Lecture V: Agricultural Lenders

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1. Major Source of Capital in Agriculture

2. Lender Categories
   - Commercial Banks
   - Cooperative Lenders
   - Government Entities

Major Source of Capital in Agriculture

- As discussed in Lecture 2, we have two general sources of capital – equity and debt investments.
- At one level it would be correct to say that most of the additional capital in agriculture enters through the debt market.
  - Commercial Banks
  - Cooperative Credit
  - Government Lending
- The dominance of debt capital needs some caveats:
  - In developing economies we often talk about remittances – money that migrants send back to the family involved in farming.
  - In the United States equity has entered the market from off-farm employment.
  - Retained earnings and especially equity generated by increases in farmland values tends to be a major source of income over time.

Land Appreciation and Equity

Year	Land Value	Debt	Payment	Principal	Equity
2017	1000.00	500.00	69.05	6.55	500.00
2018	1020.00	493.45	69.05	7.37	526.55
2019	1040.40	486.08	69.05	8.29	554.32
2020	1061.21	477.79	69.05	9.33	583.42
2021	1082.43	468.46	69.05	10.49	613.97
2022	1104.08	457.97	69.05	11.80	646.11
2023	1126.16	446.17	69.05	13.28	679.99
2024	1148.68	432.89	69.05	14.94	715.79
2025	1171.65	417.95	69.05	16.81	753.70
2026	1195.08	401.14	69.05	18.91	793.94
2027	1218.98	382.23	69.05	21.27	836.75
2028	1243.36	360.96	69.05	23.93	882.40

Commercial Banks

- We have developed some of the key points of banks as a financial institution in Lectures 2, 3, and 4.
- Historically, banks – especially local banks that served agriculture – could be either sole proprietorships, limited partnerships, or closely held corporations (corporations that are not publicly traded).
- These banks had limited lending capability because of capital limitations.
- Since the establishment of the Federal Reserve System, the number of banks has declined – a portion of this decline can be explained by the emergence of publicly held corporations.
- The consolidations in the banking sector also reduced the number and significance of independent banks in rural communities.

Cooperative Lenders

- The largest group of cooperative lenders has been the Farm Credit System which was established under the auspices of the Federal Farm Loan Act of 1916.
- A cooperative is a company (typically organized as a corporation) that is owned by its clients.
  - In the great plains, farmers would form a company (cooperative) to operate a grain elevator.
  - They could incorporate by selling a small number of shares and borrowing the remaining capital through debt (sometimes from the Bank for Cooperatives – a subset of the Farm Credit System).
  - The cooperative would hire management and operate the business – sell fertilizer and seed to farmers and purchase their output for shipment over the railroads.
  - The common stock (i.e., shares) and proceeds from the operation are distributed based on the amount of business that farmers conduct with the cooperative.

Farm Credit System

- The Farm Credit System was a federally chartered cooperative.
- Organization
  - Originally the Farm Credit System was a source of long-term – farm ownership loans.
  - It eventually contained three components – the Federal Land Banks (which provided long term capital), the Federal Intermediate Credit Bank (which provided short and intermediate term credit), and the Bank for Cooperatives.
  - The U.S. was divided into twelve districts, each of which had one of each component.
  - In addition there was a national Bank for Cooperatives that could lend across regions.
  - Local lending was carried out by local associations - the Federal Land Bank Associations and Production Credit Associations.
- It raised money by selling bonds in government enterprise market.

- Several limitations of commercial banking combined to provide impetus for the Farm Credit System.
  - Commercial banks were limited to making real estate loans of less than five years.
  - Limits on the amount of money that could be loaned to an individual borrower (for example limitations on the percent of owner's equity [common stock plus retained earnings] that could be loaned to an individual borrower) put significant limitations on the availability of capital for agriculture in some locations.

- The seeds for the future difficulties of the Farm Credit System were sown in its establishment.
  - The Farm Credit System is a **Government Sponsored Enterprise** (GSE).
  - The goal of these enterprises is typically to meet some policy objective (in this case providing for the capital needs of the farm sector) while meeting all its costs.
  - Being a cooperative, the goal was only to accumulate the amount of capital required to secure the bonds. Providing adequate security of the bonds would keep the cost of capital to the farmers as low as possible.
  - However, the capital markets often thought that as a GSE, the government would provide resources if the bonds were ever at risk of default (this became known as the implicit government guarantee).

Government Entities

- The dominate government entity lending in agriculture has been the Farmer Service Agency - Farm Loan Programs (from 1946 through the 1990s this was typically refered to as the Farmers Home Administration).
- The FSA operates in two ways:
  - The FSA does make direct loans.
  - The FSA also provides loans to farmers by guaranteeing loans – the bank makes the loan, but the FSA guarantees 80 % of the value of the loan if the farmer defaults.

Share of Real Estate Lending by Lender

Year	Farm Credit System	Farm Service Agency	Commercial Banks	Life Insurance Companies	Individuals and Others	CCC Storage & Drying Loans
1960	19.65	5.52	11.99	23.45	38.98	0.42
1965	19.91	6.95	11.95	22.94	38.07	0.18
1970	23.38	7.96	12.24	18.50	37.38	0.54
1975	32.10	6.74	12.52	13.57	34.69	0.39
1980	37.03	8.32	8.71	13.30	30.93	1.71
1985	42.13	9.81	10.72	11.26	25.75	0.33
1990	34.69	10.22	21.80	12.98	20.30	0.00
1995	31.34	6.38	28.10	11.47	22.72	0.00
2000	35.05	4.03	35.12	13.05	12.75	0.00
2005	39.30	2.34	36.18	10.79	11.15	0.24
2006	40.21	2.20	37.16	11.11	9.06	0.26
2007	41.53	2.02	37.17	11.32	7.68	0.28
2008	42.85	1.72	37.55	11.13	6.64	0.11
2009	43.55	1.78	38.14	10.26	5.91	0.36
2010	45.27	2.05	38.06	9.37	5.09	0.16