Comments of

John Dean

On Behalf of the

Independent Community Bankers of America

Before the

Farm Credit Administration

Public Hearing
McLean, VA

June 26, 2003

ICBA: *The Nation's Leading Voice for Community Banks*℠

Prepared Remarks by John Dean
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Opening Comments

Thank you for the opportunity to appear at the FCA headquarters here in McLean, You have a great place, maybe not as palatial as the Fed Headquarters, but you regulators have a tough job trying to rein in some of the wild-eyed expansion plans of those you regulate.

The FDIC does a good job, as they have not needed taxpayers to bail them out as did the Savings and Loan Insurance Fund and the FCS prior to the FCA becoming an arms length regulator.

We hear a lot about GSEs today in the news; but so far there has been only one that has needed taxpayer assistance – the one you regulate – so caution is in order on their expansionist agenda.

I work for a small bank in Southwest Iowa, pretty close to the Nebraska border and I have land in Nebraska, so put me down as representing both states. By your definitions, I guess you should put me down as a farmer as well. In our area we, as you, have seen a vast change in agriculture; our farm customers have declined and our urban customers have increased. But, contrary to the FCS, we were not conceived to finance only farmers and ranchers. The FCS – being a product of Congress – was directed to finance farmers and ranchers. Some of your regulatees think this should be changed – they want no limits.

All GSEs & Banks have Statutory Limits

Their mission could be changed, but only by Congress – just as some of the banks regulated by our regulators want banks to be able to own car dealerships, car washes, manufacturing plants and everything else, in effect eliminating the separation between banking and commerce, like in Japan. This also could be changed, but only by Congress.

The Savings and Loan debacle was brought about by Congress. It is reported that this cost the taxpayers more than the Second World War. If Congress had not changed the rules on Savings and Loans and then had not expanded their powers and insurance, I would bet a dollar against a donut that the taxpayers – that is, you and me – would not be on the hook for the unimaginable amount of money that was lost. These should count as lessons learned for all of us. The FCA is the regulator, not the cheerleader, for the FCS. The regulator is responsible to see that the system does ***no less, nor more*** than Congress intended.

A few years ago, there was a conference at the Fed in Chicago in reference to causes and remedies for the bank failures that cost, but did not break, the FDIC.

There was a great deal of evidence that mergers of mega banks, though increasing the risk to the FDIC, did not bring about any benefit to the users of the bank services. They were driven by management, which after the mergers received much larger salaries and benefits.

It was also proposed that in future bank failures, the management, the examiners and the regulators should be in some way personally liable.

You have asked us to comment on whether to revise regulations governing ELIGIBILITY and SCOPE of financing farmers. I presume by revise you mean make more restrictive or looser – but the question is what does the statute say? **It says lend to "bona fide" farmers.**

We must look at the definition of bona fide, presuming that Congress had no unusual or exotic meaning. Mr. Webster – bona fide – genuine; authentic – being exactly what the item is said to be, without counterfeiting, without mixture or adulteration.

Bona Fide Farmers Seek Their Livelihood from Farming

It would be a long stretch down a slippery slope to make wide open non-farm loans to part time farmers — somebody who works one month on a farm as a farmer; is he as farmer? How about one week, how about one day, how about 1 hour?

Some say it may be hard to define a bona fide farmer. But, some obvious requirements would be:

- a majority of the farmer's income should come from farming and the individual should be trying to earn their living from the farm;
- in order to receive FCS financing they should be required to file with their application a Schedule F tax form that shows a reasonable continuity of income or profit from the farm;
- the full-time bona fide farmer definition should not include "hobby farmers";
- the bona fide farm definition should also include somebody who really contributes land, labor, capital and management to the operation;
- the bona fide farm definition should also include one who actually produces a commodity and sells those commodities for income – and not just somebody that owns a few acres with the **potential** to produce something someday. **If they produce "something someday", then they can go to the FCS for financing at that time, but not before, because they are not bona fide farmers.**

FCA regulations are already far too loose and if anything, they should be tightened and include **all** of the above criteria I have outlined.

You ask about scope – the credit provided should be:

- primarily agricultural loans
- these loans should be intended to maintain efficient farm operations; and
- all credit should be "directly related to the farm operation" as the statute says.

FCA regulations already allow for part-time farmers to receive credit for all of their family needs and to be placed on par along with full-time farmers ***IF*** they are trying to earn their livelihood from farming. The FCA regulations are already quite generous, which suggests there is really no basis for the FCS to seek further regulatory relaxation. Sure they want to interpret the Act to say they can do anything, but that is not what Congress said or intended.

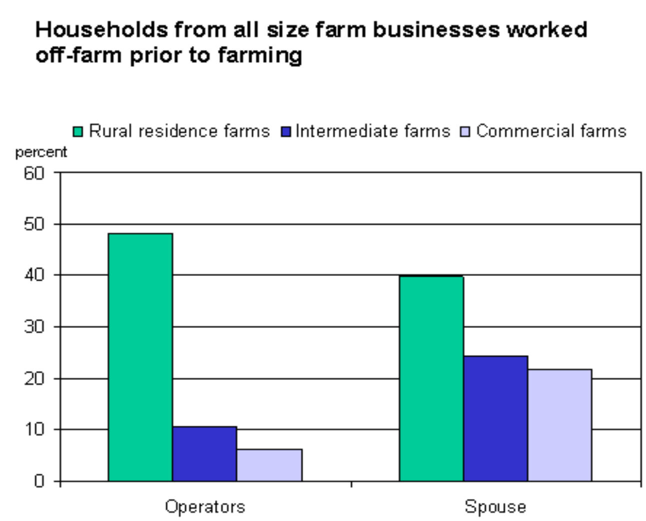
The proposal by FCS to allow local boards to decide their associations scope and eligibility activities is fraught with safety and soundness dangers that FCA, as the regulator, simply should not allow. If the FCS leaders testifying today could not even answer your question as to the merits of requiring a schedule F form be filed with the loan application, how can FCA expect local boards of directors, who lack a financial lending background, to ever be able to act as a control upon keeping FCS financing focused on agriculture. That's precisely the point – the FCS leadership wants no controls and they fully intend to shift further and further away from agriculture if they get these new powers.

You might be interested in a few quotes from the *Drake Law School Agricultural Law Journal, Volume 7 #3, Fall 2002*.

- Page 573 "Others have questioned the willingness of the Farm Credit Administration, the federal agency with regulatory authority over the FCS institution, to enforce the statutory lending limitations."
- Page 574 "The Farm Credit System was a lender to farmers that could not obtain credit elsewhere, and the Farm Credit System did not compete with private lenders. It has been proposed that the Farm Credit System return to that mission."
- Page 577 "The tax exemptions for FCS lenders, coupled with the de facto guarantee of the debt of those institutions by the Federal Government, give the FCS lenders a significant federal subsidy."
- Page 577 "(Estimating the cost advantage of the Farm Credit System lenders over private lenders at 100 basis points)." I suggest this advantage is way understated.

The FCS seems to take the position that times have changed. There are less farmers, so they should loan to, in effect, non-farmers. *Is this a job looking for a need; like keeping an obsolete army base in operation, or keeping the Federal Tea Tasting Commission in existence?*

Perhaps FCS should concentrate on their mission and not be expanding it beyond the intent and the wording of the law.



We recommend FCA keep in place the requirements that FCS loans be agricultural in nature. Further, those that do not have bona fide farming enterprises **that actually produce commodities and earn agricultural income form the sale of these commodities** should **not** receive credit.

I read the letter by the Farm Credit Council to FCA which quoted an earlier proposed rule-making by FCA as suggesting the Farm Credit Act "does not distinguish between full time and part time farmers". **I beg to disagree—when the law says *"bona fide"* farmers, *this IS the distinguishing criteria!***

If you tell your 16-year-old son he can use the car to go to the *ballgame*, you do not have to distinguish that he could not go to *the next town*. When you said that he could go to the ballgame, by plain meaning, you limited everything else.

Rural Housing Finance

Your next inquiry is rural housing and FCA comments that**:**

In general — Loans and discounts may be made to rural residents for rural housing financing. Mr. Webster defines "Rural" as "open country and farming areas." It would appear that any area that is designated a metropolitan statistical area should not qualify.
If Congress wants to change the law from rural residents for rural housing, *they know the words!* The rural resident for rural housing criteria applies to "moderately"—in other words—modest-priced homes. Most rural residents can't afford anything else.

The 75th percentile criteria certainly should not be expanded. We also need information from FCA as to what the home mortgage activities have shown in terms of FCS housing loans. Who are they lending to? How do these million dollar home loans they're making fit into the current criteria? What percentage of FCS portfolios consists of home loans? How many have they made in the last two years? Why doesn't the public have access to this information? **I request the FCA supply this information for the public meeting record** so the public has adequate information to make recommendations to FCA. And given that the FCS is a government sponsored enterprise, if there are abuses in this lending area -- and we have reason to believe there are -- as in all other lending areas, then these abuses and illegal activities should see the light of day and be publicly reported, just as occurs in the banking industry by banking regulators. Even more scrutiny should be exercised over a GSE – a public tool.

In the second letter petitioning FCA, the petitioner states that FCS accepts "the contributory value of farm buildings and farm acreage . . . Most other lenders who utilize the secondary market will not." And this petitioner would lead you to believe other lenders have problems financing residences that use non-city or non-district water supplies for their homes. This is just not correct. In fact, I have attached a few examples that show the very broad flexibility that Freddy and Fannie have in accepting rural home loans in the secondary market.
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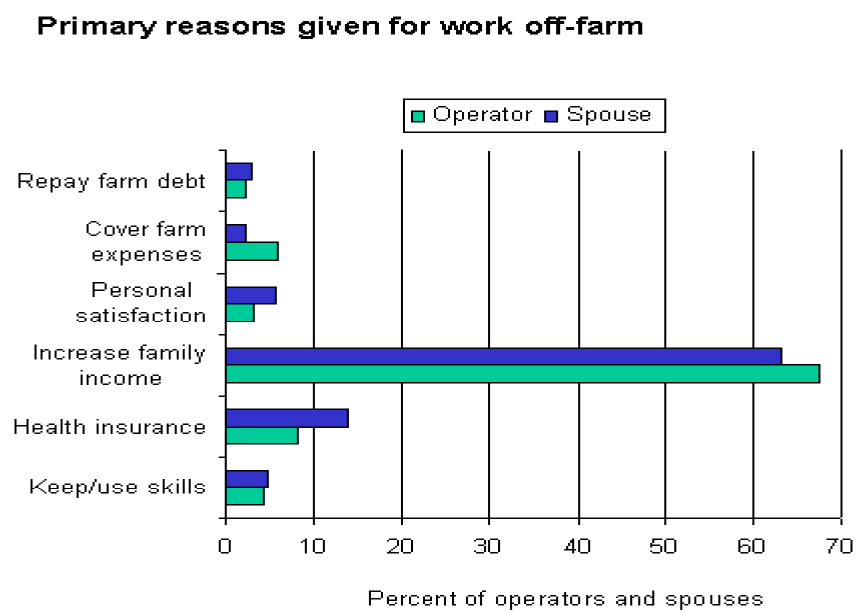
Off-Farm Income Rationalization Is Deficient

Much of our reason for being here today is really to discuss whether FCS should make non-farm loans to an undefined group of part-time farmers who have off-farm income. This supposedly would help the System "modernize".

I suggest that modernization works both ways. If the reality is that there are less "bona fide" farmers today than in decades past, then perhaps the System should down-size to keep up with the reality of these "modernization" trends.

Perhaps their legitimate, bona fide reason for existence is less justifiable then in the early parts of the previous century when they got their start and when credit access was much more limited than today in our modern society.

The System's off-farm income arguments don't hold water. Sure, off-farm income can be used to repay farm debt and off-farm jobs can be pursued to provide additional family living funds. However, USDA tells us that the vast majority of people who have off-farm jobs do so as a career choice – in other words – *they're not trying to be bona fide farmers as their principal source of livelihood – they have other careers in mind!*



That being so, why should FCS be able to lend to those who choose careers other than farming – especially when USDA also tells us that the vast majority of people who pursue off-farm incomes do **NOT** do so for the purpose of repaying their farm debt?

In other words USDA is saying that the vast majority of rural people with off farm income do not rely on that income as a means to stay on the farm. Rather, they often times want to increase their household income, as we all do, and they want access to health care and other benefits and to pursue other professional opportunities.

Why should FCS, a government sponsored enterprise that was created to exclusively serve agriculture, be able to make non-farm loans, on an unlimited basis, to those who have minimal involvement in farming or ranching? This argument completely turns the intent and the statute on its head. Why should FCS provide unlimited non-farm credit to someone that has an acre of land? Or provide unlimited non-farm credit to someone who is a hobby farmer? Or to a doctor or to a group of lawyers who want to buy land for recreational purposes?

FCA is allowing the FCS to get away with too much, and is allowing FCS to – as you said Chairman Reyna – ask for forgiveness instead of permission.

Will the FCS be making loans to Wal-Mart for all of their financing to sell lawn chairs and barbeque grills and all their retail merchandise simply because Wal-Mart owns land in rural areas and would therefore be technically considered "bona fide" farmers by FCA's definition? That's just one example of abuses that would occur and that is why these FCA definitions need to be tightened and why the FCA should reject the FCS request to do away with any constraints on their lending activities.

We need to also keep in mind that many people who have off-farm income get this income from pensions, Social Security, dividend and interest income, or have jobs working for the local school system or have administrative or government jobs. Why should FCS finance a farmer for an unlimited amount of non-farm credit simply because that farmer's wife works as an accountant in a local business on Main Street? The non-farm income argument is not at all convincing.

Chairman Reyna, you stated it well in your opening statement, the FCS is a "GSE – a public tool – chartered by Congress to serve agriculture . . .". And I can answer the questions you asked: Yes, the instances of illegal lending you mentioned and the other examples from around the country that the FCA is aware of are examples of mission creep and an attempt to use a public tool with a very limited purpose envisioned by Congress to pursue loans that legitimately can be made by private sector lenders in the pursuit of scope and eligibility activities that were never envisioned by Congress.

Purpose of Expanding FCS Lending Has No Purpose

Let me conclude by saying that another fact that the FCA might consider, if the mission is to have FCS lend to under-served loan areas – **there isn't any**!

The banking system, in general, is awash in liquidity and looking for loans – talk to the Fed the FDIC and the State banking departments.

Thank you for giving me the time to play Paul Harvey today and give you "the rest of the story."

(See Attachments Following)

Examples of Fannie / Freddie Flexibility on Rural Home Loans

Scenario A

Loan profile	95% LTV 30-year, fixed rate
Borrowers	Dick and Jane have signed a contract to purchase a rural property for their primary residence, For the past four years, Dick has been working as a mechanic repairing farm machinery. Jane works as a teller at the local bank.
Property	The borrowers are under contract to purchase a 25 year old ranch style home on a twenty acre site in a rural location. The current owners grow fruits and vegetables on eight acres of the property and sell part of their harvest from a fruit stand on the property on the weekends. Minimal income is generated from the sale of the fruits and vegetables. There is also a barn on the site. The typical residential properties in this rural area have two- to thirty- acre sites. It is not uncommon to farm part of the site.
Underwriting issues	There is a barn and fruit stand on the property, as well as AG activity on the property.
Underwriting conclusion	The appraiser performs a neighborhood or market area analysis to identify the area that is subject to the same influences as the property being appraised. The results of the analysis will enable the appraiser to define the area from which to select comparables, to understand market preferences and price patterns, and to reach conclusions about the highest and best use of the subject property site. In this case, the appraiser indicated in the appraisal report that the subject property is zoned agricultural, that the residential ranch style dwelling represents the highest and best use of the site as improved, and that it is a relatively typical dwelling and site for the subject neighborhood or market area. She also noted that the residential dwelling, fruit stand, barn and agricultural activity on the property are not uncommon for the area and are all acceptable uses under the zoning and land use regulations. Based on analysis of the information, this loan would meet Fannie Mae's underwriting standards because the property is primarily residential in nature and the mixed-use characteristics of the property (due to the fruit stand, barn, and agricultural activity) represent a minor secondary use of this residential property.

Scenario B

Loan profile	85% LTV	30 year, fixed rate
Borrowers	Mike has been a truck driver with a national firm for the last five years. Mary does not work outside the home.	
Property	The property is a new, single-family, detached property in a 50 year old rural town. It is one of three new homes that were built in the last three years on the last undeveloped parcel in the town. The appraiser used as comparables one of the other new home sales that was built on the same parcel as the subject (which sold 1.5 years ago), two recent relatively similar new home sales about 15 miles from the subject property in a new home subdivision in a competing town, and two recent sales of older dwellings from the subject town. The appraiser was not aware of any recent new homes sales in the subject town that could be considered as comparables or any recent new homes sales in older towns in the general market area.	
Underwriting issues	The uncertainty of a reliable estimate of market value for the subject property because of a lack of truly comparable sales in the subject town.	
Underwriting conclusion	Based on an analysis of the information, this loan would meet Fannie Mae's underwriting criteria. The subject is a new home in an established, stable community. The appraiser used as comparables an older new home sale in a new home subdivision in a competing town, and two recent relatively similar new home sales in a new home subdivision in a competing town, and two recent sales of older dwellings from the subject town to support his estimate of the market value of the property and to demonstrate the property's marketability.	

Scenario C

Loan profile	95% LTV 30-year, fixed rate
Borrowers	The borrowers include a husband and wife and the wife's mother. The husband has been a clerk in a sporting goods store for the last three years. The wife is a secretary, who has been on her current job for the last five years. The mother receives Social Security income.
Property	The property is an older two-story dwelling in a rural town. The house is 72 years old and has an outmoded design and layout. According to the appraiser, it suffers from significant functional obsolescence because of its layout and the fact that it has only two bedrooms and one bathroom. The appraiser used a recent comparable sale of a 60 year old house in the subject town that has three bedrooms and one bathroom and two sales with two bedrooms and one bathroom from a comparable town that are similar in vintage to the subject property in his analysis and in the appraisal report. The appraiser notes that the two bedroom comparable sales also suffer from significant functional obsolescence. The appraiser made significant adjustments in the sales comparison approach for location, size, site, and view. The net adjustments for all three sales exceeded the 15% net adjustment guideline. Two of the three sales were adjusted by more then the 25% gross adjustment guideline.
Underwriting issues	Functional obsolescence is noted in the appraisal report due to the design and layout of the property, and the reliability of the estimate of market value is uncertain because of the lack of truly comparable sales.
Underwriting conclusion	Based on an analysis of the information, this loan would meet Fannie Mae's underwriting criteria. Information provided in the appraisal report indicates that the layout and design of the property are relatively common and customary for older dwellings of this size in the town. The appraiser reflected the effect on value by comparing the property to relatively similar properties in a competing town. In addition, the appraiser adequately explained his adjustments in the sales comparison approach.

Scenario D

Loan profile	95% LTV 30 year, fixed-rate
Borrowers	Mary and Betty have been roommates for four years. Mary has worked as a waitress for the last three years. Both provided two years of tax returns and a verification of employment. Betty is a hair stylist who has established a substantial clientele over the last six years. Betty plans to run her business out of the home.
Property	The subject property is a 60 year old detached dwelling in a rural town. Properties in the town range in age from 40 to 100 years old. The appraiser stated that the property is in average condition for homes of this age in this town. She also stated that most of the older dwellings in the town have minimal updating and modernization, but there are some renovations and improvements. The appraiser estimates that about ten percent of the properties in the town are vacant, boarded up, or abandoned. The block in which the property is located in appears to be relatively well maintained; although the property next door is abandoned. Two houses on the next block also have boarded up windows.
Underwriting issues	Based on an analysis of the information, this loan would meet Fannie Mae’s underwriting criteria. Because the appraiser used sales of similar properties from the town or market area, any influence the boarded up, abandoned, and vacant homes have on the value and marketability of the property should be reflected in the sales prices of the homes in the town or market area. In addition, Betty’s plans to run her business out of the home is considered to be an acceptable use of the property under the zoning and land use regulations.