Farm Credit President Responds To Ag Financial Situation

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LANCASTER, Pa. — In a response to the agricultural situation, Gene L. Swackhamer, president Farm Credit Banks of Baltimore, told a press conference here Wednesday the Farm Credit System has been buffeted by an unrelenting barrage of problems and challenges as it attempts to deal with delinquent farm loans. The past two years have not been fun for most managers; yet, an impressive resiliency is developing among loan officers and staff. It is a resolve to adapt to do the job. Financial stress has taken a toll on both borrowers and creditors and the race to recovery is still undecided for many. Before going further, however, it seems appropriate to examine some facts to keep the analysis objective.

BACKGROUND

Table I presents selected financial data for the consolidated Farm Credit System (FCS) from December 31, 1984, through September 30, 1986 — a period of 21 months. There are several stories in these numbers. Net loans outstanding have declined steadily reflecting debt paydown and the emergence and growth of nonperforming loans classified as nonaccrual, other high risk loans and acquired property. At September 30, 1986, these categories represented $13.8 billion or 19 percent of total assets outstanding. The magnitude of that non-earning drain coupled with increased build up in loss reserves has eroded surplus to $1.9 billion at September 30, a loss of $4.3 billion of capital since December 31, 1984.

Realizing that these numbers may lack comparative perspective, Table II contains some ratios that measure exposure and risk bearing capacity. With high risk credit (nonaccrual and other high risk loans) exceeding total capital by 2:1 and non-earning loans (nonaccrual) and acquired property exceeding capital by 1.4:1, it is not difficult to understand why Congress passed the 1985 Farm Credit Act to reassure investors and provide a mechanism for the FCS to borrow from the Treasury, and why Congress passed the 1986 Farm Credit Act to permit long-term amortization of losses occurring through 1988. Time and improved agricultural profitability are essential for a successful workout of these problems.

THE STRATEGIC PLAN

As a specialized financial intermediary for the agricultural sector with only limited options for loan and investment diversification to reduce risk, the FCS has evolved a strategic business plan to contain, manage, and solve the problems of distressed credit. Some of the key provisions of this plan are:

1. Position the Farm Credit System Capital Corporation to manage resource utilization within the FCS.
2. Implement asset/liability management and marginal cost pricing to replace average cost pricing.
3. Establish differential pricing with interest rates determined on the basis of competition, risk incurred and the cost of delivery.
4. Implement structural and organizational changes to adapt to the declining agricultural credit market.
5. Restructure nonaccrual loans and move acquired properties to reduce the non-earning asset burden.

Each of the above points represent a major change in operations. The Farm Credit System Capital Corporation, organized on April 11, 1986, exists to redeploy financial resources from strong banks and associations to weak ones. Each of its actions confronts the FCS with the blunt reality that operationally the System is a single entity (assets protected by loss sharing; debt protected by joint and several liability; net worth protected by capital assessment); yet, organizationally and emotionally it is a federation of autonomous businesses with a common charter — the Farm Credit Act of 1971.

Average cost pricing worked well under reasonably stable interest rates before financial reform and deregulation, but could not cope with the volatility of the last seven years in financial markets. The transition to asset/liability management now under way would be exceedingly difficult for financial organizations under "normal" conditions; it is taxing under present conditions. Yet, it is necessary to permit marginal costs, differential pricing. The downsizing of agriculture to better bring production in balance with demand is affecting all agribusiness suppliers including creditors.

The FCS has made many organizational and operational changes since December 31, 1984, with all district banks now having some joint mangement, seven districts with a majority of offices in district-wide associations, and two others in the process of deciding on district-wide associations. These changes have helped eliminate redundant functions, have strengthened capital bases and have pooled reserves; yet, more will be needed to achieve maximum efficiency in the delivery of products and services.

Finally, of the five strategies mentioned, a major effort is under way to restructure nonaccrual loans if compromise of interest and principal results in a lower loss and cost than foreclosure. Emotionally, this too is a bitter pill for good borrowers since it seems to reward failure at the cost to borrowers who have sacrificed to keep loans current. It must be presented strictly as a least cost business decision to return loans to an accruing basis which will inure to the benefit of all borrowers and the business in the long-run.

Will this strategic plan succeed? Yes, I think that it will if collateral values (primarily land) do not deteriorate much further and if agricultural businesses can reduce operating losses. I realize that these are big "IF's", but are not unreasonable assumptions.

ACTION PLANS

To achieve the desired strategic direction, the Farm Credit System has implemented several action plans. I will list only a few of the key ones.

1. Adopted uniform credit standards under policy direction of the Farm Credit Corporation of America (FCCA).
2. Instituted a model pricing plan to insure competitive pricing above minimum base spreads.
3. Instituted uniform information standards for credit and financial reporting under General Accepted Accounting Practices including loss reserve accumulations.
4. Established liquidity and investment standards through operations of the Farm Credit System Funding Corporation.
5. Adopted standard forecasting models for better system financial and operational planning.
6. Executed assistance agreements between the Capital Corporation and six Federal Land Banks to provide financial resources to avoid stock impairment.
7. Adopted a uniform loan restructuring policy for all FCS entities.
8. Adopted a uniform acquired property policy to insure fair and equitable treatment of borrowers in all regions.

FUTURE ISSUES

Change seldom comes easily. It has not in the FCS and yet it is occurring notwithstanding litigation to test the validity of FCA's assessment regulations, debate over the amount of power to concentrate in FCCA, in differences on legislative and policy issues with the government's regulator — the Farm Credit Administration.

It seems logical that public policy debate will continue in 1987 regarding the possible role of the Farm Credit System as a secondary mortgage market maker, what system structure will best serve the needs of agriculture, how to best strengthen permanent capital within the system and how to mitigate the painful and costly out-migration from agriculture of insolvent farm businesses.

None of these are simple policy issues. They are too important to ignore and too important to leave to chance solution. Each must be addressed through our democratic processes.

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Principal speakers at the Farm Credit Service press briefing this week in Lancaster are (L to R) Dr. David Kohl, professor of agricultural economics at Virginia Polytechnical Institute; Gene Swackhammer, president and CEO Farm Credit Banks of Baltimore and James Ownes, president Lancaster Farm Credit Service.

TABLE I
FARM CREDIT SYSTEM FINANCIAL CONDITION
(BILLIONS)

	9/30/86	6/30/86	3/31/86	12/31/85	12/31/84
Net Loans Outstanding	$58 2	$61 5	$64 9	$66 6	$77 1
Nonaccrual Loans	8 0	7 6	5 9	5 3	1 4
Acquired Properties	1 1	1 0	1 0	1 0	3*
Other High Risk Loans	4 7	4 7	5 1	4 0	5 4*
90+ Days Delinquent	1 2	1 6	1 9	1 2	
Total Capital	6 3	7 0	7 9	8 4	11 8
Stock	4 4	4 6	4 7	5 0	5 6
Surplus	1 9	2 4	3 2	3 4	6 2
Total Risk Funds	10 0	10 5	11 1	11 6	13 1
Loss Reserves	3 7	3 5	3 2	3 2	1 3

* Excludes PCAs

TABLE II
FARM CREDIT SYSTEM FINANCIAL CONDITION

	9/30/86	6/30/86	3/31/86	12/31/85	12/31/84
Nonaccrual Loans/Loans Outstanding	13 0%	12 0%	9 0%	8 0%	2 0%
Loss Reserves/Loans Outstanding	6 0%	5 4%	4 7%	4 6%	1 7%
Nonearning Loans (Nonaccrual) and Acquired Property to Capital	1 4 1	1 2 1	0 9 1	0 8 1	19 1
High Risk Loans (Nonaccrual and Other High Risk Loans) to Capital	2 0 1	1 8 1	1 4 1	1 1 1	**
High Risk Loans to Risk Funds	1 3 1	1 2 1	1 0 1	0 8 1	
High Risk Loans to Surplus and Loss Reserves	2 3 1	2 1 1	1 7 1	1 4 1	
High Risk Loans to Loss Reserves	3 4 1	3 5 1	3 4 1	2 9 1	

** Comparable information not available

TABLE III
BALTIMORE DISTRICT FINANCIAL CONDITION
(MILLIONS)

	9/30/86	6/30/86	3/31/86	12/31/85	12/31/84
Net Loans Outstanding	$2,692 7	$2,804 6	$2,859 8	$2,915 9	$3,112 8
Nonaccrual Loans	68 6	54 9	44 1	42 7	17 3*
Acquired Properties	7 1	7 7	8 9	9 0	3 4
Other High Risk Loans	77 5	112 4	123 7	112 8	**
90+ Days Delinquent	18 9	55 8	71 7	55 7	**
Total Capital	435 0	456 0	477 4	474 8	478 7
Stock	176 4	182 0	184 3	187 7	220 5
Surplus	258 6	274 0	293 1	287 1	278 2
Total Risk Funds	508 2	527 4	549 1	548 4	551 3
Loss Reserves	73 2	71 4	71 7	73 6	72 6

* Excludes PCAs
** Comparable information not available

TABLE IV
BALTIMORE DISTRICT FINANCIAL CONDITION

	9/30/86	6/30/86	3/31/86	12/31/85	12/31/84
Nonaccrual Loans/Loans Outstanding	2 5%	1 9%	1 5%	1 4%	**
Loss Reserves/Loans Outstanding	2 7%	2 5%	2 5%	2 5%	2 3%
Nonearning Loans (Nonaccrual) and Acquired Property to Capital	17 1	14 1	11 1	11 1	*
High Risk Loans (Nonaccrual and Other High Risk Loans) to Capital	34 1	37 1	35 1	33 1	**
High Risk Loans to Risk Funds	29 1	32 1	31 1	28 1	*
High Risk Loans to Surplus and Loss Reserves	44 1	48 1	46 1	43 1	
High Risk Loans to Loss Reserves	2 0 1	2 3 1	2 3 1	2 1 1	**

** Comparable information not available