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Rural credit like the weather: sunny with threatening clouds

By Jon H. Harsch

Overall, credit availability for rural America is on the mend, at least for credit-worthy borrowers. But dairy, poultry, hog and cattle operations and ethanol plants are under continuing pressure. And credit conditions for the farm sector as a whole could deteriorate significantly if current cap-and-trade legislation is enacted without significant changes to guarantee new income opportunities for agriculture to offset the bill's expected negative impact on input costs.

That was the mixed message delivered by seven witnesses who testified on rural credit conditions in a June 11th hearing held by the House Agriculture Subcommittee on Conservation, Credit, Energy, and Research.

Questioning the witnesses, Rep. Bob Goodlatte (R-VA) specifically warned that passing the Waxman/Markey cap-and-trade bill would "result in a massive national energy tax" which he said "will cause producers to pay more for seed, equipment, machinery, steel, and other supplies needed for their agricultural operations." He said these higher input prices "will also increase the need for larger operating loans during times when credit is already becoming more difficult to obtain." In response to Goodlatte's concerns, Leland Strom, Chairman of Farm Credit Administration (FCA) which oversees the Farm Credit System, said that impacts on agriculture from the cap-and-trade provisions in the climate change bill "could be significant."

Doug Caruso, Administrator of the USDA's Farm Service Agency (FSA) which provides loans to borrowers unable to obtain commercial credit, confirmed Goodlatte's point that "credit is already becoming more difficult to obtain." Caruso testified that "Reports from the Federal Reserve and other sources indicate there is a tightening of credit for farmers and ranchers around the country. A combination of limited or negative returns in much of the livestock industry, reduced profit margins in crop production, and increased sensitivity to credit risk has caused many farm lenders to raise their credit standards, reduce the amount they are willing to lend in agriculture, or both. Many lenders report that increased scrutiny from regulators has caused them to raise credit standards significantly."

Caruso also reported that as of June 10th, FSA has a total backlog of $373 million in farm loans that have been approved for funding but can't be completed due to USDA's lack of funds. This backlog of over 3,000 approved but unfunded loans includes $96 million for direct operating loans and $277 million for direct farm ownership loans. Indicating more trouble ahead, Caruso said that due to a maximum nine-year time limit for FSA loans, more than 4,800 FSA borrowers must repay their loans within one year and more than 7,800 FSA borrowers must repay their loans within two years. He warned the subcommittee members that:

- "Without FSA direct loan assistance, many of these borrowers may be forced out of farming as they may not have access to the capital necessary for them to conduct their farming operations.
- "Under the current credit environment, it is unlikely that many borrowers reaching their term limits will be able to obtain conventional financing. They will be left with nowhere to turn.
- "It will be unfortunate if these borrowers are forced out of business because they reached their term limits during a period of unprecedented upheaval and uncertainty in the banking and financial sectors."

FCA's Strom commented that credit remains widely available to agriculture and that the Farm Credit System remains "fundamentally safe and sound." But he said credit is available "at a higher cost" to producers. He also pointed out that the situation could worsen since foreign central banks, previously major investors in the Farm Credit System "have basically existed the market. There's virtually no investment from overseas." A similar warning came from Patrick Sullivan, Economic Development Specialist and Agricultural Mediation Program Project Leader at New Mexico State University. He concluded that "Overall, agricultural producers and agribusinesses that depend heavily on credit could be constrained. This is especially true with respect to dairy, poultry, cattle feeding and pork production. Farmers that are closely tied to local rural banks tend to have secure long-term relationships that should mitigate much of the economic crisis's effect on farm loans. However, without adequate funding for Farm Service Agency direct loans, many producers that have weak to moderately weak credit could find it difficult to secure adequate financing. . . more and more farmers may be forced to use credit cards to finance their operations."

Dr. Mark Drabenstott, Director and Research Professor at the University of Missouri's RUPRI Center for Regional Competitiveness summarized the unsettled credit situation:

- "This committee is rightly concerned about current agricultural credit conditions. Conditions have deteriorated over the past nine months, reflecting a softening farm economy and turbulent financial markets.
- "The most notable change has been a sharp increase in lender credit standards. Lenders are requiring more collateral to offset rising credit risks. At the same time, farmland values appear to have stalled, after one of the biggest booms on record.
- "Lastly, farm income is projected to tumble more than a fifth this year due to a sharp fall in commodity prices from last year's peaks.
- "These developments are cause for concern, but they do not yet translate into alarm. Farm borrowers and their lenders are both coming off a period of strong profits, leaving them with solid capital cushions. Nevertheless, in a small number of cases, that cushion may be tested this year."

To read witness statements from the June 11th rural credit hearing, go to: http://agriculture.house.gov/hearings/statements.html

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