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| **Type**: | Bookletter |
| **Section Number**: | BL-020 |
| **Section Title**: | Leasing Authority of Farm Credit Banks and Agricultural Credit Banks Operating Under Title I, and Direct Lender Associations |
| **Old/Additional ID**: | (Original # 404-OE) |

December 22, 1994

To: Chairman, Board of Directors

The Chief Executive Officer

Each Farm Credit Bank

Each Agricultural Credit Bank

Each Production Credit Association

Each Agricultural Credit Association

Each Federal Land Bank Association

Each Federal Land Credit Association

From: Marsha Martin, Chairman

Farm Credit Administration Board

Subject: Leasing Authority of Farm Credit Banks and Agricultural Credit Banks Operating Under Title I, and Direct Lender Associations

In recent months, the Farm Credit Administration (FCA) has addressed several issues concerning leasing programs administered by Farm Credit institutions. The purpose of this bookletter is to provide clarification of the statutory leasing authorities of Farm Credit Banks (FCBs), and Agricultural Credit Banks (ACBs) operating under Title I, and direct lender associations operating under Title II.

**Farm Credit banks and associations derive their leasing authorities from the lending provisions of the Farm Credit Act of 1971, as amended (Act).**

From time to time, there has been some confusion over whether leasing falls under a Farm Credit System (System) institution's lending authority or its authority to provide financially related services. This situation is partly due to the location of FCA regulation § 618.8050 under part 618. At this time, the FCA is clarifying that the System's leasing powers are derived from the lending provisions of the Act.

Sections [1.11](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%201.11.docx)(c)(2) and [2.4](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%202.04.docx)(b)(4) of the Act grant Farm Credit banks and associations, respectively, express leasing powers. The structure of the Act and its legislative history reveal that leasing is a separately enumerated power that supplements the lending authorities of FCBs, ACBs, and associations, not a financially related service pursuant to sections [1.12](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%201.12.docx) and [2.5](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%202.05.docx) of the Act. Leasing provides eligible borrowers with other options for financing the acquisition of facilities and equipment through either financing or operating leases.

The lending and leasing authorities are subject to the same requirements concerning: (1) the scope of financing; and (2) activities conducted outside an institution's chartered territory pursuant to 12 CFR [614.4070](http://ww3.fca.gov/readingrm/handbook/FCA%20Regulation/614.4070.docx). Furthermore, FCBs, ACBs, and associations may enter into lease transactions only with eligible borrowers who are bona fide farmers, ranchers, or aquatic producers or harvesters because of the statutory and regulatory requirement that the equipment or facilities leased must be needed in the lessee's operations.

**Leasing authorities of Federal Land Credit Associations (FLCAs) are not the same as those of Production Credit Associations (PCAs).**

When FCBs were created, they inherited separate and distinct leasing authorities from their constituent Federal Intermediate Credit Banks and the Federal Land Banks. As a result, FCBs and ACBs are authorized to make: (1) equipment leases pursuant to their short- and intermediate-term lending authorities; and (2) facility leases pursuant to their long-term real estate lending authorities. Under section [7.6](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%207.06.docx) of the Act, an FLCA assumes its transferor bank's authority to make and participate in only long-term real estate loans; therefore, it is only authorized to make long-term facility leases. The Federal Land Bank Associations have no express leasing authority.

The PCAs, under section [2.4](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%202.04.docx)(b)(4), are authorized to make only short- and intermediate-term equipment leases. The PCAs and FLCAs may operate joint equipment leasing programs as long as the PCA is the lessor or holds title to the leased assets in its name, and records all lease transactions on its balance sheet. The ACAs have authority to make both long-term facility and short- and intermediate-term equipment leases.

**Stock purchase is required by statute for some, but not all, leases.**

Section [1.11](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%201.11.docx)(c)(2) authorizes FCBs to lease facilities and equipment to "persons eligible to borrow"; whereas, section [2.4](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%202.04.docx)(c)(4) of the Act authorizes PCAs to lease equipment to "stockholders." Based on these authorities, the FCA has determined that stock purchase is not required for facility leases. With regard to equipment leases, stock purchase is required for those leases made by a PCA or ACA, but not those made by an FCB or ACB.

The minimum stock purchase requirement contained in section [4.3A](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%204.03A.docx)(c)(1)(E) applies only to "loans." For this reason, each PCA or ACA may determine the class and amount of stock that it will require for equipment leases. A PCA or ACA may require equipment lessees to purchase only a single share of stock provided that the association continues to meet its minimum permanent capital level under section [4.3](http://ww3.fca.gov/readingrm/handbook/Statutes/SEC.%204.03.docx) of the Act. Such stock requirements must be included in the institution's capitalization bylaws.

**The lending limit applies only to financing leases.**

Under FCA regulations in subpart J of part 614, financing leases must be included in the lending limit calculations of each System institution. Similarly, financing leases are treated as loans for the purpose of calculating Farm Credit System Insurance Corporation insurance premiums. Operating leases, which are ordinarily reported as fixed assets on an institution's balance sheet, should not be included in lending limit or insurance premium calculations.

Further basis for distinguishing between the two leases rests with their tax treatment. Rental payments under an operating lease are fully tax deductible to the lessee.1 A financing lease qualifies as a conditional sale under the Internal Revenue Code. Under such a lease, the lessee is permitted to deduct interest payments and depreciation on the equipment.

Those institutions that have addressed leasing in their financially related services and technical assistance policies should make the appropriate changes. In making such changes, FCBs will not be required to resubmit their policies to the FCA for prior approval.

If you have any questions, please call Charlotte Miller, Policy Development and Planning Division, at (703) 883-4483.

Copy to: CoBank-National Bank for Cooperatives

Springfield Bank for Cooperatives

St. Paul Bank for Cooperatives

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1 For tax purposes, an operating lease complies with the following requirements: (1) the lessor must expect to derive a profit from the transaction; (2) the lessee may not lend funds to the lessor to acquire the leased property, or guarantee the lessor's debt; (3) the lease should expire before the end of the economic life of the leased property so that the lessor's investment in the equipment remains at risk; (4) lease payments must amortize only the value of the equipment consumed during the lease term; (5) at the end of the lease, the lessee may not have the right to purchase the equipment for less than its fair market value; and (6) the lessee is not allowed to furnish any of the cost of the leased property, and the lessor cannot accept down payments or trade-ins.