

The Farm Credit System: Today's GSE Success Story

Although it is a relatively marginal player in the residential home loan market, the Farm Credit System is weathering the recession.

By Phil Hall

Within the realm of government-sponsored enterprises (GSEs), the Farm Credit System (FCS) remains something of an anomaly. Operating as both a lender and a GSE, it focuses exclusively on the nation's agricultural and rural sectors. Residential lending is part of its mission, albeit with geographically tight restraints.

But whereas the other GSEs have experienced various degrees of agita during the economic crisis, FCS appears to be holding its own.

FCS consists of 95 private cooperative institutions. It has its own regulator, the Farm Credit Administration, and it carries its own self-financed insurance fund that comes from premiums paid by the member institutions.

Unlike the housing GSEs, the FCS emerged from 2008 in a solid state, with a combined net income of \$2.9 billion - a \$213 million increase from the prior year. However, FCS got off to a rocky start in the first quarter of this year, reporting a net income of \$615 million for the quarter ending March 31; it had reported \$760 million for the same quarter in 2008.

In testimony before the House Agriculture Subcommittee on Credit June 12, Bob Frazee, president and CEO of MidAtlantic Farm Credit, spoke on behalf of the FCS and detailed the GSE's economic viability.

"Despite the fact that we have had no assistance from the government throughout these times of extreme stress in the financial markets, we are very proud to report to you that we have not had to deny a single farmer, cooperative or other eligible borrower access to credit because we could not access the nation's money markets," he says.



Within the realm of residential lending, FCS has lagged behind Fannie Mae and Freddie Mac. This is due, in large part, to a 1971 congressional mandate to provide home loans to towns with populations of 2,500 or fewer people. In 2007, the FCS tried to expand its residential lending restrictions through the HORIZONS initiative, which was targeted for that year's Farm Bill. The initiative would have enabled the FCS institutions to make mortgage credit available in communities with populations up to 50,000.

In a June 2007 interview with *Secondary Marketing Executive*, John Blanchfield, director of the Center for Agricultural and Rural Banking at the American Bankers Association (ABA), questioned whether such changes were keeping with FCS' mission of serving small-town rural America.

"Farm Credit's lending limit is \$750 million," says Blanchfield. "So Donald Trump could get his damn house financed through Farm Credit!"

The HORIZONS initiative never made it into the Farm Bill, and to date, FCS has made no attempt to broaden its residential lending activities. Doug Stark, president and CEO of Farm Credit Services of America, based in Omaha, Neb., states that the system has no plans for a HORIZONS encore.

"We're focused on the rural setting," he says. "That's our niche and that's where we serve very well."

Wider horizons

Blanchfield also does not believe that a reprise of HORIZONS is likely, though he expresses concern that FCS is expanding its mission by using a different strategy.

"Yes, they are doing it in a stealthy manner," he says. "There is a pending rule for Farm Credit lenders to make investments in areas where they are not legally allowed to lend, such as hospitals and charter schools."

Blanchfield also points to the Frazee congressional testimony of the FCS trying to get more federal support without being locked into greater federal oversight.

"The FCS is angling for the government to buy their debt," he says. "They are doing it artfully, in saying that farmers are suffering, but the FCS is strong."

Last year, the FCS stepped forward to rescue another agricultural GSE. In September 2008, Farmer Mac - which was not experiencing the portfolio convulsions that Fannie Mae and Freddie Mac felt - faced a crisis when its investments in Fannie Mae preferred shares and Lehman Brothers holdings drove the company off the road. Five institutions from the FCS combined to purchase \$60 million in aggregate of senior cumulative perpetual preferred stock of Farmer Mac as a means of saving the cash-strapped GSE.

As part of the arrangement, Farmer Mac's president and CEO, Henry D. Edelman, was replaced, after nearly two decades on the job, with Michael A. Gerber, CEO of Farm Credit of Western New York.

Although he is often critical of the FCS, Blanchfield commends the system's institutions and executives for saving Farmer Mac and keeping FCS and Farmer Mac operating separately.

"I am pretty impressed at how Farmer Mac survived that near-death

experience," he says. "We were very concerned about it. But we have seen no evidence that the FCS is interfering in what Farmer Mac is doing. In fact, FCS is Farmer Mac's main customer, and their CEO is doing a good job."

Keeping it local

So how is the FCS staying on course at a time when other financial entities have either been slowed or even derailed? According to Doug Williams, managing director and chief administrative officer with the Farm Credit Banking Funding Corp. in Jersey City, N.J., the system was already in a strong position by the time the recession began to damage the rest of the economy.

"We depend almost solely on capital markets to raise funds," says Williams. "Through the fall, when things were at their worst, we were still able to access funds, albeit in a more limited fashion. Shorter maturity debt was still accessible to the system.

"Due to strong risk management in the FCS," Williams continues, "we started building a fairly large base of capital. We went into this period with good earnings, good credit quality and strong capital levels."

For Stark, the institutions within the FCS are able to maintain customer loyalty among homeowners by keeping their business activities in-house, whereas many of the sys-

tem's community bank competitors are active with Fannie Mae and Freddie Mac.

"The FCS provides options for both portfolio lending and secondary marketing," he explains. "But in today's environment, many home buyers want to know who they are doing business with. So many FCS institutions are holding their home loans in their portfolios."

Stark adds that the FCS institutions are also able to handle distinctive elements of rural properties that urban or suburban lenders would dismiss as nonconforming.

"We understand the rural market, as opposed to the metropolitan market," he continues. "We can accommodate unique properties, such as a fixed-up older farm house with an old barn or a home on a 40-acre tract instead of one acre or a lot."

Bill York, president of AgriBank in St. Paul, Minn., points out that the FCS as a home loan source attracted more attention in rural America as the recession widened.

"Although this has not been one of our core businesses, we have seen an increasing percentage of requests," he says.

York believes that in a post-recession economy, more rural homeowners will seek out the FCS for its mortgages.

"Our footprint and our knowledge is in this marketplace," he says. "This gives us an advantage." **SME**