

**Statement of Kenneth E. Graff, CEO
Farm Credit West
Before the
Farm Credit Administration Public Meeting on
FCA Regulations Governing Eligibility and
Scope of Financing
June 26, 2003
McLean, Virginia**

Chairman Reyna. Board Members Flory and Pellett. Thank you for this opportunity to appear before you today. My name is Kenneth Graff. I am the President/CEO of Farm Credit West, headquartered in Visalia, California.

I appreciate the opportunity to appear before you today representing the associations in Arizona, California, Hawaii, Nevada and Utah, regarding the Farm Credit Administration's (FCA) regulations governing eligibility and scope of financing for farmers, ranchers, and aquatic producers or harvesters who borrow from Farm Credit System institutions. I would note that the agency has also published an advanced notice of public rulemaking (ANPR) regarding this matter and the comment period for that is open until July 31, 2003. Farm Credit West, as well as several other institutions that I represent today, will most likely be submitting comments in response to that notice that will supplement what I will be presenting to you today.

Let me begin with a brief reflection in history. I have been with the Farm Credit System in various management roles for about 30 years and have seen many changes. For the most part, very positive, progressive changes have been made that have enabled system institutions to meet the mandate set by Congress. While many people have had a hand in designing, developing, and adjusting the System over the years, the world around us is also changing, and it is changing at an ever increasing rate; thus we all have an obligation to continue making those changes necessary to ensure that the Farm Credit System continues to fulfill the purpose set forth by Congress. That express purpose was "to provide for an adequate and flexible flow of money into rural areas, and...to meet current and future rural credit needs and for other purposes."

Mr. Chairman, today we applaud the FCA in recognizing the continuing need to explore how the regulations can become more responsive to the needs of "all" eligible farmers and ranchers as well as those non-farm rural residents that we are mandated to serve.

Today I will provide a brief response to three of the four questions raised in your notice of public hearing, as well as share some examples of how the current interpretation of the regulations has been a departure from prior FCA guidance.

First, the current regulatory definition of a bona fide farmer is fine and should remain unchanged.

Second, you asked for input on what limits, if any, FCA regulations should place on lending for farmers' other credit needs. There is no statutory basis for limiting credit to bona fide farmers. In fact, the Act specifically authorizes credit for "other needs of the applicant" and "other requirements of such borrowers" (Sections 1.11(a)(1) and 2.4(a)(1), respectively.) As such, FCA should delete the restrictions in Regulation Section 613.6005(a) to more closely parallel the Act.

The third question you posed was regarding the existing distinction between full-time and part-time farmers, which I feel should be deleted. There is no distinction in the Act. In today's agriculture, and more so as time goes on, the individual or individual(s) who need financing to produce agricultural products (let alone provide inputs and process those products) may not fit what some view as the traditional definition of a producer. They will be asset owners or investors and service providers like agribusiness companies that supply inputs or applicators or processors. Simply stated, all farmers should be eligible for financing for all of their credit needs. FCA should recognize the broad purposes of the Act, and adjust the regulations so that the System can better fulfill the critical mission to:

- “meet current and future credit needs”
- “provide for an adequate and flexible flow of money into rural areas”
- “improve the income and well-being of American farmers” and to be
- “responsive to the credit needs of all types of agricultural producers having a basis for credit”

There are numerous examples of how current regulations in this area are out of step with the intent of the Farm Credit Act. It is my intent today to share just a few examples to give the members of the FCA Board an indication of the issues that we, and your Examiners, deal with on an everyday basis. While some may construe my comments as being critical of your Examiners or their actions, I can assure you that is not my intent. These examples are simply intended to illustrate the difficulties we both face in making a distinction between full-time farmers and part-time farmers; the problems encountered in attempting to limit the scope of financing to individuals who may have interests outside farming; and how interpretations have changed over the last few years.

In my first example, we have a customer who started raising ducks in the 1950's. We began financing this individual in the 1970's and have financed his operations for the past 25 years. He continued expanding his operations until he reached the point that he was producing over 3.2 million ducks annually and was the second largest duck producer in the United States. This customer used some of the profits from his duck operation to invest in vineyards, which we also financed. Today he owns and operates about 480 acres of vineyards and has a partial interest in a winery. In the last few years this customer sold a major portion of the duck operations and used 1031 property exchanges to purchase and develop some of the vineyards as well as some commercial property in the small rural town where he lives. FCA examiners have reviewed this account for years without any question, but this year, they indicated we were in violation of scope of financing on this account and told us we would have to remove one questionable loan from our eligible collateral. The questionable loan was used to finance some of his commercial development and amounts to about \$4 million of his total borrowings of \$16 million (about 25 percent).

A second example involves one of our directors. A few years ago the FCA Examiners determined that one of our Association directors was not a full-time farmer. He had been a full-time farmer all of his adult life – he raised alfalfa hay and cattle and personally performed the farming operations. However, he had been successful and had invested some of the profits from his agricultural operations in some development projects in the rural communities nearby his farming operation. As frequently happens,

agricultural income can be variable, and one year the development operations contributed more than 50 percent of his income for that year. That's when the Examiners declared he was no longer a full-time farmer and suggested we should limit our financing only to his agricultural operations. He subsequently took some of the profits earned from his off-farm operations and invested them in developing some of his alfalfa ground into vineyards. This has increased his ag income to the point it substantially exceeds his off-farm income. We're sure glad we didn't send him down the street to a competitor – we may have lost an excellent customer as well as a director!

In another instance, we have two individuals who each own substantial agricultural assets – in excess of \$5 million each. These individuals were college roommates and have been in farming for nearly all of their adult life. One of the individuals is the fourth generation of a farming family – his family began farming in the 1880's. Collectively they own nearly 5,000 acres of agricultural land, most of which is developed to various permanent plantings, and about 300 acres of non-agricultural land. If asked, they would both say they spend the majority of their time in their ag operations and that they consider themselves full-time farmers. They were also fortunate enough to inherit some commercial property and they also owned some agricultural property near a growing rural community. That property was recently rezoned and suddenly became much more valuable. Last year we made these individuals a \$4 million loan on some commercial property – now, because of that rezoning and the appreciation in value of that formerly ag property, the FCA Examiners recently determined these people were not full-time farmers, therefore this loan exceeds the scope of financing, and it should be removed from eligible collateral. It should be noted that we could have made this loan against agricultural properties – the customers had plenty of equity – but for sound business reasons, they preferred to have the loan against the commercial properties.

In another instance, we have a customer for whom we have financed his winery and vineyard operation for over 20 years. He was also in the outdoor media advertising business with other family members and they were very successful. A couple of years ago, they sold the media advertising business for a very large sum of money. He also subsequently sold his interest in the winery to his brother-in-law because they could no longer work together, but he retained the vineyard properties and remains actively involved in the management thereof. Because of other financial interests, his non-agricultural assets make him less than a full-time farmer at this point in time. At his request, we recently made him a loan to finance a commercial project. In spite of our long-term relationship with this individual, the Examiners indicated this loan exceeded the scope of financing and should be removed from eligible collateral.

Another example comes from an association in Northern California who has a customer who owns several thousands of acres of agricultural land. This borrower has a significant amount of agricultural income. However, because the borrower provides only capital and management to the agricultural operation, he is considered a part-time farmer and therefore only eligible for credit for his agricultural needs. It should be noted that the Association had asked for an interpretation from FCA prior to financing this type of operation and had been given the "green light" to proceed. That was a few years ago. During the most recent Examination, the loan was deemed to be a violation of scope and eligibility and it was recommended that it be removed from eligible collateral.

These are just a few examples, but as I indicated at the outset, they indicate the very real everyday problems that we face in distinguishing between full-time and part-time

farmers and the extent of financing which may be provided. While some of these customers are less than full-time farmers, it is obvious that they are deeply involved in agriculture and that Farm Credit should be able to offer them a full package of financial products and services to meet their needs. Several of the examples also clearly illustrate that FCA's own Examination staff has the same problem, because they have reversed position on some of the same instances over the last several years. That is why, in my opinion, Congress showed great wisdom in NOT making any distinction between full-time farmers and part-time farmers and why FCA should recognize the broad purposes of the Act, and adjust the regulations so that the System can even better fulfill the critical mission to:

- “meet current and future credit needs”
- “provide for an adequate and flexible flow of money into rural areas”
- “improve the income and well-being of American farmers” and to be
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In closing, let me repeat what I have often said to our staff – we are in the lending business, but more importantly, we are in the relationship business. It is our business to establish and maintain long-term relationships with our customers. To do that we must work closely with them to help ensure that they succeed. Many times as customers grow larger and expand, diversification of risk is an important element of that strategy to ensure continuity and achieve success. It makes no sense at all for us to work with a customer to the point where he is achieving some degree of success and then have to introduce him to a competitor for further financing. No one else that I know of does that. Farmers and ranchers are not second-class citizens, thus they should be free to establish and maintain lending relationships wherever they choose to do so.

System institutions which are responsive to such other credit needs helps agricultural and aquatic producers remain on their farms and ranches and in America's rural communities. Today, the need for rural development is greater than ever. In my opinion, System lenders are fulfilling their obligation to “provide for an adequate and flexible flow of money into rural areas, and to meet current and **future** (emphasis added) rural credit needs” when they finance certain non-farm businesses owned by farmers in rural areas. We are also contributing to rural development by financing the other business needs of farmers and ranchers.

Last, but certainly not least, lending for farmers' “other credit needs” also enables System institutions to strengthen their viability by diversifying their loan portfolio. This added diversification of risk contributes to maintaining safe and sound operations.

In summary, I believe Congress made a wise choice in not distinguishing between full-time and part-time farmers, and in not limiting our ability to provide credit to these people. FCA should follow that example and provide system institutions with the latitude to adjust to the evolving needs of agricultural producers, rural businesses, and rural communities.

Thank you, Mr. Chairman. I would be happy to answer any questions you might have.