MACC INDUSTRY SECTOR UPDATE

May 2014

May Features the Farm Credit Sector of our Membership

Nearly a century ago after the end of WWI, with lower demand and falling prices for farm commodities, the U.S. agriculture economy and most of rural America fell on hard times. Land prices fell, as farmers could not meet their mortgage payments. **At that time, as is today, the price and ownership of farmland provided the economic foundation for most of rural America**.

In the 1920s, farm land was acquired by inheritance or purchasing with cash contract or financed through a local bank. With falling land prices, many local bankers were forced to roll the loan over to the next year or repossess the land in hopes of selling the property to minimize local bankers' losses. It is clear that during most of the 1920s and 30s there was a very limited amount of cash liquidity, in most of rural America. The Hollywood movie "Places in the Heart" starring Sally Field, depicts such a time. Additionally, the inherent production risk due to changing weather and price/marketing risk made financing farms and stabilizing America's food production infrastructure a challenge.

The result was a series of Federal Farm Legislation to keep the U.S. from experiencing the poverty and famine faced in Europe during the 18th and 19th centuries. *Here are some highlights of such legislation:*

- **1916** - Federal Farm Loan Act established 12 Federal Land Banks in 12 districts across the U.S.;
- **1923** - The Agricultural Credit Act created 12 Federal Intermediate Credit banks for operating lines of credit (allowed farmers to buy equipment, breeding stock and crop inputs).
- **1933** - The Farm Credit Administration was established with Henry Morgenthau, as the acting secretary. Congress passed the Farm Credit Act to establish the cooperative Farm Credit System with 40,000 farmers applying for loans. These are the seeds of the cooperative model we know today with the farmers taking an equity position in the Farm Credit System. These farmer/owners were very proud that they eventually paid off all of the government loans, with interest.
- **1939** - The Farm Credit Administration was placed under the United States Department of Agriculture, under its' secretary Henry Wallace.
- **1953** - The Farm Credit System becomes an independent agency with a 13 member board, one member for each district and one appointed by the secretary of agriculture.
- **1969** - The country was in a recession until 1970, and the Farm Credit Administration broadened their authority to serve the needs of farmers and rural communities. Young Farmer programs, loans to farm related businesses, production, and processing, marketing, and input suppliers were allowed to borrow funds, as well as rural utility systems.
- **1970s** - The Farm Credit Act of 1971 gave banks and associations more flexibility in lending to production agriculture, and authorizes lending to commercial fisherman and nonfarming rural home ownership. *(continued on next page)*

2014 MAC-ED PROGRAM CALENDAR

Cultivating the Cooperative Difference in Kalamazoo		
June 5	Kalamazoo, MI	Kalsee Credit Union
Co-ops101 Classes		
June 6	E. Lansing, MI	GreenStone Farm Credit
June 23	Tiffin, OH	Ag Credit
June 27	Louisville, KY	Farm Credit Mid-America
July 25	Medina, OH	Dairy Farmers of America
August 13	Pigeon, MI	Scheurer Prof. Building
August 26	Normal, IL	1st Farm Credit Services
September 3	Piqua, OH	Trupointe Cooperative
September 4	Xenia, OH	Trupointe Cooperative
September 18	Louisville, KY	Farm Credit Mid-America
October 14	Wabash, IN	Beacon Credit Union
November 6	Louisville, KY	Farm Credit Mid-America
Illinois Co-op Youth Conference		
June 5-6	Carbondale, IL	Southern IL University
Co-op Credit Conference		
October 16-17	Indianapolis, IN	Holiday Inn North/Carmel
CFO Essentials Conference		
November 19-20	Indianapolis, IN	Embassy Suites North
CFO/Controller Conference		
November 20-21	Indianapolis, IN	Embassy Suites North

Farm Credit *(cont'd. from page 1)*

- **1979** - The Federal Reserve tightens currency to rein in inflation. Interest rates soar and foreign demand for U.S. farm exports falls. Other macroeconomic policies combine to produce large U.S. farm surpluses, lower prices, and lower incomes to repay farm loans.
- **1985** - Hundreds of thousands of farmers are at risk of losing their farms, and many FCS institutions are financially unstable as a result of non-performing loans and poor loan policies. The FCS suffers the largest losses of any financial institution in U.S. history. Congress passes the Farm Credit Amendments Act to separate FCA from the FCS, making FCA an "arm's-length" regulator. The Act gives FCA increased regulatory oversight, and enforcement powers and responsibilities to restore safety and soundness to the System. It does away with the policy-making structure of the part-time Federal Farm Credit Board, replacing it with a presidentially appointed board of three full-time members. Frank W. Naylor is named the first Chairman of the FCA Board.
- **1987** - Congress, recognizing the need for financial assistance for failing FCS institutions, passes the Agricultural Credit Act. The Act creates the FCS Financial Assistance Corporation and the FCS Assistance Board to provide and administer financial and technical assistance to weak institutions, authorizing up to $4 billion in total (but spending only about $1.3 billion). The Act also creates the Farm Credit System Insurance Corporation (FCSIC) to ensure timely payment of interest and principal on Systemwide and Consolidated bonds and other obligations issued by FCS banks. In addition, the Act strengthens borrower rights and creates the Federal Agricultural Mortgage Corporation (Farmer Mac) to establish a secondary market for agricultural real estate and rural home mortgages.
- **1988-1990s** - The increased oversight, regulatory, and enforcement powers granted to FCA help the System to rebound. Falling interest rates and record-high farm income, boosted by large Government subsidies, also facilitate the System's recovery. FCS institutions start posting profits instead of losses, and loan quality significantly improves. Both mandatory and voluntary mergers of institutions bolster their financial strength and services. The Food, Agriculture, Conservation, and Trade Act Amendments (1991) create the Office of Secondary Market Oversight within FCA to administer the regulation of Farmer Mac.
- **2000s** - The System continues to build capital reserves and enjoys the strongest financial position in its' history. Loan growth increases at impressive rates. In 2004, one FCS association, which does not have a patronage program to disburse surplus earnings to its' members, announces plans to terminate System status and become a subsidiary of Rabobank International. Although termination of System status is allowed under the Farm Credit Act of 1971 as amended, the association does not go through with it. Nevertheless, the proposed termination helps spur the trend of the preceding decade of more associations establishing patronage programs. The percentage of associations with patronage programs increases from 43 percent in 2000 to 81 percent in 2005. In 2005, total patronage paid out by both banks and associations is $874 million, up from just $391 million in 2000.

All Federal assistance received by FCS institutions during and after the agricultural credit crisis of the mid-1980s is repaid, with interest, by June 2005.

Rod's Thoughts

Since the **Farm Credit Administration** was established nearly 100 years ago, there has been a strong focus in the financial security of the rural economy. This unique cooperative allowed individual farmers to borrow money to buy land, livestock, equipment and the operating loans to sustain our rural economy.

The farm economy has experienced difficult times, and the farm credit system has mirrored these market challenges. However, as the farm credit system is a cooperative owned by the farmers who borrow the money, they understand the needs of their fellow borrowers. They know that the farmers' planning horizon can be more than a year and when a drought hits, it can be longer. Fortunately, the member/owner boards have focused on business efficiencies and sound credit management practices.

When I think of sound credit policies, I remember the training classes of Dr. David Kohl, a retired professor of Agriculture Economics from Virginia Tech. Dr. Kohl reminds us of the five key areas we must constantly monitor for economic sound businesses. *They are:*

1. <u>Strong Liquidity Position</u> - Lack of liquidity is probably the most common factor forcing well-run businesses to cease operations. Practical experiences have shown that there are many causes for weak liquidity: a family or business tragedy that pulls cash from the operations, such as a health claim or divorce making a seemingly good operation lose money. Poor risk management policies will also lead to unexpected drains in working capital or cash.

2. <u>Strong Solvency Position</u> - The lack of solvency means the business cannot pay its' bills and the credit demands become more than its' immediate ability to bay those debts. It is the result of a weak business, or the business is not adequately collecting their businesses accounts.

3. <u>Adequate Profitability</u> - The business must be profitable and managed consistently, to offer value to its' owners. Simply put, the business must consistently earn more than its' combined expenses. In this area, each representative of the Farm Credit system works closely with their member/owner to help them realize how to be more profitable. They encourage the use of risk management tools to minimize risk, and improve marketing plans to optimize earnings.

4. <u>Repayment Capacity</u> - The ability to repay the loan from the Farm Credit System. There was a time when most lenders simply looked at the financial strength of the borrower. If they had adequate asset resources at the current market prices, then the loan could be made. They were called 'asset lenders' and it was very common in the late 1970s when the market value of farm assets was growing. Unfortunately, the 1980s saw a decline in those asset values and the farm economy had their own market bubble. The Farm Credit System has learned these lessons and now forces all borrowers to meet repayment capacity tests prior to the loan.

5. <u>Financial and Operational Efficiency</u> - Dr. Kohl reminds us that all businesses must continue to seek greater financial and operational efficiency. This can be achieved in various ways, but technology has allowed for more production to be achieved with fewer hours of labor.

The lessons of the past remind us of the importance of focusing on these key financial principles. More importantly, is the culture of striving to be a better cooperative business every day.