life and crop insurance, and appraisal services.

With Michigan being the second most diverse agricultural state in the nation with over 200 different commodities produced, GreenStone's loan portfolio is equally as varied. Dairy makes up the largest concentration of our total loan volume, with just under 24 percent; however, we also provide financing for an array of other agricultural industries, including cash crops, vegetables, timber, sugar beets, poultry, potatoes, cattle, hogs, fruit and greenhouses plus, residential loans in rural areas.

For much of the past decade, GreenStone has consistently maintained high levels of customer satisfaction, with annual scores ranging between 92 and 95 percent. In addition to our strong focus on customer service and our years of consistent commitment to financing the agricultural industry, we are also very proud of our ongoing customer patronage program.

In the spirit of our cooperative structure, for six straight years GreenStone has returned approximately 20 percent of its overall net earnings in the form of cash patronage. Just last month, we gave back $18.2 million to our customers, bringing our overall patronage return to more than $85 million since 2005.

Credit Conditions

The growing season in our territory was good to excellent in 2010 for row crops and below average for the apple and cherry industries, which were adversely impacted by an early season frost that reduced yields approximately 50 percent over 2009 levels. Crop insurance minimized the financial impact for the apple industry; however, the cherry industry did not fare as well as it continues to work with excess inventory carryover that is keeping prices low.

Grain commodity prices started the year at moderate levels. Favorable growing conditions deteriorated in the Midwest during July with excess levels of moisture in the Corn Belt. There was also an increase in export levels due to drought in Eastern Europe. The industry went from expectations of losing money to near record profits as expectations of ending stock levels shrank. As a result, grain prices have risen steadily.

An example of the impact is the March 2011 corn futures contract increased from $4.24 in July of last year and recently expired at just over $6.50 per bushel. With tight inventory levels, the 2011 price outlook is very favorable. Input costs for seed, fuel and fertilizer are moving up steadily. We also expect to see upward pressure on land rents as a result of the current price environment. Even with the increase in input prices, the opportunity for solid profit margins exists in 2011 for grain and crop producers in general.

Midwest dairies returned to profitable levels in 2010 after losing money in 2009. Increased production was absorbed by the export market as domestic demand remained relatively flat. The dairy industry has not rationalized cow and bred heifer numbers sufficiently to offset increases in production per animal unit. The industry will remain in an excess capacity situation dependent on the export market in 2011. The run up in feed prices that started in August of last year will place significant pressure on margins in 2011. This increase in cost should be felt first in the western U.S. where the majority of operations purchase their feed. Dairies in Michigan enjoyed a good to record feed harvest in 2010. Most operations have large, high quality forage inventories to work with in 2011. Improved milk prices and relatively lower feed costs in 2010 provided the opportunity for many of our operations to recover all of their 2009 operating losses.

Hog producers operated at prices well above breakeven cash flow prices in 2010 for the first time since the fall of 2007 as the industry right sized production units and export levels grew. Yet, feed prices are tempering the outlook for 2011.

Non-farm economic conditions have improved slightly within Michigan as unemployment peaked out in December 2009 at 14.5% and has since improved steadily to the current level of 12.4% according to the Bureau of Labor Statistics. While employment conditions appear to have stabilized and have shown improvement, the state of Michigan has significant financial challenges that will also impact the private sector. Rural Michigan has not been impacted as greatly as the large urban areas of Michigan economically, but it is still well below 2007 employment levels due to adjustments in the automotive industry that have impacted the state. These circumstances continue to put some stress on the association’s portfolio of residential and part-time farm loans, but it continues to be very manageable.

The world economy continued to show signs of improvement in 2010 as did the U.S. during the fourth quarter. The Federal Reserve continues to pursue a strategy of utilizing a weaker U.S. dollar to strengthen exports. This resulted in agriculture exports increasing throughout all of 2010. Chicago Board of Trade prices for grain and Chicago Mercantile Exchange (CME) futures prices for the protein sector and milk continue to reflect this slow, but improving trend for 2011.

The slow recovery of the general economy continues to negatively impact timber, greenhouse, and nursery operations. Several timber and greenhouse assets in our portfolio were downgraded to an adverse asset classification during the year and are not expected to improve significantly until the housing sector also improves.

The 2011 outlook for the protein sector is for reduced earnings. Feed costs will likely eat into available margins and have the potential to send several industries into the negative earnings range. Current 2011 CME Class III milk prices are above 2010 levels, which should allow our Midwest dairies to maintain breakeven or better margins.

Interest rates continue to be at or near record low levels, which when coupled with relatively high margins for most feed grains can, and is, leading to rapidly increasing farm land values in several parts of the country. Fortunately, we have experienced only moderate land value increases in Michigan, which should help mitigate the impact of any significant decline in crop prices on our customer's ability to service their debts. As an agricultural lender, we are very sensitive to escalating land values and continue to follow sound underwriting standards when extending credit to the industry.

Farm Bill Issues/Challenges

At Farm Credit we continue to utilize all available authority and program resources that permit us to make credit available to the broadest group of producers. The guaranteed loan programs of the Farm Services Agency help us work with farmers that may not be as sound financially or that present a greater risk for some other reason compared to other customers. We urge you to review these programs to ensure that they reflect the needs of today's farmers. It is essential that the caps on loan size be allowed to increase to reflect continued inflation in land values and the cost of production. Farmers must be able to obtain sufficient financing for them to have a viable sized operation. We would encourage as well that the definition of what is an eligible farm be made more flexible to recognize corporate structures that producers are using today to mitigate risk. This is especially important in the case of young and beginning farmers who may bring outside investment into their operation by those not actively engaged in agriculture -- a retired parent for instance. If we are truly interested in promoting young and beginning farmers, we need to allow them to be as creative as they need to be to make their operation viable.

We also recognize that rural development continues to be a key focus of the farm bill. Having a vibrant rural economy that provides job opportunities for farmers and members of their families and amenities such as quality education and healthcare facilities and access to broadband remain critically important to the rural quality of life. It is important that programs be maintained that assist rural communities in addressing their necessary community facility needs. As you know, the Farm Credit System has been granted limited “pilot” authorities to assist with financing rural economic development and stands ready to assist with this in any way that it can.

Finally, much attention has been given to consumer demand for more locally produced food. Major retailers and food service providers are responding to consumer demand as are farmers themselves who are increasing direct marketing of their production to consumers. Often, we are seeing these local value-added opportunities are allowing beginning farmers to get started in agriculture. These agricultural entrepreneurs are seizing opportunities created by consumer demand. As these markets continue to develop, we would encourage the Committee to be mindful of the infrastructure needs that these new marketing channels require and to ensure that they have access to the resources they need to be successful.

Madame Chairman, I want to thank you again for inviting me to participate in today’s hearing and look forward to assisting you and your staff in any way we can as Congress begins the process of rewriting the 2008 Farm Bill. This concludes my comments.