



FARM CREDIT

**Testimony of
Tom Halverson, President and CEO
CoBank
on behalf of the Farm Credit System
before the U.S. House Committee on Agriculture
March 29, 2017**

Good morning Chairman Conaway, Ranking Member Peterson and Members of the Committee. Thank you for the opportunity to testify today on behalf of the vital role the Farm Credit System plays in the U.S. rural economy.

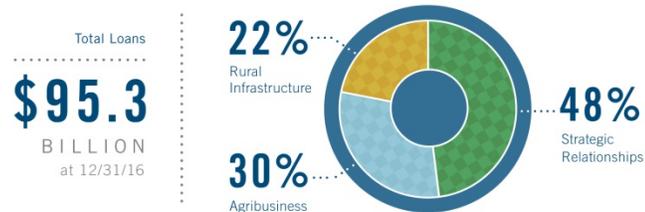
My name is Tom Halverson and I am President and CEO of CoBank.

CoBank is a proud member of the Farm Credit System, and we share the Farm Credit mission to support rural communities and agriculture. CoBank is unique in Farm Credit in that we are chartered to serve farmer-owned cooperatives, agribusinesses, and rural infrastructure providers. We also finance the export of about \$5 billion worth of U.S. farm products around the world.

Unlike most Farm Credit institutions, CoBank doesn't directly lend to farmers. Instead, we provide funding to 23 farmer-owned Farm Credit associations that make loans to more than 70,000 agricultural producers in 23 states in the Northeast, Plains, and West. In addition to providing funding to Farm Credit associations, CoBank directly loans to cooperatives and other businesses in the agribusiness, rural power, rural water and rural communications industries in all 50 states.

Like all Farm Credit institutions, we are a cooperative owned by our customers, and our board of directors is comprised predominantly of men and women from agricultural co-ops and rural infrastructure companies we serve or from the Farm Credit lending associations we fund. A substantial percentage of CoBank board members are themselves farmers or ranchers. Our board members live and work in rural communities throughout the country; they have a generational mindset and are deeply committed to the bank's mission to support rural communities and agriculture.

COBANK INDUSTRY PORTFOLIOS



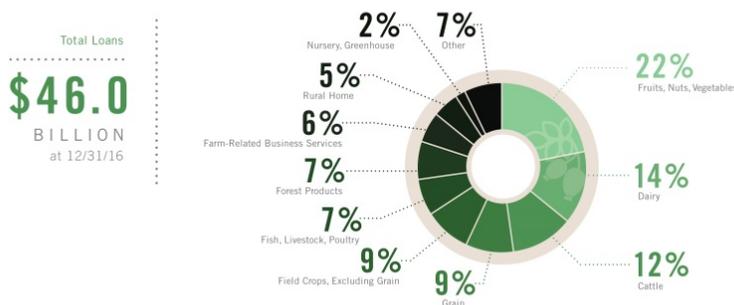
CoBank's customer-owners operate in highly capital-intensive sectors, and need reliable access to credit, regardless of market conditions. CoBank has built financial strength to deliver that reliable access to credit. We maintain our capital levels far in excess of regulatory minimums. We have a

strong credit underwriting culture. And most importantly, we have deep expertise and experience in industries in which our customers operate.

With commodity prices continuing at low levels, we are watching closely for signs of stress among our customers. Loan quality for CoBank, however, remains very strong by virtually every measure, despite stresses in the rural economy that have impacted our customers.

The first line of defense for any financial institution is its earnings, and CoBank is no different. Like other Farm Credit institutions, CoBank's cooperative structure means that the bank's net income can only be used in two ways – either retained within the bank to build financial strength to withstand downturns and continue meeting the needs of our customers, or returned to those customers in the form of cooperative dividends (known as patronage distributions) that directly lower the cost of borrowing.

STRATEGIC RELATIONSHIPS PORTFOLIO



Like every member of the Farm Credit System, CoBank is focused on providing credit and financial services to production agriculture. Lending Farm Credit associations comprises nearly half of our portfolio. Our affiliated associations serve farmers and ranchers in many of the states represented on the Committee.

One of these associations is Farm Credit East, headquartered in Enfield, Connecticut, serving 14,000 customers in seven states reaching from New Jersey north to Maine. Agriculture and the future of our rural communities depend on the next generation of farmers getting started. To help in that effort CoBank partnered with Farm Credit East on their FarmStart program.

FarmStart invests working capital up to \$75,000 to give new farmers in their first three years of operation a healthy start as agricultural producers. The producers start with a business plan and work with a FarmStart advisor to create a roadmap to success. Recently, FarmStart made its 200th investment in the future of agriculture in the Northeast. Yankee Farm Credit, another CoBank-affiliated association serving Vermont and parts of New York and New Hampshire, is also a partner in FarmStart.

One FarmStart success story is Abigail Barrows of Deer Isle, Maine. In early 2015, Abigail combined her science background and her interest in farming with an investment from FarmStart and a loan from the USDA Farm Service Agency to purchase the Long Cove Sea Farm. She appreciates the flexibility of FarmStart in accommodating the seasonal nature of her business. Marketing at a local night market and via FaceBook, her first season's demand exceeded supply. Now she is hoping to grow her business while improving the marine environment.

Another FarmStart success story is Hudson Valley Seed Library in Accord, New York. Founded by Ken Greene and Doug Muller, its mission is to produce ethically grown and regionally sourced

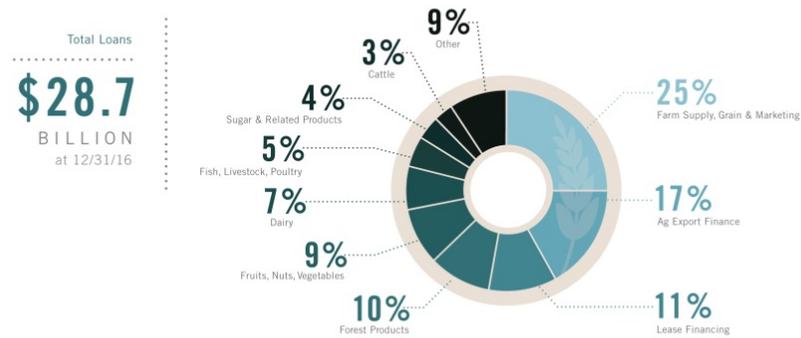
seeds to add to the diversity available to farmers. As their business grew faster than expected, FarmStart helped Greene and Muller make an investment in cold seed storage, improved germination testing equipment, and add an employee to help with sales and marketing. Today they boast a certified organic catalog of 400 vegetable, flower and herb varieties. They are creating local jobs and increasing the genetic diversity of plants found in their region.

Thirty percent of CoBank’s loan volume is with agribusiness. These loans support grain handling and marketing, farm supply, food processing, biofuels, and all types of agricultural products. These businesses provide the inputs and market the products of farmers and ranchers across the U.S. and abroad. CoBank serves agribusinesses in all 50 states.

The cooperative business model has a long history of helping farmers and ranchers manage their input costs and market their products more efficiently, allowing producers to keep more of the revenue. That is especially important when times are tough in the agricultural marketplace. Like the entire Farm Credit System, CoBank has a

long track record as a dependable provider of credit to co-ops of all sizes and shapes, from start-ups to well-established brands. We support our customers in good times and bad.

AGRIBUSINESS PORTFOLIO

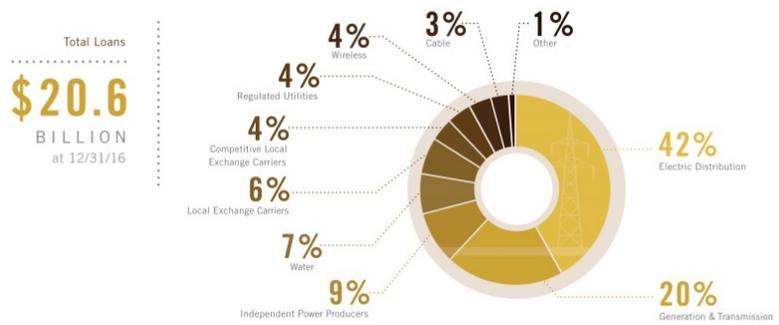


In 2015, CoBank customer CHS undertook a joint venture with CF Industries to help provide CHS and its member-owners with a dependable source of fertilizer through supply chain efficiency, thereby generating economic value for farmers and ranchers. The longstanding CHS relationship with CoBank meant the deal could move quickly while partnering with other Farm Credit institutions and commercial banks to get the transaction closed smoothly.

Banking in agriculture doesn’t require low prices to be challenging. In 2007 and 2008, a huge spike in global prices for corn, soybeans, and wheat placed enormous stress on farmer-owned grain elevators throughout the American Midwest, the vast majority of which were CoBank customers. During that period, hundreds of these cooperatives requested emergency increases to seasonal lines of credit and term loans from CoBank to fund grain purchases from their members and resulting margin calls. Without this financing, elevators were at risk of liquidity shortages that could have prevented them from meeting their obligations to producers and ultimately put them out of business. CoBank, consistent with its mission, expanded the availability of credit to the grain industry, approving incremental commitments to grain and agronomy customers that added more than \$6 billion of loan volume between September 2007 and September 2008. Doing so helped avert tremendous dislocation for our agribusiness customers and the U.S. grain industry as a whole.

Today, 22 percent of CoBank's business is rural infrastructure. These loans provide the capital that rural telephone co-ops, rural water systems, and rural electric cooperatives need to provide affordable and reliable service across all 50 states. While these three businesses are organized separately within CoBank, they are inextricably linked in rural America. CoBank and the entire Farm Credit System provide the capital that finances agriculture and rural communities.

RURAL INFRASTRUCTURE PORTFOLIO



Union Wireless is a CoBank customer in Mountain View, Wyoming, serving 4,000 wireline customers and 10 times that many wireless customers. Union covers over 120,000 square miles, relying on over 40 towers. CoBank has worked with Union for more than 25 years, including financing their 2016 network upgrade.

As electric co-ops have brought more renewable resources on-line, CoBank has been there as a partner. Indiana's generation and transmission co-op, Hoosier Energy, provides power to 18 distribution co-ops serving more than 300,000 homes, businesses, and industries in central and southern Indiana and southeastern Illinois. In 2015 CoBank financing helped Hoosier construct the first of 10 planned 1MW solar arrays, on the way to Hoosier's goal of 10 percent renewables by 2025.

Since CoBank is a financial cooperative, our owners share in the bank's financial success. Earlier this month, CoBank returned \$588 million in patronage distributions, and we have returned over \$2.4 billion over the past 5 years. Patronage effectively lowers the net cost of borrowing for our customers, and provides them with funds they can reinvest in their businesses and in their local communities.

CoBank's board has generously committed to additional direct investment in support of rural economic development. To date, the bank has committed \$45 million as a limited partner in equity funds that promote economic growth and job development in rural communities, including two funds formed under the auspices of the USDA's Rural Business Investment Program. Additionally, the bank is an active investor in rural health care, senior care, and other community facilities through bond purchases that support individual projects, with investments totaling more than \$80 million over the past five years.

A great example of rural community investment by CoBank is Cook County Hospital in the rural town, Grand Marais, Minnesota. CoBank partnered with four local community banks and Farm Credit's AgStar Financial Services to fund a full-scale renovation of the hospital that began in 2016. The 16-bed critical access facility provides a community of 1,300 with 24-hour emergency services, inpatient care and outpatient services. The project will update the facility, which was first built more than a half-century ago, meaning local residents won't be forced to drive 90 minutes for care. This investment will help the hospital remain a reliable resource for the community.

CoBank also supports rural communities by providing funds for a wide array of charitable organizations throughout the country. Consistent with the cooperative principle of concern for community, the board targets 1 percent of budgeted net income for charitable giving in rural areas and where the bank has business operations. In 2016, that meant CoBank invested \$8.3 million in charitable contributions. Additionally, CoBank supports organizations and associations of the industries we serve. In 2016, CoBank provided \$3 million directed to supporting cooperative advocacy and industry organizations.

CoBank's *Sharing Success* program matches contributions directed by our customers, making their local contributions go twice as far. Those investments help fund public safety equipment like thermal imaging equipment for the volunteer fire department in Centerville, South Dakota.

CoBank is also ready to lend a hand when disaster strikes. On March 16, 2017, CoBank announced the establishment of a \$150,000 matching fund to support wildfire relief in Kansas, Oklahoma and Texas. In Kansas, \$80,000 of that pledge matches contributions from the five Kansas Farm Credit associations. The remainder is available to match contributions from other customers, or Farm Credit banks or associations. We subsequently increased the size of the fund to \$200,000 in response to requests from customers who wanted to contribute to relief efforts.

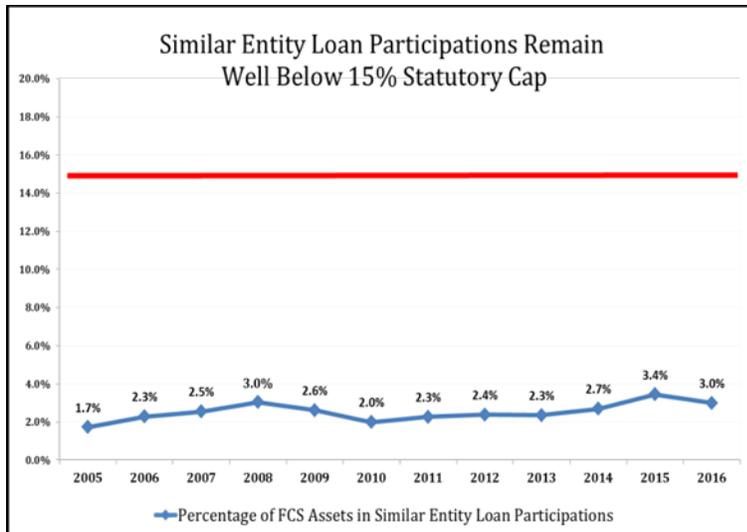
Moreover, like our Farm Credit partners, we focus on financial strength and stability to ensure we can be the dependable source of credit and financial services during our customer's good times and bad.

CoBank, like other Farm Credit institutions, however, face unique challenges when it comes to portfolio diversification. We are, as you, know limited by statute to financing agriculture rural utilities and other infrastructure companies. Therefore, given the nature of our authorities there is a natural and inherent concentration in the loan portfolio that we diversify through our participation authorities.

This leads me to the topic that I would like to focus the remainder of my testimony today on the "similar entity" participation authority that has been extended by statute to all Farm Credit institutions. Critics, especially trade associations from the commercial and community banking sectors, have frequently pointed to System participations under this authority as an indication that Farm Credit is straying beyond its mission. I respectfully submit that similar entity participations help fulfill Farm Credit's mission by providing a vital source of diversification.

Similar entity loan participations are an important way that commercial banks and Farm Credit partner to serve customers. Similar entity transactions support Farm Credit's mission by providing valuable diversification that helps ensure Farm Credit can support its core customers through good times and bad. The authority is especially important in the current environment as falling commodity prices are impacting the incomes of many of the farmers, ranchers, and agribusinesses we serve.

Similar entity loan participation authority is designed to encourage Farm Credit and commercial banks to partner on loans to entities that are not directly eligible to receive loans from Farm Credit but that are functionally similar to the entities that are eligible. The authority applies to all types of loans Farm Credit is eligible to make, including loans to agricultural and aquatic producers, certain agribusinesses, and rural infrastructure providers.



Congress placed significant restrictions on similar entity participation authority. Farm Credit cannot, in the aggregate, hold a majority of an individual loan in this category. Commercial banks must hold at least half of every similar entity loan. In other words, without directly partnering with commercial banks, Farm Credit cannot participate in any similar entity lending transactions.

We understand the concerns of some Members of Congress over the similar entity loan participation

involving Verizon made four years ago in 2013. Even though this transaction was fully authorized by law, we respect the views of the Congress and have imposed a variety of self-discipline measures that support the Farm Credit Administration’s expectation of robust due diligence regarding the size and scope of similar entity loan participation activities while preserving their value as a diversification tool.

Congress also mandated a hard limit on the aggregate amount of similar entity transactions any Farm Credit institution can hold to no greater than 15 percent of its total assets.

Similar entity participation authority has existed for nearly 25 years and, as the chart above demonstrates, today only 3 percent of Farm Credit’s assets are invested in similar entity participations.

Farm Credit uses similar entity loan participation authority in a limited manner to diversify loan portfolios, withstand industry downturns, and continue serving core customers. It is a small but meaningful way we are able to build the financial strength necessary to support customers during the kind of cycle we are experiencing right now in agriculture.

Along with benefits from portfolio diversification for mission achievement, similar entity lending is important in providing support for rural infrastructure that CoBank is expected to serve. The U.S. rural economy encompasses far more than production agriculture; rural communities also depend on power, water, and communications services in order to remain vibrant and competitive.

The area of greatest change and impact for rural infrastructure is communications services. In the rural communications space, our directly eligible borrowers include small, medium, and large carriers that provide communications services to rural areas. However, rural communications has evolved tremendously over the past two decades due to disruptive technology change and the transition of the industry away from the old utility-based business model of local phone service. The proliferation of broadband and mobile technology has fundamentally altered the requirements of consumers, and they have reshaped the industry as well, changing the appearance of those providers – CoBank customers – which serve rural America.

Similar entity authorities not only support mission service through portfolio diversification but also through support of needed rural infrastructure services, including within the communications and broadband sectors. That infrastructure is critical to enabling farmers to take advantage of the latest

technology to increase their efficiency. That broadband is critical to providing telemedicine services so people can live in their rural communities longer. And that communications technology is important to draw young people back to rural communities, to enhance the education of their children, and to power the new web-supported jobs that are possible anywhere.

Congress was visionary when it established Farm Credit more than a century ago. That vision has helped produce great productivity in rural America. A quarter-century ago Congress provided similar entity authority to help Farm Credit diversify, manage risk, and today serve our mission in ways unimagined in 1992. And today, there still remains a need for capital investment in rural communities across this country. CoBank is proud to stand ready with our partners in Farm Credit to meet those needs.

Thank you for the opportunity to testify and I would be happy to address any questions from the Committee.