GSE policy environment, Farmer Mac has a clearly defined and targeted mission, that was reinforced by the 1996 Act.

Concluding Comments

Farmer Mac's revised statute has given the agency a fresh start in which to establish an effective secondary market for farm real estate and rural housing loans. The goal is to add another viable linkage to the connection between rural financial markets and funding sources in the national and international capital markets, and to bring the potentially profitable securitization approach to agricultural finance.

Important elements of this process include prudent management of credit risks, conservative underwriting criteria, sound capitalization, adequate loan volume, profitable opportunities for participating lenders, a high performing customer base, and a favorable agricultural and financial market environment. Farmer Mac is now engaged in meeting these requirements in order to provide successful secondary market services for the agricultural sector. ▲

Recent References

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Barry, Peter J., Bruce J. Sherrick, and Paul N. Ellinger. *Farmer Mac's New Environment: Key Issues and Performance Factors.* Center for Farm and Rural Business Finance, University of Illinois, 1996.

Feldman, Ron. "Changes in Farmer Mac's Charter: Who's Affected," *CHOICES,* Third Quarter, 1996, pp. 8-11.

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Farmer Mac's Underwriting Standards

Farmer Mac initially developed a set of underwriting standards to use in determining loans that would be eligible for Farmer Mac guarantees and pooling. Most of the standards are based on financial ratios or other quantitative measures. Several others are stated in qualitative terms.

Farmer Mac underwriting standards are as follows:

1. Credit Worthiness of Borrowers. In addition to confirming the character, capital, capacity, condition and collateral involved in each loan, loan originators must obtain complete and current credit reports for each borrower. The credit report must include a current uniform commercial code lien search, historical experience, identification of all debts, and all other pertinent information.

2. Income Statements and Balance Sheets. The loan applicant must provide income statements and fair market value balance sheets for the last three years. The current statements should be adjusted to reflect the value of production by recognizing non cash expenses and changes in inventory, accounts payable, accounts receivable, and prepaid expenditures.

3. Debt-to-Asset Ratio. The entity being financed should have a pro forma debt-to-asset ratio of 50% or less, after closing any new loans.

4. Earnings and Liquidity. The entity being financed should be able to generate sufficient earnings and liquidity to meet all obligations as they come due and provide a reasonable margin for capital replacement and contingencies. This standard is achieved by having: a) a total debt service coverage ratio of not less than 1.25, including income from farm and non farm sources; and b) a current ratio of not less than 1.0.

5. Loan to Appraised Value (LTV) and Cash Flow Debt Service Coverage Ratio. The LTV in financing any individual property should not exceed 75%. A minimum debt service cash flow ratio of 1.0 from the subject property is also required, except for loans in which the borrower's principal residence is on the property securing the loan.

6. Minimum Acreage and Annual Receipts Requirement. Agricultural real estate must consist of at least 5 acres of land, or be used to produce annual receipts of at least $5,000 in order to be eligible to secure a qualified loan.

7. Loan Conditions. The loan must be level payment or level principal paymentand either: a) fully amortized principal over a term not to exceed 30 years; or b) amortized principal according to a schedule not to exceed 30 years, and mature no earlier than the time at which the remaining principal balance of the loan equals 50% of the original appraised value of the property securing the loan.

In addition to the above underwriting requirements, the size of loan must not currently exceed $3.5 million, adjusted annually for inflation.

These underwriting standards are applied on a screening basis. Eligible loans must meet each of the standards. The screening approach differs from a credit scoring approach in which higher values for some standards may offset lower values for other standards. Farmer Mac may, however, evaluate and accept screened loans utilizing a "Standard 9" condition in which mitigating factors outweigh a loan's inability to meet all of the above underwriting standards. ▲