



STATEMENT OF
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LEBANON VALLEY FARMERS BANK
LEBANON, PENNSYLVANIA
ON BEHALF OF
THE AMERICAN BANKERS
ASSOCIATION
AT A PUBLIC MEETING OF THE
FARM CREDIT ADMINISTRATION
McLEAN, VA
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Chairman Reyna, Mr. Florey, and Ms. Pellett, my name is Mike Firestine. I am a Senior Vice President and Manager of the Agricultural Department at Lebanon Valley Farmers Bank and at Fulton Bank in Lebanon, Pennsylvania. My company has \$300 million outstanding in agricultural loans in Pennsylvania, Maryland, Delaware, and New Jersey to approximately 1,500 customers. Our customers are engaged in a wide range of agricultural enterprises. Approximately 70% of my customers are from the Plain Sects (Amish, Mennonite, and Brethren). I am also proud to say that my family meets every definition in current use, or proposed, of a “bona fide farmer”. I appear before you today as a representative of the American Bankers Association (“ABA”).

The ABA brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership—which includes community, regional, and money center banks and holding companies, as well as savings associations, trust companies, and savings banks—makes ABA the largest banking trade association in the country.

We appreciate the opportunity to provide our thoughts today regarding the Farm Credit Administration’s (“FCA”) current regulatory definition of a bona fide farmer, how FCA should regulate Farm Credit System (“FCS” or “System”) lending for a farmer’s “other” credit needs, how FCA should regulate FCS credit to those that are marginally involved in agriculture, and to discuss FCA’s current definition of “moderate priced” housing.

Because of the limited time available today, and because you asked the public to respond to four very specific questions, I will provide my comments to you in the order in which you posed the questions.

Question #1. Should FCA retain the definition of a bona fide farmer?

FCA’s current definition of a bona fide farmer is: “A person owning agricultural land or engaged in the production of agricultural products”, and “a person(s) whose primary business and vocation is farming, ranching, or producing or harvesting aquatic products.” The well documented proliferation of “country living” and “rural lifestyle” lending by System institutions has been fostered by a creative reading of the existing definition of a bona fide farmer.

Let me share some of the copy used by one System institution in advertising their “Country Mortgages” program: ***“Maybe you’re looking for that special place in the country. Just a few acres. Somewhere to kick back, shift to a lower gear and get in touch--with yourself, family and Nature’s simple beauty.”***

Much further in the advertisement, the lender advises, ***“Property must be able to produce agricultural income on a sustained basis (timber, crops, livestock, or cash rent)...”***

Further down, the lender very helpfully points out that the *“owner [is] not required to participate in [an] operation.”* (Pee Dee Farm Credit web site, June 17, 2003)

This is just one of many examples of the way in which System lenders are working to undermine the spirit by which the Farm Credit System was established. These abuses are not limited to any particular geographic area of the country.

It is ABA’s belief that Congress never intended for the Farm Credit System to be engaged in this type of lending. System lenders enjoy special privileges, and subsidies, because Congress intended the special benefits they bestowed upon the System to flow to farmers, ranchers, and rural homeowners.

I think the current definition of a bona fide farmer needs to be modified to curb the abuses occurring within the System. I have looked at a number of definitions for a farmer in use today and am well aware that we could engage in a never-ending process of debate, discussion, and then continued debate on the subject. The Department of Commerce, USDA, and its predecessors, have, since 1850, struggled to define what constitutes a farm and a farmer.

As recently as 1995 there was a controversy between the Census of Agriculture and the National Agricultural Statistics Service about how many ponies one would have to own to be classified as a farmer. I am happy to report that the pony question was settled when both parties agreed to stop counting ponies and decided that a “farm” is an establishment that has annual sales of agricultural products of at least \$1,000 or would normally have sales of this amount or more during the year in question.

There is one commonality in all of the available definitions of a farmer, and that is the generation of some income and expenses related to the agricultural enterprise. Based on this, we suggest a small addition to FCA’s current definition of a bona fide farmer:

- Retain the current definition: “A person owning agricultural land or engaged in the production of agricultural products.”
- Add the following: **“Such individual currently files, or will file, an IRS 1040 Schedule F, “Profit or Loss From Farming,” within 24 months of the completion of the financing.”** If there is farm income, income is reported to IRS on an annual basis on Schedule F. The filing of a Schedule F is universal in the United States.

There are many benefits to adding this requirement to the current definition of a bona fide farmer. The public can be assured that FCS is meeting its public purpose mission by supplying credit to farmers and ranchers, and not folks needing space to “kick back” or pretending to be pony ranchers. It does not impose any additional burden on farmers since every farmer with some income, or farm expenses, is currently filing the form with IRS. My family farm operation has filed a Schedule F for the past 26 years, and while

there has been some screaming and crying from time to time, we have not found filing it to be an immense burden.

We are suggesting the 24-month period from the time credit is granted to filing a Schedule F to enable new growers of permanent crops time to get their crops established. There are some other crops that may require longer than 24 months to establish, and we are confident that FCA can adjust the time frame for filing to accommodate everyone.

The benefit of adding this requirement to the definition is that the form is universal, and produces a ready-made audit trail for FCA examiners to examine. If FCA were to adopt this definition, the uncertainty about eligibility for FCS credit would evaporate. There would either be a Schedule F on file, or there would not.

Question #2. What limits, if any, should FCA regulations place on lending for a farmer's other credit needs?

The Farm Credit System has a unique and limited charter for a reason. Congress created the FCS to meet the credit needs of farmers and ranchers. Neither Congress, nor the public, ever intended, ever envisioned, and does not today want FCS institutions to be involved in credit cards, home equity lending, or other types of consumer/non-farm lending. The FCS was established as a tax-advantaged, direct-lending, government-sponsored enterprise ("GSE") in 1916 to serve the special credit needs of America's farmers and ranchers at a time when national banks and many state-chartered banks were generally prohibited from lending money on real estate. In 1933, at the height of the Great Depression and at a time when credit was difficult for farmers and ranchers to obtain, the charter of the System was expanded to include short- and intermediate-term operating loans. Since its creation, the System has had a special, limited mission to deliver specific services to a particular segment of the economy. In exchange, the System enjoys significant freedom from taxation and enjoys an implied full faith and credit of the United States government when borrowing lendable funds.

Are farmers and ranchers missing credit opportunities because there are some non-farm credit products they cannot obtain from the System? No, for there is a wide proliferation of consumer credit opportunities available to farmers and ranchers today, as is true for non-farmers, and non-rural residents. My institution offers the same products to farmers as it does to non-farmers. Other banks in my service area offer the same variety of products. Credit unions, insurance companies, Realtors, car dealers, appliance dealers, gas companies, department stores, and just about everyone else is offering credit to all Americans.

Farm Credit was created to fill a specific, identifiable gap. If the FCA does not act to regulate the lending for the "other" credit needs of farmers, then what is left of the "special" nature of the System? There is no economist, no government official, no farm organization representative, not even an all-night radio talk show host saying farmers are not getting all the consumer credit they need, and more.

ABA appeared before this Board last November to discuss ways the System could, and should do more to help finance young, beginning, and small farmers (“YBS”). We pointed out to this board that it not only makes sense for a tax advantaged, retail lending GSE that was chartered to provide credit to farmers and ranchers to do this, it is also the law. If this Board would like to act to fill a gap in the delivery of credit to farmers and ranchers, I strongly suggest you adopt the recommendations ABA made to you at that time to focus System lending more thoroughly on helping young Americans that want to farm or ranch to finance their businesses. I would like to restate our recommendations, one more time, for the record:

- **Work aggressively to improve the reporting of FCS loan information.** The current YBS reporting system is badly flawed. Multiple loans to a single farmer or rancher are not aggregated, and many young and beginning farmers are also small farmers. Hence, these farmers are being double- and triple-counted in the FCS reporting system—as young AND beginning AND small farmers.
- **Develop a “hard target” system for FCS institutions to follow** when making, monitoring, processing, and reporting loans to YBS borrowers. We define “hard target” as a specific assignment of loans to be made on an annual basis to qualifying YBS farmers and ranchers. FCA can utilize USDA data to determine the population of qualifying YBS farmers and ranchers in an association’s service area.
- **Develop actionable criteria that FCA can enforce to regulate the performance of a specific FCS institution.** For example, many FCS institutions take great pride in announcing their patronage refund programs. Under these schemes, existing borrowers get a certain amount of the profit back from the association as a patronage dividend. We recommend that FCS institutions, before they distribute a dividend to their existing borrowers, use some of their profits to fund special low interest programs for YBS borrowers. The system that is currently in place rewards insiders while actively discriminating against new entrants to the system.
- **Develop a “Scorecard” for System performance.** A scorecard will give FCA, policy makers, and the public, the opportunity to compare one FCS institution against another. FCA will be able to determine which System institutions are making a good faith effort, and which institutions are not engaged in meeting YBS lending goals. With this information, FCA will be able to take meaningful steps to supervise and correct institutions that continue to flaunt the will of Congress. With a scorecard, FCA could intervene in patronage dividend schemes to enforce FCA’s goals for YBS lending.
- **Create an Affordable Farming Program modeled after the Affordable Housing Program (“AHP”) implemented by the Federal Home Loan Bank System (“FHLBS”).** The AHP is funded by a charge of 10 percent of the net profit of each of the 12 banks in the FHLBS and is administered by the Federal Housing Finance Board (“FHFB”), the regulator of the FHLBS. A Farm Credit System Affordable Farming Program, if funded at the level of the FHLB Affordable Housing Program, would generate more than \$100 million per year to assist YBS borrowers.

Question #3. How should FCA regulate the access to the other credit needs of eligible farmers who derive most of their income from off-farm sources?

It is reasonable for FCA to demand that System loans made to less than bona fide farmers are made on an “increasingly conservative” basis. FCA is the safety, soundness, and mission regulator of the Farm Credit System. You have a fiduciary responsibility to Congress and the American people to ensure that the loans made by the System are safe, sound, and fall within the mission of the Farm Credit System.

FCA regulations currently direct the FCS to “provide full credit, to the extent of creditworthiness, to the full-time bona fide farmer,” and “conservative credit to less than full-time farmers for agricultural enterprises, and more restricted credit for other credit requirements as needed to ensure a sound credit package or to accommodate a borrower’s needs as long as the total credit results in being primarily an agricultural loan.”

FCA further requires that “loans to farmers shall be on an increasingly conservative basis as the emphasis moves away from the full-time bona fide farmer to the point where agricultural needs only will be financed for the applicant whose business is essentially other than farming.”

It seems to us that the FCA is acting reasonably, responsibly, and correctly to regulate Farm Credit System lending, and it makes good sense that credit should be increasingly conservative the further the credit gets from bona fide farmers. Further, it appears that the existing regulations provide ample room for System lenders to do more to assist YBS borrowers, even if they farm on a part time basis, since the regulations allow System lenders to help those who are part time farmers, as long as the loan is for the “agricultural needs” of the applicant.

Question #4. Should FCA change the definition of “moderately priced” rural housing?

FCA has asked the public to evaluate the current definition of “moderately priced” rural housing. Because System lenders have asked to change the status quo, we believe the public has the right to know what System home mortgage lending practices have been. Without this, we have no basis for evaluating this request.

“Moderately priced” is currently defined by FCA regulations two ways. For the purpose of secondary market sales: “dwellings (excluding the land) that do not exceed \$100,000, as adjusted for inflation.”

FCS lenders are further allowed to “determine whether housing in a particular rural area is moderately priced by documenting data from a credible, independent, and recognized national regional source...if the housing value is at or below the 75th percentile, it is deemed to be moderately priced.” Congress mandated “moderate” when they inserted

the word in the statute, so FCA is required to come up with some definition of “moderate.”

The fact of the matter is that the public has very little information available to make any kind of judgment about FCS mortgage lending practices. Data about home mortgage lending is only reported as a total on System institution’s annual reports. There is no data available to the public about the average price of homes being financed, income of borrowers, race, or ethnicity. As the public, we have to assume that FCA is doing a good job of regulating FCS compliance with the letter and the spirit of our nation’s housing laws.

The one tool the public has available to evaluate performance on home mortgage lending by financial institutions is the Home Mortgage Disclosure Act (“HMDA”). Since January 1, 1990, Farm Credit institutions have been subject to the Home Mortgage Disclosure Act (HMDA), but the HMDA statute is structured in a way that exempts most System institutions from reporting. Our research indicates that only five (5) FCS lenders reported HMDA data for 2001, out of approximately 80 plus entities that can make home loans within the Farm Credit System.

For the public to be able to evaluate the home mortgage lending practices of System lenders, we recommend the following:

- FCA should require all System institutions that make housing loans, or have the authority to make housing loans, to report home mortgage lending data, as if they were required to report under HMDA. The data would include, but not be limited to: applications taken, funded, and rejected for home purchases (FHA, FSA/RHS, VA and conventional), refinancings, home improvements, non-owner occupied, and 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 meeting its mandate to fund “moderate” housing in rural America.
- Until FCA, and the public, has at least 24 months of System data to evaluate, we do not believe there should be any change in FCA’s current definition of “moderate.”
- Once the public, and FCA, have had the opportunity to examine data about System mortgage lending practices, it may be appropriate to re-examine the definition of “moderate.” It may make more sense for the FCA to define “moderately priced housing” by examining the income level of the borrower, rather than focusing on the cost of the dwelling.

Mr. Chairman, Board members Florey and Pellett, I appreciate the opportunity to appear at this public meeting today as a banker, and as a farmer, to discuss these important questions that will have an immense impact on the future of the System and rural America. I will be happy to answer any questions.