

Leaving The Tunnel

Financial markets unfreeze as ag profits shrink.

Jamie Stewart's 14th-floor office at 10 Exchange Place in Jersey City, New Jersey, has a sweeping view of the Manhattan skyline across the Hudson River.

New York's metro area seems an unlikely spot for one of American agriculture's key institutions. Here, the Federal Farm Credit Banks Funding Corporation, with a staff of 40, issues bonds that finance the Farm Credit System's \$163 billion loan portfolio – almost 40% of U.S. ag loans.

For more than a year, Stewart, the Funding Corporation's CEO, hasn't had much time to admire the view.

"We take a great deal of pride in the fact that during the panic, which I think is the right word for it, we were able to provide access to credit for our borrowers," he says.

"We went into this thing in pretty good shape," he recalls. "We also saw, early on, some worrying signs that the

credit markets were getting kind of crazy."

In March of 2008, Bear Stearns, an investment bank that pioneered reselling subprime loans, collapsed. Summer brought calm. Meanwhile, the Funding Corporation advised Farm Credit lenders to shore up loan portfolios. It scaled back overnight borrowing. Then in September, home mortgage giants Fannie Mae and Freddie Mac got a federal bailout, days before the bankruptcy of investment bank Lehman Brothers triggered the Great Recession.

The Farm Credit System has only this in common with Fannie Mae and Freddie Mac: It, too, is a government-sponsored enterprise selling bonds with implied backing of the U.S. government. Unlike Fannie Mae, the System is sound. Its growing surplus tops \$20 billion.

In the darkest days of 2008, the Funding Corporation carried on, reassuring investors. "Even the very basics of being a cooperative took a lot of explaining," says Funding Corporation vice president Regina Gill. "And we also had to explain that we're not in the subprime mortgage business," Stewart adds.

Today the light is a bit brighter at the end of the ➤

“
[Insurers] are betting the Farm Credit System will still be in good shape in 30 years.”
– Jamie Stewart, Funding Corporation”

Federal Farm Credit Banks Funding Corporation has its offices at 10 Exchange Place in Jersey City, New Jersey.

Photography: Dan Looker



Holland Tunnel linking New York's financial district with Jersey City. After nearly a year of not being able to sell bonds maturing much beyond five years, an insurance company asked the Funding Corporation in September to issue 30-year bonds. Longer term bonds make a better match with intermediate and long-term loans that allow fixed rates for machinery and land loans.

"I think it's a good sign," Stewart says. "I think some of the insurance companies are starting to take the view that inflation isn't going to be a problem. They're betting that the Farm Credit System will still be in good shape in 30 years."

Although many farmers worry that unprecedented federal debt will lead to inflation, Stewart doesn't see much

evidence yet, especially with the drag of high unemployment on the economy.

Jeff Plagge, president of Northwest Financial Corporation in Arnolds Park, Iowa, agrees. "Rates are low, and it would be a good time to lock down some," he says. Plagge was honored by the American Bankers Association this fall for his service to ag lending.

Both commercial ag banks and the Farm Credit System are cautious about rapid expansion of lending and are increasing reserves for losses. But Plagge says there are still adequate funds for farm loans. If growth in loan volume slows, it will be because of less demand

from farmers, he says. "Some of the good operators are the first ones to pull in their horns," he says.

One is Larry Paulsen, who with his son, Loren, raises corn, soybeans, cattle, and hogs near Coleridge, Nebraska. They haven't borrowed for new machinery in the last few years. "We're playing it pretty close," he says.

And, as a board member of Farm Credit Services of America in Omaha, Paulsen sees less demand from other farmer borrowers. "I think it's really tapered off in the last six months to a year," he says. "People are more cautious."

Both Paulsen and Plagge say that loan officers are going over farmer financial statements more carefully these days.

But it's not an adversarial relationship. In agriculture's most stressed businesses – dairy and hogs – farmers have gotten out when lenders would have stayed with them, Plagge says.

Funding Corporation CEO Stewart sees those trends. "We had years over the past five with 12% to 16% growth year over year," he recalls. In the first half of 2009, Farm Credit System loan volume grew 1.1%. These days, moderation looks good.

"You want to be conservative and you want to meet your borrowers' needs. But you don't want to get way ahead of yourself," Stewart says. □



Pictured are Funding Corporation's Jamie Stewart, Regina Gill, and its trading floor, which sells bonds through 29 investment and commercial banks.

Prep For Inflation

Ag finance expert Dave Kohl of Virginia Tech believes that at some point the nation's federal debt levels will lead to inflation. Here's what you can do to get ready.

"First of all, you've got to look at your debt levels," Kohl says. "And you've got to look at interest expense as a percent of your gross income."

"One thing I like to do is run a financial scenario and see the bottom-line margin," he says. "Then look at the effect of an interest rate increase of 1%, 2%, on the bottom line."

"If you're extremely vulnerable, now is probably a time to lock in some of those interest rates if the package is appropriate," he says.

It's similar to locking in a profitable corn price with a futures hedge. And it can apply to any variable-rate loans you may have for livestock, machinery, or land.

Watch For These Inflation Signs

"Watch the core inflation rate that's reported once a month," Kohl says. That's the Bureau of Labor Statistics consumer price index, excluding volatile energy and food prices.

Currently it's about 1.5%. If it's above 2% or 2.5%, the Federal Reserve is likely to act to slow inflation by raising interest rates, he says.

"Also watch the prices of copper and gold," he advises. "Copper is used in a lot of manufacturing products and is a sign that people are building. Gold reflects uncertainty."

"I think your short-term interest rates will stay fairly low through the first of the year, unless we have a catastrophic event," he says.

"As you move into the next decade, there's going to be pressure to increase interest rates," he says. "Don't take it off the dashboard. That oil indicator light could come on at any time." □