



# FARM CREDIT ASSOCIATIONS OF KANSAS

*Lending support to rural America*

House Financial Institutions Committee

RE: Overview of the Farm Credit System

January 29, 2013

Submitted by: Greg Reno, Regional Vice President  
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Wichita, Kansas

Chairman DeGraaf and members of the Committee, thank you for the opportunity to join you today to share information about the Farm Credit System. I am Greg Reno, Regional Vice President of American AgCredit, Wichita, Kansas. I am here on behalf of the Farm Credit Associations of Kansas – six autonomous financial services cooperatives that finance agriculture. Each of our associations is a part of the national Farm Credit System, with retail offices across the state and service to farmers and ranchers in every Kansas county. (Illustration A, attached). Our six associations represent more than \$3.3 billion in loan volume to more than 15,000 farmer and rancher customer-owners.

Those of you who are students of U.S. History may remember that President Theodore Roosevelt formed a Country Life Commission in 1908 to investigate ways to make country life more attractive. The issues in rural America were of importance, and concern, to the President who believed that rural American was the “backbone of our nation’s efficiency.” Presidents Taft and Wilson continued the study of rural matters and sent commissions of ambassadors to Europe to study cooperative land-mortgage banks, rural credit unions, and other institutions that promoted agriculture and rural development. The administration of President Wilson recommended a system of agricultural banks to provide both long-term, or land-mortgage credit, and short-term credit to meet recurring needs. The national government recognized the need for a stable, dependable, reliable source of long-term credit for farmers and ranchers – many of whom had limited access to competitive credit. Congress responded with the Federal Farm Loan Act of 1916.

The purpose of the act was “To provide capital for agricultural development, to create a standard form of investment based upon farm

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*Attachment 1  
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mortgage, to equalize rates of credit upon farm loans, to furnish a market for United States bonds, to create Government depositaries and financial agents for the United States, and other purposes." Thus, hundreds of National Farm Loan Associations were formed to be agents for Federal Land Banks. Part of each farmer's loan bought stock in the association, making the individual farmers owners of the association. That farmer and rancher ownership remains the governance model of Farm Credit associations today. The Farm Credit System has a mission to provide a dependable source of credit to agriculture and rural America, with a special public purpose concerning Young, Beginning and Small Farmers. While authorized by the U.S. Congress as a Government-Sponsored Enterprise (GSE), the Farm Credit System is a network of financial cooperatives, owned and operated by the very same farmers, ranchers and rural customers it serves. This unique structure keeps the Farm Credit System involved in the industries we finance and local communities we serve.

The first U.S. Farm Credit land loan was made in Pawnee County, Kansas, in 1917. There have been revisions and updates to Farm Credit since 1916, but the mission of the Farm Credit system continues to be the availability of stable, dependable and reliable credit. Within that mission, I'd like to explain the structure, governance and regulatory oversight of Farm Credit.

The structure of Farm Credit has changed somewhat in the last century, as have the needs and demands of farmers and ranchers. Independent Farm Credit Associations are borrower-owned and controlled cooperatives. The Association is a member-owner of a Farm Credit Bank from which dollars are secured to loan to farmers, ranchers and residents of rural America. The Farm Credit Banks acquire funds from the Federal Farm Credit Funding Corporation, which sells bonds to gain the dollars needed by banks. (Illustration B, attached.) Both Farm Credit entities and commercial banks can acquire funds in such a manner. The commercial banks are able to do so through the Federal Agricultural Mortgage Corporation, a government-sponsored enterprise (GSE) commonly known as Farmer Mac. Commercial banks also buy and sell loan participations from and to Farm Credit entities. Two major differences between Farm Credit institutions and our commercial bank competitors are 1) that Farm Credit is prohibited from taking deposits thus do not have access to those funds to loan to customers and 2) Farm Credit only loans to agriculture and rural America.

7 Farm Credit governance reflects the cooperative principle of one member, one vote. Association boards are elected by stockholders – regardless of loan size or type, each borrower has one share and one vote. In addition to the elected board members, there are appointed directors, chosen for the outside expertise they can bring to the board room. These may be attorney, accountants, economists or business owners who enhance board diversity. Boards hire a President/CEO to manage the business of the association. Farm Credit Associations are first committed to being a financially-strong entity committed to the long-term needs of agriculture and rural America. A portion of the profits of many Farm Credit Associations, including those in Kansas, are returned to stockholders in the form of patronage. Last year \$20.2 million in patronage dividends were returned to borrower-owners in Kansas.

7 Farm Credit Associations and Farm Credit Banks are regulated by the Farm Credit Administration (FCA), the independent federal regulatory agency overseeing the safety and soundness of the Farm Credit System. It has the full range of regulatory and enforcement authorities similar to other federal banking regulators and regularly examines the operations of Farm Credit institutions to ensure compliance with regulations and law. The Farm Credit Administration is under the jurisdiction of the U.S. Senate and House Committees on Agriculture. FCA receives no federal dollars, but

is funded through assessments paid by Farm Credit Institutions. The regulator requires strong capitalization requirements and scrutinizes the eligibility of loans that are made by entities.

Further, the Farm Credit System is the only GSE with a self-funded insurance fund. The insurance fund is administered by an independent federal government controlled corporation. Neither the System nor the insurance fund has a back-up borrowing line with the U.S. Treasury similar to what commercial banks have protecting their deposits. Farm Credit is truly a self-insured system. Regulatory reforms have been included in legislative updates through the history of Farm Credit, including the Agricultural Credit Act of 1987, which addressed troubled institutions. The Act also strengthened borrower rights. As an aside, federal dollars that were infused into the Farm Credit System during the 1980s ag crisis were paid in full back to the U.S. Treasury with interest and ahead of schedule.

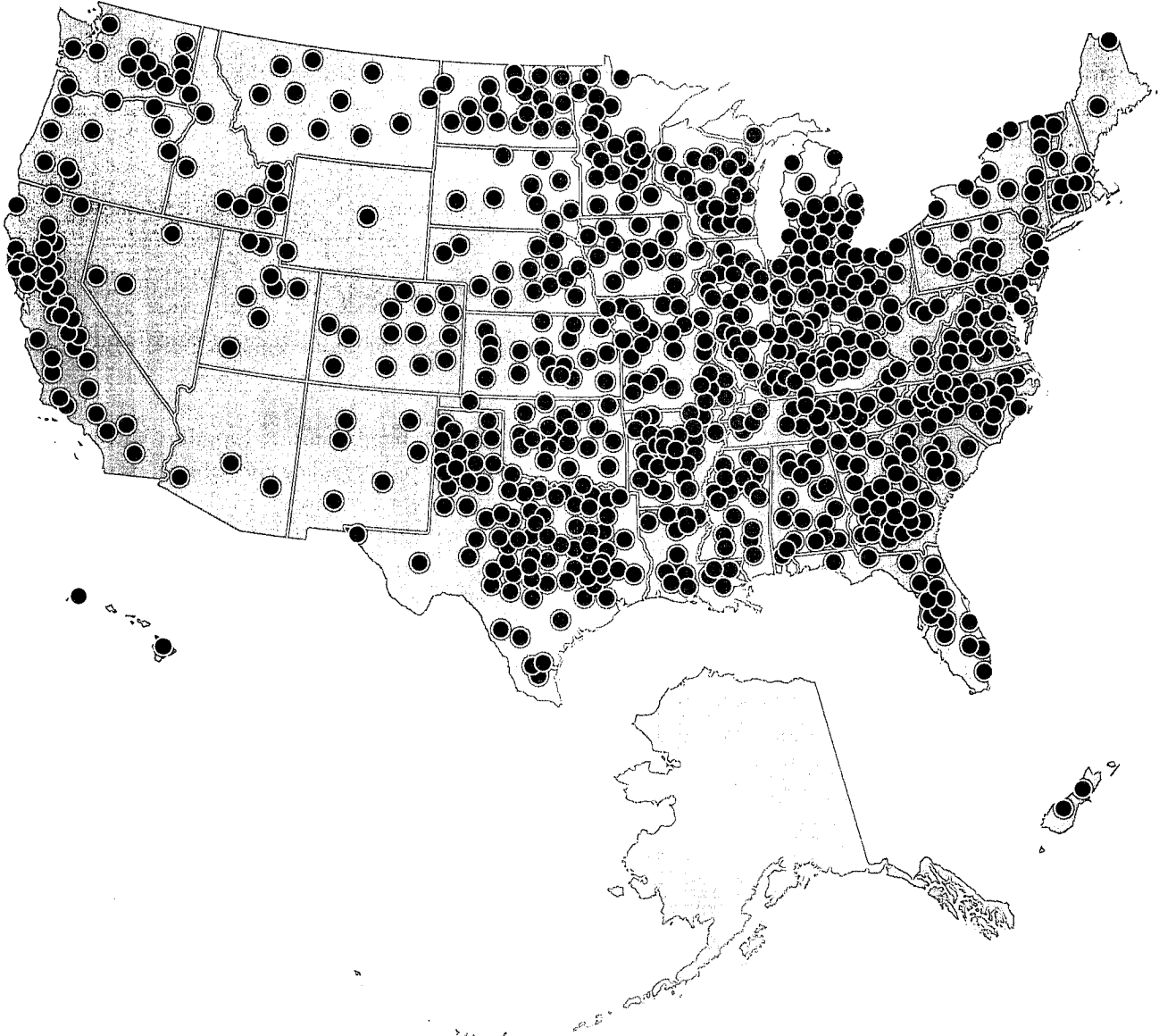
As is detailed in the legal review by attorney Martin Ufford (Illustration C, attached) federal land banks are federal instrumentalities. As such, the land bank comes under regulation of the federal government and is granted protections and privileges afforded by federal statutes. Further, a portion of our portfolio is subject to tax, specifically our short-term loans and all direct loans made by CoBank. And, Farm Credit associations pay property taxes on association buildings, fixtures and vehicles that dot the landscape of rural Kansas.

Prior to the inception of the Farm Credit System, and throughout nearly century-long history of serving farmers and ranchers, the U.S. Congress has maintained a public policy encouraging multiple sources of credit to ensure that farmers, ranchers, and rural America have access to credit. Through the most recent financial crisis of 2008, the Farm Credit System continued to provide funds to rural America without delay and without any government support. It is vitally important to maintain that system with the appropriate provisions set forth in U.S. statutes. We have a very specific mission and we do that well, with an eye to safety and soundness. The private ownership of ag real estate is the bedrock of American agriculture. The ability to obtain long-term financing so that farmers and ranchers can continue to hold that land and maintain those farm or ranch enterprises sometimes for generations is the reason that many of us come to work every day.

Mr. Chairman and members of the committee, thank you for your attention today and, more importantly, for your interest in the state's number one industry: agriculture.

Thank you for your time today and I'd welcome the opportunity to answer questions you might have at this time.

# Farm Credit Locations Map



Please note, this document represents an approximation of Farm Credit locations in the U.S. and Puerto Rico. Please visit [FarmCredit.com/locations](http://FarmCredit.com/locations) to find the Farm Credit branch that serves your area.

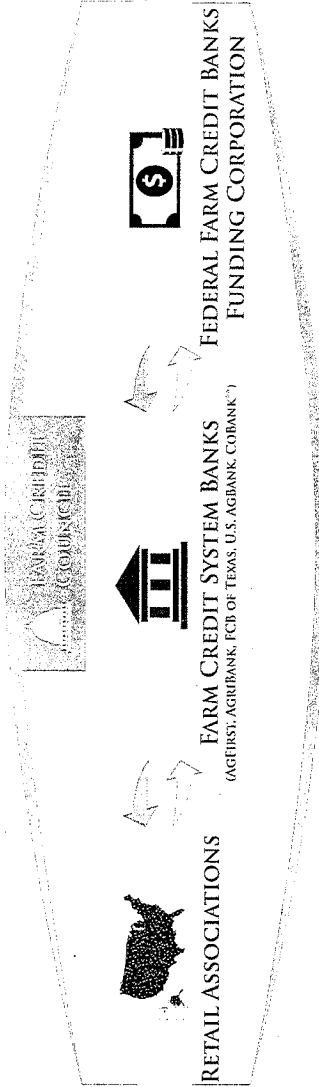
Updated January 2012

# FARM CREDIT SYSTEM FLOW OF FUNDS



REGULATED BY FCA | REPAYMENT | LOANS | FUNDS

U.S. CONGRESS  
 FARM CREDIT ADMINISTRATION (REGULATOR)



**MEMBER BORROWERS**  
 (COOPERATIVE OWNERS)\*\*

**RETAIL ASSOCIATIONS**

**FARM CREDIT SYSTEM BANKS**  
 (AGFIRST, AGRIBANK, FCB OF TEXAS, U.S. AGBANK, COBANK\*)

**FEDERAL FARM CREDIT BANKS**  
**FUNDING CORPORATION**

**SELLING**  
**GROUP DEALERS**

**U.S. AND**  
**GLOBAL INVESTORS**

\* Federal, state, and local banks, and branches, rural utility systems & subsidiaries  
 \*\* CFBank has lending authority to assist in their districts District as well as nationwide lending  
 authorities to agricultural cooperatives, rural utilities, and other eligible borrowers

**Federal Land Bank Association Mortgage Tax Exemption Background**  
**JANUARY 22, 2013**

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The members of the Farm Credit Associations of Kansas are part of the Federal Farm Credit System which was originally established by the United States Congress in 1916.

The Federal Farm Credit System is comprised of several types of entities including: (a) CoBank, which makes loans to large and small cooperatives throughout the nation, including the state of Kansas; (b) Production Credit Associations, also called PCAs, which make short and intermediate term loans to farmers and ranchers. PCA loans are used to finance capital purchases such as tractors and combines, and to pay operating expenses such as the costs of fertilizer, seed, and feed for livestock; and (c) CoBank, which provides funds to PCAs to loan to their farmer-rancher borrowers.

Another type of Federal farm credit institution are the Federal Land Bank Associations , which are also known as Federal Land Credit Associations. These Federal farm credit institutions are authorized to make real estate mortgage loans with maturities of not less than 5 years nor more than 40 years as provided by federal regulation 12 C.F.R. § 614.4030.

Of all of the Federal farm credit entities, Congress has declared only mortgages owned by the Federal Land Bank Associations to be exempt from state mortgage registration taxes.

Specifically, 12 U.S.C. 2098 provides:

#### TAXATION.

Each Federal land bank association and the capital, reserves, and surplus thereof, and the income derived therefrom, shall be exempt from Federal, State, municipal, and local taxation, except taxes on real estate held by a Federal land bank association to the same extent, according to its value, as other similar property held by other persons is taxed. **The mortgages held by the Federal land bank associations and the notes, bonds, debentures, and other obligations issued by the associations shall be considered and held to be instrumentalities of the United States and, as such, they and the income therefrom shall be exempt from all Federal, State, municipal, and local taxation**, other than Federal income tax liability of the holder thereof under the Public Debt Act of 1941 (31 U.S.C. 3124).

All other Federal farm credit entities must pay mortgage registration taxes for their borrowers' mortgages.

Just like commercial banks, CoBank and the Production Credit Associations pass on the cost of the mortgage registration taxes they pay to their customer-borrowers. At current rates (.26% of the principal amount of the mortgage), the mortgage registration tax on a \$100,000 mortgage would be \$260.26, and the mortgage registration tax on a \$1,000,000 mortgage would be \$2600.00.

The Kansas Attorney Generals have issued several opinions throughout the years which recognize that Federal land bank associations and other federal instrumentalities are exempt from paying state mortgage registration taxes. As recently as 2009, Attorney General Opinion 2009-6 stated in part:

**Kansas law requires that a registration fee, currently .26% of the principal debt or obligation, be paid before any mortgage of real property, or renewal or extension of such a mortgage, is filed for record with a register of deeds in the county where such property is located.** n1 However, the statute also provides for a number of exemptions from this fee, including "any mortgage for which the registration fee is otherwise not required by law." **Federal instrumentalities that serve as lenders, such as the Home Owners Loan Corporation and the Federal Land Bank, have long been considered to fall within this exemption.** (citing *Home Owners' Loan Corporation v. Anderson*, 145 Kan. 209 (1937); *Federal Land Bank of Wichita v. Thompson*, 12 Kan.App.2d 561 (1988); and Attorney General Opinion Nos. 77-103, 86-78 and 87-190.)

Kansas Attorney General Opinion 86-78 states in part:

**Synopsis: Federal law prescribes that federal land banks are exempt from state taxation, except for those taxes or real estate held by a federal land bank. In that federal law supersedes inconsistent state law, and that the Kansas mortgage registration fee is a tax on an intangible, the federal land bank must be allowed to register its validly executed mortgages in Kansas without being required to pay mortgage registration fees, and such mortgages are enforceable in Kansas courts. Cited herein: K.S.A. 79-3101, 12 U.S.C. §§ 931, 2011, 2055.**

\* \* \* \* \*

For most purposes, federal land banks are federal instrumentalities. 12 U.S.C. § 2011. As such, the land bank comes under regulation of the federal government and is granted protections and privileges afforded by federal statutes. One such protection is from the plenary power of the state to tax; one such privilege is that of immunity from state taxation at the discretion of Congress. *Federal Land Bank v. Board of County Comm'rs*, 368 U.S. 146, 149, 82 S.Ct. 282, 7 L.Ed.2d 199 (U.S. Kan. 1961). Kansas has held that this protection and privilege extends to instrumentalities to exempt them from paying taxes on mortgages offered for registration. *Home Owner's Loan Corp. v. Anderson*, 145 Kan. 209 (1937). These protections and privileges are codified for land banks at 12 U.S.C. § 2055 (essentially a recodification of 12 U.S.C. § 931) which states:

"Every federal land bank and every federal land bank association and the capital, reserves and surplus thereof, and the income derived therefrom shall be exempt from federal, state, municipal, and local taxation, except taxes on real estate held by a federal land bank or a federal land bank association to the same extent, according to its value, as other similar property held by other persons is taxed."

Thus, the only state tax the Federal land bank is required to pay is one placed on real estate.

The Kansas mortgage registration fee is a tax. *Berger v. Bierschbach*, 201 Kan. 740, 745 (1968). It is not a fee charged for the administrative work necessary to protect land titles with mortgages. *Home Owners' Loan Corp. v. Anderson*, 145 Kan. 209, 210. The mortgage registration tax is imposed upon the mortgage instrument. See, Attorney General Opinion No. 79-84. In that the federal land bank is a federal instrumentality immune from state taxes other than those placed upon real property, 12 U.S.C. § 2055, and the mortgage registration tax is imposed upon the instrument evidencing debt upon the real property, but not on the property itself, the land bank is not required to pay mortgage registration fees on mortgages it holds.

\* \* \* \* \*



Since federal law supersedes inconsistent laws of the state, it is our judgment that the federal land bank must be allowed to register its mortgages in Kansas without being required to pay mortgage registration taxes and is protected from the usual consequences for failure to pay mortgage registration taxes. It is our opinion, therefore, that all validly executed federal land bank mortgages may be filed without payment of the mortgage registration fee, and such mortgages are enforceable in Kansas courts.

Kansas Attorney General Opinion No. 77-103 states in part:

**Synopsis: The mortgage registration fee is a tax upon the debt or obligation secured by the instrument offered for recording, and is in lieu of all other taxation upon that debt.** The tax is paid by the owner of that debt, who pays the tax at the time of recording a lien against real estate to secure payment. **Where an agency of the federal government owns the debt, a state may not tax the federal agency in securing payment of that debt.** It is different where a private bank loans the money, owns the debt, seeks to record a mortgage lien to secure payment, and claims exemption because the Farmers Home Administration, a federal agency, has guaranteed repayment of the loan. The imposition of the registration tax on the bank is no direct burden on the federal agency, nor does it impair its usefulness. The bank cannot clothe itself with the immunities of the agency.

\* \* \* \* \*

Where a federal agency makes the loan itself, owns the obligation, and takes a mortgage on the borrower's land to secure repayment of the loan to the agency, there is no question but that the general rule, of exemption of federal agencies and instrumentalities from state or local taxation, applies. *Home Owners Loan Corp. v. Anderson*, 145 Kan. 209, Syl. #1, 64 P.2d 14 (1937).

**But we do not have that situation here. This mortgagee is a private bank. It has loaned its own money to a private borrower. It wants a mortgage recorded against land to secure repayment of its loan. Even if the borrower be an exempt body, this does not excuse the private bank from the registration tax.** *Assembly of God v. Sangster*, 178 Kan. 678, 680, 290 P.2d 1057 (1955). It is the mortgagee who is interested in recording a mortgage, and it is he who pays the fee.

The registration tax is imposed, not directly on the FHA, but directly upon the bank. **This tax does not** burden any governmental function of the federal agency, or impair its usefulness and efficiency, or **frustrate the purpose of national legislation.** *Clinton v. State Tax Comm.*, 146 Kan. 407, 71 P.2d 857 (1937), cited in support of text in 84 C.J.S. 396, Taxation, Sec. 207. Federal Agencies.

In contrast with the mortgage registration tax exemption provided under federal law for Federal land bank associations, the Kansas Attorney General has properly recognized that mortgages

owned by other Federal Farm Credit Act institutions such as Banks for Cooperatives (CoBank) and Production Credit Associations are not exempt from the payment of the mortgage registration tax.

Attorney General Opinion 88-60 states in part:

**Synopsis: Banks for cooperatives are not so closely connected to the federal government to entitle them to constitutional immunity from state taxation, nor are they exempt from payment of mortgage registration tax by virtue of 12 U.S.C.A. § 2134 (West Supp. 1988). Language in Attorney General Opinion No. 87-190 indicating a contrary conclusion for production credit associations in hereby withdrawn.**

The Kansas Attorney General Opinions are consistent with federal and state appellate court from Kansas as well as other states. In *Blake v. Federal Land Bank of Springfield*, 469 N.Y.S.2d 908 (N.Y. 1983) a New York court held:

**In case of conflict between the Farm Credit Act and State law, the Federal law will control.** (US Const, art VI; 9 CJS, Banks & Banking, § 885, subd a, par [1], p 1373.)

Likewise, in *Federal Land Bank of Wichita v. The Board of County Commissioners of the County of Adams*, 788 F.2d 1440 (10<sup>th</sup> Cir. 1986) the United States Court of Appeals for the Tenth Circuit (which includes the state of Kansas) stated:

**A state cannot tax a federal instrumentality absent permissive federal legislation.** *First Agricultural National Bank v. State Tax Commission*, 392 U.S. 339, 340, 20 L. Ed. 2d 1138, 88 S. Ct. 2173 (1968)...

**A state law classification that defies reason or manipulates legal labels with a discriminatory intent to avoid federal immunity from tax can, of course, be questioned.** *City of Detroit v. Murray Corp.*, 355 U.S. 489, 492, 2 L. Ed. 2d 441, 78 S. Ct. 458 (1958); *Reconstruction Finance Corp.*, 328 U.S. at 210.

Like the Court of Appeals, the Kansas Attorney General has recognized that what cannot be done directly must not be permitted to be done indirectly. Attorney General Opinion 88-278 provides in part as follows:

**SYNOPSIS:** An option to purchase land may be an executory contract subject to the mortgage registration tax when offered for recording. Such tax cannot be avoided by

recording an affidavit or executed memorandum, which incorporates by reference the existence of an option of purchase, but which discloses none of the details of such purchase agreement. The Register of Deeds must require a complete disclosure of the purchase agreement referred to, and, if such disclosure is not made, refuse to record such affidavit or memorandum.

\* \* \* \* \*

We believe that this "Memorandum of Purchase Option" may be just another attempt to avoid the Mortgage Registration Tax. **What cannot be done directly must not be permitted to be done indirectly.** To administer the law properly, the Register of Deeds must examine the option contract itself, not a "memorandum" of it.

As the court decisions, statutes, and Attorney General Opinions quoted above indicate, there can be no question that mortgages owned by Federal Land Bank Associations are exempt from mortgage registration tax, and any attempt to circumvent that tax by charging the associations' customers the amount of the registration tax will not be permitted by the courts.

Why is there a mortgage registration tax exemption for long term real estate loans funded by Federal land bank associations? To answer this question, we need to look at the purposes behind the Federal Farm Credit Act as stated by Congress.

The introductory section of the Federal Farm Credit Act which states the policies and objectives of the Federal Farm Credit System are found in 12 U.S.C. § 2001 which provides:

**POLICY AND OBJECTIVES.—**

(a) It is declared to be the policy of the Congress, recognizing that a prosperous, productive agriculture is essential to a free nation and recognizing the growing need for credit in rural areas, **that the farmer-owned cooperative Farm Credit System 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, their cooperatives, and to selected farm-related businesses necessary for efficient farm operations.

(b) **It is the objective of this Act to continue to encourage farmer- and rancher-borrowers participation in the management, control, and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers** having a basis for credit, and to modernize and improve the authorizations and means for furnishing such credit

and credit for housing in rural areas made available through the institutions constituting the Farm Credit System as herein provided....

In its wisdom, Congress has determined that one way of meeting these stated objectives is to provide an exemption for mortgage registration taxes only for, the Federal Land Bank Associations which are the Federal Farm Credit System's lenders authorized to make long-term real estate loans to farmers and ranchers.

As indicated previously, if the Federal land bank associations were not exempt, the cost of any mortgage registration tax would be passed on to their borrowers, just like commercial banks, as well as the other Federal farm credit institution such as CoBank and the Production Credit Associations. This results in the Federal land bank association borrowers paying less for the same amount of credit for loans secured by real estate mortgages in Kansas. While commercial lenders might not like this result, the proper venue for them to argue a change in this law is with the Congress of the United States; and not the Kansas Legislature.

The state of Kansas has long been a leader in agricultural production, and has long recognized that the farmers and ranchers in this state are a critical part of our economy. In this time of drought conditions affecting much of our state, and financial uncertainty at both state and national level, the last thing our farmers and ranchers need is another tax imposed upon them either directly or indirectly as advocated by the Kansas Bankers Association. This would be especially true for a tax that would violate the spirit and intent of federal law and which would be found unconstitutional for the reasons previously recognized by Kansas Attorney Generals from both parties.