



Implications of Current Farmland Trends for Agricultural Lending

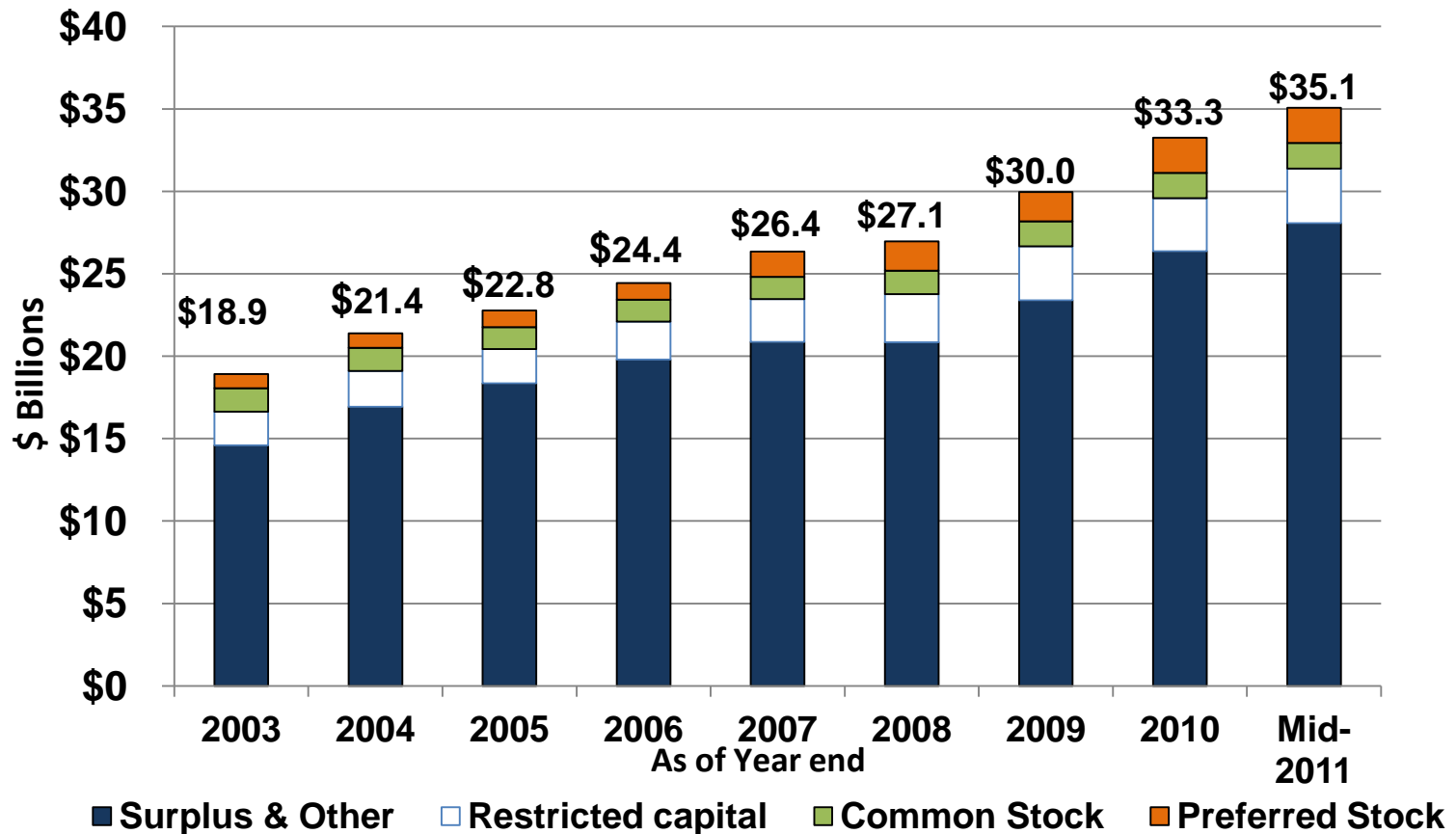
Federal Reserve Bank of Chicago

November 15, 2011

Leland A. Strom
Chairman and CEO
Farm Credit Administration

Farm Credit System capital continues to grow, reflecting earnings growth

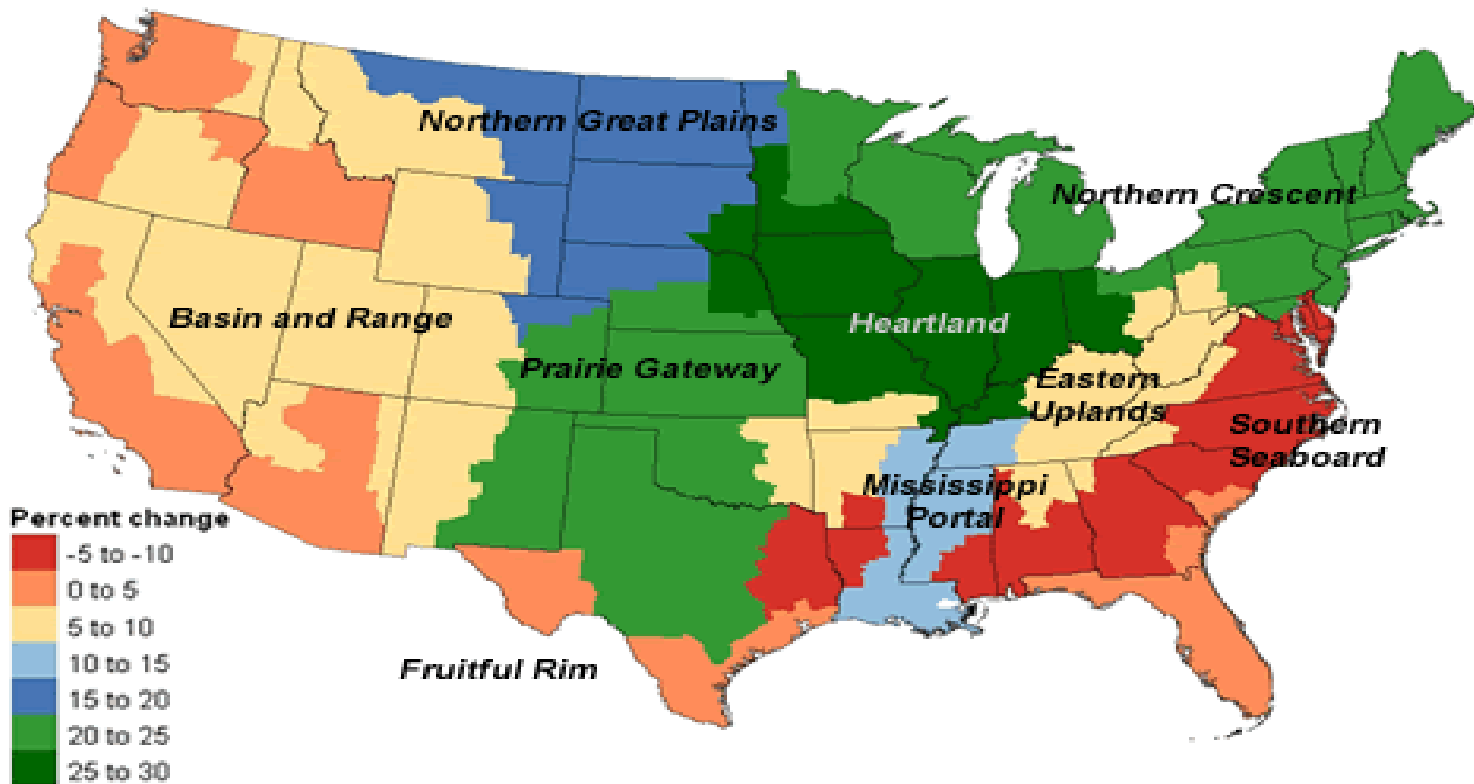
Farm Credit System Capital



Source: Federal Farm Credit Banks Funding Corporation.

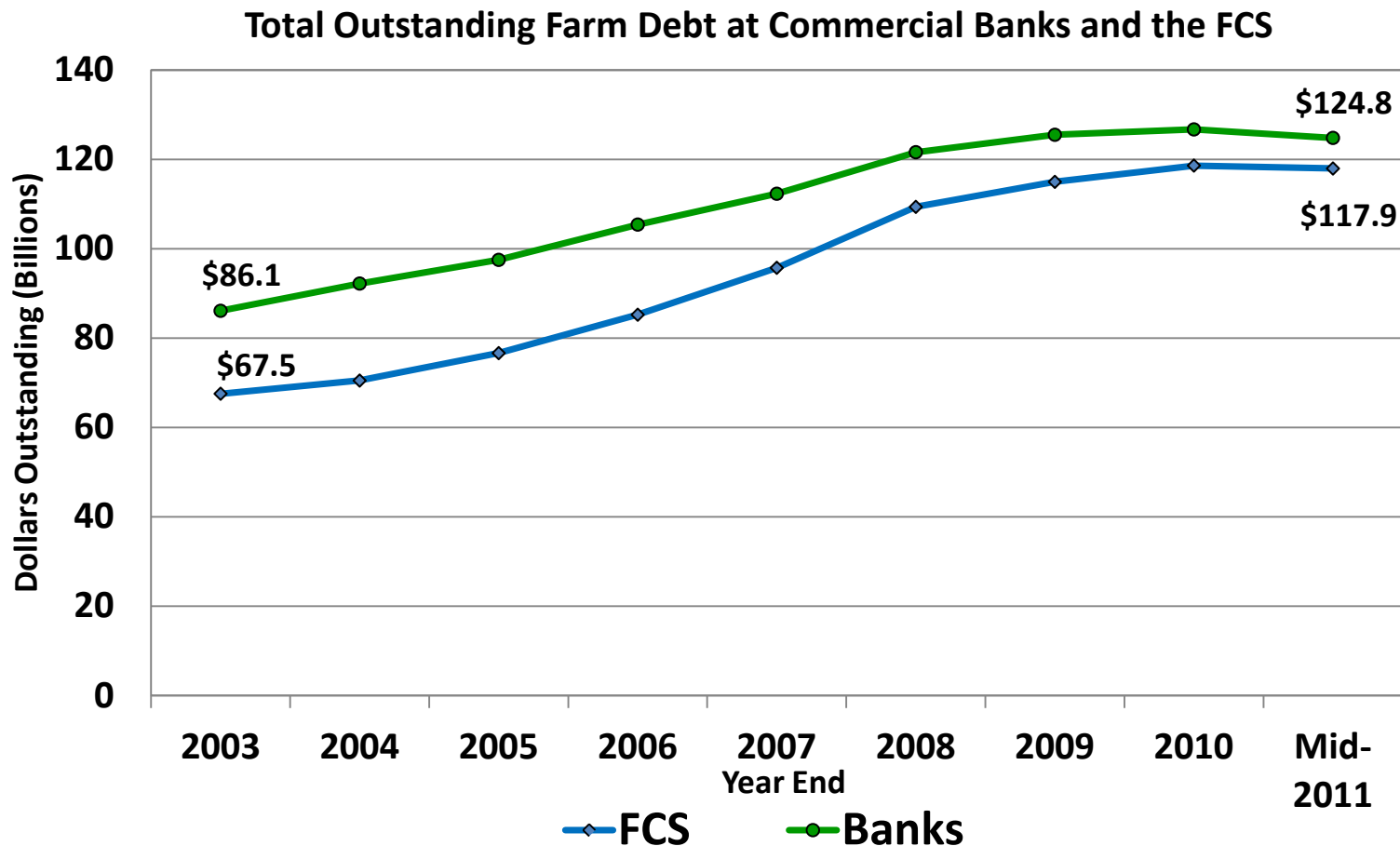
Higher midwest farmland prices reflect strong farm earnings

2011 farm business net cash income forecast compared with 2010



Source: ERS partial budget model based on the 2010 Agricultural Resource Management Survey (ARMS) using parameters from the sector forecasts.

Growth in farm debt slows



Sources: Federal Farm Credit Banks Funding Corporation, Federal Reserve Bank of Kansas City.

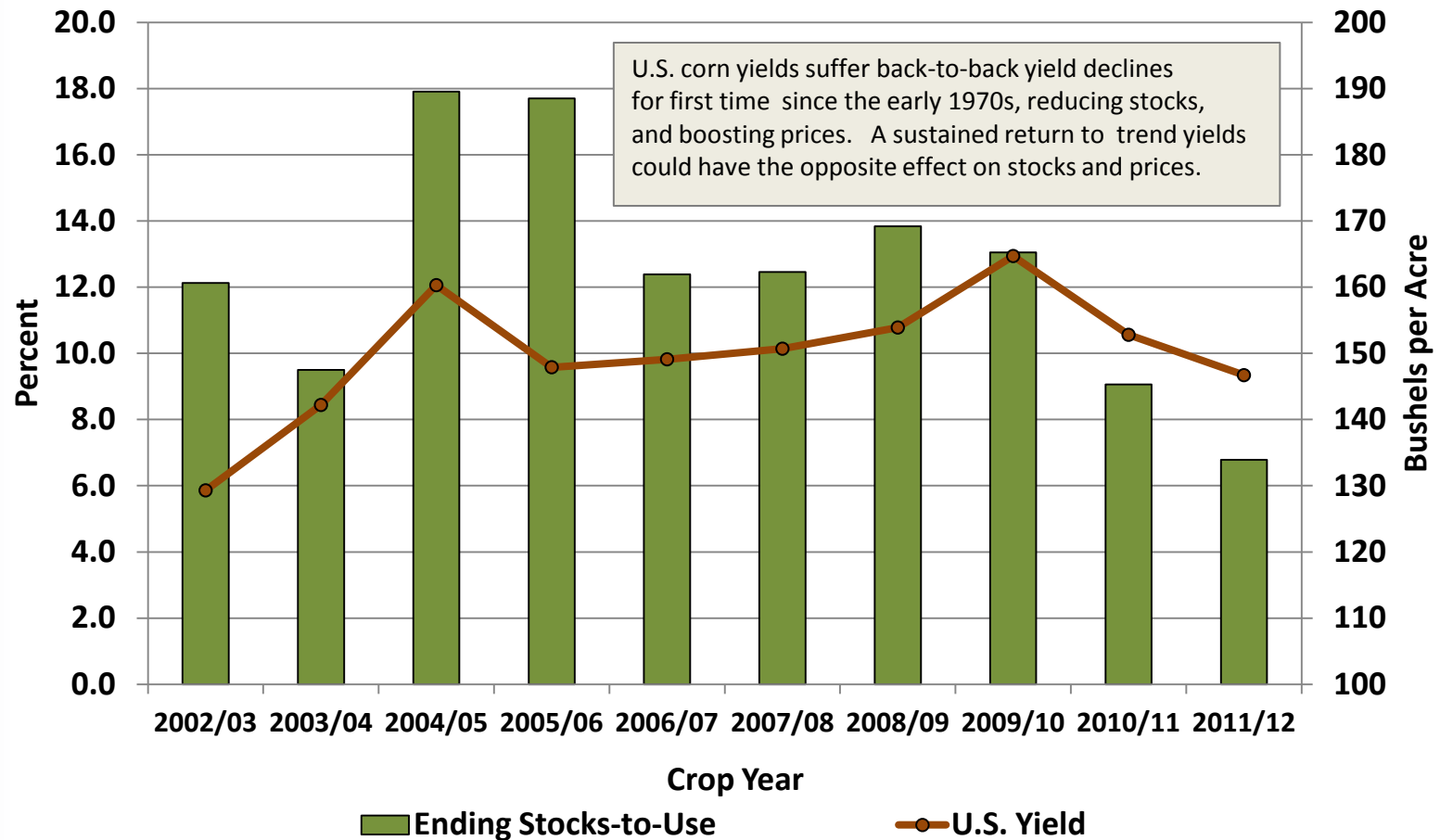


Farmland values – risks going forward

Drivers to watch	Farmland Price expectations <i>could</i> change if:
Crop Production/Supply	Favorable weather returns and/or continued growth in plantings significantly boost grain supplies.
Production Costs	Rising input costs cut profit margins, even if crop prices remain strong.
Interest Rates	Expectation for much higher interest rates takes hold making alternative investments more attractive and thus reducing investor demand and increasing supply of land for sale.
World Economic Growth	Growth slows sharply or dollar rises in value causing export demand to drop.
Farm Policy	Farm program “safety net” does not sufficiently protect against future multi-year declines in crop revenues.
Bio Energy Policy	Ethanol mandates and subsidies are reduced, lowering corn demand.

Land value risk – improved weather

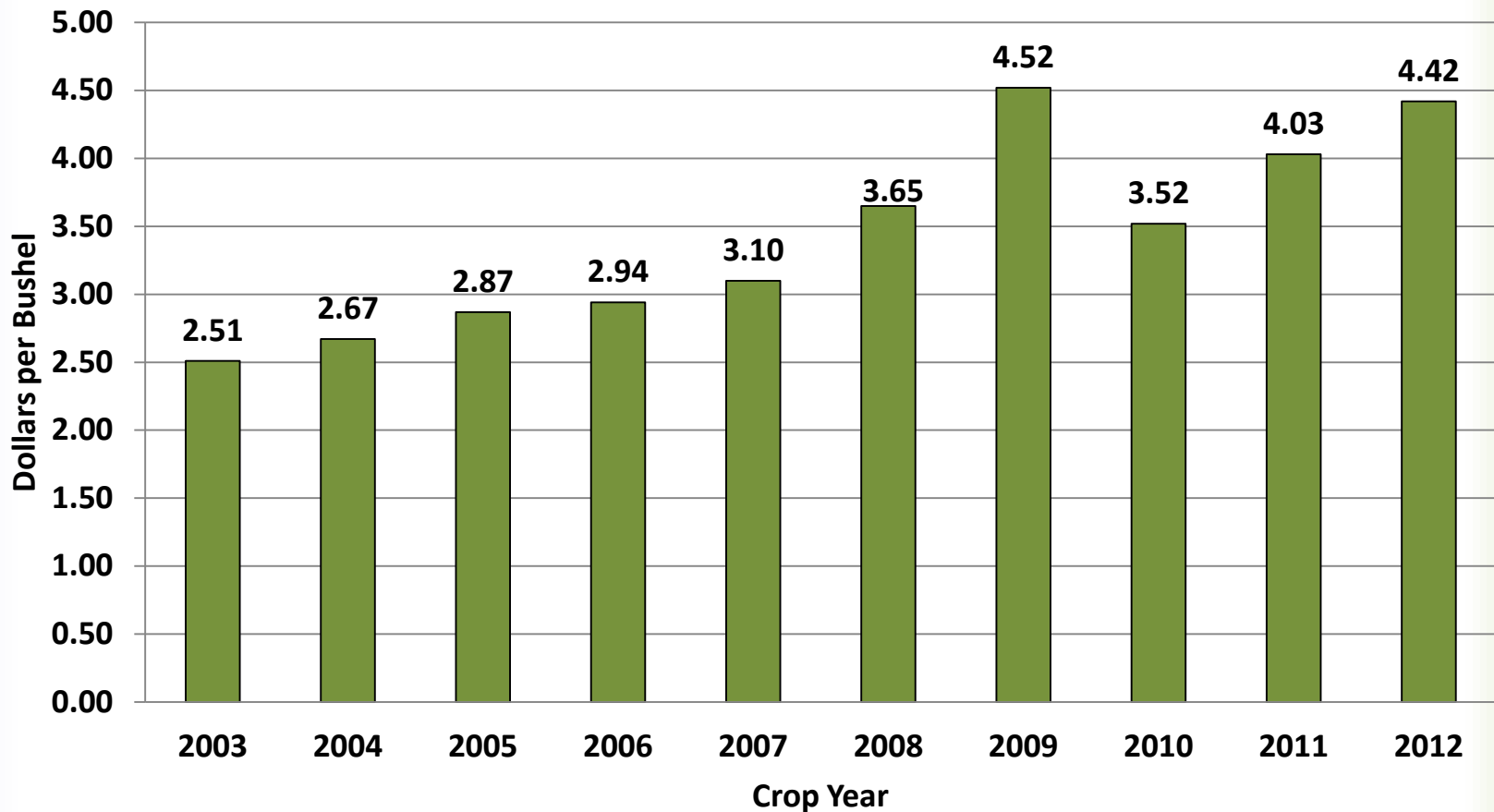
U.S. Corn Stocks and Yield Trends



Source: USDA: World Agricultural Outlook Board, November 9, 2011.

Land value risk – increasing input costs

Estimates of the Total Cost of Corn Production in Iowa



Source: Iowa State University Ag. Ext. Pub. A1-A21.



What is collateral risk?

FCA defines real estate collateral risk as:

“the portion of real estate value that is not supported by the net income derived from the real estate’s normal production of and prices for agricultural products (including net rental income that can be realized from the property and its facilities).”

“Collateral Risk Management in Farm Credit System Institutions,” FCA Informational Memorandum, June 17, 2010.



Some common internal causes of collateral risk at FCS institutions

1. Inappropriate loan underwriting standards
2. Weak credit administration at loan origination
3. Ineffective internal audit coverage
4. Failure to perform “what if” scenarios and assess impact on adequacy of allowances, earnings and capital



Recent FCA collateral risk management guidance

- Asset Growth, Market Volatility, and Best Practices for Fast Growing Institutions (May 2008 IM)
- FCA Bookletter – BL #58 in May 2009
- Guidance for Evaluating the Safety and Soundness of Real Estate Lending (December 2009 Exam Bulletin)
- FCA's Stress Testing Expectations (March 2010 IM)
- Collateral Risk Management in FCS Institutions (June 2010 IM)



FCA's oversight strategies regarding collateral risk

- Collateral risk is a primary focus area for our ongoing examination work
- Offsite systemic analyses and monitoring
 - Analyses of FCS loan data and LTVs
 - Monitor industry trends and developments
 - Regular FCA Risk Committee briefings
- Regulator roundtable meetings
 - Information sharing with other regulators
 - ✓ FCA, Federal Reserve, FDIC and OCC
 - ✓ Staff level discussions
 - ✓ Met in February and July 2011





How are institutions responding to increased collateral risk?

- Improved loan underwriting standards
- Establish sustainable agricultural values as a lending limit
- More conservative loan terms
 - Limit LTVs, shorter maturities, pricing
- Efforts to identify and report portfolio risk
 - Land value and collateral risk studies
 - Stress testing of land value changes



Concluding comments

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- Today's business environment in agriculture is extraordinarily complex and extremely volatile
 - We face great risks in the midst of prosperity
 - Farm income is record high while the general economy struggles
 - Midwest farmland prices soar while southeast land-in-transition plummets
 - High grain prices boost grain farmers' margins but leads to weaker profits in the protein, dairy and ethanol sectors
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Concluding comments

- FCA is tasked with allowing the FCS to take prudent risks in an increasingly risky environment
- We strive to accomplish this with:
 - Effective communications and regulations
 - Risk-based examinations and enforcement activities
 - Diligent monitoring and analyses of systemic risks and industry developments