Testimony of the Honorable Glen R. Smith
Chairman and Chief Executive Officer
Farm Credit Administration
Before the Subcommittee on Agriculture, Rural Development, Food and Drug Administration, and Related Agencies
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Chairman Bishop, Ranking Member Fortenberry, and Members of the Subcommittee, I am Glen R. Smith, board chairman and CEO of the Farm Credit Administration (FCA or agency). On behalf of my board colleague, Jeffery S. Hall of Kentucky, and all the dedicated men and women of the agency, I am pleased to provide this testimony. Mr. Hall also serves as chairman of the board of directors of the Farm Credit System Insurance Corporation.

In my testimony today, I will discuss the agency's responsibilities, the current state of the farm and rural economy, and the condition of the Farm Credit System (FCS or System) and the Federal Agricultural Mortgage Corporation (Farmer Mac).[1] I will discuss the effects that the COVID-19 pandemic has had on the rural and farm economy. I will also discuss the response by FCA, the System, and Farmer Mac to the challenges of the pandemic.

FCA's responsibilities

FCA is the independent agency responsible for examining and regulating the banks, associations, and related entities of the Farm Credit System, a government-sponsored enterprise created by Congress in 1916 to provide American agriculture with a dependable source of credit. The System's banks and associations form a nationwide network of cooperatively organized lending institutions that are owned and controlled by their borrowers, serving all 50 states and Puerto Rico. The System is currently made up of 4 banks, 67 associations, 5 service corporations, and the Federal Farm Credit Banks Funding Corporation. FCA is also responsible for the oversight of Farmer Mac, which was established in 1988 under Title VIII of the Farm Credit Act.

As directed by Congress, FCA's mission is to ensure that System institutions and Farmer Mac are safe, sound, and dependable sources of credit and related services for all creditworthy and eligible persons in agriculture and rural America. We accomplish this mission in two ways.

First, we protect safety and soundness by examining and supervising all FCS institutions and Farmer Mac, and we ensure that they comply with applicable laws and regulations. If an institution violates a law or regulation or operates in an unsafe or unsound manner, we use

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[1] Although Farmer Mac is an FCS institution under the Farm Credit Act, we discuss Farmer Mac separately from the other institutions of the FCS. Therefore, in this testimony, unless Farmer Mac is explicitly mentioned, the Farm Credit System refers only to the banks and associations of the System.

our supervisory and enforcement authorities to take appropriate corrective action. Second, we develop policies and regulations that govern how System institutions and Farmer Mac conduct their business and interact with customers. We also approve the corporate charter changes of System institutions, the issuance of System debt, and other financial and operational matters.

Condition of the farm economy

Over the past year, U.S. farmers and ranchers have once again demonstrated their resourcefulness. Agricultural producers repeatedly braced themselves and their operations as the coronavirus disrupted many aspects of the farm and rural economy. Price volatility, sudden shifts in demand, processing disruptions, and general uncertainty have contributed to one of the most challenging times for U.S. agriculture. Moreover, before the pandemic, farm prices for many commodities had been relatively low for five years, and financial stress was building for producers.

The hallmarks of U.S. agriculture — creativity, perseverance, and hard work — have served the nation well during the pandemic. Farmers and ranchers quickly adjusted to fast-changing conditions. Processors and manufacturers worked through spot shortages and continue to look for ways to make the food supply chain more resilient.

Fortunately, the farm economy is in better shape today than it was a year ago, thanks to robust U.S. exports and strong crop prices since last fall, particularly for major commodities such as corn and soybeans. Meat trade is also strong. For example, 2020 was the third-highest year on record for U.S. beef exports despite the COVID-19–related disruptions, which drove down exports by 30% in May and June. For fiscal year 2021, USDA expects total U.S. exports to hit a record high, with shipments to China leading the way.

USDA estimates gross farm income will remain unchanged in 2021 because an increase in total farm cash receipts is expected to offset a decline in government payments. With rising farm expenses, net cash farm income in 2021 will decline modestly, but it remains well above levels recorded from 2015 to 2019.

A record level of government support in 2020 has helped stabilize the farm sector. Payments arrived through traditional farm programs, USDA's Coronavirus Food Assistance Program, and the Market Facilitation Program. Some producers also received proceeds under the Paycheck Protection Program. Importantly, a broad swath of agriculture and rural America has benefited from the Coronavirus Food Assistance Program, especially those who encountered serious market disruptions. A concern for the future is that, if agriculture faces another major disruption, current law does not provide for assistance of the magnitude supplied in recent years.

Farm debt continues to grow, with an expected increase of nearly 50% between year-end 2012 and year-end 2021. USDA estimates that by the end of this year inflation-adjusted farm debt will be just $2 billion shy of the record set in 1980 and 1981. Despite the continued rise in debt, net cash farm income is expected to keep pace this year. A positive indicator for loan repayment is strong farm income relative to debt, coupled with interest rates that are expected to remain low for the immediate future.

Farmers are now gearing up for spring planting season with a degree of optimism they haven't felt for years, according to the Purdue/CME Group Ag Economy Barometer, which measures farmer sentiment. Expectations for the future beyond spring 2021 also remain high but have drifted lower in recent months, reflecting longer-run concerns about policies that could affect U.S. agriculture.

While producers certainly need a well-deserved dose of optimism, as a grain producer, I know how markets can reverse course. Higher prices will motivate more plantings here and abroad, which may add to supplies and cause prices to moderate. As always, weather during the growing season will shape the size of crops. In the meantime, producers have excellent opportunities to manage their risks through federal crop insurance and their own marketing plans. For livestock producers, margins have tightened or turned negative because of the rise in feed costs. Agricultural disaster funds continue to provide financial support to farmers and ranchers as they strive to overcome the weather-related calamities of the past year, including the severe winter weather that caused hardship for many operations last month.

Speaking of extreme weather events, a growing concern is the effect that climate change may have on agriculture and the rural economy. Fortunately, farmers have a history of adopting conservation practices in their operations that improve water, air, soil, and wildlife habitat and will no doubt continue to be receptive to further innovations. And I'm happy to report that the Farm Credit System and Farmer Mac are already supporting many renewable energy projects, including wind and solar.

Farmland values

Farmland and ranchland make up more than 80% of the farm sector's total assets, and agricultural land value serves as a key indicator of farm financial health. Farmland values generally increased last fall after an extended period of relative weakness. In the agriculturally rich Chicago Seventh Federal Reserve District, a survey of agricultural bankers showed that agricultural land values rose 6% in 2020 — the largest gain since 2012. Moreover, values for "good" farmland in the district were up 4% in the fourth quarter of 2020 from the third quarter.

Higher cropland values in the Midwest are being driven by a robust upturn in income from higher grain and oilseed prices, large government payments to producers, and historically low rates on loans. Farmer and investor interest in purchasing farmland has risen, while the limited supply of land for sale has declined. Land that is attractive for recreation or housing also increased in value during the year. Farmland prices will likely continue to be strong in 2022 if the current factors driving supply and demand do not change significantly.

The rural economy

While the COVID-19 pandemic touched every corner of our country, many rural areas were hit particularly hard. COVID-19 outbreaks in the meat processing industry garnered considerable media attention, especially in the early days of the pandemic. By fall, COVID-19 had infiltrated most rural communities. Farm and rural businesses in these communities had to cope with the huge impact on their employees and communities, as well as changes in the markets they serve.

Unlike some suburban and urban areas, rural communities often face inadequate medical infrastructure. Many found themselves less capable to cope with the crisis. Some rural hospitals were already struggling financially before the pandemic. While the national number of cases has receded from its January peak, access to medical care and to vaccines remains a vital concern for many rural communities. Through its investments in rural economic development and infrastructure, including health care facilities, the System is helping those communities make the necessary investments for their future. Today, rural economies are recovering from disruptions caused by the pandemic — with gains in rural manufacturing, a rebound in agriculture and forestry, and rising demand for recreational resources. Yet I remain concerned that some parts of the rural economy may face a rougher road to recovery, especially in areas with high unemployment.

One tool that can benefit all rural communities is high-quality broadband services. Unfortunately, broadband access is limited or unavailable in many rural communities. Even before the pandemic, broadband was critical to the future health and growth of rural communities. Now, with millions of people needing to work, learn, and receive medical care from their homes, broadband has become essential to the survival of these communities. Increasing broadband access will allow communities to retain current residents and attract new ones. This will in turn create opportunities for new businesses in these communities. I'm pleased to report that the System is an important source of credit for communication providers serving rural America. At the end of 2020, the System's portfolio for communication loans grew to $9.7 billion, up nearly $2 billion from the end of 2019.

Farm finances

Although farm income had deteriorated in recent years and was further weakened by the pandemic, farm finances and credit conditions improved as 2020 progressed. USDA estimates that net cash farm income increased 25% in 2020 to $136 billion. This income boost greatly improved the ability of farmers to make timely payments or reduce balances on credit lines. However, although working capital increased during the year to $84 billion, it is far below the 2012 peak of $165 billion, so this remains a concern.

Another factor that helped improve credit quality in 2020 was the sharp decline in interest rates during the year. Many farmers took advantage of the lower rates to restructure their balance sheets and lock in low interest rates. The average interest rate on outstanding System farm real estate loans fell from 5.03% in 2019 to 4.51% in 2020.

FCA encourages System lenders to work with borrowers to help them navigate difficult financial conditions without jeopardizing the long-term viability of the borrower or the System institution. Lenders have been proactive with borrowers encountering difficulty this past year, encouraging them to adjust their operations before it is too late. Also, most

System institutions implemented payment modification and loan deferral programs that are specific to the COVID-19 pandemic.

Some farmers will continue to restructure their balance sheets (to the extent they are able) in 2021 and make changes in their operations. In 2020, use of Chapter 12 farm bankruptcy filings declined to 552 in 2020 from 595 in 2019. Annual filings over the past 10 years have been in a relatively tight range — between 400 and 700.

Condition of the FCS

The FCS continues to be safe and financially sound. Despite the shock of the pandemic to the U.S. economy and agriculture, the System reported favorable financial results for the year, including strong earnings, increased capital, and acceptable portfolio loan quality. System institutions remain strongly capitalized, with significant risk-bearing capacity to support the credit needs of U.S. agriculture.

The System experienced strong loan growth in 2020 as borrowers took advantage of declining interest rates. Gross loans at year-end 2020 totaled $315.5 billion, up $28.5 billion or 9.9% year over year. Real estate mortgage lending, up $15.4 billion or 11.7%, accounted for most of the loan growth. Overall, real estate mortgage loans represented just under 47% of the System's loan portfolio.

Credit quality remains sound, and the System's portfolio continues to perform well despite the unprecedented challenges in 2020. Nonperforming assets totaled $1.9 billion, or 0.60% of loans and other property owned as of December 31, 2020. This is down from $2.3 billion or 0.82% at year-end 2019. Loan delinquencies (accruing loans that are 30 days or more past due) declined to 0.28% of total accruing loans from 0.32% at year-end 2019.

For 2021, although prospects have improved for the major cash crops, stress is likely to remain elevated for certain agricultural sectors and geographical regions. Uncertain demand prospects and rising feed costs are pressuring margins for livestock producers. High-cost producers and those with significant debt will be the most vulnerable to financial stress.

The System remained well capitalized and continued to build capital in 2020. As of December 31, total System capital was $65.5 billion, up from $61.7 billion a year before. Almost 80% of total capital is in the form of retained earnings. The System's overall capital-to-assets ratio was 16.4%, down from 16.9% a year ago.

The System's strong capital position enhances its capacity to support agricultural producers and rural America. The allowance for loan losses at December 31, 2020, was $1.8 billion or 95% of the System's nonperforming assets. Capital, combined with the allowance for loan losses, represented 21% of total System loans outstanding as of year-end 2020.

Growth in System capital is due in large part to the System's strong earnings. For 2020, the System reported net income of $6.0 billion, up from $5.4 billion for the same period a year ago. The net interest margin increased to 2.46% for 2020 from 2.42% for 2019 because of strong loan growth and the ability of System funding banks to take advantage of the decline in the yield curve. Debt called during 2020 totaled $115 billion, compared with $54 billion during 2019.

The System continues to maintain reliable access to the debt capital markets. Investor demand remains positive, allowing the System to continue to issue debt at competitive rates. Risk spreads and pricing on System debt securities remain favorable relative to corresponding U.S. Treasuries.

With a balance of $5.5 billion as of year-end 2020, the Farm Credit Insurance Fund further enhances the financial integrity of the System. Administered by the Farm Credit System Insurance Corporation, this fund protects investors in Systemwide consolidated debt obligations. System banks also maintain liquidity reserves to ensure they can withstand market disruptions. As of December 31, 2020, the System's liquidity position equaled 171 days, significantly above the 90-day regulatory minimum required for each FCS bank.

Response of FCA to the pandemic

When the national emergency was declared almost a year ago, our first concern was how to keep our employees safe while continuing to fulfill our public mission. Thanks in large part to our IT staff and the technologies they have put in place for our use, we were able to do just that. We also relied heavily on real-time data to make decisions about closing offices, opening them on a limited basis, and establishing protocols to keep employees safe when they are in the office.

One of our first actions in response to the pandemic was to send a message to the institutions we regulate, urging them to work with borrowers affected by the pandemic and notifying them that we can provide some temporary regulatory relief to help them manage the challenges of the pandemic. Since then, we have issued numerous guidance documents related to the pandemic, including detailed guidance on providing Paycheck Protection Program loans to System borrowers.

Young, beginning, and small farmers and ranchers

Congress requires each System association to have a program to provide credit and related services to young, beginning, and small (YBS) farmers and ranchers. In the late 1990s, FCA established a system to monitor the associations' YBS programs and activities and to receive reports regarding the associations' YBS lending. We include data from these reports in our annual reports to Congress.

On February 21, 2019, we published an advance notice of proposed rulemaking to seek public comment on ways to improve the YBS data collection process. Using the input we received, we are modernizing the System's reporting of YBS data for lending and nonlending activities. Over the past year, we have made significant strides in improving the collection of YBS data. To accomplish this, we are engaged in a transparent long-term process to use existing data assets to reduce regulatory burden, improve efficiency, and promote consistency in YBS data reporting. We are also working to enhance public reporting of YBS activities; these public reports are available on our website.

In addition, we are working with USDA's Farm Service Agency to find ways for agricultural lenders to better use USDA resources for YBS producers. In October, we helped USDA facilitate a meeting of stakeholders to determine how to improve service to beginning farmers and ranchers.

Condition of Farmer Mac

Congress established Farmer Mac in 1988 to create a secondary market for agricultural real estate and single-family rural housing mortgage loans. Farmer Mac has authority to purchase agricultural real estate mortgages and rural home loans, USDA-guaranteed farm and rural development loans, and rural utility cooperative loans. It is also authorized to create and guarantee securities and other secondary market products that are backed by such loans.

By providing a ready source of liquidity for primary lenders, Farmer Mac increases the availability of reasonably priced credit to agriculture and rural America. It provides wholesale portfolio funding, credit guarantees, and other products for its network of lenders, including agricultural banks, insurance companies, Farm Credit System institutions, nonbank lenders, and rural utility cooperative lenders. Since its inception, Farmer Mac has helped fund farmers, ranchers, rural electric cooperatives, and agribusinesses in all 50 states and has provided more than $58 billion of investment in rural America.

Even with its workforce working remotely for the past 12 months, Farmer Mac has continued to fulfill its mission, and its condition is safe and sound. As of December 31, 2020, Farmer Mac's outstanding program volume reached $21.9 billion. Net income available to common stockholders for the 12 months ended December 31, was $89.2 million, up 0.9% from the same period in 2019. Farmer Mac's core capital totaled $1.0 billion as of December 31, which exceeded its statutory minimum requirement of $674.5 million by $352.5 million.

Despite recent stress in the agriculture sector, Farmer Mac's credit quality remains sound. No delinquencies exist in Farmer Mac's Institutional Credit, USDA Guarantees, and Rural Utilities lines of business, which represent 61% of its program volume. In fact, rural utilities have seen reasonably stable demand throughout the pandemic — despite some brief demand disruption.

The Farm & Ranch portfolio represents the remaining 39% of outstanding volume. As of December 31, 2020, substandard loans were 3.4% of the total Farm & Ranch portfolio, down 0.6 percentage points from a year earlier, and loans more than 90 days delinquent decreased to 0.54% of the total Farm & Ranch portfolio from 0.78% as of December 31, 2019. Farmer Mac worked with loan servicers to facilitate COVID-19–related payment deferment requests from borrowers. It executed 472 payment deferments on $432 million of outstanding principal on Farm & Ranch loans and loans underlying USDA securities.

Cybersecurity

Cybersecurity is a key focus for us at FCA. We protect our systems and data in a variety of ways: filtering out known malicious websites and emails, monitoring our network for unexpected activity, encrypting our data and sensitive communications, and communicating with other agencies and our regulated entities to ensure we're using best practices. We're also looking for ways to constantly strengthen cybersecurity. This past year we emphasized staff awareness by increasing cybersecurity training. As the recent SolarWinds hack demonstrated, cybersecurity is an area that no organization can afford to ignore. Fortunately, our agency was not affected by the incident because we were not using the version of the software with the vulnerability that enabled the hack. We often wait to install the latest version of software programs to ensure that any technical issues are worked out.

Cybersecurity is also one of the many aspects we consider when examining the institutions we regulate. Although, at the time of the incident, three institutions were using the version of SolarWinds with the vulnerability, none appeared to have been attacked, and all have since switched to a safe version of the software.

Conclusion

We at FCA remain vigilant in our efforts to ensure that the Farm Credit System and Farmer Mac remain financially sound and focused on serving agriculture and rural America. We will continue our commitment to excellence, effectiveness, and cost efficiency and will remain focused on our mission of ensuring that System institutions and Farmer Mac are safe, sound, and dependable sources of credit for agriculture and rural America.

This concludes my statement. On behalf of my colleagues and the staff at the agency, I thank you for the opportunity to share this information.