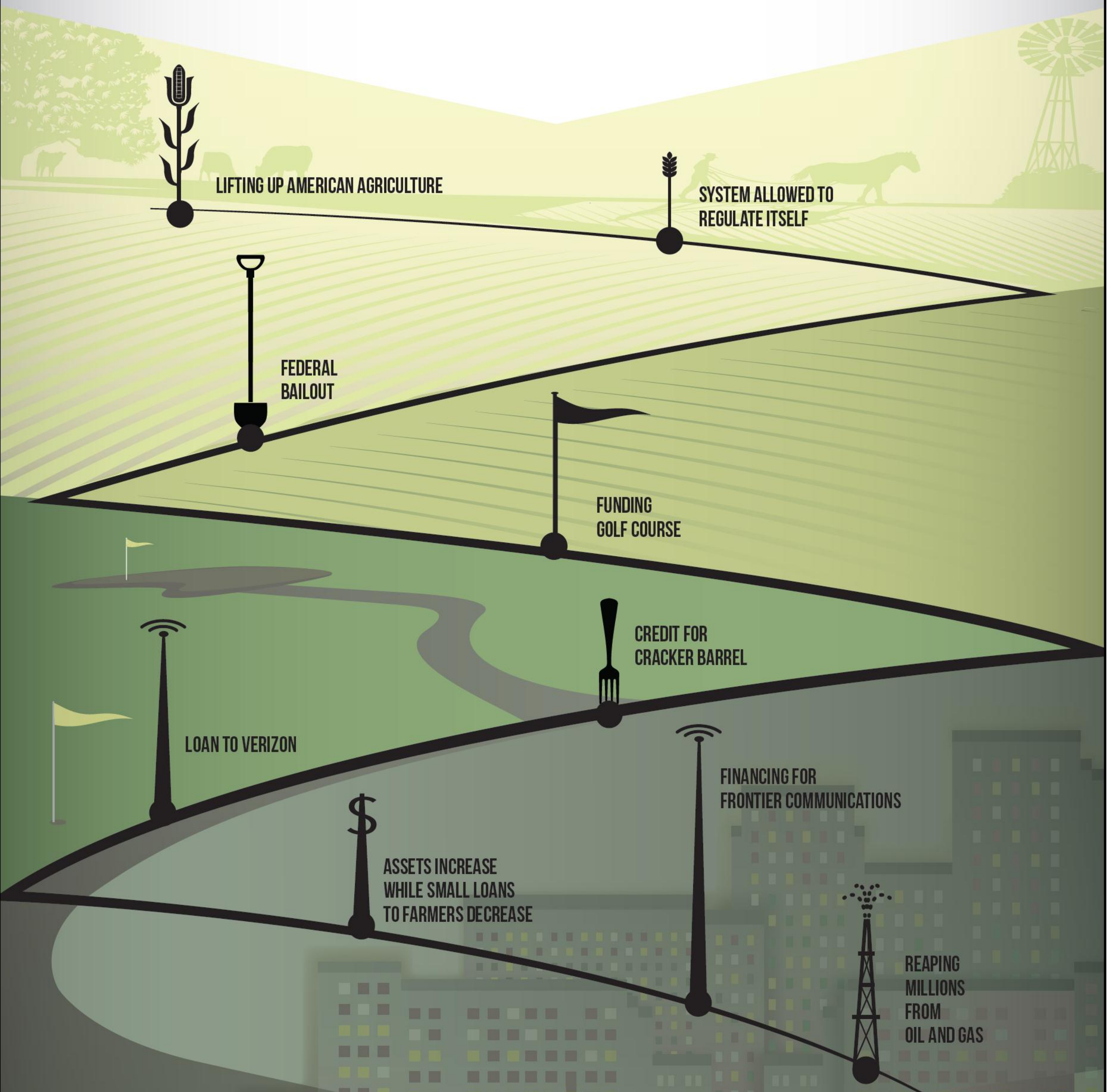
THE FARM CREDIT SYSTEM:
A GSE THAT HAS LOST ITS WAY



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Introduction

The FCS (FCS) is a Government Sponsored Enterprise (GSE) with a reported *net income of $4.7 billion and $283 billion in assets in 2014.*[i] Although it is a highly profitable operation, its status as a GSE provides benefits that are not available to its commercial banking competitors. Thus, the FCS is able to use its federal benefits to undercut local banks in lending to farmers and other entities. For example, due to the federal government saving the FCS in 1987 and the two housing GSEs — Fannie Mae and Freddie Mac in 2008 — from financial collapse, Wall Street bond investors believe that there is an "implicit guarantee" that the federal government will back up the FCS's debt obligations.[ii]

Although the FCS obtains substantial federal and other benefits (including an exemption from Dodd-Frank financial reform and an "exemption from federal, state, municipal and local taxes on profits earned by the real estate side of FCS"[iii]), its lending practices have moved far beyond its mission of primarily serving young, beginning and small farmers and ranchers. Instead, the bulk of FCS lending today is focused on large farmers, agribusinesses, utilities and businesses having nothing to do with farming. Further, FCS banks are also generating tens of millions of dollars in oil and gas royalties that go to their bottom lines and investors, rather than being spent to support young, beginning and small farmers and ranchers.

The information and data below is derived from government and other independent reports and sources documenting the failure of the FCS to carry out its congressionally mandated mission, its use of GSE status and various exemptions to undercut local community banks[iv] and its use of its federal benefits and resources to lend to large corporations at the expense of small and other farmers and ranchers.

Given the findings below, the time has come to reform the FCS.

Background – Lending Authority

The FCS is "authorized by statute to lend to farmers, ranchers, and harvesters of aquatic products. Loans may also be made to finance the processing and marketing activities of these borrowers; for home ownership in rural areas; certain farm- or ranch-related businesses; and agricultural, aquatic, and public utility cooperatives."[v] There is, however, no mention of lending to major corporations or to non-farm businesses and no mention of FCS lending for golf courses, hunting preserves and weekend retreats for the wealthy.

A recent report[vi] by the Congressional Research Service (CRS) of the Library of Congress specified four "types of eligible borrowers" and the "scope of their financing":

- **Full-time farmers.** For individuals with over 50 percent of their assets and income from agriculture, FCS can lend for all agricultural, family and non-agricultural needs (including vehicles, education, home improvements and living expenses).
- **Part-time farmers.** For individuals who own farmland or produce agricultural products but earn less than 50 percent of their income from agriculture, FCS can lend for all agricultural and family needs. Non-agricultural lending is limited.
- **Farming-related businesses.** FCS can lend to businesses that process or market farm, ranch or aquatic products if more than 50 percent of the business is owned by farmers who provide at least some of the "throughput." FCS also can lend to businesses that provide services to farmers and ranchers, such as crop spraying and cotton ginning. The extent of financing is based on the amount of the business's farm-related income.
- **Rural homeowners.** FCS can lend for the purchase, construction, improvement or re-financing of single-family dwellings in rural areas (2,500 population limit).

Given these four types of "eligible borrowers," it appears that the FCS has stretched these definitions like "silly putty" to accommodate borrowers who otherwise would not fit.

According to a paper published by the Federal Reserve Bank of Kansas City, "[T]oday's FCS receives its structure and regulatory framework from the Farm Credit Act of 1971, which superseded all prior authorizing legislation." This paper goes on to explain how the FCS is organized and how it is designed to operate. It cites congressional policy that the "farmer-owned cooperative FCS be designed to accomplish the objective of improving the income and well-being of American farmers and ranchers by furnishing sound, adequate and constructive credit and closely related services to them and their cooperatives, and to selected farm-related business necessary for efficient farm operations."[vii] Importantly, the Federal Reserve paper also stated:

> The same section stipulates that "the credit needs of farmers, ranchers, and their cooperatives are best served if the institutions of the FCS provide equitable and competitive interest rates to eligible borrowers." However, later amendments qualified this policy statement to require that "in no case is any borrower to be charged a rate of interest that is below competitive market rates for similar loans made by private lenders to borrowers of equivalent creditworthiness and access to alternative credit" (Farm Credit Act of 1971, Section 1.1.c).[viii]

The many advantages enjoyed by the FCS (as documented in this paper and elsewhere) have led to increased, and often unfair, competition between the FCS and local community backs that specialize in agricultural lending. As far back as 2009, the Federal Reserve Bank of Kansas City concluded:

> The future agricultural finance market will likely continue to be very competitive. As noted in this article, community banks face many challenges in competing for ag loans. Their smaller scale, operating structure, and retail banking activities drive overhead costs much higher than government-sponsored enterprises. For community banks that specialize in agricultural finance, their competitive environment for ag lending will likely be intense as they compete with FCS lenders and larger banks — both of whom have access to capital market funding enabling more rapid growth.[ix]

Background – Government Sponsored Enterprise (GSE)

Government Sponsored Enterprises (GSEs) are a creation of Congress. The intended purpose of GSEs was to improve the workings of credit markets from agriculture to housing that would otherwise be underserved. Congress created the first GSE — the FCS — with *passage of the Federal Farm Loan Act in 1916.*[x]

The term Government Sponsored Enterprise was more clearly defined in the Omnibus Reconciliation Act of 1990.[xi] According to a 2007 report[xii] by the Congressional Research Service, "Each GSE is created by Congress with its particular attributes defined in its enabling legislation and charter. Despite this diversity, there are at least four readily observable characteristics of GSEs: (1) private sector ownership, (2) limited competition, (3) activities limited by congressional charter, and (4) chartered privileges that create an inferred federal guarantee of obligations." None of the GSEs, except the FCS and its banks, can lend money directly to the public.

According to a 1998 report by the US General Accounting Office, now the Government Accountability Office (GAO):

> Government-sponsored enterprises engage in financial services activities, such as issuing capital stock and short- and long-term debt instruments, guaranteeing mortgage-backed securities, purchasing loans and holding them in portfolio, funding designated activities, and collecting fees for guarantees and other services. Government-sponsored enterprises generally do not receive government appropriations. Although the enterprises' charters state that their obligations must include a statement that they are not guaranteed by the United States, the enterprises' federal ties cause their securities to receive preferential treatment in financial markets. For example, the enterprises generally can borrow at rates that are only slightly above Treasury borrowing rates.[xiii]

The Congressional Research Service report cited above acknowledges that GSEs have been successful in providing liquidity and in "serving rural agriculture's financial requirements." However, the report finds that "with these successes have come reservations and questions. These concerns are rooted in investors' inference that the federal government backs GSE obligations, and in the privileges accorded by the federal government to GSEs, as well as in their hybrid nature, size, and subsidization."

Despite the fact that there is "no explicit guarantee in law for GSE liabilities,"[xiv] meaning that the federal government does not have to financially back up the GSEs, there is an "implicit" guarantee. As the CRS report points out:

> Through their charters, GSEs receive a number of privileges not granted to private sector financial firms. These privileges and the public-private (hybrid) nature of GSEs create the perception among investors that the federal government backs GSE obligations. To be clear, there is no explicit guarantee in law for GSE liabilities. In fact, the charter of each GSE requires that it inform investors that its securities are not government-backed. Nevertheless, there is a general presumption to the contrary, which Fannie Mae acknowledged in a letter to the Office of the Comptroller of the Currency:
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>> Fannie Mae standard domestic obligations, like Treasuries, typically receive no rating on an issue-by-issue basis, because investors and rating agencies view the implied government backing of Fannie Mae as sufficient indication of the quality of Fannie Mae obligations. (As quoted in Stanton, *Government Sponsored Enterprises,* p. 35.)

This impression of federal backing has been encouraged by the federal government's past actions. For example, when the FCS was in crisis in the late 1980s, the federal government arranged a bailout.[xv]

It should be noted that the Farm Credit Act of 1971 had expanded the FCS's lending authority. This together with an "aggressive lending strategy, allowed the FCS…to control a large part of the farm credit market."[xvi]

Lending "Money to Anyone"

As quoted in a 2010 *Wisconsin Law Review* article, *The Wall Street Journal* in 1985 provided a window into how "the FCS would lend money to anyone. Herbert Ashton, an Indiana fruit farmer, recalls being wined and dined at a local country club by bankers from his local system bank who extolled the virtues of inflation and offered to lend him $1 million on the spot. 'I turned it down,' he recalls. 'But they sounded like a soap testimonial. They were giving money to whoever passed their way, and they didn't ask too many questions.'"[xvii]

Forcing a Farmer into Bankruptcy

Another example is the case of D&E Dairy Farms LLC (owner of the Rio Bravo Dairy and the Joharra Dairy in Arizona), which was forced to file for bankruptcy protection "in response to significant financial challenges, a mounting debt level that was borne out of the 2011 milk crisis and a deterioration of its relationship with its largest secured creditor, Farm Credit."[xviii]

According to the lawsuit filed by the dairies and their owners against Farm Credit Services Southwest (FCSSW) on October 14, 2014, Farm Credit knew that the dairy owners "were deficient in the critical area of interpreting and preparing financing statements," that "Farm Credit became actively involved in the day-to-day dairy and farming operations, directing payments, preparing financial reports, preparing budgets, preparing cash flow analyses, analyzing the dairy and farming operations financial performance, and recommending specific steps." Over the course of the relationship, according to the lawsuit, Farm Credit used its financial control to not only increase the debt of these farmers, but to profit at their expense despite the claim by Farm Credit's President and CEO Roger Becker that "Farm Credit holds itself out to be "*more than just an ag lender; we're your partner in agriculture."*[xix]

Adding injury to insult, just two weeks prior to the above described lawsuit, *the Board of Directors and the management of Farm Credit Services Southwest announced* that they "have determined that the Association's financial statements as of and for the year ended December 31, 2013, and the prior years included therein, as well as the three months ended March 31, 2014 and the six months ended June 30, 2014 can no longer be relied upon. Accordingly, the Association expects to restate such financial statements."[xx]Farm Credit Services Southwest's "Mission Statement" includes the following, *"We exercise RESPONSIBLE MANAGEMENT OF OUR FINANCIAL AND HUMAN RESOURCES [Capitalization in the original]."*[xxi]

Despite the lawsuit filed by the dairies and the announcement that FCSSW's recent financial statements "can no longer be relied upon," FCSSW entered an agreement to merge with Farm Credit West. *The vote, which would produce a bank with $8.5 billion in assets, is expected to be held in the August/September time frame with the anticipated merger date being sometime in the fourth quarter of 2015.*

Given the apparent management failures at FCSSW, what role has the Farm Credit Administration (FCA) played in overseeing this aspect of the FCS? Thus far, the FCA website reveals only that "[O]n May 11, Farm Credit Services Southwest, ACA, and its subsidiaries, and Farm Credit West, ACA, and its subsidiaries, requested that FCA grant preliminary approval to a proposed plan of merger by and between the associations."

It is unclear, given the problems at FCSSW, how the FCA could approve the merger.

Making it Tough for Community Bankers to Compete

One final example is from a rancher who was also the president and CEO of his family-owned Farmers State Bank in Pine Bluffs, Wyoming. In his capacity of bank president, John Gross "goes head to head with the FCS, when it comes to making agricultural loans." Mr. Gross says that he has difficulty competing with the FCS given its size. "When the other family business, Gross Wilkinson Ranch, needed a multimillion-dollar line of credit, Mr. Gross's family became a customer of their bank's biggest competitor. "We had to," Mr. Gross says, explaining a community bank like his was too small to make such a large loan to the ranch and a larger bank couldn't beat the FCS's rate. "As a banker, I'm discouraged," he says. "As a rancher, I like the interest rates."[xxii]

Farm Credit: To be a called GSE or to not be called a GSE

GSEs were valuable instruments of government policy, especially in the first half of the twentieth century. The public benefits are now much less, and the actual and potential public costs are much greater.[xxiii]

The FCS prefers not calling itself a GSE, but rather a *"national network of cooperatives that support rural communities and agriculture with reliable, consistent credit and financial services."*

However, the Congressional Research Service states, *"[A]s a GSE, FCS is a privately owned, federally chartered cooperative designed to provide credit nationwide"*[xxiv] — not quite the same spin as the FCS's.

Despite clearly being a $283 billion GSE, the FCS rarely identifies itself as such. On its website, for example, there is no mention of being a GSE in the *About* section or in the *History* section. The only way to find a reference to GSE is by actively doing a search of the website where one finds just four references — one in a *2011 second quarter income report*, one in the *FAQ section* and two in a section call the Aggregator — *Farm Credit Basics: Unique Structure Delivers Long-Term Stability (May 2, 2014)* and *Farm Credit History: Embodying the Cooperative Ideal (June 19, 2014*).

16 years ago, one of the most astute analysts of government sponsored enterprises, Thomas Stanton, wrote, "Because of the implicit federal backing, GSEs have become some of the largest financial institutions in the United States. At year-end 1997…the FCS held over $78 billion in assets... Implicit federal backing also enables GSEs to grow rapidly. On average the combined size of the GSEs more than doubled every five years between 1970 and 1990 (Congressional Budget Office, 1991)."[xxv] Just for the sake of comparison: at the end of 2014, FCS assets were nearly $283 billion, an increase of 263 percent.

The growth of FCS assets parallels significant consolidation in the system. According to the Congressional Research Service, "The number of banks and associations has been declining for decades through mergers and reorganizations. This consolidation has continued in recent decades through the 'parent ACA' structure. In the mid-1940s, there were over 2,000 lending associations, nearly 900 in 1983, fewer than 400 by 1987, 200 in 1998, 95 in 2006, and 80 in 2015. The system operated with 12 district banks into the 1980s, 8 districts in 1998, 5 districts in 2004, and 4 regional banks since 2012."[xxvi]

GSE status provides the FCS with significant benefits and advantages. As *Ralph Nader has observed*, "While the subsidy flowing from their links to the federal government vary, all the GSEs enjoy the implicit guarantee that the federal government would not allow the enterprises to default on their obligations. This means that the GSEs are able to reduce their debt costs substantially below that of similar corporations, which operate without government sponsorship. In fact, most of the GSE borrowing is at rates only a small fraction above that enjoyed by the federal government, itself."[xxvii]

The Federal Farm Credit Banks Funding Corporation similarly admits in its *March 2015 Annual Information Statement:*

> The System's government-sponsored enterprise status has been an important factor in its ability to continually access the debt capital markets. In addition, the System's funding costs historically have been below that of similar non-government sponsored entities.[xxviii]

Additionally, in its *First Quarter 2015 Information Statement,* the Federal Farm Credit Banks Funding Corporation states:

> Historically, one of the primary benefits of our status as a government-sponsored enterprise debt issuer has been that, through the Funding Corporation and its selling group, the System has had daily access to the debt markets and a great deal of flexibility in structuring the maturity and types of debt securities we issued.[xxix]

Federal Benefits – Tax and Financial Regulatory Exemptions

The FCS benefits from significant tax exemptions.[xxx] For example, Leland A. Strom, the former chairman and CEO of the Farm Credit Administration, the independent regulatory agency that oversees the FCS, said in 2012, "My estimate, based on a back-of-the-envelope calculation, is that approximately $600 million of the $4 billion in earnings is a result of the tax exemption. In addition, even though it is impossible to put an exact value on the System's GSE status in terms of savings from lower funding costs, certainly there is a monetary benefit extracted because of that status."[xxxi]

In 2014, the FCS had net income of $4.72 billion while paying just $221 million in combined federal, state and local taxes — a tax rate of just 4.7 percent of net income. In contrast, the nation's sixth largest commercial bank, PNC Financial Services, had net income of $4.207 billion in 2014 and paid $1.199 billion in income taxes, a tax rate of 28.5 percent. Similarly, Bank of America, the nation's second largest bank, in 2014 earned $4.833 billion and paid over $2 billion in income, taxes resulting in an effective tax rate of 29.5 percent. Thus, despite comparable amounts of net income, the FCS paid over five times less in income taxes than Bank of America.

Lending to Non-Farm Corporations and Others

Although FCS banks are chartered to serve farmers, ranchers and harvesters of aquatic products as well as provide loans for processing and marketing activities of those borrowers and some other farm- or ranch-related businesses, in recent years, FCS banks have increasingly expanded their loan portfolio far from the farm.

While providing loans to huge agri-businesses may pass the haystack smell test, loans to large corporations, to non-farm enterprises and to wealthy individuals and families for a variety of non-farm investments are clearly beyond what the FCS was set up to do, especially given its GSE benefits and taxpayer support.

The FCS is supposed to "provide expertise" to participate in these types of loans. But it is unclear what expertise the FCS has in, for example, providing large corporate telecommunications loans, which have little, if anything, to do with agriculture and whether those funds could have been better used to support young, beginning and small farmers. It's one thing to provide loans to rural utility cooperatives, but CoBank's $725 million loan to Verizon is hardly a loan to a rural utility cooperative.

> According to the *University of Wisconsin Center for Cooperatives:*
>
> The 260 US telephone cooperatives are consumer-owned utilities established to provide quality telecommunications service at reasonable cost. They offer various telecommunication services to 1.2 million rural Americans in 31 states. Telephone cooperatives are most often located in rural areas where there is a strong cooperative tradition. They provide local telephone exchange services, long distance telephone operations, direct broadcast satellite, wireless, TV, mobile radios, cellular and key systems, and Internet access.[xxxii]

Verizon is a rural cooperative just as ExxonMobil is a local independent gasoline dealer. *According to NASDAQ, Verizon's ownership tells it all: 1,900 institutions account for 64 percent of Verizon shares. And five institutional investors hold nearly 25 percent of all shares.*

And as Sean Williams, president and CEO of First National Bank of Wynne, Arkansas, pointed out to a House Agriculture Subcommittee in June 2014:

> This deal finances large, corporate, multinational firms located in New York City and London. This is a non-rural and non-cooperative international corporate financial deal inappropriate for an ag-based cooperative operating as a taxpayer-backed GSE.

CoBank defended its Verizon loan claiming that it provides "credit to a wide variety of rural communications companies, including voice, Internet, cable, wireless and data service providers." It further claimed, "Everyone we loan to is eligible to borrow from CoBank under applicable law."

And Jill Long Thompson, board chair and chief executive officer of the Farm Credit Administration, at the same June 2014 hearing made virtually the same claim saying, "Congress gave the entities that we regulate the authority to engage in similar-entity participation lending to be used as a risk mitigation tool. And we reviewed those transactions in complete detail and found that they met any reasonable reading of the statutory authority provided."

In answer to a subsequent written question on the term "similar entity," Ms. Thompson replied, "To be considered a similar-entity, a party must derive a majority of its income from, or invest a majority of its assets in, the conduct of activities that are performed by eligible borrowers. Verizon Wireless has operations functionally similar to those of directly eligible rural wireless carriers."[xxxiii]

It is also important to note that the FCS's regulator, the Farm Credit Administration, failed to seriously review the loan. *The FCA's then-Chairman Leland Strom in a speech to the FCA Symposium on System Consolidation defended CoBank's Verizon loan,*

> Greater lending capacity provides opportunity for System institutions like CoBank to participate in large corporate banking transactions such as the recent Verizon purchase of Vodaphone's stake in Verizon Wireless. **This loan was made under the Farm Credit Act's similar-entity lending authority as it relates to rural telecom lending.** That lending group consisted of some of the largest global banking firms, with CoBank and its subsequent participation to other System institutions representing the largest single piece. When such large and complex lending transactions occur, FCA must ensure it has the resources to adequately examine for safety and soundness. We must also ensure that we fully understand the potential risks to the rest of the System and to the public.

The claim of "similar lending authority" has been challenged by Rep. Mick Mulvaney (R-SC) in a March 2015 letter to Ms. Thompson. Rep. Mulvaney wrote:

> While lending to similar entities is permissible, I fail to see how a large, publically traded telecommunications company is similar to a small, rural telephone cooperative. Even if

companies like Verizon, AT&T, US Cellular and Frontier Communications serve rural areas, I do not believe they meet the letter or spirit of the statute as a similar entity to which CoBank may lend.

Under the Farm Credit Act as amended, "the term 'similar entity' means an entity that, while not eligible for a loan under section 3.8, is functionally similar to an entity eligible for a loan under section 3.8 in that it derives a majority of its income from, or has a majority of its assets invested in, the conduct of activities functionally similar to those conducted by the entity." Thus, the question is: what percentage of Verizon's income is derived from assets invested in serving rural customers? Verizon does not reveal this information, but given Verizon's size,[xxxiv] it is highly unlikely that it derives a "majority" of its income or has a "majority" of its assets invested in serving rural customers.

The FCS has used every opportunity to expand the boundaries of its loan portfolio beyond lending according to its original mission. For example, for years the FCS sought approval from its regulator, the Farm Credit Administration, for a rule to broaden its lending authority. In May 2008, for example, the *FCA proposed a rule to allow "FCS Institutions to Make Rural Community Loans."* This proposed rule significantly expanded the types of "investments" that FCS banks could pursue in "rural communities" at the same time that the FCA used a broader definition of rural community — one "having fewer than 50,000 residents." However, according to the US Census Bureau, *"To qualify as an urban area, the territory identified according to criteria must encompass at least 2,500 people."* This means that rural areas are defined as those having fewer than 2,500 people, not 50,000.

However, in response to public pressure and the completion of several "pilot programs," the FCA in *November 2013 withdrew its "Rural Community Investment"* proposal.[xxxv] Not to abandon the idea completely, the FCA in *September 2014 issued a "Guidance for Investment Requests"* for the purpose of allowing FCS institutions the opportunity to obtain case-by-case approval for rural community investments.

Lending to Large Non-Farm Corporations

Verizon

October 2013 – CoBank, a $93 billion enterprise, agreed to loan $725 million to Verizon to help finance its acquisition of Vodafone, a London-based telecom giant. *According to the Denver Post*, "CoBank's part was a major piece of the $12 billion loan Verizon needed in the $130 billion buyout." Further, the newspaper reported, "The deal was Verizon's purchase of Vodafone's 45 percent stake in their joint venture, Verizon Wireless, and is expected to close next year. CoBank carried the largest debt load among those that helped finance the deal."[xxxvi]

Frontier Communications

June 2014 - *CoBank, ACB, which served as "administrative agent, lead arranger and lender" entered into a $350 million "delayed draw term loan facility" with Frontier Communications Corp.* to partially finance Frontier's acquisition of AT&T Inc.'s Connecticut fixed-line business.[xxxvii] Specifically, the purchase includes AT&T's local exchange operations and statewide fiber network that provides services to residential, commercial and wholesale customers in Connecticut along with AT&T's Connecticut U-verse video and satellite TV operations. John Jureller, executive vice president and chief financial officer of Frontier, said, "This is a very positive arrangement that provides financing for our pending acquisition on favorable terms and rates."[xxxviii] In a state where *agriculture represents less than 2 percent of the state's gross national product,*[xxxix] it's not clear how CoBank's loan supports agriculture.

US Cellular

January 2015 - *CoBank, which served as lead arranger, administrative agent and bookrunner, and other FCS lenders provided US Cellular*, a Chicago-based wireless company, a $225 million seven-year term loan for "general corporate purposes, including potential spectrum purchases and capital expenditures."[xl]

Cracker Barrel Old Country Store

January 2015 – Among the 15 financial institutions providing *a $750 million revolving line of credit to Cracker Barrel Old Country Store. Inc. was Greenstone Farm Credit Services,* which serves Michigan and part of Wisconsin.[xli]

California Water Service Group

March 2015 – CoBank, one of two syndication agents, joined with several other banks, including the Bank of China, to finance "unsecured revolving credit facilities" for a five-year term to the California Water Service Group, a New York Stock Exchange company.[xlii]

Black Hills Corp.

April 2015 – *CoBank participated in a $300 million unsecured term loan* to Black Hills Corp., a vertically integrated energy company with natural gas and electric utility operations in Colorado, Iowa, Kansas, Montana, Nebraska, South Dakota and Wyoming.[xliii] According to an *October 2014 study by MSCI's Environmental, Sustainability & Governance*[xliv] entitled *Water Issue Report: Corn or Current? The Agro-Industrial Water Conflict*, "Both US assets and entire companies — including UNS Energy, Black Hills Corporation, MGE Energy and Sempra Energy — are at risk due to choices soon to be made over whether to use water for crop production or electricity generation." In other words, CoBank helped provide a loan to a company — Black Hills Corporation —

whose business is at significant financial risk because of water shortages.

Lending to Other Businesses and Wealthy Individuals

Kluge Estate Winery

April 2011 – A $35 million loan from Farm Credit to the Kluge Estate Winery and Vineyard soured when the estate was auctioned off — the estate which Farm Credit bought for $19 million — for $7.3 million, including a $6.2 million bid for the winery by Donald Trump. The Farm Credit spokesperson commented, “What can you say? The market has spoken."[xlv]

Fox Den Development Company

April 2002 – Carolina Farm Credit, ACA, lent $4.5 million to Fox Den Development Company, L.L.C. The loan is secured by 400 acres near Statesville, North Carolina, consisting of “an exciting 18-hole championship golf course” and contiguous, developable land. According to the Fox Den website, “luxurious, but surprisingly affordable homes” will be built on this property. The deed of trust for this loan provides that this property can collateralize up to $8 million in loans to Fox Den. This loan clearly violates the Farm Credit Act and the FCA’s lending regulations. Hopefully, the FCA will investigate the propriety of this loan.

Other Non-Agricultural Loans

Central Kentucky Agcredit publicizes the fact of its “non-agricultural loans” stating:

> Loans for non-agricultural purposes include car and truck loans, student loans, apartment loans, investment loans or vacation home loans.
>
> The ability of Ag Credit to make these types of loans is limited to full and part-time farmers. A full-time farmer could receive a loan from Ag Credit for any purpose. A part-time farmer would be able to receive loans for these purposes but on a more limited basis. Our dedicated loan officers can help explain your options.[xlvi]

Central Kentucky Agcredit similarly offers *loans that “aren't limited to traditional farming.* We provide funding for homes located in rural areas, farms used for vacationing or hobby activities and even farm operations used to draw tourism. Our loan packages are as diverse as your imagination.” In short, all one has to do is “imagine” a loan and Central Kentucky Agcredit will figure out a way to make it happen. As they say, “Our lending experts know the ‘ins and outs’ of building and buying in the country. It’s all part of our country mortgages loan service program.”

Ag Carolina Farm Credit similarly publicizes its “non-agricultural loans”:

> If you farm full-time, you are eligible for AgCarolina Farm Credit lending for all of your agricultural and family needs as well as your non-agricultural needs. This could include, but is not limited to, automobiles and trucks, educational expenses, home improvements, vacation expenses and much more.[xlvii]

Farm Credit of Central Florida's "non-agricultural purpose loans":

> If you qualify, Farm Credit can make you a loan for a family member's college tuition, buy a boat, airplane, condominium, second home on the beach or to build that mountain retreat you've always wanted.[xlviii]

Cape Fear Farm Credit "non-agricultural purpose loans":

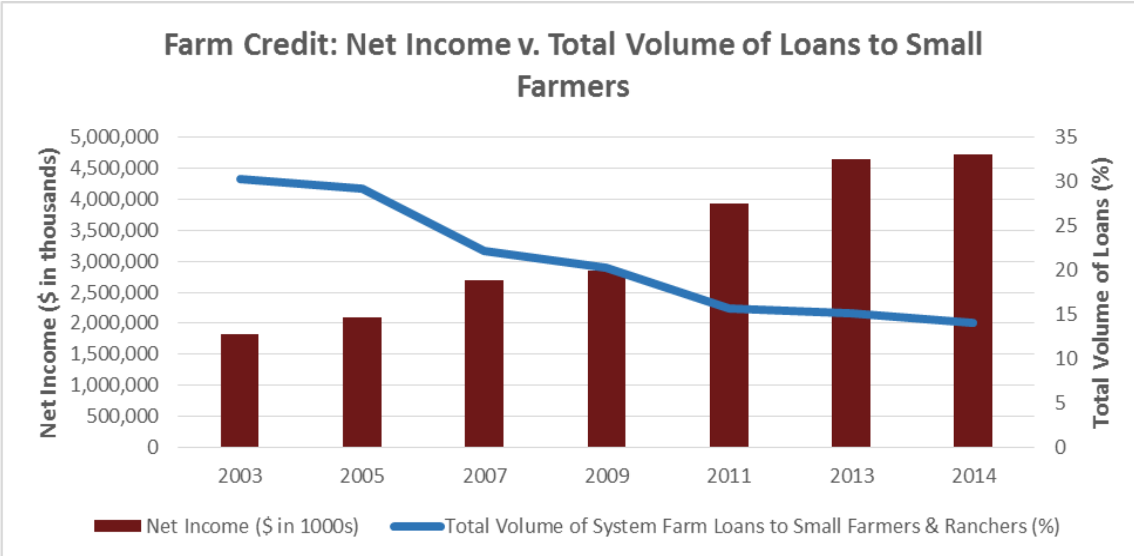
> We also offer loans for automobiles, college tuition, investments, vacation homes or almost any credit need you may have as a farm owner or operator. As with our other loans, payment dates can be tailored to your income schedule.[xlix]

Loans to Small Farmers and Ranchers Decline While Loans to Large Farmers and Ranchers Grow

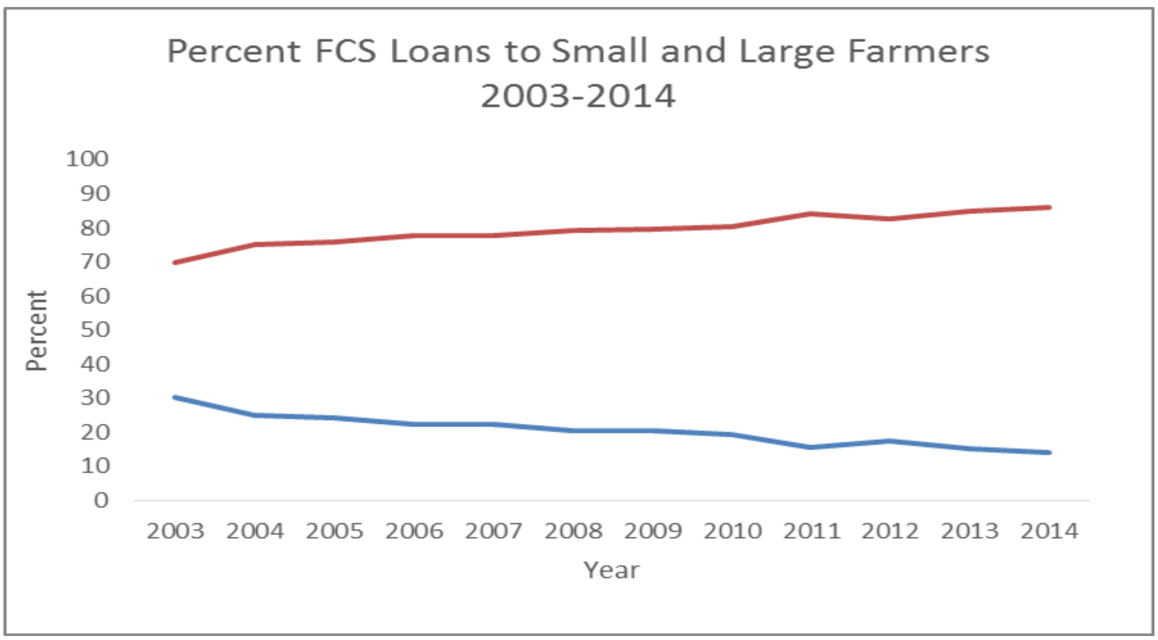
Although the FCS frequently touts its lending to small farmers and ranchers, the record of its lending speaks otherwise. According to the Farm Credit Administration 2013 Annual Report (latest published):

> The number and volume of loans made during the year is an indicator of the extent to which System institutions are serving YBS producers. Relative to 2013, the dollar volume of new loans made and the number new loans made in 2014 to young and beginning farmers rose, while the dollar volume and number of loans made to small farmers declined. The number and dollar volume of loans outstanding in all three YBS categories increased in 2014 from those of 2013.
>
> Small FCS institutions made 140,608 loans, totaling $10.7 billion, to small farmers in 2014. The dollar volume and number of new loans made fell 5.2 percent and 1.4 percent, respectively. Because of the larger drop in loan volume, the average size of a new small farmer loan fell 4.0 percent to $76,359.[l]

However, over the period 2003 to 2014, lending to small farmers declined precipitously — from 30 percent of FCS loans made in 2003 to just 14 percent of total FCS loans made in 2014. On the other hand, total FCS net income grew from just under $2 billion in 2003 to over $4.7 billion in 2014. Clearly, the focus of the FCS was less on providing loans to America's small farmers and more to various ways of boosting its bottom line.



Source: FCA annual reports 2004 and 2014.



Source: FCA Annual Reports and Fact Sheet on FCS Young, Beginning and Small (YBS) Farm Lending Results for 2014, June 11, 2015.

Similarly, as FCS lending to small farmers declined from 30 percent of loans made in 2003 to just 15 percent in 2013, loans to large farmers increased from 70 percent to 85 percent of total loans. Small farmers are defined as those with gross annual farm sales of $250,000 or less.

According to the Farm Credit Administration's 2014 Annual Report:

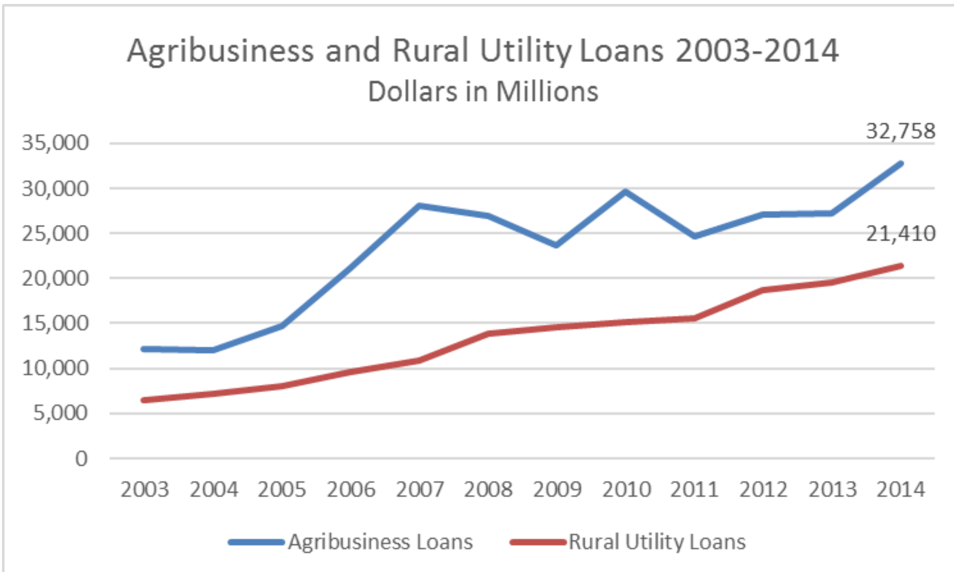
> Small US farms have been consolidating for generations as new technologies have increased productivity and reduced the number of farmers needed. From 1982 to 2012, the share of total farms considered to be small farms — those with $250,000 or less in farm sales — declined from 96 percent to 88 percent. Commodity price inflation, particularly since the mid-2000s, has contributed to this decline, with total farm revenues and average sales per farm nearly doubling. Because of their great diversity, the 1.9 million small farms in the United States are difficult to characterize. Many small farmers report little, if any, in farm sales, and many consider themselves to be retired or semiretired from their farming operations. In 2012, 600,000 farms generated less than $1,000 in farm sales that year. Small farms such as these typically have negative farm incomes and small amounts of farm debts. Those who operate small farms generally seek credit for consumer, rather than farm, products. Within this large segment are farming operations that are growing in size or producing higher-margin agricultural products for local markets, often on a seasonal basis.[li]

Former Chairman and CEO of the FCA Leland A. Strom recognized that FCS associations have developed very efficient marketing programs for farmers and ranchers involved in commodity-type agriculture (from corn and soybean production to livestock, for example) in addition to an "ongoing and impressive" effort at "education and outreach to these farmers and their children."

"However," he continued,

> "The concept of service to all farmers and ranchers includes those farmers who are not involved in commodity agriculture, but rather farm and market their products directly to consumers, local restaurants, schools, hospitals, etc., in what many call the Local Foods System. My recent travels to meet with some of these farmers, and the groups that work within this sector, demonstrated to me that these groups of farmers are for the most part operating viable farming operations that are part of the all of agriculture. But in my discussion with these farmers, I discovered that many do not know the FCS, or know that its mission is to serve all agricultural producers with a basis for credit. I encourage you, in your research of the agricultural operations within your lending territory, to seek out these farmers and understand their operations and credit needs.
>
> The second issue is the concept of creditworthiness as it relates to these farmers. As you know, a model to determine the creditworthiness of these farmers would likely be different from that used for a commodity-based farmer. These farmers typically do not present strong capital positions or real estate to pledge as collateral, but that, in and of itself, does not mean that they are not creditworthy. I am not advocating that you make loans that would pose safety and soundness concerns for your association, but in fact these farmers may be creditworthy, taking into account their various strengths."

Based on the lending by the FCS associations, Mr. Strom's concerns about small farmers and ranchers not getting the same kind of services that the FCS extends to large farmers and ranchers have not been heeded. Loans to large farmers have been increasing while loans to small farmers have been decreasing. Similarly, there has been significant growth in loans to agribusinesses and utilities over the same period with loans to agribusinesses growing by 125 percent and to utilities by 205 percent (see graph below).



Agribusiness loans include loans to cooperatives, processing and marketing operations, and farm related businesses. Rural utility loans include loans to energy and water/wastewater utilities and to communications utilities.

Farm Credit Banks and Income from Oil and Gas Production

There are three FCS banks — Agribank, CoBank and Northwest Bank — that account for all mineral (essentially oil and natural gas) income in the FCS. In their annual reports, mineral income is included under noninterest income. Thus, in 2014, the three banks reported net mineral income of $132 million, up from $63 million in 2010, an increase of 110 percent.

Agribank, based in Minnesota, had by far the lion's share of net mineral income — $48 million in 2010 and $106 million in 2014, a jump of 121 percent. Agribank's 2010 net mineral income represented 76 percent of all FCS banks' net mineral income in 2010 and 80 percent of all net mineral income in 2014. Agribank's net mineral income was 8 percent of total net income in 2010 but increased to 19 percent of the total net income in 2014.

Agribank's oil and gas lease interests are primarily in North Dakota's Williston Basin where the second largest oil formation in the United States — the Bakken Field — is located. *The field began producing over 1 million b/d in April/May 2014.*[lii] In terms of *US oil production*, North Dakota (12 percent of US production) now ranks second behind Texas (36 percent of US production) and ahead of California and Alaska (each with 6 percent of US production).[liii]

Much of the production in the Bakken formation is with the use of technology called hydraulic fracturing or "fracking," which forces a liquid — primarily water — under pressure to fracture tight geologic formations that contain oil.

According to Agribank's annual reports:

> The Bank's 2012 gross mineral income was $77 million, a 67 percent increase from 2011. Mineral income for the previous five years (2007-2011) averaged $29.5 million. *More than 90 percent of AgriBank's mineral income* comes from interests located in North Dakota.[liv]
>
> *Non-interest income increased to $159.9 million* driven by mineral income of $105.9 million primarily from royalties received due to increased production activities in North Dakota. Mineral income has continued to increase in recent years; however, prolonged low oil prices may result in a decline in mineral income for 2015.[lv]

AgriBank owns mineral interests in 13 of 15 states in the District.[lvi] These interests were acquired following the Great Depression when the FCS became the unwilling owner of foreclosed farms. FCS adopted the policy of reserving a portion — in most cases a one-half interest — of the mineral rights when selling the property. If the mineral rights became valuable, the landowner would also profit. In 1986, all System institutions discontinued the practice of reserving mineral rights when selling acquired properties due to an act of Congress. AgriBank also reports that the staff of its *"Minerals Management Division works to maximize long-term income* from these assets with their knowledge of the petroleum industry, its accounting practices, lease agreement, legal regulations and management techniques, as wells access to outside expertise in geology and petroleum engineering. There are a total of 1,594 oil and gas wells on AgriBank mineral properties with hundreds more planned by energy company Lessees. Royalty income should continue to climb as new wells come into play and further exploration yields dividends."[lvii]

As AgriBank and others profit handsomely from the North Dakota oil boom, many farmers are seeing the darker downside. An investigation in 2014[lviii] by *The New York Times* found, among other things:

- "…as the boom really exploded, the number of reported spills, leaks, fires and blowouts has soared, with an increase in spillage that outpaces the increase in oil production…"

- Over all, more than 18.4 million gallons of oils and chemicals spilled, leaked or misted into the air, soil and waters of North Dakota from 2006 through early October 2014.
- In the spring thaw of 2011, however, after a winter of record snowfall, scores of oil waste pits overflowed at once. The large, open pits, adjacent to rigs throughout the Bakken at that point, disgorged oil-based drilling mud that mixed with snowmelt and streamed across farmland and into stock ponds, creeks and river tributaries. Farmers were horrified; the local news media took note.
- Three years ago, a farmer in the Antler audience experienced one of the largest oil field wastewater spills ever in North Dakota. A leaking wastewater line contaminated some 24 acres of farmland and eight surface ponds, and the site has yet to be restored to health.

  After the leak was detected, cleanup crews pumped out two million gallons of severely contaminated water, with chloride levels 2,700 times higher than normal, and a generator was still pumping out contaminants this summer.

  "Three years!" the farmer, Darwin Peterson, exclaimed at the meeting. "Three years, and this spill has been addressed in a Band-Aid fashion. Meanwhile, that 24 acres has expanded, with Mother Nature, to the neighbors. When is enough enough?"

  State officials say the spill far exceeded the 12,600 gallons originally reported by the company, Petro Harvester, though it remains listed that way on the state's spills website. Mr. Helms, in an email last year to his spokeswoman, Alison Ritter, estimated it at 332,000 gallons. Mr. Nelson, the legislator and agronomist, thinks it probably was three times that much.

An earlier report in The New York Times found that:

- "The furious pace of energy exploration in North Dakota is creating a crisis for farmers whose grain shipments have been held up by a vast new movement of oil by rail, leading to millions of dollars in agricultural losses and slower production for breakfast cereal giants like General Mills.

  "The backlog is only going to get worse, farmers said, as they prepared this week for what is expected to be a record crop of wheat and soybeans.

  "'If we can't get this stuff out soon, a lot of it is simply going to go on the ground and rot,' said Bill Hejl, who grows soybeans, wheat and sugar beets in the town of Casselton, about 20 miles west of here.

  "Although the energy boom in North Dakota has led to a 2.8 percent unemployment rate, the lowest in the nation, the downside has been harder times for farmers who

> have long been mainstays of the state's economy. Agriculture was North Dakota's No. 1 industry for decades, representing a quarter of its economic base, but recent statistics show that oil and gas have become the biggest contributors to the state's gross domestic product."[lix]

In addition to train delays faced by North Dakota farmers, there are also the dangers posed by oil train derailments and explosions.

- *On January 23, 2014 the Minneapolis Star Tribune reported,* "[T]he oil train that crashed and burned after colliding with a derailed train near Casselton, N.D., on Dec. 30 spilled 400,000 gallons of crude, U.S. investigators said Monday in a preliminary report on the accident.[lx]
- *On May 6, 2015, CBS News reported* on the derailment and fire of a 109-car oil train 115 miles north of Bismarck. Additionally, CBS reported, "Since 2006, the U.S. and Canada have seen at least 24 oil train accidents involving a fire, derailment or significant amount of fuel spilled, according to federal accident records reviewed by the AP."[lxi]

  According to The Center for Investigative Reporting, "The railroads are moving 40 times more oil now than in 2008 due to an oil boom in the Bakken formation of North Dakota. Bakken crude oil contains high concentrations of volatile gas, with a flashpoint as low as 74 degrees Fahrenheit."[lxii]

An example of Agribank's interest in oil and gas producing leases

As mentioned above, Agribank owns a vast amount of mineral interests in the Williston Basin's Bakken Formation — a major oil and gas-producing region. The Bakken and other similar formations exist across states and counties. More oil in North Dakota is produced from the Bakken Formation than any other. Dunn County, for example, ranks third in the state for oil production and fifth in natural gas production. In Dunn County, oil and gas are produced from the Bailey Field (among others).

In March 2015, for example, oil production in Dunn County was over 6 million barrels. The Dunn County Bailey Field production reached over 357,000 barrels. One of the wells (Andi Schollmeyer 41-5H) leased by Agribank to Marathon Oil in 2010 produced nearly 680 barrels of oil and over 700,000 cubic feet of natural gas. But, determining the total royalty revenue realized by Agribank for production of oil and gas in all of North Dakota will require a major analysis of enormous amounts of data from a variety of sources.

Although Agribank has substantial profits from its interests in properties that are producing oil and gas, it seems to have less interest in the impact of oil and gas production on farmers and ranchers in North Dakota that are harmed by spills, train derailments and delays caused by oil trains, which are backing up farmer grain and other agricultural shipments.

Conclusion

Need for Congressional Oversight

US House of Representatives

No substantive, focused House congressional oversight hearing of the FCS has been held since September 29, 2004 — more than 10 years ago. At the conclusion of that hearing entitled "Subcommittee Reviews FCS" and held by the of the House Agriculture Subcommittee on Conservation, Credit, Rural Development and Research, then-Subcommittee Chairman Frank Lucas (R-OK) pledged the continued oversight of the FCS and the FCA by the subcommittee, stating: "I will work to ensure that any future actions taken by the subcommittee are in the best interest of America's farmers and ranchers." While other subcommittee hearings have been held on credit availability (June 25, 2014) or credit conditions (April 14, 2011) for agricultural producers, none have been an oversight hearing focused on examining the performance of the FCS and the Farm Credit Administration.

US Senate

The Senate Committee on Agriculture has not held an oversight hearing focused on the FCS for at least 10, if not more, years, although it has held confirmation hearings on nominees to the Farm Credit Administration and other agriculture agency or department positions.

Need for Reform Legislation

- Reduce or eliminate FCS tax exemptions
- Make FCS subject to the Dodd-Frank Act
- Narrow definition of "similar entity" lending authority
- Require FCS to Increase Lending to Young, Beginning and Small Farmers and Ranchers
- Limit Lending to Non-Farm Corporations and Non-Farm Activities

[i] *First Quarter 2015 Quarterly Financial Information Statement of the FCS,* Federal Farm Credit Banks Funding Corporation, May 7, 2015.

[ii] Congressional Research Service, *FCS*, RS21278, April 6, 2015.

> "Because of the significant role of GSEs in the U.S. economy, most investors feel the federal government will not allow a GSE to fail. Thus, an implicit, albeit not statutory, guarantee exists."

[iii] *Ibid.*

[iv] *Lending Competition of Community Banks and the FCS,* Financial Industry Perspectives, Federal Reserve Bank of Kansas City, August 2009.

[v] *Op. Cit.* CRS, April 6, 2015.

[vi] *Op. Cit.* CRS, April 6, 2015.

[vii] Farm Credit Act of 1971, Public Law 92-181, Section 1.1.c.

[viii] *Op. Cit.*, Federal Reserve Bank of Kansas City, August 2009.

[ix] Ibid., p. 14.

[x] *History of the FCA and FCS,* Farm Credit Administration.

[xi] Congressional Research Service, *Government-Sponsored Enterprises (GSEs): An Institutional Overview,* (CRS Report RS21663, April 23, 2007)

> a corporate entity created by a law of the United States that —
> (A) (i) has a Federal charter authorized by law;
> (ii) is privately owned, as evidenced by capital stock owned by private entities or individuals;
> (iii) is under the direction of a board of directors, a majority of which is elected by private owners;
> (iv) is a financial institution with power to —
> (I) make loans or loan guarantees for limited purposes such as to provide credit for specific borrowers or one sector; and
> (II) (II) raise funds by borrowing (which does not carry the full faith and credit of the Federal Government) or to guarantee the debt of others in unlimited amounts; and
> (B) (i) does not exercise powers that are reserved to the Government as sovereign (such as the power to tax or to regulate interstate commerce);
> (ii) does not have the power to commit the Government financially (but it may be a recipient of a loan guarantee commitment made by the Government); and
> (iii) has employees whose salaries and expenses are paid by the enterprise and are not Federal employees subject to title 5. (104 Stat. 1388-607, Sec. 13112; and 2 U.S.C. 622(8).

[xii] *Ibid.*

[xiii] U.S. General Accounting Office, *Financial Services Institutions: Information for Assessing the Government's Potential Financial Exposure,* GAO/GGD-98-125 (Washington: GAO, 1998).

[xiv] *Op. Cit.* CRS Report RS21663, April 23, *2007.*

[xv] On the rescue of the FCS, see US General Accounting Office, *FCS: Repayment of Federal Assistance and Competitive Position*, GAO/GGD-94-39 (Washington: DC 1994)

[xvi] *"*Bailouts And Credit Cycles: Fannie, Freddie, And The FCS," Julie Andersen Hill, *Wisconsin Law Review*, 2010.

[xvii] (Charles F. McCoy, Out of Options: FCS, Buried in Bad Loans, Seeks Big U.S. Bailout, WALL ST. J., Sept. 4, 1985, at 1.)

[xviii] Law 360, *Dairy Farm Blames Lender for Debt Woes In Ch. 11 Bid,"* October 28, 2014.

[xix] *Daniel and Elaine Nowlin, et.al. v. Farm Credit Services Southwest, et. al,* Arizona Superior Court, Pinal County, No. 01402506, October 24, 2014.

[xx] *Notification of Non-Reliance on Previously Issued Financial Statements,* From Credit Services Southwest, October 10, 2014.

[xxi] *Ibid.*

[xxii] *Range of Options,* Brye Stevens, TEN Magazine, Federal Reserve Bank of Kansas City, Fall 2009.

[xxiii] *Government –Sponsored Enterprises, Mercantilist Companies in the Modern World,* Thomas Stanton, AEI Studies on Financial Market Deregulation, 2002, p. 107.

[xxiv] Congressional Research Service, *FCS,* Report RS21278, June 12, 2007.

[xxv] J. Of Public Budgeting, Accounting & Financial Management, 11(1), 136-173, *Accountability Of Government Sponsored Enterprises*, Thomas H. Stanton, Spring 1999,
[xxvi] *Op. Cit., FCS*, RS21278.
[xxvii] Ralph Nader Blog, *Government Sponsored Enterprises (GSEs)*, May 30, 2002.
[xxviii] *2014 Annual Information Statement of the FCS*, Federal Farm Credit Banks Funding Corporation, March 11, 2015, p.25.
[xxix] *First Quarter2015 Quarterly Information Statement of the FCS*, Federal Farm Credit Banks Funding Corporation, May 7, 2015, p.22.
[xxx] *Ibid.,* p. F-17.

> The Farm Credit Banks, certain Associations, and the income related to the Insurance Fund are exempt from federal and other income taxes as provided in the Farm Credit Act. CoBank, ACB, certain other Associations and service organizations are not exempt from federal and certain other income taxes. Taxable institutions are eligible to operate as cooperatives that qualify for tax treatment under Subchapter T of the Internal Revenue Code. Under specified conditions, these cooperatives can exclude from taxable income amounts distributed as qualified patronage refunds in the form of cash, stock or allocated surplus.

[xxxi] Remarks by Leland A. Strom, Chairman and CEO, Farm Credit Administration, at the Farm Credit Council Annual Meeting in Washington, D.C., January 24, 2012.
[xxxii] University of Wisconsin Center for Cooperatives, "Research on the Economic Impact of Cooperatives, http://reic.uwcc.wisc.edu/telephone/.
[xxxiii] A Review of Credit Availability in Rural America, Hearing before the Subcommittee on Livestock, Rural Development, and Credit, Committee on Agriculture, U.S. House of Representatives, June 25, 2014, p. 32.

[xxxiv] Verizon Wireless is the largest wireless service provider in the United States as measured by retail connections and revenue. At December 31, 2014, Verizon Wireless had 108.2 million retail connections and 2014 revenues of approximately $87.6 billion, representing approximately 69% of Verizon's aggregate revenues. We provide wireless communication services across one of the most extensive wireless networks in the U.S. and have the largest fourth-generation (4G) Long-Term Evolution (LTE) technology and third-generation (3G) Evolution—Data Optimized (EV-DO) networks of any U.S. wireless service provider.

Our 4G LTE network is available to over 98% of the U.S. population in more than 500 markets covering approximately 309 million people, including those in areas served by our LTE in Rural America partners. Under this program, we are working with wireless carriers in rural areas to collaboratively build and operate a 4G LTE network using each carrier's network assets and our core 4G LTE equipment and 700 MHz C Block and Advanced Wireless Services (AWS) spectrum.
We have substantially completed the deployment of our 4G LTE network and are focusing our capital spending on adding capacity and density to this network,
[xxxv] Note how the term "community loans" morphed into "community investment."
[xxxvi] The Denver Post, *Group challenges CoBank's financing of Verizon-Vodafone deal*, David Migoya, Oct. 22, 2013.
[xxxvii] Stamford Advocate, *Frontier Communications gets loan to pay for AT&T network purchase,* June 3, 2014.
[xxxviii] *Ibid.*
[xxxix] *Economic Impacts of Connecticut's Agricultural Industry,"* Department of Agricultural Resources and Economics, University of Connecticut, September 2010, p. 5.
[xl] PRNewswire, *U.S. Cellular secures a $225 million bank term loan,* January 22, 2015.
[xli] Yahoo Finance, *Cracker Barrel Closes on Five-Year $750 Million Credit Facility,* January 9, 2015.
[xlii] Market Wired, *California Water Service Group Enters New $450 Million Credit Agreement, March 10, 2015.*
[xliii] Market Watch (Thomson Reuters), *Black Hills Corp. Closes $300 Million Term Loan,* April 13, 2015.
[xliv] MSCI is an independent provider of research-driven insights and tools for institutional investors, especially to provide investors with measures of risk assessment.

[xlv] The Hook, *Trump towers: Kluge vineyards go to The Donald,* April 14, 2011.
[xlvi] Central Kentucky Agcredit website.
[xlvii] AgCarolina Farm Credit website.

[xlviii] Farm Credit of Central Florida website.
[xlix] Cape Fear Farm Credit website.
[l] Farm Credit Administration, Annual Report 2014, p. 27.
[li] *Ibid.* p.25.
[lii] "Bakken Fuels North Dakota's Oil Production Growth," *Today in Energy,* Energy Information Administration, August 2014.
[liii] U.S. Energy Information Administration, Crude Oil Production, May 28, 2015.
[liv] 2012 Annual Report, Agribank, p. 36.
[lv] 2014 Annual Report, Agribank, p. 18.
[lvi] *Op. Cit,* 2012 Annual Report, p. 36.
[lvii] 2011 Annual Report, Agribank, p. 23.
[lviii] *The New York Times*, November 22, 2014, November 23, 2014 and December 28, 2014.
[lix] "Grain Piles Up, Waiting for a Ride, as Trains Move North Dakota Oil," *The New York Times,* August 25, 2014.
[lx] "NTSB: 400,000 Gallons of Crude Oil Spilled in N.D. Train Wreck," *Minneapolis Star-Tribune*, January 23, 2014.
[lxi] "North Dakota town evacuated after oil train derailment," *CBS News,* May 6, 2015."
[lxii] "Growing oil train traffic is shrouded in secrecy," *The Center for Investigative Reporting*, June 13, 2015.