FARM CREDIT CORPORATION

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GSE Access to Rural Markets

Panel Discussion

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The Capital Markets

Markets where capital (debt and equity) are traded.

Issuers

U.S. Government
Farm Credit System
Other U.S. Agencies
Municipalities
Banks
Corporations
Foreign Entities

Wall Street

Investors

Banks
Insurance Companies
Individuals
Trust Companies
Pension Funds
Mutual Funds
Money Market Funds
Municipalities
Corporations
Foreign Entities

Farm Credit Systemwide Debt Outstanding

($ Billions)

	5/31/96	12/29/95
Discount Notes	$15.6	$15.3
Monthly Bond Sales (1 year or less)	14.9	13.9
Monthly Bond Sales (over 1 year)	2.0	2.3
Medium-Term Notes	25.6	22.4
Specialized Funding	3.1	4.3
	$61.2	$58.2

Farm Credit System Debt Issued

($ Billions)

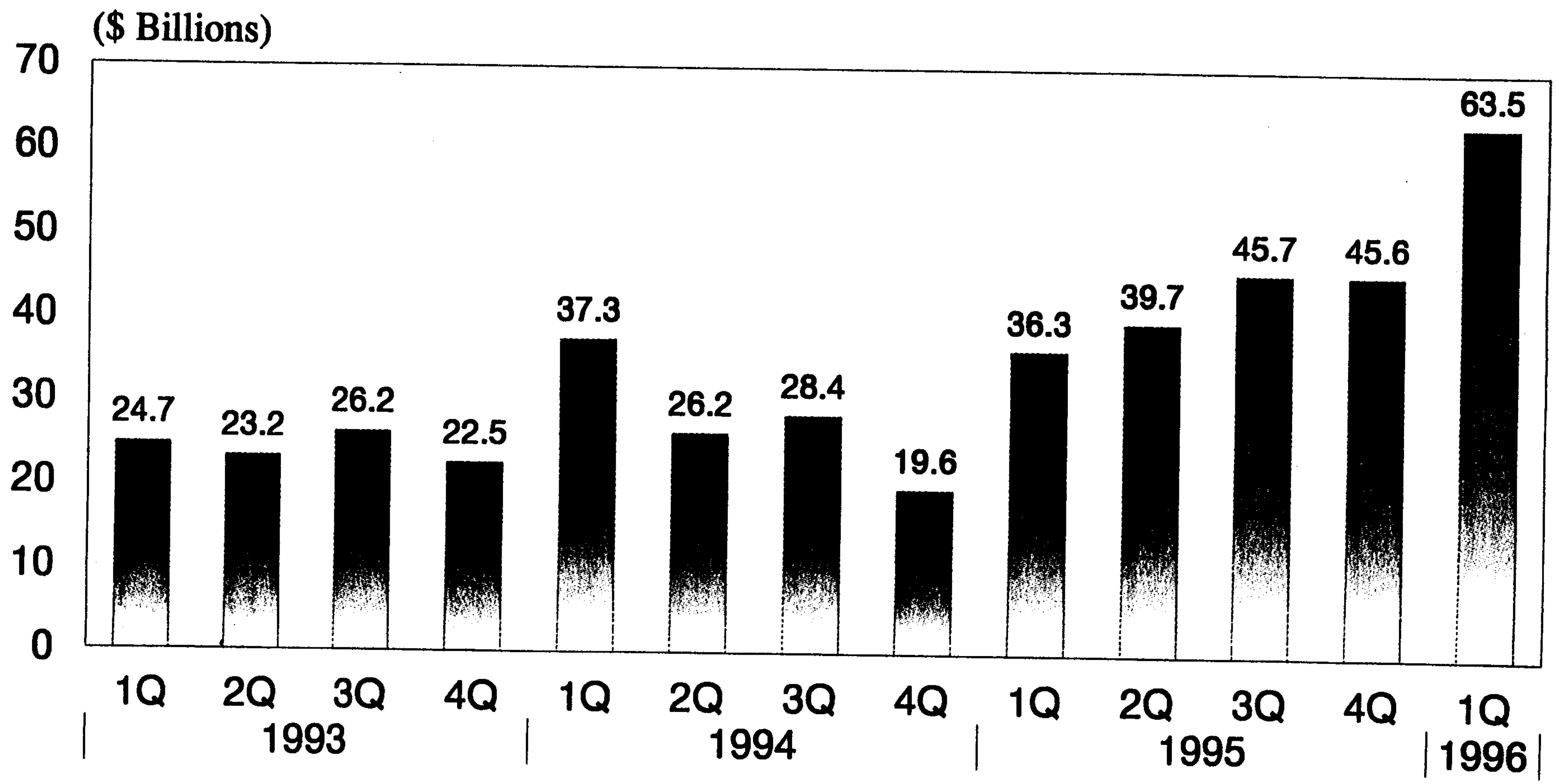
	5/31/96	1995
Discount Notes	$93.9	$198.5
Monthly Bond Sales (1 year or less)	13.3	28.7
Monthly Bond Sales (over 1 year)	0.0	0.0
Medium-Term Notes	9.2	13.0
Specialized Funding	0.8	2.5
	$117.2	$242.7

Farm Credit Systemwide Floating Rate Debt Outstanding

($ Billions)

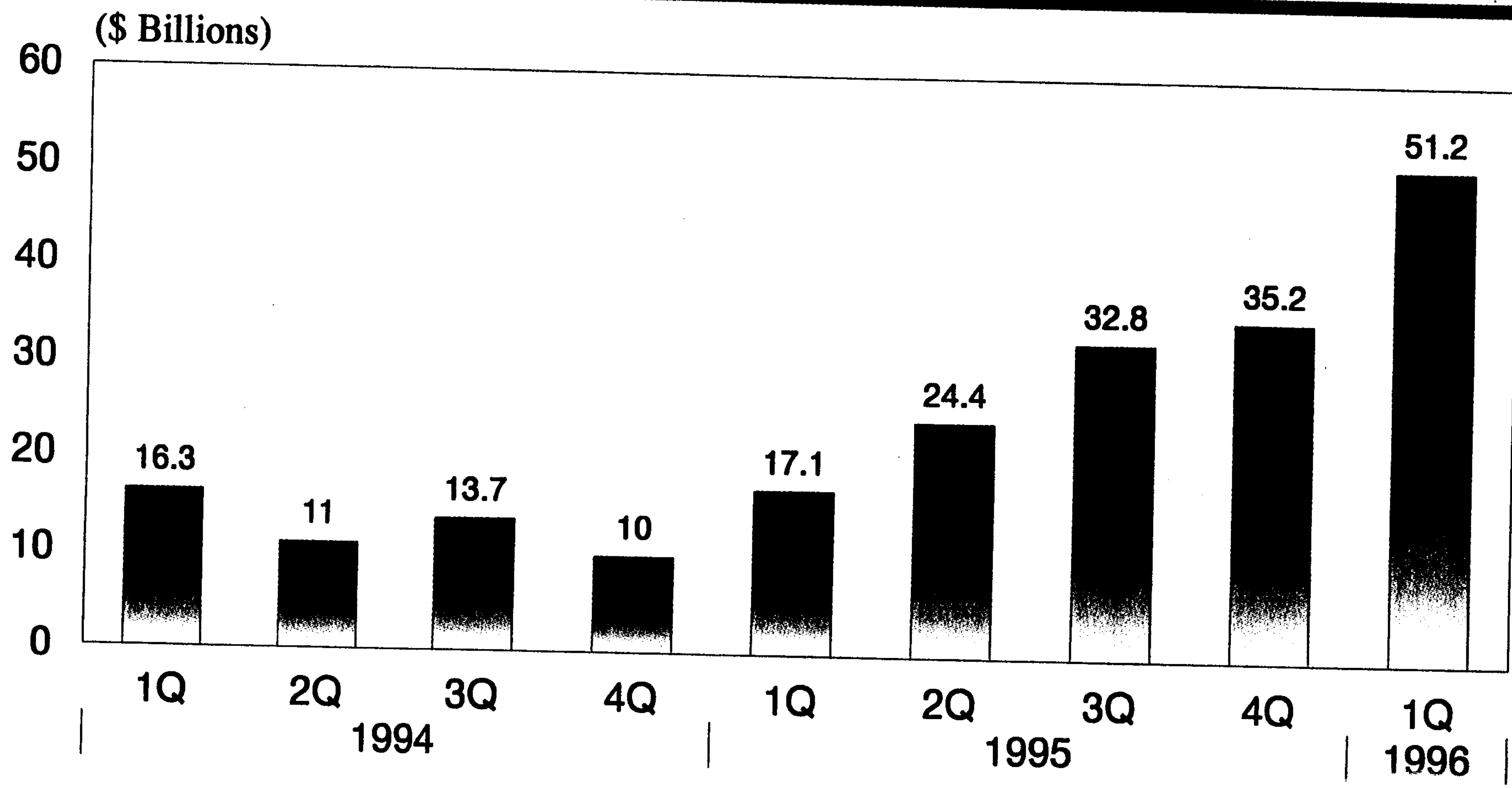
	May 31, 1996
Prime	$4.7
T-Bills	1.4
Fed Funds	1.1
LIBOR	1.1
COFI	0.5
	$8.8

Agency New Issue Volume



Source: Lehman Brothers

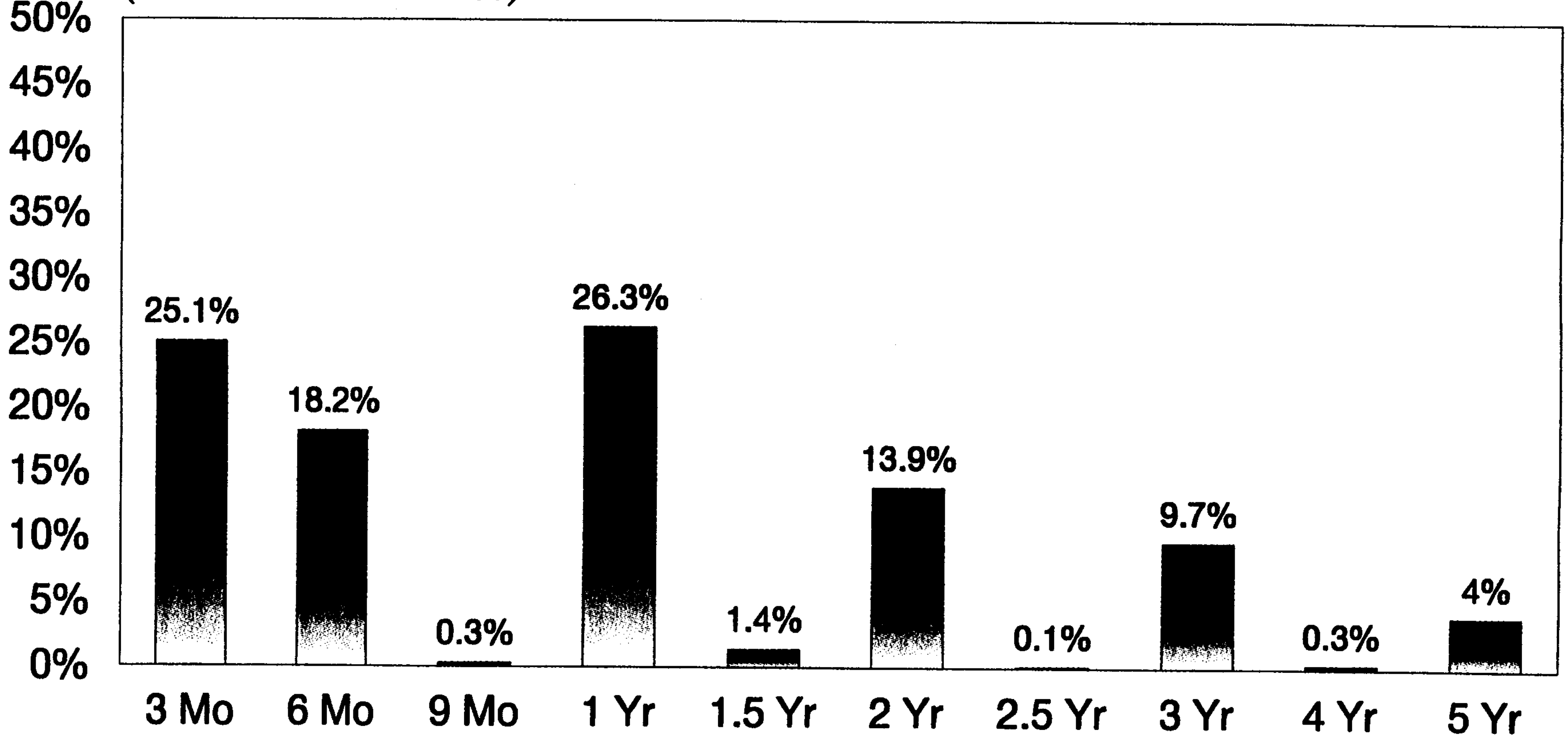
Fixed Rate Callable Debt Issuance



Source: Lehman Brothers

Distribution of Fixed Rate Callable Debt
by Lockout Period

(% of Callable Issuance)



Source: Lehman Brothers

Government-Sponsored Enterprise Debt Outstanding

($ Billions)

12/31/1995

	FNMA	FHLB	FHLMC	SLMA	FFCB
Discount Notes	$89	$66	$49	$1	$15
Bonds & MTNs	$210	$177	$70	$47	$43
Total	$299	$243	$119	$48	$58

12/31/1990

	FNMA	FHLB	FHLMC	SLMA	FFCB
Discount Notes	$38	$18	$19	$6	$15
Bonds & MTNs	$85	$101	$12	$33	$39
Total	$123	$119	$31	$39	$54

Farm Credit Specialized Funding

Gross New Issue Volume

	Year to Date May 31, 1996	1995
Fixed Rate Bullet	$1.8	$3.4
Floating Rate	3.6	6.2
Callable		
Fixed Rate	4.2	5.2
Step-Up	--	--
Index Amortizing - Fixed Rate	--	--
Complex Structured	--	0.1
Total	$9.6	$14.9

Farm Credit Systemwide Debt Outstanding
($ Billions)

	05/31/96	12/29/95
Discount Notes	$15.6	$15.3
Monthly Bond Sales (1 year or less)	14.9	13.9
Bullets	9.4	8.8
Callables	8.6	8.1
Floating Rate	8.8	7.4
Structured	3.1	4.0
Other	0.7	0.7
Total	**$61.1**	**$58.2**

Sources Of Lendable Funds For Banks

Discussant Remarks

Marvin Duncan[1]

The current credit environment is very favorable for commercial banks lending to agriculture. Banks have increased their share of farm loans among other lenders, having gained 21.3 percent from 1981. Commercial banks now hold 39.7 percent of farm loans in the United States. Most of the gain in market share has come at the expense of the Farm Credit System (FCS). The increase in portfolio share is particularly striking in real estate lending. Banks' real estate portfolios are up by 196.2 percent from their low point in 1982. Commercial banks now hold 14.8 percent of farm real estate debt, as compared to 16.1 percent for the FCS. Farm real estate lending has always been the strongest market for the FCS. To have gained near parity with the FCS in real estate lending is a major achievement for commercial banks in the United States. Most of the real estate portfolio held by commercial banks is of relatively short maturity, or has repricing windows at three to five year intervals. FCS real estate loans tend to have much longer maturities, but typically are variable rate loans with interest rates being adjusted as often as quarterly.

Commercial banks have been very successful in growing their non real estate agricultural loan portfolio, as well. Commercial banks' non-real estate portfolio is up 36 percent from the recent low in 1987. Moreover, that portfolio is substantially higher in loan quality than was true in 1987. Banks currently hold 24.8 percent of non real estate agricultural credit, compared to only 8.6 percent for the FCS.

In addition to managing loan portfolio growth, bank earnings have also recovered from the stress of the 1980s. Rates of return on bank equity for agricultural banks are about equal to the 11.7 percent of non agricultural small banks. Rates of return on bank assets are somewhat stronger than that experienced by non agricultural small banks.

While agricultural bank performance has been very strong in recent years, banks find the market very competitive for new loans. This is especially true for agricultural loans, that represent a high proportion of rural community bank lending. Competitive pressures in agricultural lending are fueling heightened consolidation activity among agricultural banks as individual banks and bank holding companies seek to grow large enough to internalize almost all of the business of their best customers.

[1] Marvin Duncan is a professor in the Department of Agricultural Economics at North Dakota State University.

Access To Lendable Funds

Despite strong performance, rural community banks are experiencing increasing difficulty in achieving needed deposit base growth. While only a few years ago this was not an important issue for these banks, it is now one of the top strategic issues they face. Increased competition for deposits from money market mutual funds has created a much more competitive market in rural areas. Additionally, as communities decline in size and business activity, much of that activity now occurs in larger centers, with the result that deposit growth occurs in banks there rather than in banks located in the rural communities. This trend of slower, or in some cases flat, deposit growth is occurring at a time when the size of business loans required by rural banks best customers continues to grow.

Another dimension of the lendable funds dilemma for rural banks is that banks are increasingly being asked to provide debt capital for rural development type projects. Yet, these projects typically require loans larger than rural banks can make out of their deposit base. Moreover, rural development type loans often have longer maturities than those of the banks' traditional customers. Thus, there is a mismatch between loan maturity and the maturity of the banks' deposits. As a consequence, banks need access to lendable funds with maturities that can be better matched to the maturities of rural development loans.

Rural banks, including agricultural banks, are pursuing a number of strategies to achieve greater deposit growth and to gain greater flexibility in the maturities of these deposits. One strategy is to broaden a bank's market territory. This involves opening branches, consolidation of banks, purchase of other banks by the parent bank's holding company, and in some cases, moving a bank charter to a growth market. Another strategy, as yet little used except in the case of housing loans, is to reliquify a bank's portfolio through sale of loans into a secondary market such as Fannie Mae, Farmer Mac, or through private placement of loans into a secondary market.

Another strategy currently pursued by the American Bankers Association and the Independent Bankers Association of America is to seek federal legislation that would substantially broaden the currently very limited access of lendable funds from FCS banks. This would likely work similarly to the current authority of FCS banks to lend money to Other Financial Institutions (OFIs), which may be organized and owned by agricultural banks. As commercial banks envision it, new legislation would broaden their ability to borrow from FCS banks, after buying stock in these banks. From the commercial bankers' perspectives, an advantage of this strategy is that necessary legislation could be originated in the agricultural committees of the Congress, since they have oversight responsibilities for the FCS. As yet, the FCS is strongly opposed to such legislation, despite the potential growth opportunities it appears to hold for FCS banks. The FCS correctly identifies as a problem the competitive disadvantage such legislation have for Farm Credit Associations, with their commercial bank competitors able to access lendable funds from the same sources the associations use.

Another alternative is for the rural commercial banks to purchase stock in a Federal Home Loan Bank (FHLB). Currently, membership is open to commercial banks. Banks that hold stock ownership and have a threshold proportion of their loan portfolio devoted to housing loans are able to borrow lendable funds from the FHLB in whose district they are located. Substantial commitment to rural housing is necessary to meet the FHLB required loan portfolio proportion devoted to housing. Even then, savings and loan associations are able to leverage their borrowing to a greater extent than are commercial banks. FHLBs are, however, friendly partners in providing lendable funds to rural community banks.

Banks would probably seek additional federal legislation designed to ease the access of rural community banks to this source of lendable funds and clarifying the authority of borrowing commercial banks to use the funds to support loans for purposes other than housing. Currently, their is considerable ambiguity on the use of funds borrowed from FHLBs for purposes other than in support of housing. Any federal legislation would, however, have to originate in the banking committees of the House of Representative and the Senate. These committees might be reluctant to broaden the authority of the FHLBs.

Yet another potential alternative source of lendable funds for rural community banks engaged in rural development lending might be found in a reconfigured Farmer Mac. If Farmer Mac were granted authority to securitize a broad range of loans, rural community banks could reliquify their portfolios by selling loans to Farmer Mac. That could be of substantial value to rural community banks experiencing loan demand that exceeded their capacity to fund through their deposit base. Three important questions must be answered before this alternative could be pursued. First, is the Congress interested in broadening the authority of Farmer Mac when it has not yet achieved a profitable level of operations. Second, would Farmer Mac be open to, or opposed to, such broadened authority. Finally, and importantly, would rural community banks be interested in focusing more effort on loan origination, sale, and servicing of loans sold as opposed to the portfolio lending focus of these banks currently.

Equity

As important to rural economic development as access to debt capital is, access to equity capital may be even more important. Yet, rural equity markets are very unorganized and access to equity is both uneven and haphazard. Because the size of most rural business projects is below the threshold of interest by urban venture capital firms, because rates of return on rural projects typically fall below those available in urban settings, and because of the high information cost of identifying potential rural-based projects, the existing venture capital market has not been actively involved in rural America. It may be important to encourage rural community banks to form specialized financial institutions, perhaps in partnership with other lenders or community organizations, such as bank development corporations or community development corporations that are able to provide both specialized debt capital and equity capital to start-up and growth businesses in rural communities.

Cultural change among rural community banks may be necessary before much use is made of the existing authority to create such specialized financial institutions.

Research Issues

A number of researchable issues arise from any discussion of new authorities for rural community banks and new access to lendable funds for these banks. These issue include:

- Is there a generalized lack of credit in rural America? Or, are there shortfalls of credit only in certain circumstances?
- Does tapping GSEs for lendable funds by commercial banks add new risk to U. S. Taxpayers? Or, does it simply transfer that risk from deposit insurance funds to the GSEs?
- What public policy levers are available to support market solutions to narrowly defined problems in rural credit markets? Can such policy levers be applied in a cost effective manner?
- Would the perceived shortfall in access to lendable funds in rural financial markets be resolved by major improvements in rural equity capital markets? And, finally:
- Are rural financial markets actually efficient, but we are unsatisfied with the market outcome? If so, what can, or should, be done to change the outcome?

On balance, a number of interesting research issues surface in discussions about sources of lendable funds for rural community banks. These issues address researchable questions and are likely to become more prominent on the policy horizon if lendable funds issues for rural community banks emerge as a major rural financial market issue.

References

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