APPENDIX 4

Answers to questions on notice received from the Department of Agriculture

Department of Agriculture

Committee inquiry: Senate Economics Legislation Committee inquiry into the Reserve Bank Amendment (Australian Reconstruction and Development Board) Bill 2013

Date Held: 18 March 2015

Question Taken on Notice

Question:

Senator XENOPHON: Firstly, why didn't we get a submission on this earlier? Can you explain that to me?

Mr Padovan: I cannot answer that one.

Senator XENOPHON: Who can? Maybe you can get back to me as to why there was a decision made not to provide a submission to this inquiry. That would be useful. Dr McGovern says that there is very little public data that is available on the performance of rural loans. Ms Schneider, do you disagree with that? Do you believe that there can be a more comprehensive picture of rural loans other than has been provided to date?

Answer:

The department does not routinely submit to all inquiries and takes into consideration; whether the department is the lead agency, information currently available and its capacity to contribute.

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Mr Padovan: I would have to go back and look at the timings around Basel III.

Senator XENOPHON: Could you take that on notice as to when Treasury and your department will be having discussions about Basel III and the impact on rural debt.

Answer:

The current prudential framework is based on the principle that banks are required to hold more capital against riskier lending. Overall compared with residential mortgages, business loans may have higher risk weightings because of the additional risks present.

The Basel III capital framework sets out internationally-agreed minimum requirements for higher and better quality capital for banks globally. The Australian Prudential Regulatory Authority’s application of Basel III came into effect in Australia in January 2013 and has been largely implemented.

Treasury is continuing to monitor global developments in capital rules and is consulting with industry on the recommendations in the Financial System Inquiry. Treasury has indicated that it will engage with the Department of Agriculture as regulatory standards are progressed.

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Question:

CHAIR: But you really do not know whether you are replicating what other countries like Canada and the US are doing in this space. Can you have a look at that? Can you have a look at where you are at variance with those models that operate in those two bodies and perhaps give us a one-page brief, on notice?

Answer:

The Department of Agriculture has worked with Treasury to provide the following high-level summary based on publicly available information of the current farm credit systems in the United States of America and Canada.

US Farm Credit System (FCS) and Farm Credit Canada (FCC): comparisons with Australian Government Concessional Loans

- **US Farm Credit System (FCS)**
- The FCS was established in 1916 to provide below market-cost loans and credit to the US agriculture sector. It operates as a nationwide network of cooperative borrower/farmer owned, government-sponsored lending institutions. The cooperatives were created to spread risk and ensure the FCS was only partially underwritten by the US government.
- The US Federal Agricultural Mortgage Corporation, commonly known as 'Farmer Mac', was established in 1987 as part of the FCS, as the 1980s farm recession sent the government-backed FCS into crisis. It operates as a secondary credit market of cheap liquidity and lending capacity for FCS lenders, so it can meet demand from the agriculture sector for credit and long-term loans at stable interest rates and terms.
- Farmer Mac conducts its business primarily through two programs:
    - Farmer Mac I, in which Farmer Mac purchases, or commits to purchase, qualified agricultural or rural housing mortgage loans, or obligations backed by qualified loans
    - Farmer Mac II, in which Farmer Mac purchases the portions of qualified loans that are guaranteed by the U.S. Department of Agriculture

- Farmer Mac guarantees the timely payment of principal and interest on securities backed by qualified loans or guaranteed portions, and either retains those securities in its portfolio or sells them in the secondary capital markets.
- Farmer Mac also purchases non-performing loans from stressed lenders and provides US Government guarantees on those loans to prevent the cost of credit rising in the FCS and the system becoming unsustainable as it did in the 1980s.
- Farmer Mac does not lend directly to farmers, but effectively acts as a 'lender of last resort' given it can purchase non-performing loans from other lenders.
- There is risk that, as a holder and guarantor of non-performing loans, ongoing cheap credit creates an artificial market of low cost loans that are not viable in the long term.

- **Farm Credit Canada (FCC)**
- Farm Credit Canada (FCC) is Canada's largest provider of business and financial services (including loans) to farms and agribusinesses. FCC is financially self-sustaining, raising funds on public markets, as well as borrowing from the Canadian Government.
- It is argued that FCC operates on a semi-commercial basis, as it borrows from the Canadian Government at preferential rates or issues debt backed by it. It is therefore able to fund riskier loans as the expected return, minus funding costs, is higher than for private competitors, and provides loan products which have higher risks of default (i.e. those with long amortization periods, higher loan-to-value ratios, and interest-only periods).
- FCC argues it is not a lender of last resort as it charges a premium on its lending, assesses credit history, past/projected financial performance, off-farm income and security. It argues it should not become a lender of last resort as it would expose taxpayers to more risk; its current practice of lending to varying sized customers and sectors spreads risk.
- FCC provides specialised and personalised business and financial services and products to farming operations, including family farms, and to those businesses in rural Canada, including small and medium-sized businesses, that are businesses related to farming and that provide the inputs to and outputs from primary production and young farmers (below the age of 40).
- The FCC product portfolio includes: lines of credit, crop input finance, livestock purchases, equipment finance, farm transfer finance, land and building purchase, environmental solution finance to assist in switching to more environmentally sound practices and renewable energy resources. There are various intermediate and long-term loans, with lending periods as long as 29 years

- **Australian Government Concessional Loans Schemes**
- The Australian Government's concessional loans provide short-term, targeted assistance to farm businesses suffering financial hardship but which have sound prospects of returning to commercial viability.

- The two drought-related concessional loans schemes are targeted at those farm businesses experiencing significant financial impacts due to circumstances that are outside the ability of a farm business to reasonably prepare for, manage through and recover from.
- The loan can be for no more than 50 per cent of a farm business's debt; is limited to debt restructuring and/or productivity enhancements; is for a maximum of five (Farm Finance and Drought Concessional Loans Schemes) or ten years (Drought Recovery Concessional Loans Scheme); must be repaid in full at the end of the loan term.

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CHAIR: I would extend on that, Senator Madigan. Australian people regard the security of their food as a very high priority. In the context of berries recently, they would be somewhat shocked if they felt that the Australian government was not supportive of continuing a vibrant industry. We are going to have to wrap up shortly, but can you tell me the cost of the concessional loan scheme to the Australian taxpayer?

Answer:

Answer: The net cost of the concessional loans schemes (Farm Finance, Drought and Drought Recovery) to the Australian taxpayer over financial years 2013-14 and 2014-15 is $22.105 million. The actual cost in the out years of the programmes will be determined by the level of uptake under each scheme and levels of default and/or write-off.