STATEMENT OF

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PRESIDENT & CHIEF EXECUTIVE OFFICER

FARMERS & MERCHANTS SAVINGS BANK
LONE TREE, IOWA

On Behalf Of The

IOWA BANKERS ASSOCIATION

At A Public Meeting Of The

FARM CREDIT ADMINISTRATION

JUNE 26, 2003

McLEAN, Virginia

Chairman Reyna and Board Members Flory and Pellett, my name is Gayle Kaalberg. I am an active farmer and president and chief executive officer of Farmers & Merchants Savings Bank in Lone Tree, Iowa. Farmers and Merchants has approximately $80 million in assets and $40.5 million in outstanding loans and loan commitments, 35 percent of which are to farmers in our community. I am before you today as a representative of the Iowa Bankers Association and its approximately 412 member banks – most of which would have a similar asset size and loan portfolio as my bank.

You have requested that today's witnesses take 5 minutes to comment on four specific questions – Since the state banking association's have discussed and debated each of these questions and have agreed on what we believe are reasonable suggestions, I suspect many of the comments will be similar and reflect this consensus. I would however, like to share some Iowa's specific information that we considered in helping us reach the conclusions shared here today. The first question:

1. **Should FCA retain the definition of bona fide farmer and if a change is supported, what definition is suggested?**

   I believe the Farm Credit Administration should retain its current definition of bona fide farmer and consider a requirement that FCS borrowers file an IRS 1040 Schedule F.

   Existing regulations allow System lenders to finance part-time farmers as long as the loan is for the "agricultural needs" of the applicant. It is entirely appropriate that FCS not be allowed to finance the consumer credit needs (i.e. credit cards, home equity loans, car loans) of a borrower whose business is other than farming.

   The System will argue that the language must be eliminated to enable them to help young, beginning, and small farmers who often times must have off-farm employment. But when you consider that FCS currently has the ability to finance the "agricultural borrowing needs" of YBS farmers, and the evidence supports they are not doing so in a meaningful way – it is not good policy to broaden the scope of the definition. I don't believe broadening the definition would help YBS farmers and I strongly believe it would lead to further abuses of the System lending to wealthy, established landowners whose business is not primarily farming.

   To support my statements, I refer you to recent data from the USDA Agriculture Economics and Land Ownership Survey. Eight percent of the System's portfolio was loans to young farmers while 54 percent of the portfolio was dedicated to those farmers over 50 years of age. Additionally System institutions, on average, loan to significantly larger operations than do banks. The average size operation served by bank financing was 600 acres. The average size operation served by FCS lending was 935 acres, 56 percent larger than bank-financed operations. The data also revealed the average market value of production on bank-financed operations was $156,000 while the average market value of production on FCS-financed operations was $311,000, fully double that of bank-financed operations.

I can assure you that my bank, nor any of the ag lenders I have visited with in Iowa, are losing YBS loans to System lenders. The loans we lose are to older, well-established individuals.

In preparing my testimony, I visited with some fellow lenders that are members of the Iowa Bankers Association Ag Committee and collected a few examples to support my comments. I want to share a couple.

FCS recently loaned 100 percent of a farm purchase in Boone County to a doctor from the Des Moines area. The doctor had a net worth of over $2 million, income of over $150 thousand/yr, not including his wife's income. The doctor "hobby" farms the land on weekends. If the definition of bona fide farmer was loosened, this doctor could go to FCS for all his credit needs – I do not believe Congress had this intent when they created FCS and I don't believe it is the intent today.

In April of this past year, the same bank lost a farm real estate loan to FCS. The land was owned by a couple that had reportable income of $120,000. The land was leased on a cash rent basis and was not being farmed by the owners - both of whom had full-time off-farm employment. The couple refinanced their house debt and were able qualify through FCS because it was done in connection with the ag land.

In an effort to better assist YBS farmers who are the losers when limited resources are used for the purposes I just described, we ask that you consider a minor addition to the definition of a "bona fide farmer." We suggest that FCS borrowers be required to file an IRS 1040 Schedule F within 24 months of the completion of the financing. The filing of a Schedule F is universal in the United States if farm income or expenses are being generated and would assist FCA examiners in determining the legality of a loan.

2. **I will comment jointly on Questions 2 and 3 since they both essentially deal with "the degree, if any, to which FCS should be engaged in the non-farm credit needs of its borrowers and how any limits should be reviewed."**

The current FCA rules are completely appropriate in limiting System loans to "full-time bona fide farmers" and on an "increasingly conservative basis" for those who are part-time.

I believe most taxpayers would reject the notion of allowing a government-sponsored enterprise that currently enjoys a $1 billion-plus subsidy and competes with taxpaying financial institutions, to veer away from its original mission of meeting the agricultural needs of farmers.

When FCS was established nearly 100 years ago, the purpose was to provide financing for ag real estate because state chartered banks were generally prohibited from that activity. During the depression, when banks were struggling to meet the short and intermediate credit needs of its farm borrowers, the FCS was allowed to expand into that arena.

In today's environment, there is no evidence to suggest that the private sector is not able to meet citizens' credit needs – agricultural or otherwise.

In Iowa alone we have approximately 430 commercial banks and 25 savings institutions located in all areas of the state; 190 credit unions; John Deere Credit with its headquarters in Johnston, Iowa offers a full range of ag lending services through its statewide dealers including operating loans, equipment, breeding stock, and real estate; there are also 623 mortgage bankers and brokers, 440 car dealerships that offer financing through GMAC Financing, Ford Motor Credit, Chrysler Financial and more; in addition we have ag cooperatives offering a full range of operating loans and insurance companies providing real estate financing.

There is no credit shortage that exists today and the competition in all parts of our state is vigorous.

The FCS should focus its efforts on meeting the agricultural credit needs of young, beginning, small farmers, which is possible today under current regulation – but has been largely ignored.

I offer the following recommendations so that FCA can better monitor the 1980 Congressional mandate of serving YBS farmers:

- **Aggregate loan reporting for more accurate FCS loan information** – multiple loans to a single farmer are not currently aggregated. As a result, if a young farmer is also a beginning farmer and a small farmer, that loan is currently counted three times for the purpose of reporting YBS loans.
- **Develop a "hard target" for System lenders to follow in determining if they are meeting the YBS mandate –** FCA should utilize USDA data to determine the number of YBS farmers and ranchers in an association's service area and set forth a "hard-target" of how many of those that are qualified it expects the System lenders to accommodate. Because there is no current system of measurement, there is no enforcement.
- **Develop specific criteria that an FCS institution must follow if it does not reach the "hard target" –** For example, FCA should not

allow patronage dividends to be paid out among existing borrowers within an FCS institution until it meets the "hard target" set forth for in its district.

- **Develop a "scorecard" for System performance –** A scorecard will allow FCA, policy makers, and the public the opportunity to compare one FCS institution against another. Perhaps even more important, it will create a new paradigm for System lenders that emphasizes the importance that its regulator and the public places on this mission.
- **Get creative as other GSE's have done –** For example, Federal Home Loan Bank has implemented an "Affordable Housing Program". Why not an "Affordable Farming Program" for YBS farmers? The housing program is funded by a charge of 10 percent of the net profits of each of FHLB's 12 banks. A FCS "Affordable Farming Program" if funded at the same level, would generate in excess of $100 million per year to assist YBS borrowers.

3. Question 4 - should FCA change the definition of "moderately priced" rural housing and if so how?

The current definition of "moderately priced" is a sufficient and reasonable measurement and a change should not be considered until FCA has at least 24 months of data to suggest otherwise.

The public currently has very little information available to make any kind of judgment about FCS mortgage lending practices, which is a concern. In order to answer the question that FCA has posed to the public regarding the definition of "moderate", I recommend that FCA require all System institutions that make housing loans to report home mortgage lending data. The data should include: applications taken, funded and rejected for home purchases (FHA, FSA/RHS, VA and conventional); for refinancing; for home improvement; for non-owner occupied; and for multi-family loans. In addition, System lenders should report applications and lending by race, gender, income, and home price to allow the public to evaluate System lending practices, and to allow the public to see if the System is indeed meeting their mandate to fund "moderate" housing in rural America.

Conclusion

On behalf of the Iowa Bankers Association, I appreciate this opportunity to comment on these important issues. As the regulator of the System, it is clear that FCA has the authority and obligation to ensure that FCS lenders are developing programs to furnish sound and constructive credit and related services to young, beginning and small farmers and ranchers as mandated by Congress.

To that end, it is important FCA sets forth guidelines to ensure performance, creates a measurement system, provides for public disclosure of results and most important – creates a mindset within the System of what its mission really is.

Today, the agricultural credit market has evolved into one that is well served by many private sector lenders willing and able to provide affordable credit to a broad cross section of farmers. FCS could be a great partner to these private sector lenders and most importantly help to ensure the future of agricultural through meaningful YBS farmer programs if it truly focused on what Congress has mandated as a key part of its mission.

I can tell you that is not currently happening in Iowa and ample evidence exits that it is not happening System wide.

Thank you.