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# *Ag Lenders Benefit from New Rule*

by Thurman C. "Sam" Connell

**I**t is not news that a growing number of small financial institutions have recently begun to look for additional sources of funds as their deposit balances have shrunk. Many of these financial institutions, particularly rural commercial banks, have found the Federal Home Loan Banks (FHLBs) an attractive solution. Until recently, this has not been a viable option for many of the nation's small, rural financial institutions.

Only July 29, 1998, a much-anticipated regulation went into effect. Simply known as the "Ag Rule," it ultimately expands membership in the FHLBs, as well as allows members to use a wider range of assets as collateral for advances. Specifically, the Federal Housing Finance Board, the bank system's regulator, has approved a rule that allows financial institutions to count combination farm and business property loans where there is a permanent residence to qualify for membership and to provide collateral necessary to obtain advances.

Why is this necessary? As more and more banks across the nation realize the versatility of the Home Loan Banks, the entire system has experienced vast growth during the past several years. With the addition of 748 banks, thrifts, credit unions and insurance companies in 1997, the total system membership now exceeds 6,500. Of these members, more than 5,500 are voluntary members. On the advance side, the banks had more than \$202.2 billion outstanding in advances last year — a growth of more than 25 percent.

The Des Moines Bank has shown growth as well. Just since the beginning of the year, more than 90 financial institutions have joined the Des

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Moines Bank, which has increased total membership to more than 900 financial institutions. In response to the membership growth and favorable interest rates, balances have grown more than \$3 billion. All of this indicates that the banks are providing much-needed services.

However, because of existing regulatory limitations, the banks were missing an opportunity to fulfill their mission in all geographic areas. It became increasingly evident that the needs of many small, rural institutions were going unmet, primarily because they could not meet the 10 percent rule. This rule states that to be an FHLB member, a financial institution must hold 10 percent of its assets in mortgages or mortgage-backed securities.

To expand these guidelines, financial institutions with assets of less than \$500 million may now count farm or small-business properties where there is a permanent residence. Previously, the residence needed to account for at least 50 percent of the property, which in many cases the value of the land was far more than 50 percent of the property's value.

The impact of this regulation change is far-reaching. It has been estimated there are more than 700 financial institutions that have been ineligible for membership in the Des Moines Bank. Already, the Des Moines Bank has more than 40 applications waiting for the rule to become effective. By year's end, the Des Moines Bank's membership will most likely exceed 1,000 members, a growth of nearly 100 percent since the early 1990s.

The new rule also has ramifications for existing members with as-

sets under \$500 million, which at the Des Moines Bank is 94 percent of the stockholders. Simply, many of these members will be able to borrow more from the Des Moines Bank because of the liberalization of collateral requirements. It is necessary to note that collateral requirements will differ from Home Loan Bank to Home Loan Bank because the rule allows individual Home Loan Banks to set their own guidelines. Financial institutions should check with their Home Loan Bank for more information.

The following is a summary of how the new rule will affect the Des Moines Bank's collateral requirements:

- A Blanket Agreement for Advances, Pledge and Security Agreement must be completed.
- Only first mortgages are eligible.
- Maximum outstanding principal balance for individual loans must be equal to or less than \$3 million.
- Loans must be fully disbursed (excludes construction loans).
- Loans must be amortizing, non-revolving (excludes lines of credit).
- Loans must be whole loans (no participation).
- Loans must not be contractually past due more than 90 days.
- Loans must not be classified Sub-standard, Doubtful or Loss.
- Loans must not be pledged to secure other debt.

Overall, this rule stands to impact most of the FHLB members, regardless of whether they are located in rural or urban areas. However, from the Des Moines Bank's perspective, it is the rural banks with combination ag loans that stand to gain the most from this regulation change. This rule potentially provides an additional source

of liquidity for financial institutions struggling to succeed at a time when deposits are decreasing.

The FHLBs, in particular the Des Moines Bank, have worked to forge partnerships and products that specifically benefit rural communities.

The Ag Rule is just another step to ensuring the bank system is providing funds for rural housing and economic development. It is a wonderful opportunity to make sure rural America continues to prosper. jal

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