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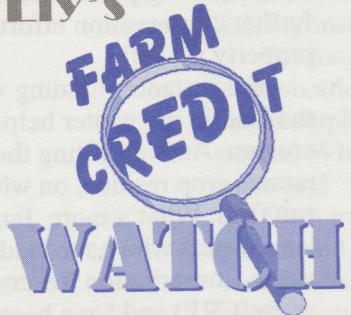
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Bert Ely's



Shedding Light on the Farm Credit System, America's Least Known GSE

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FCA's Revealing Annual Report

(April 2001)

Editor's Note: Bert Ely's Farm Credit Watch is a monthly report that is available in the "Members Only" section on the ABA Web site (www.aba.com). The following articles are the most recent installments.

To keep Journal of Agricultural Lending readers up to date on Mr. Ely's comments, we will publish all his columns that appear between publication dates. Mr. Ely welcomes information about the Farm Credit System in your area and can be reached at (703) 836-4101 or by e-mail at bert@ely-co.com.

The Farm Credit Administration (FCA) recently issued its accountability report for the year ended September 30, 2000. Bankers should read this report for its valuable, if not always intended, insights into trends within the Farm Credit System (FCS) and how the FCA is working feverishly to enhance the FCS's competitiveness. The report can be found at www.fca.gov. Some key insights:

FCA noted that federal payments to farmers totaled almost one-half of net farm income in 2000. Consequently, a drop in government assistance "would have a serious impact on many agricultural producers, likely resulting in upsurges in credit quality problems at System institutions." The FCA also noted that "the recent surge in government payments may have been capitalized into land values." That appears to be the case, which is why FCS lenders should stop trying to cream-skim the ag lending market by low-balling interest rates and boosting acceptable loan-to-value ratios. One can understandably wonder if the FCS is setting itself up for another round of major credit problems.

The FCA claims the FCS has been a major farm real estate lender "because of its ready

access to long-term debt markets." Only in tiny type does the FCA also note the FCS's federal income tax exemption on its real estate lending; there is no acknowledgment of a similar state income tax exemption. Those tax breaks are key to FCS's lending edge.

While hinting at future credit problems, the FCA reported that borrower capital actually at risk in the FCS has continued its steady decline even as total FCS capital continues to rise because of retained earnings growth. Capital-at-risk is the amount of stock that borrowers have purchased in the FCS association they are borrowing from; usually the stock purchase amount is added to the borrower's loan balance. From the end of 1995 to the end of 2000, FCS capital stock declined from \$2.1 billion to \$1.6 billion even as FCS assets were growing. Consequently, borrowers' capital at risk dropped from 2.9 percent of assets at the end of 1995 to 1.7 percent five years later. This decline is another piece of evidence that the FCS is not the genuine member-controlled cooperative that it claims to be.

More evidence the FCS is cutting loose from its roots: The FCA reported that "participation transactions between System and non-System lenders have grown rapidly in recent years." FCS lenders owned about \$3.3 billion of such participations on September 30, 2000 – triple the amount three years earlier. This increase in loans purchased from non-FCS lenders accounted for 22 percent of the FCS's total loan growth over the three-year period. The FCA decision

to allow FCS institutions to purchase 100 percent of loans originated outside of the System (see the fall 2000 issue of the *Journal*) probably will accelerate these loans purchases.

The FCA discusses the extensive restructuring taking place within the FCS as associations form a "parent" ACA (agricultural credit association) that in turn owns a taxable PCA (production credit association), which does non-real estate lending, and a tax-exempt FLCA (federal land credit association), which does the ACA's real estate lending. This restructuring is strictly a tax dodge, as the last *FCW* reported, but the FCA stated in its report that the restructuring's "net effect is increased capital at the association level." Bankers know full well the effect is lower FCS rates on its real estate loans.

Reflecting its defensiveness over the FCS's poor performance as a lender to young, beginning and small (YBS) farmers, the report stated that the FCA "believes" that YBS lending "should be a high priority for the System." It then refers to a section of the Farm Credit Act requiring each Farm Credit Bank to report yearly on its district's YBS activities. However, the report conveniently overlooked the preceding section of the Act, which states that each FCS association "shall prepare a program for furnishing sound and constructive credit" to YBS farmers and ranchers. It's puzzling that the FCA does not understand the difference between a belief and a legal requirement.

AgFirst's New Preferred Stock

The FCA board took another bold step on Jan. 24 to undermine the FCS as a set of member-borrower cooperative institutions by authorizing the AgFirst Farm Credit Bank to sell nonvoting cumulative preferred stock to "sophisticated investors in blocks of \$100,000 or more." Clearly, the typical farmer will not be buying this preferred. AgFirst funds FCS associations in 15 states, primarily in the Southeast, plus Puerto Rico. According to FCA's approval letter, AgFirst will be able to count outstanding preferred stock for up to 25 percent of its total capital. Based on its Dec. 31, 2000, balance sheet, AgFirst could issue as much as \$230 million of preferred, which would enable it to expand its loan portfolio by at least \$4.5 billion. Given that AgFirst already is an active purchaser of loan participations, it is reasonable to assume that AgFirst's preferred stock will further loosen its ties to its member-borrowers. AgFirst has not yet issued any of this preferred stock, but could do so at any time.

National Charters: Watching and Waiting

The FCA's 60-day comment period on its proposed National Charters regulation ended on April 20. The FCA has not yet indicated how it will proceed now that the comment period has closed. *FCW* will track this proposed regulation closely as the FCA continues its attempt to unleash unhealthy competition within the FCS.