SPEAK OUT

January 2009

The Financial Crisis: How is Agriculture Affected?

Objectives

- To provide background information on the financial crisis and how it affects agriculture.
- To provide information that could aid in decision making for producers.
- To gain insight on how the financial crisis is affecting rural Ohio and Ohio agricultural producers.

Overview

Its official, America is in a recession! For most folks this probably isn't news, but the National Bureau of Economic Research (NBER) released its official findings Monday, Dec. 1, 2008 stating that the economy has been in a recession since December of 2007. So why did it take so long to determine you might ask. Well according to the NBER Web site, "The committee waits long enough so that the existence of a recession is not at all in doubt." The NBER committee that sets official dates for recessions typically does not act for many months after a downturn has begun. The panel is looking for clear evidence of a substantial, lasting contraction. "It waits until it can assign an accurate date."

So how did we get here? It's a long story, but we can start by going back a few years and examining mortgage lending. Historically, mortgage lending has been done through "local" savings and loan institutions that lend money directly to people within their communities at fixed interest rates over fixed terms. However over time the amount of debt owned by traditional savings and loan institutions has declined while total mortgage debt held by "non-local" parties, through the use of asset-backed securities, has increased significantly. Recently, the combination of relatively low interest rates and credit availability combined to create the boom in U.S. real-estate markets. Originating lenders were more than willing to approve loans to even the riskiest borrowers because they never intended to personally finance and take on the risk of the mortgages. This was done by the buyers of the mortgage-backed securities. In 2006 it all started to fall apart. Many of the existing non-traditional mortgage contracts became unaffordable to borrowers as variable interest rates adjusted upwards and balloon payments on no-interest loans became due. At the same time housing values began to decline so that the collateral upon which the individual mortgages and pooled securities were based upon were not sufficient to cover the outstanding loan balances. This

has caused many homeowners to have zero or negative equity in their homes.

The value of mortgage-based securities has plummeted as default rates increase and investors shift their money out of increasingly risky debt-based instruments into safer investments. This has led to the failure of large investment institutions and the current credit crisis, which is driven by a lack of liquidity. Investors are wary of putting their money at risk in debt markets, which makes it exceedingly difficult for lenders to obtain the financing needed to originate new loans or lines of credit, even to creditworthy borrowers. The money is simply not there to do so.

Agricultural Lending

A key question currently facing farmers is how the economic disruptions and turmoil will impact the availability and cost of credit through their traditional lending channels. Another issue is how the recent government actions will impact lenders serving agriculture.

Agricultural lenders are generally in strong financial health. Most of the agricultural related institutions did not participate in the higher risk housing lending procedures of the larger urban banks nor were they substantially invested in the structured securities that have lost substantial market value. Hence, most agricultural lenders have not incurred the huge losses of the Wall Street banks.

In comparison with other sectors of the economy, agriculture is generally characterized as using a low amount of debt relative to assets. The U.S. Department of Agriculture estimates total farm debt of approximately $211 billion at the end of 2007. Total assets in the farm sector exceeded $2.2 trillion resulting in a farm aggregate debt-to-asset ratio of only 9.6 percent.

Primary lenders in agriculture are commercial banks, the Farm Credit System, insurance companies, Farm Service Agencies and captive finance companies. Of these lenders, the Farm Credit System holds approximately 42 percent of the real estate debt and 31 percent of the nonreal estate farm debt. Commercial banks have the highest market share of nonreal estate farm debt (53 percent) while lending 38 percent of the farm real estate loans.

Commercial banks lending to agriculture are generally dominated by small, community banks that use local deposits as their primary source of funds. As a group, they have fared relatively well. Only 5 percent of “agricultural banks” had negative income during the first half of 2008, a far smaller fraction than of all commercial banks. Moreover, over 50 percent of agricultural banks reported net income higher than the previous six-month period.

The Farm Credit System (FCS) is a cooperatively owned, government-sponsored entity (GSE) that has a mandate to serve agriculture. It is a nationwide network comprised of five Farm Credit Banks that provide funding to 92 associations that in turn serve as direct lenders to farmers. FCS uses the capital markets to acquire funds by issuing consolidated system-wide FCS bonds and notes. Importantly, the market views GSE debt as being relatively safe, and generally requires modest spreads over Treasuries for placement of the debt.

The Farm Credit System associations have generally strong balance sheets and have experienced recent strong profitability. The capital positions and credit quality of the banks and associations remain strong

through this economic downturn. Howerver, the rapid recent growth of volume and concerns about capacity for future growth without undue capital dilution have been greater concerns than losses from either the credit or investment exposure within the Farm Credit System institutions.

Farmer Mac, the GSE which serves as the secondary market for agricultural loans, did maintain a substantial investment portfolio, and did suffer substantial capital losses due to investments in Fannie Mae, Freddie Mac, Lehman Brothers, and similar securities. As a result of their exposure to these positions, they issued $65 million in preferred stock to increase their effective capital ratio. Importantly, the motivation for the recapitalization was not due to problems with the quality of their agriculture loan portfolio, but due to exposures to positions largely viewed as high-quality investment grade bonds just a couple of months earlier.

Summary

These are truly unprecedented times in our economy and our policy makers are in uncharted waters. The government is using many tools and approaches to relieve the credit stress and liquidity problems in an attempt to restore confidence in the financial markets. To put the rarity of the economic situation into context, consider the probability of occurrence implied by the widely recognized Bloomberg Financial Conditions Index, a quantitative measure of financial conditions relative to the average of the 1992-June 2008 period. The implied likelihood of the magnitude of the downturn experienced by this Index during the past month is over 9.5 standard deviations or approximately equivalent to winning the lottery twice in one week -- truly a “black swan” event. The high degree of uncertainty surrounding the current market situation makes any economic forecast difficult, but the financial health of agricultural lenders seems to remain strong. The agricultural lending industry is also characterized by strong customer-borrower relationships. And, the institutions are well regulated in a manner to protect the safety and soundness of the institutions and the safety of the insurance deposit base. However, the economic downturn and declining interest rates have lowered profit margins in 2008 for agricultural lenders, and nonperforming and past-due loans have increased at most financial institutions. The strong current capital positions of agricultural lenders provides a buffer for these economic downturns.

For most agricultural lenders, the primary concern may not be a capital or liquidity issue in the sector. A larger concern for agricultural lenders will be the impact the current economic downturn has on the profit margins for producers. Rising input costs and cash rents, combined with lower commodity prices, increase the operating fund needs and financial risks for producers and for lenders providing debt funds. Another concern involves the impact that shrinking margins will have on land prices and thus, on the financial health of their borrowers.

Given the current economic downturn, lenders and their regulators will be especially cautious. In response, regulators of agricultural lenders will likely require additional documentation about the quality of individual loans. Do not be surprised when your lender asks for financial information and cash flow projections. This reaction is not likely a response indicating a loss in trust, but rather a requirement from the enhanced regulations of banks.

You should certainly discuss any concerns you have about these issues with your own financial partner(s).

Questions:

1) Are you seeing the effects of the credit crisis and the larger financial crisis in your own community?
2) How are you seeing agriculture affected?
3) What additional steps should our government take if any?

February Topic: Climate Change

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CONNECTIONS

COMPARE YOUR RESPONSES

The following is a tabulation of the responses to the September Speakout Guide on the issue of *Our Ohio* communications. Samplings of some of the comments received are also included.

1. **Do members of your council regularly watch *Our Ohio* TV series?**

Most councils seemed to watch the television program at least once a month. Several councils also didn't realize we had a television program or when it was on TV.

- We watch occasionally
- It is on at the same time as church
- Maybe if it aired at a different time
- It is a very interesting program
- Its good stuff
- We will make an effort to watch

2. **Do members of this council read *Our Ohio* magazine?**

Many councils members read the magazine regularly and most read the magazine at least sometimes.

- It is very informative and well written
- Good stories, we like the format
- Very nice magazine
- Beautiful scenery pictures
- Great variety of articles
- We like the recipes and the pictures

3. **Do members of this council frequently visit the OurOhio.org Web site?**

Most councils have seldom or never viewed the Web site. A few view it regularly. Most agreed that it could be better publicized.

4. **Do members of this council feel the *Our Ohio* brand is helping educate consumers about agriculture.**

Most councils responded that they "somewhat agreed" that the *Our Ohio* brand is helping educate consumers about agriculture.

- It is getting the exposure where it is most needed.
- Not enough people know about it
- A small percent of people

5. **Do members of this council personally learn a lot by reading *Our Ohio* magazine and Web site and watching the TV series?**

Most councils responded that they somewhat agreed that they learned a lot by reading and watching the *Our Ohio* programs and publications.

- The magazine is informative we like the recipes
- Most of us just read the magazine

PUBLIC POLICY

Now that the election is behind us and members have successfully approved the 2009 OFBF policies at our annual meeting, we are ready for the beginning of Ohio's 128th General Assembly. It will be a challenging time as we look at a very difficult state budget scenario. As always we will be working diligently on the issues that make a difference to Ohio agricultural producers and rural landowners.

COMMUNICATIONS

The process of building the new Ohio Farm Bureau Web site, www.ofbf.org, is underway. The new site will feature attractive design, be user friendly and be an important platform for service to members, public officials, media and other important constituencies. In conjunction with the new Web site, OFBF is researching "new media" opportunities. Also known as "social media," these channels are Internet based, user-driven, interactive and highly targeted.

If you have suggestions or recommendations on the Web site or OFBF's new media initiative, send them to jcornely@ofbf.org.

ORGANIZATION

Look here for future news and information about Ohio Farm Bureau's Organization programs and activities.

HONEYBAKED WINNER

Windy Ridge Advisory Council
Carroll County

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PRINTED WITH SOY INK

Discussion Leader's Notes
January 2009

TIPS FOR LEADING THIS MONTH'S DISCUSSION

- Understand that this guide was written in late November and early December and things may have changed since then regarding the economy.
- Be prepared to discuss the changes that have occurred in the economy since this guide was printed.
- Provide feedback regarding potential policy that Farm Bureau may want to support or oppose regarding the national and state economic crisis.

CONNECTIONS

Communications
New OFBF Web site is coming soon!

Public Policy
Gearing up for the 128th General Assembly

HONEYBAKED HAM WINNER

Windy Ridge Advisory
Carroll County

FUN SHEET

SUBMITTED BY: COUNCIL #21
MIAMI COUNTY

Nutty Names

Clue	Answers
1. What nut is part of a lake?	1. Beech
2. What nut means you are well fed?	2. Nutrition
3. What nut is part of a nickname of a famous person?	3. Hickory
4. What nut gives flavor?	4. Nutmeg
5. What nut makes you think of money?	5. Dough-nut
6. What nut is a girl's name?	6. Hazel
7. What nut is part of a house?	7. Walnut
8. What nut is a small instrument?	8. Nut Pick
9. What nut is a dairy product?	9. Butternut
10. What nut is a bird?	10. Nuthatch
11. What nut do we drink?	11. Coconut
12. What nut is a vegetable?	12. Peanut
13. What nut is a country?	13. Brazil nut
14. What nut do we sneeze?	14. Cashew nut