FARM CREDIT ADMINISTRATION

2007

Annual Report on the Farm Credit System

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STATEMENT OF THE CHAIRMAN AND CEO

May 2008

Dear Reader,

On behalf of the Board and the dedicated employees of the Farm Credit Administration, I present the 2007 Annual Report on the Farm Credit System (FCS or System).

I am pleased to report that the System continues to be in a sound financial position, having had several years of solid growth and performance. This conclusion is based on our examinations, independent ratings, and risk assessments. The System's growth in loan volume reflects the fulfillment of its public policy purpose of providing for the credit needs of agricultural producers and rural America. We believe that agriculture and rural areas will continue to demonstrate a growing need for competitive credit and financially related services. It will take the resources and expertise of all rural lenders to provide for this demand.

In 2007, FCA completed a final rule amending disclosure requirements for reports to System shareholders and investors. These amendments ensure that the Farm Credit System's disclosures and financial reporting keep pace with recent changes in industry practices, Securities and Exchange Commission regulations implementing the Sarbanes-Oxley Act of 2002, and Public Company Accounting Oversight Board auditing standards. We also issued an advance notice of public rulemaking to solicit public input on appropriate changes to FCA's capital adequacy requirements for the System in light of Basel II proposals by the other Federal banking agencies.

Also in 2007, the FCA Board continued to support pilot programs in the FCS that provide funds for investments in rural America. These investments can help fund the economic development, infrastructure improvements, essential community facilities, and revitalization projects that are so important for the vibrancy of agriculture and rural communities.

The System is required to provide credit to young, beginning, and small (YBS) farmers and ranchers. In 2007, lending by the System to YBS producers continued its upward trend. But there are still many opportunities to make it more feasible and attractive for people to live in rural communities and to make farming or ranching their career. Along these lines, the FCA Board acted to ensure that all

System institutions assist YBS farmers to enter, grow, or remain in agricultural or aquacultural production. The Agency issued guidance to all FCS institutions that encourages System lenders to provide credit enhancements so that YBS farmers can qualify for financing, and it encourages System lenders to mitigate the risk of lending to YBS farmers by increasing coordination with other lending entities and sharing best practices.

Finally, the agricultural economy has experienced several favorable years. Producers have had strong net earnings, thanks to high commodity prices and strong exports. However, several factors—a weakening general economy, the growing biofuels industry, rising input costs, increasing feed costs, changing farmland values, and evolving Government farm and trade policies—are creating uncertainties in the future of the agricultural economy. In addition, we continue to see increases in the demand for seasonal credit as a result of higher commodity and input prices.

As the regulator of the FCS, FCA will continue to ensure that the System maintains appropriate internal controls, financial capacity, expertise, and underwriting requirements. We are increasing our examination and systemic risk analysis activities to remain proactive in our oversight of the System, and we will continue to provide the System the flexibility it needs to manage its balance sheet and capital.

The agriculture industry and those of us who are invested in its future are going through exciting and unpredictable times. Through it all, we are mindful of the System's original mandate to be a dependable lender to agriculture and rural America in both good times and bad. As the regulator of the System, FCA remains committed to its responsibility to ensure that the System can fulfill its mandate to current and future generations of farmers and ranchers and the rural areas in which they live.

Nancy C. Pellett

Sincerely,
Nancy C. Pellett

FARM CREDIT ADMINISTRATION

THE MISSION

The Farm Credit Administration (FCA or Agency) is an independent agency in the executive branch of the U.S. Government. FCA is responsible for regulating and supervising the banks, associations, and related entities in the Farm Credit System (FCS or System), including the Federal Agricultural Mortgage Corporation (Farmer Mac). The FCS is a nationwide network of borrower-owned financial institutions that provide credit to farmers, ranchers, residents of rural communities, agricultural and rural utility cooperatives, and other eligible borrowers.

The Farm Credit Administration ensures a safe, sound, and dependable source of credit and related services for agriculture and rural America.

FCA was created by a 1933 Executive order of President Franklin D. Roosevelt; the Agency now derives its powers and authorities from the Farm Credit Act of 1971, as amended (Farm Credit Act or the Act). The U.S. Senate Committee on Agriculture, Nutrition, and Forestry and the U.S. House of Representatives Committee on Agriculture oversee FCA and the FCS.

FCA is responsible for ensuring that the System remains a dependable source of credit for agriculture and rural America. The Agency does this in two specific ways:

1. It conducts examinations of FCS institutions to monitor and oversee the safety and soundness of their activities. Examiners also evaluate compliance with applicable laws and regulations.
2. It approves corporate charter changes and researches, develops, and adopts regulations and other guidelines that govern how System institutions conduct their business and interact with their customers.

If a System institution violates a law or regulation or if its operations are unsafe or unsound, FCA can use its enforcement authority to ensure that the problem is corrected. FCA also protects the rights of borrowers, reports to Congress on the financial condition and performance of the FCS, and approves the issuance of System debt obligations.

The Agency maintains its headquarters and a field office in McLean, Virginia. FCA also has field offices in Bloomington, Minnesota; Dallas, Texas; Denver, Colorado; and Sacramento, California.

THE BOARD

FCA policy, its regulatory agenda, and supervisory activities are established by a full-time, three-person Board, whose members are appointed by the President of the United States, with the advice and consent of the Senate. They serve a six-year term and may not be reappointed after serving a full term or more than three years of a previous member's term. The President designates one member as Chairman of the Board, who serves until the end of his or her own term. The Chairman also serves as FCA's Chief Executive Officer (CEO).

FCA does not receive a Federal appropriation. The Agency is funded through assessments paid by System institutions and by reimbursable activities.

Nancy C. Pellett
Chairman and CEO

Nancy C. Pellett is Chairman of the Board and CEO of FCA.* Ms. Pellett was appointed to a six-year term on the FCA Board by President George W. Bush on November 26, 2002, and she was designated Chairman on May 22, 2004. Her term expires on May 21, 2008.

Ms. Pellett also serves as a member of the board of directors of the Farm Credit System Insurance Corporation, which is responsible for ensuring the timely payment of principal and interest on obligations issued on behalf of FCS banks.

Ms. Pellett brings to her position on the FCA Board extensive experience in production agriculture and agribusiness. In partnership with her husband, she managed Prairie Hills, Ltd., a feedlot, cow-calf, and row-crop operation in Atlantic, Iowa, from 1966 until her appointment to the Board. While she serves her term as FCA Chairman and CEO, her husband, son, and daughter-in-law continue to operate this fifth-generation family farm.

For more than 20 years, she also served as president and treasurer of Fredrechsen Farms, Ltd., a family-owned swine and row-crop operation in Walnut, Iowa.

A long-time beef industry leader, Ms. Pellett held State and national leadership positions in cattle industry organizations. As a member of the National Cattlemen's Beef Association, she served as chairman of the check-off division, as chairman of the consumer marketing group, and most recently as a member of the Cattlemen's Beef Board. She also was president of the Iowa Beef Industry Council.

She is a partner in Premium Quality Foods, Inc., which markets precooked beef entrees. Previously, she served as president and consumer marketing director for the company.

Ms. Pellett served a six-year term as a member of the Board of Regents for the State of Iowa, which oversees the three State universities as well as the University of Iowa Hospital and its affiliated clinics. She was also selected as a member of the Governor's Student Aid Commission.

Dedicated to the future of agriculture, Ms. Pellett worked with 4-H at the local and State levels and served on the Iowa 4-H Foundation board. She is a founding member of the 4-H/FFA "Sale of Champions" committee for the Iowa State Fair.

Ms. Pellett is on the Iowa State University Foundation Board of Governors and was a member of the advisory committees for the College of Agriculture and the College of Family and Consumer Sciences. She is past president of the university's Alumni Association and was awarded the Alumni Medal in 1987. The Pellett family was honored as the "Family of the Year" by the university in 1997.

The Pellett family also received the "Friends of Youth Award" in 2000 from the Knights of AkSarBen, a foundation that supports education, youth programs, and rural development in Nebraska and western Iowa.

A native of Walnut, Iowa, Ms. Pellett holds a B.S. from Iowa State University at Ames. She and her husband have four children.

* Ms. Pellett's tenure as Chairman and CEO ended on May 21, 2008. She continues to serve as a member of the Board until a successor is nominated by the President and confirmed by the Senate.

Leland A. "Lee" Strom
Board Member

Leland A. Strom was appointed to a six-year term on the FCA Board by President George W. Bush on December 12, 2006. His term expires on October 13, 2012.

Mr. Strom also serves as the chairman of the board of directors of the Farm Credit System Insurance Corporation (FCSIC), which is responsible for ensuring the timely payment of principal and interest on obligations issued on behalf of FCS banks.

For more than 30 years he has been active in the agriculture industry. He served for more than 25 years on the board of 1st Farm Credit Services, an FCS institution in Illinois, holding various positions, including chairman. During the agriculture crisis of the 1980s, he was selected to sit on the Restructuring Task Force of the Sixth Farm Credit District.

From 2000 to 2006, he was on the Federal Reserve Bank of Chicago Advisory Council on Agriculture, Labor, and Small Business. Part of this time he also served on the Country Mutual Fund Trust Board, an investment fund of the Illinois Farm Bureau and its Country Financial organization.

Other boards Mr. Strom has served on include Northern F.S., Inc., a farm service and supply cooperative serving farmers in Northern Illinois; AgriBank, FCB; and the Farm Credit Council, the national trade organization representing FCS in Government affairs.

Mr. Strom has served in several capacities with the Illinois Farm Bureau. He also served on his county Farm Bureau board. He was a member of the State Young Farmer Committee from 1981 to 1985. For his overall involvement in agriculture, he received an Outstanding Young Farmer Award.

In his community of Kane County, Illinois, which lies at the edge of suburban Chicago, Mr. Strom helped develop a farmland preservation program. The original Strom family farm was the first to be dedicated to permanent agricultural use under the program.

Mr. Strom studied agriculture business at Kishwaukee College and business administration at Northern Illinois University. His community involvement includes having served as vice president of his local K–12 school district, chairman of his church council, 4-H parent leader, and coach of boys' and girls' sports teams. Mr. Strom owns a third-generation family farm in Illinois that produces corn and soybeans. He and his wife, Twyla, have two sons and a daughter.

Dallas P. Tonsager
Board Member

Dallas P. Tonsager was appointed to the FCA Board by President George W. Bush on November 30, 2004, for a term that expires May 21, 2010.

Mr. Tonsager also serves as a member of the Board of Directors of the Farm Credit System Insurance Corporation, which is responsible for ensuring the timely payment of principal and interest on obligations issued on behalf of FCS banks.

Mr. Tonsager brings to his position on the FCA Board extensive experience as an agriculture leader and producer and a commitment to promoting and implementing innovative development strategies to benefit rural residents and their communities. As executive director of the South Dakota Value-Added Agriculture Development Center in Huron from 2002 until his appointment to the FCA Board, he coordinated initiatives to better serve producers interested in developing value-added agricultural projects. Services provided by the center include project facilitation, feasibility studies, business planning, market assessment, technical assistance, and education.

In 1993 he was selected by President William J. Clinton to serve as the State director in South Dakota for rural development for the U.S. Department of Agriculture. Mr. Tonsager oversaw a diversified portfolio of housing, business, and infrastructure loans in South Dakota totaling more than $100 million. In 1999, he was recognized as one of two outstanding State directors in the nation by then-USDA Under Secretary Jill Long Thompson. His term concluded in February 2001.

A long-time member of the South Dakota Farmers Union, Mr. Tonsager served two terms as president of the organization from 1988 to 1993. He served on the board of National Farmers Union Insurance from 1989 to 1993, and he was a member of the advisory board of the Commodity Futures Trading Commission from 1990 to 1993.

From 1988 to 1993, Mr. Tonsager was a board member of Green Thumb, Inc., a nationwide job training program for senior citizens. Until recently he served on the board of Lutheran Social Services of South Dakota.

Mr. Tonsager grew up on a dairy farm near Oldham, South Dakota. In partnership with his brother, he owns Plainview Farm in Oldham, a family farming operation that includes corn, soybeans, wheat, and hay.

Mr. Tonsager is a graduate of South Dakota State University, where he earned a B.S. in agriculture in 1976. He and his wife, Sharon, have two sons and a daughter-in-law.

FARM CREDIT SYSTEM— AN OVERVIEW OF EVENTS AND CONDITIONS

FCS ROLE AND STRUCTURE

The Farm Credit System is a network of borrower-owned cooperative financial institutions and service organizations. It is the largest single agricultural lender in the country and serves all 50 States and the Commonwealth of Puerto Rico. Created by Congress in 1916 to provide American agriculture with a dependable source of credit, the FCS is the oldest financial Government-sponsored enterprise (GSE).[1]

FCS institutions provide credit and financially related services to farmers, ranchers, producers or harvesters of aquatic products, and farmer-owned cooperatives. They also make credit available for agricultural processing and marketing activities, rural housing, certain farm-related businesses, agricultural and aquatic cooperatives, rural utilities, and foreign and domestic entities in connection with international agricultural trade. The System raises funds by selling securities in the national and international money markets, subject to approval by FCA. These securities are not guaranteed by the U.S. Government. The funds are used to meet the credit needs of rural America through the FCS lending institutions.

As of December 31, 2007, the System was composed of 100 banks and associations. Five Farm Credit banks provided loan funds to 86 Agricultural Credit Association (ACA) parent organizations[2] and 9 Federal Land Credit Associations (FLCAs). ACAs make short-, intermediate-, and long-term loans; FLCAs make only long-term loans; and Production Credit Associations (PCAs), which are subsidiaries of ACAs, make only short- and intermediate-term loans.

The parent-subsidy structure, with an ACA as parent and its wholly owned PCA and FLCA as subsidiaries, accounted for 90 percent of all associations as of December 31, 2007. The ACA and its two subsidiaries operate with a common board of directors and staff, and each of the three entities is responsible for the debts of the others. As a result, for most regulatory and examination purposes, FCA views the ACA and its subsidiaries as a single entity.

This parent-subsidiary structure offers several benefits. It allows the ACA to build and use capital more efficiently and enables members to be stockholders of one entity—the ACA—and to be borrowers of the ACA or of one or both subsidiaries. This gives the ACA and its subsidiaries greater flexibility in serving their customers and allows credit and related services to be delivered to borrowers more efficiently. Further, the structure allows an association to provide a broader range of specialized services to its member-borrowers. It enables one-stop borrowing—borrowers can obtain both long- and short-term loans from the same institution—and it also allows earnings made by FLCA subsidiaries of an ACA to remain tax exempt.

One of the five Farm Credit banks is an Agricultural Credit Bank (ACB), which has a nationwide charter to make loans to agricultural and aquatic cooperatives and rural utilities, as well as to other persons or organizations that have transactions with, or are owned by, these cooperatives. The ACB finances U.S. agricultural exports and imports and provides international banking services for farmer-owned cooperatives. In addition to making loans to cooperatives, the ACB provides loan funds to five ACAs, which serve New York, New Jersey, Connecticut, Rhode Island, Maine, Massachusetts, New Hampshire, Vermont, Alaska, Oregon, Washington, Montana, and Idaho.

FCA also examines the Federal Farm Credit Banks Funding Corporation (Funding Corporation), a special-purpose entity owned by the System. The Funding Corporation markets debt securities that the banks sell to raise loan funds.

1. 1 The Federal Land Banks were created in 1916, when the System was originally established. Other major parts of the FCS were created in 1923 and 1933.

2. 1 The ACA is the parent company of two wholly owned subsidiaries, a PCA and an FLCA. Although legally separated, the ACA, the PCA, and the FLCA operate an integrated lending business, with loans made through the subsidiaries possessing the appropriate authority. The ACA, the PCA, and the FLCA are jointly and severally liable on the full amount of the indebtedness to the bank under the bank's General Financing Agreement. In addition, the three associations agree to guarantee each other's debts and obligations, pledge their respective assets as security for the guarantee, and share each other's capital. The three institutions have a common board and management and a common set of shareholders. Under the Farm Credit Act, the FLCA is exempt from State and Federal income taxes.

FCA also examines and regulates the following five service corporations organized under section 4.25 of the Farm Credit Act:[3]

1. AgVantis, Inc., which provides technology-related and other support services to the associations affiliated with U.S. AgBank, FCB (Farm Credit Bank). AgVantis is owned by the bank and 19 of its affiliated associations.
2. 1 Farm Credit Leasing Services Corporation, which provides equipment leasing services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities, and is wholly owned by CoBank, ACB.
3. Farm Credit Financial Partners, Inc., which provides support services to CoBank, ACB; CoBank's five affiliated associations; two associations affiliated with U.S. AgBank, FCB; one association affiliated with AgriBank, FCB; and two System-related entities.
4. The FCS Building Association, which acquires, manages, and maintains facilities to house FCA's headquarters and field office staff. The FCS Building Association is owned by the FCS banks. The FCA Board oversees the Building Association's activities on behalf of its owners.
5. Farm Credit Finance Corporation of Puerto Rico (FCFCPR), which offered tax incentives to investors to provide low-interest funding (other than that from the Federal Farm Credit Banks Funding Corporation) to Puerto Rico Farm Credit, ACA. Because of changes in the tax treatment of the corporation, AgFirst Farm Credit Bank, the sole owner of FCFCPR, suspended operations of FCFCPR as of December 31, 2005. The service corporation is currently inactive, although the charter remains outstanding.

FCA also examines and regulates the Federal Agricultural Mortgage Corporation (Farmer Mac).[4] Farmer Mac provides a secondary market arrangement for agricultural real estate, Government-guaranteed portions of certain loans, and rural housing mortgage loans; in doing so, it provides greater liquidity and lending capacity to agricultural lenders. Under the Farmer Mac I program, Farmer Mac guarantees prompt payment of principal and interest on securities representing interests in, or obligations backed by, mortgage loans secured by first liens on agricultural real estate or rural housing; it also purchases, or commits to purchase, qualified loans or securities backed by qualified loans directly from lenders. Under the Farmer Mac II program, Farmer Mac guarantees securities backed by the "guaranteed portions" of farm ownership and operating loans, rural business and community development loans, and certain other loans guaranteed by the U.S. Department of Agriculture (USDA).

When Congress established the FCS as a GSE, its purpose was to provide a permanent, reliable source of credit and related services to agriculture and aquatic producers, their cooperatives, and related businesses in rural America. Congress intended the farmer-owned cooperative FCS to improve the income and well-being of American farmers and ranchers. It also encouraged the participation of farmer- and rancher-borrowers in the management, control, and ownership of these cooperative institutions to help the institutions remain focused on serving their members' needs.

The System meets a broad public need by preserving liquidity and competition in rural credit markets in both good and bad economic times. The accomplishment of this public goal benefits all eligible borrowers, including young, beginning, and small (YBS) farmers, as well as rural homeowners.

FCA's regulations, policy statements, examinations, chartering activities, and other regulatory activities (discussed in later chapters of this report) support and facilitate the accomplishment of the System's mission by ensuring that FCS institutions operate in a safe and sound manner, without undue risk to taxpayers, investors in System securities, or borrower-stockholders.

3. Section 4.25 of the Farm Credit Act provides that one or more FCS banks or associations may organize a service corporation to perform functions and services on their behalf. These federally chartered service corporations are prohibited from extending credit or providing insurance services.

4. Farmer Mac is established in law as an FCS institution. However, Farmer Mac has no liability for the debt of any other System institution, and the other System institutions have no liability for Farmer Mac debt. Farmer Mac is organized as an investor-owned corporation, not a member-owned cooperative. Investors in voting stock may include commercial banks, insurance companies, other financial organizations, and FCS institutions. Nonvoting stock may be owned by any investor. Farmer Mac is regulated and examined by FCA through the Office of Secondary Market Oversight, whose director reports to the FCA Board on matters of policy.

The sections in this chapter first assess the System's financial strength and then its service to rural America. The discussion relies on commonly used measures, including trends in volume by a variety of loan types, volume of funding for non-System rural lenders and participations with other lenders, and the System's share in the marketplace. Discussion in the next chapter also covers lending activity and programs that benefit YBS farmers and ranchers and the use of Government guarantee programs in supporting loans to farmers who are unable to meet normal underwriting requirements.

FINANCIAL CONDITION OF THE FCS[5]

As selected financial indicators show (tables 1 and 2), the overall condition and performance of the Farm Credit System remained safe and sound during 2007. Earnings, asset quality, and capital levels indicate that the System is in strong financial condition.

Because of strong demand for agricultural credit and favorable lending conditions, the System experienced robust growth in 2007. In addition, asset quality remained high and even improved in 2007. All banks and associations continue to maintain capital ratios well in excess of minimum regulatory requirements.

The System has benefitted, and is expected to continue to benefit, from the strength and increasing profitability of the farm sector. The February 2008 USDA forecast estimates that net cash income for farmers (i.e., cash income after payment of cash business expenses) will increase to $96.6 billion in 2008, up $9.0 billion from 2007 and $28.6 billion from its 10-year average.

Despite the overall increase in farm income, higher feed costs have negatively affected the profitability of livestock producers, as well as those who use corn or other grains in their products. In addition, most other production cash expenses, such as fertilizer, seed, and energy and labor costs, are forecasted to continue to rise in 2008. Also, the heightened volatility of commodity prices and rapidly rising farmland values in some parts of the country suggest a potentially riskier lending environment for the FCS going forward.

5. The information presented in this section pertains to all Farm Credit Banks, the Agricultural Credit Bank, and the affiliated associations of the System banks. The FCS institutions provided the data used in the overall FCS analysis to FCA or to the Federal Farm Credit Banks Funding Corporation. The analysis in this report is based on publicly available information and, except where noted, is based on the 12-month period ended December 31, 2007.

Table 1

Farm Credit System Major Financial Indicators, Annual Comparison

As of December 31

Dollars in Thousands

FCS banks[a]	2003	2004	2005	2006[b]	2007
Gross loan volume	82,986,046	85,411,707	94,865,873	112,260,474	131,191,826
Accruing restructured loans[c]	9,492	7,050	6,131	5,378	4,301
Accrual loans 90 or more days past due	22,456	5,420	1,322	5,439	12,917
Nonaccrual loans	444,663	227,003	152,223	107,556	46,069
Nonperforming loans/total loans[d]	0.57%	0.28%	0.17%	0.11%	0.05%
Cash and marketable investments	19,908,823	23,089,548	27,788,225	31,680,712	34,408,807
Capital/assets[e]	6.89%	6.79%	6.20%	5.65%	5.43%
Unallocated retained earnings/assets	3.49%	3.54%	3.28%	2.95%	2.69%
Net income	613,401	733,012	740,785	845,191	987,109
Return on assets[f]	0.68%	0.68%	0.61%	0.60%	0.60%
Return on equity[f]	9.85%	9.82%	9.48%	10.24%	10.65%
Net interest margin	0.99%	0.92%	0.84%	0.80%	0.83%
Operating expense rate[g]	0.33%	0.36%	0.33%	0.33%	0.30%
Associations					
Gross loan volume	70,897,369	75,619,681	83,253,781	93,413,704	105,620,553
Accruing restructured loans[c]	83,075	68,439	53,885	51,384	47,212
Accrual loans 90 or more days past due	20,742	15,375	13,156	19,504	43,840
Nonaccrual loans	607,351	419,312	371,703	425,545	465,479
Nonperforming loans/gross loans[d]	1.00%	0.67%	0.53%	0.53%	0.53%
Capital/assets[h]	16.34%	17.72%	17.19%	16.27%	15.57%
Unallocated retained earnings/assets	13.96%	15.28%	14.79%	13.89%	13.60%
Net income	1,341,261	2,420,251	1,613,346	1,662,255	1,935,530
Return on assets[f]	1.83%	3.10%	1.85%	1.75%	1.74%
Return on equity[f]	11.10%	18.22%	10.55%	10.44%	10.82%
Net interest margin	2.72%	2.72%	2.71%	2.64%	2.57%
Operating expense rate[g]	1.56%	1.58%	1.53%	1.58%	1.49%
Total FCS[i]					
Gross loan volume	92,790,000	96,367,000	106,272,000	123,436,000	142,906,000
Nonperforming loans	1,186,000	743,000	600,000	615,000	621,000
Nonaccrual loans	1,049,000	646,000	524,000	533,000	512,000
Nonperforming loans/gross loans[d]	1.28%	0.77%	0.56%	0.50%	0.43%
Bonds and notes	95,310,000	100,330,000	113,576,000	134,466,000	155,295,000
Capital/assets[j]	16.19%	17.13%	16.28%	15.00%	14.175
Surplus/assets	12.68%	13.69%	13.30%	12.25%	11.52%
Net income	1,825,000	2,993,000	2,096,000	2,379,000	2,702,000
Return on assets[f]	1.60%	2.46%	1.58%	1.56%	1.53%
Return on equity[f]	10.11%	14.85%	9.38%	9.99%	10.37%
Net interest margin	2.65%	2.56%	2.58%	2.48%	2.43%

Sources: Farm Credit System Call Reports as of December 31 and the Farm Credit System Annual Information Statements provided by the Federal Farm Credit Banks Funding Corporation.

a. Includes Farm Credit Banks and the Agricultural Credit Bank.
b. Some of the data for 2006 have been corrected from the amounts reported in the 2006 FCA Annual Report on the Farm Credit System.
c. Excludes loans 90 or more days past due.
d. Nonperforming loans are defined as nonaccrual loans, accruing restructured loans, and accrual loans 90 or more days past due.
e. Capital excludes mandatorily redeemable preferred stock.
f. Income ratios are annualized.
g. Operating expenses are divided by average gross loans, annualized.
h. Capital excludes protected borrower capital.
i. Cannot be derived through summation of above categories because of intradistrict and intra-System eliminations used in Reports to Investors.
j. Capital includes restricted capital (amount in Farm Credit Insurance Fund) and excludes mandatorily redeemable preferred stock and protected borrower capital.

Table 2

Farm Credit System Major Financial Indicators, by District[a]

As of December 31, 2007

Dollars in Thousands

FCS Banks	Total assets	Gross loan volume	Nonaccrual loans	Allowance for loan losses	Cash and marketable investments[b]	Capital stock[c]	Surplus[d]	Total capital[e]
AgFirst	26,926,621	19,114,517	2,507	2,816	7,486,446	764,759	731,429	1,457,481
AgriBank	52,264,029	44,005,559	3,768	3,162	7,577,658	1,073,403	1,393,581	2,396,619
CoBank	52,188,896	40,490,561	14,808	447,226	11,156,060	1,791,421	1,470,191	3,233,424
Texas	13,520,778	10,865,990	23,922	1,065	2,561,644	398,864	334,394	728,601
U.S. AgBank	22,683,825	16,715,199	1,064	889	5,626,999	779,860	591,567	1,288,746
Total	167,584,149	131,191,826	46,069	455,158	34,408,807	4,808,307	4,521,162	9,104,871
Associations								
AgFirst	17,736,427	16,226,839	93,974	76,056	638,532	179,469	2,479,080	2,650,790
AgriBank	51,634,008	47,789,840	179,048	93,144	998,715	205,837	7,529,029	7,735,646
CoBank	11,215,780	10,541,696	39,139	63,247	104,812	24,478	1,793,868	1,807,538
Texas	12,786,250	12,282,018	76,882	23,433	65,849	63,308	1,703,620	1,777,320
U.S. AgBank	20,583,469	18,780,160	76,436	65,274	838,583	248,385	3,515,858	3,767,383
Total	113,955,934	105,620,553	465,479	321,154	2,646,491	721,477	17,021,455	17,738,677
Total FCS	**186,451,000**	**142,906,000**	**512,000**	**781,000**	**36,460,000**	**1,357,000**	**21,481,000**	**26,419,000**

Sources: Farm Credit System Call Reports as of December and the Farm Credit System Annual Information Statements provided by the Federal Farm Credit Banks Funding Corporation.

a. Aggregations of district data may not equal totals because of eliminations.
b. Includes accrued interest receivable on marketable investments.
c. Includes capital stock and participation certificates, excludes mandatorily redeemable preferred stock and protected borrower capital.
d. Includes allocated and unallocated surplus.
e. Includes capital stock, participation certificates, perpetual preferred stock, surplus, accumulated other comprehensive income, and restricted capital (amount in the Farm Credit Insurance Fund, for Farm Credit System total only). Excludes mandatorily redeemable preferred stock and protected borrower capital.

Earnings

The FCS earned $2.703 billion in 2007 compared with $2.379 billion in 2006. This 13.6 percent increase in net income was largely driven by continuing high growth in the volume of loans and investments. See figure 1.

The $476 million increase in net interest income more than offset the 6.2 percent increase in noninterest expenses in 2007. In addition, the higher volume of loans and investments more than offset a limited ongoing compression in net interest margin. Net interest spread was also largely unchanged, falling only 3 basis points from 1.76 percent to 1.73 percent. Although the yield on earning assets rose by an annualized rate of 19 basis points, the cost of interest-bearing liabilities rose slightly faster, by an annualized rate of 22 basis points.

Nevertheless, return measures continue to be strong. Despite substantial asset growth, net income was sufficient to keep return on average capital and return on average assets strong. The System's return on average assets declined slightly to 1.56 percent in 2007 from 1.59 percent the prior year. Return on average capital, however, increased to 10.4 percent in 2007 from 10.0 percent in 2006.

Asset Growth

The System experienced substantial loan and asset growth in 2007, as shown in table 3. Generally high agricultural commodity prices continued to stimulate loan demand, especially for seasonal agribusiness loans. Corn prices have risen substantially as a result of a combination of continued food and feed demand and expanding ethanol demand. In addition, the depreciation of the U.S. dollar against other currencies, combined with strong global demand, has increased U.S. agricultural exports. Higher feed costs and increased land values have also increased loan demand. In 2007, FCS assets grew to $186.5 billion, up $23.6 billion (14.5 percent) from year-end 2006. This increase was led by continued growth in gross loans, which increased from $123.4 billion in 2006 to $142.9 billion at year-end 2007 (figure 2).

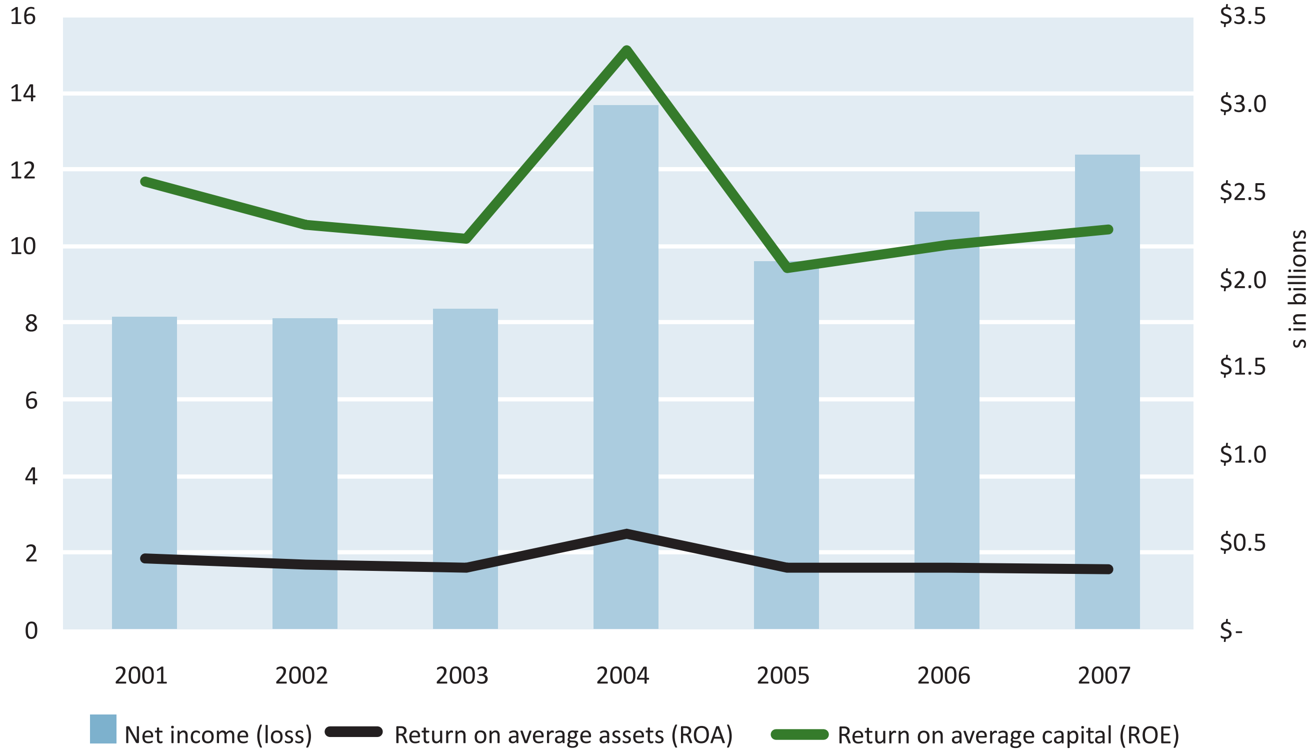
In percentage terms, CoBank, Texas, and AgriBank districts experienced the strongest growth as gross loans increased by 22.0 percent, 17.1 percent, and 16.5 percent, respectively. The CoBank district had the largest dollar growth at $7.6 billion followed by the AgriBank district at $6.9 billion.

Asset growth from 2005 to 2007 averaged more than 14 percent. The growth rates of the past 3 years are higher than any experienced by the System over the past 25 years.

Investment Assets

Investments available for sale also grew rapidly, from $27.7 billion in 2006 to $30.4 billion in 2007, with the greatest increases in mortgage-backed securities and U.S. Government securities. The System's portfolio of mortgage-backed securities available for sale grew by 17.7 percent in 2007 (table 4). Yields have not changed appreciably during 2007 in any segment of the investment portfolio. The overall yield decreased from 5.1 percent to 5.0 percent for available-for-sale securities and increased from 5.7 percent to 5.8 percent for held-to-maturity securities.

Figure 1
FCS Net Income, 2001–2007
As of December 31



Sources: Federal Farm Credit Banks Funding Corporation, Annual Information Statements.

Note: The net income for 2004 includes $1.167 billion in net reversals of the allowance for loan losses.

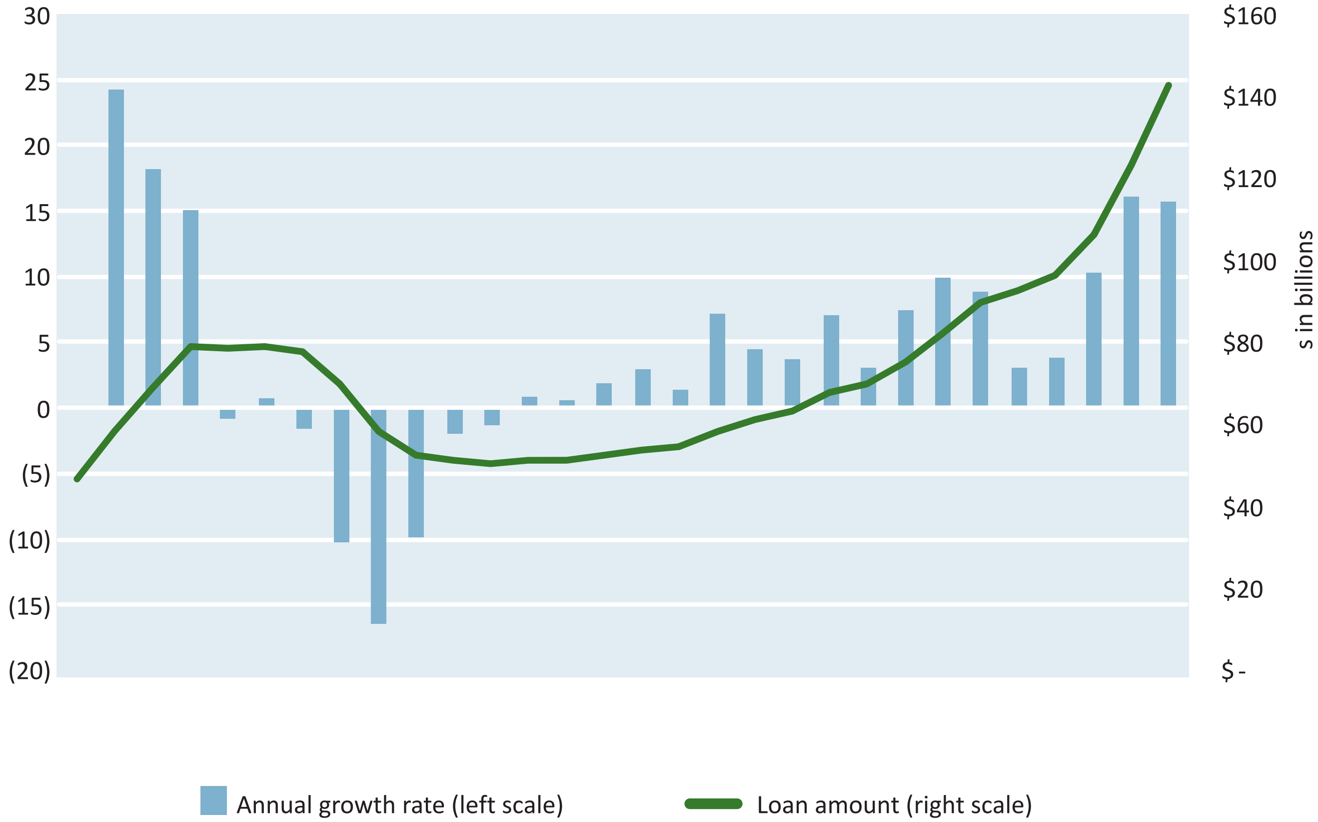
Table 3
FCS Assets
Dollars in Millions

	As of December 31		Change	
	2006	2007	Dollars	Percent
Cash	568	718	150	26.4
Federal funds sold and repossessed	1,952	1,907	(45)	(2.3)
Investments				
Available for sale	27,736	30,378	2,642	9.5
MRIs held to maturity	2,083	2,774	691	33.2
MRIs available for sale	778	683	(95)	(12.2)
Total investments	30,597	33,835	3,238	10.6
Gross loans	123,436	142,906	19,470	15.8
ALL	(734)	(781)	(47)	6.4
Net loans	122,702	142,125	19,423	15.8
Accrued interest receivable	1,839	2,013	174	9.5
Premises and equipment	526	552	26	4.9
Other assets	2,368	2,702	334	14.1
Restricted assets	2,312	2,599	287	12.4
Total assets	**162,864**	**186,451**	**23,587**	**14.5**

Sources: FCS Annual Information Statements.

MRI = mission-related investment
ALL = allowance for loan losses

Figure 2
FCS Loans Outstanding, 1978–2007
As of December 31



Sources: FCS Annual Information Statements.

Table 4
FCS Investments
Dollars in Millions

	As of December 31				Change		
	2006		2007		Amount		WAY
	Dollars	**WAY %**	**Dollars**	**WAY %**	**Dollars**	**%**	**bp**
Available for sale (fair value)							
Money market instruments	2,857	5.3	1,878	5.1	(979)	(34.3)	(23)
U.S. Agency securities	283	4.3	1,337	4.7	1,054	372.4	39
Mortgage-backed securities	21,172	5.1	24,926	5.1	3,754	17.7	(3)
Other asset-backed securities	3,424	5.5	2,237	5.1	(1,187)	(34.7)	(35)
Mission-related and other investments	778	5.2	683	5.2	(95)	(12.2)	(3)
Total	**28,514**	**5.1**	**31,061**	**5.0**	**2,547**	**8.9**	**(10)**
Held to maturity (amortized cost)							
Money market instruments	24	7.5	162	6.4	138	575.0	(102)
Mortgage-backed securities	1,921	5.6	2,302	5.7	381	19.8	9
Other asset-backed securities	138	5.8	310	6.5	172	124.6	74
Total	**2,083**	**5.7**	**2,774**	**5.8**	**691**	**33.2**	**19**

Sources: FCS Annual Information Statements.

WAY = weighted average yield
bp = basis point (1 /100 of 1 percent)

Asset Quality

The quality of FCS assets continues to improve from the already high levels of 2006. Nonperforming loans, which represented just 0.50 percent of gross loans at the end of 2006, fell further to 0.44 percent at the end of 2007 (figure 3). In 2007, nonaccrual loans fell to $512 million from the 2006 year-end total of $533 million. However, an increase from $25 million to $56 million in delinquencies (i.e., total accruing loans that are 90 days or more past due) caused nonperforming loans to increase slightly to $621 million from the 2006 year-end total of $615 million.

Net charge-offs fell in 2007 from the 2006 year-end levels but were negligible in both years. The System had net charge-offs of $34 million in 2007 and $50 million in 2006. These represented 0.03 percent and 0.04 percent of loan volume, respectively. With the decline in nonaccrual loans and despite a slight increase in nonperforming loans mentioned previously, the allowance for loan losses provided increasing coverage of nonperforming and nonaccrual loans.

Although FCS asset quality is currently strong, the current riskier lending environment may lead to some deterioration in coming years. Fortunately, the System has significant risk-bearing capacity for facing the adversity that may lie ahead.

Liabilities, Funding, and Liquidity

In 2007, the System's funding composition remained relatively constant: short-term debt securities made up 37.2 percent of total Systemwide debt securities at December 31, 2006, and 36.9 percent at December 31, 2007. Debt securities due within a year increased by 14.7 percent, while those due after one year increased by 16.1 percent.

As noted in figure 4, the System's liquidity position remained significantly above the regulatory minimum[6] despite tightening somewhat from 141 days at year-end 2006 to 122 days at year-end 2007.

The duration[7] gap (i.e., the gap between the estimated duration of interest-earning assets and the estimated duration of interest-bearing liabilities) is a primary measure of asset-liability risk exposure. A positive duration gap (i.e., asset duration exceeds liability duration) of more than three months indicates a greater exposure to rising interest rates. A duration gap within the range of a positive three months to a negative three months generally indicates a small exposure to changes in interest rates. Since the duration gap for the FCS was a positive 1.4 months on December 31, 2007 (up slightly from a positive 1.0 month at December 31, 2006), the interest rate risk is still limited.

Capital

In 2007, capital from net income grew substantially, as well as from the issuance of preferred stock and subordinated debt. At 81.3 percent, surplus accounts for the overwhelming majority of capital, compared with 81.7 percent as of December 31, 2006. Overall, the System's capital-to-assets ratio fell slightly from 15.0 percent at year-end 2006 to 14.2 percent at year-end 2007 (figure 5). Total capital increased almost $2.0 billion during 2007 to $26.4 billion. The increase was primarily the result of increases in net income earned and retained and in preferred stock issuances. These issuances totaled $850 million—$468 million at the bank level and $382 million at the association level. Overall, preferred stock outstanding after retirements grew from $1.0 billion to $1.5 billion.

System banks, both as a whole and as individual institutions, are capitalized well in excess of the System's regulatory requirements. However, the banks and associations are actively evaluating further opportunities to improve and diversify their capital positions.

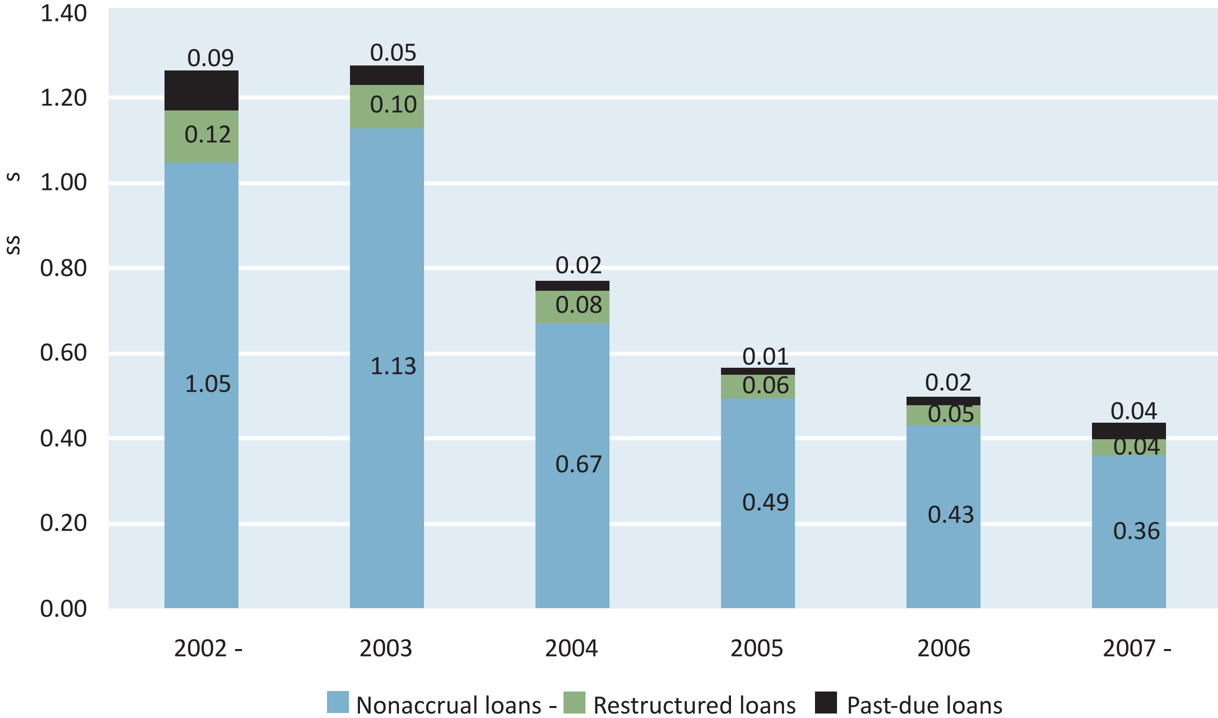
6. The regulatory liquidity standard requires each FCS bank to maintain a minimum of 90 days of liquidity on a continuous basis to guard against a possible interruption in its access to the capital markets. The number of days of liquidity is calculated by comparing maturing Systemwide debt securities and other bonds for which the bank is primarily liable with the total amount of cash, investments, and other liquid assets maintained by that bank. For purposes of calculating liquidity, liquid assets are subject to discounts that reflect potential exposure to adverse market value changes that might be recognized upon liquidation or sale.

7. 1 Duration is the weighted average maturity of cash flows. It is a useful way to estimate the direction and size of changes in the value of a financial instrument when market interest rates change. When the duration gap is small, changing market interest rates pose less interest rate risk than when the gap is large. The Funding Corporation considers a gap of ± three months to be small.

Figure 3

FCS Nonperforming Loans, 2002–2007

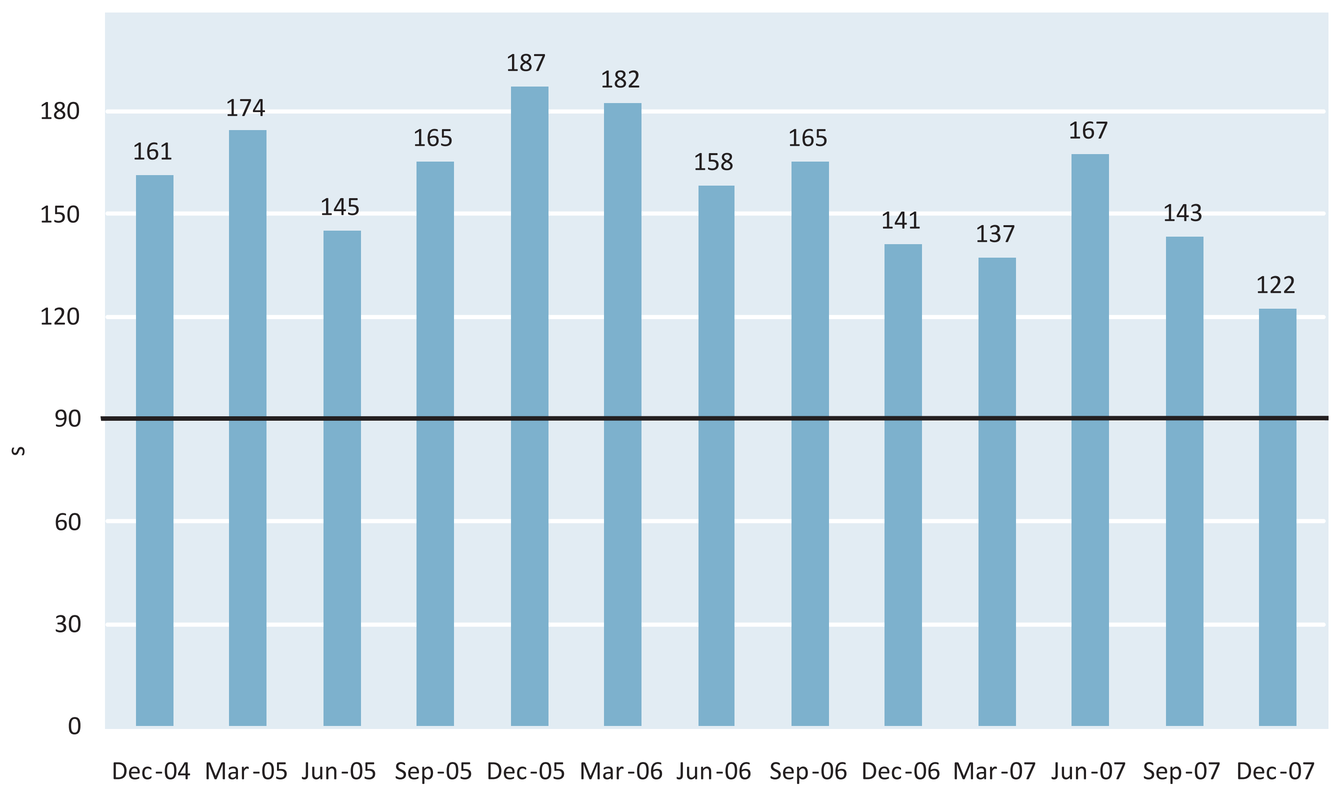
As of December 31



Sources: Federal Farm Credit Banks Funding Corporation Annual Information Statements.

Figure 4

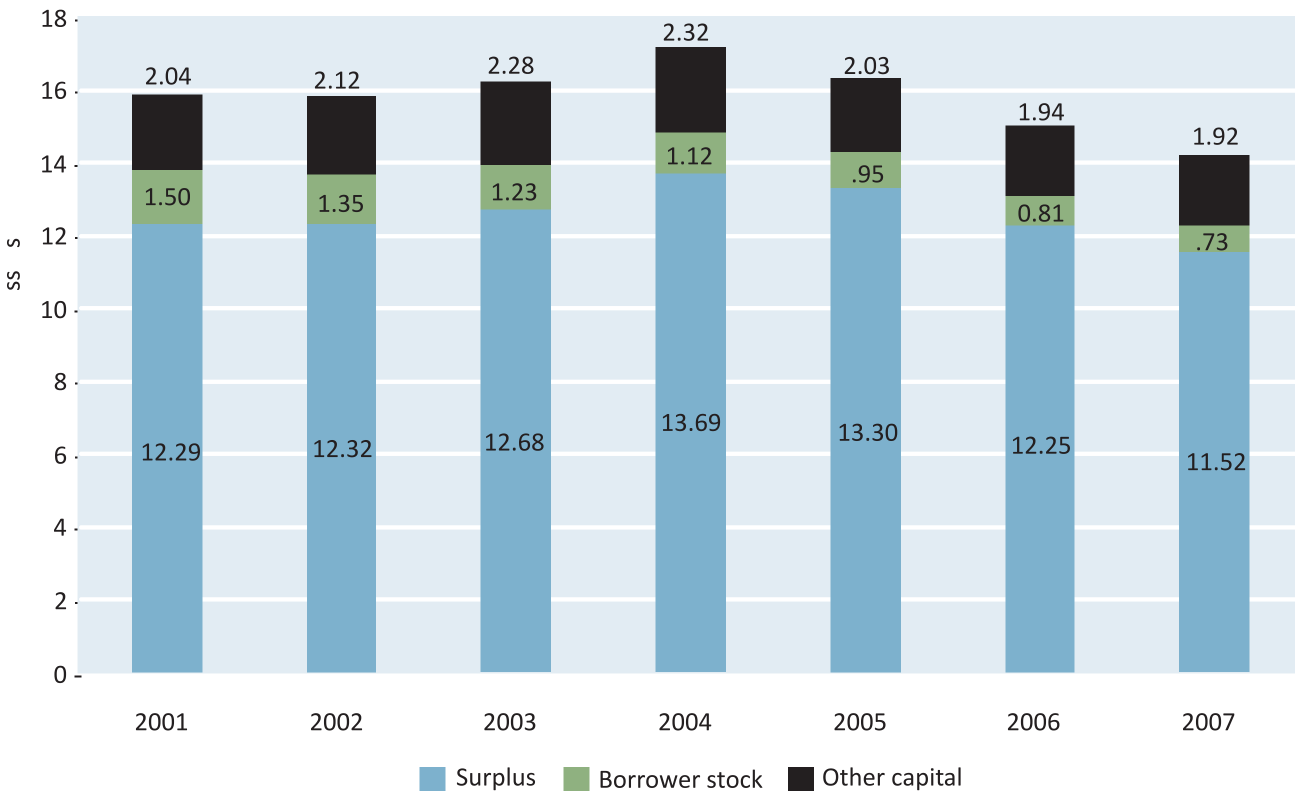
FCS Liquidity, 2004–2007



Sources: FCS Annual and Quarterly Information Statements. 1

Note: The regulatory liquidity standard requires each FCS bank to maintain a minimum of 90 days of liquidity on a continuous basis, with no access to the capital markets

Figure 5
FCS Capital, 2001–2007
As of December 31



Sources: Federal Farm Credit Banks Funding Corporation Annual Information Statements.

BORROWERS SERVED

The System fulfills its overall mission by lending to agriculture and rural America. Since 1916, when the first part of the FCS was established, the System's authority to serve its customer base has evolved to include the following loan products:

- Long-term agricultural real estate loans
- Short- and intermediate-term agricultural loans
- Loans to producers and harvesters of aquatic products
- 1 Loans to certain farmer-owned agricultural processing facilities and farm-related businesses
- 1 Loans to rural homeowners
- 1 Loans to farmer-owned agricultural cooperatives
- Loans that finance agricultural exports and imports
- Loans to rural utilities

Nationwide, the System had $142.9 billion in gross loans outstanding as of December 31, 2007 (see table 5). Agricultural producers represented by far the largest borrower group, with $95.7 billion, or 67.0 percent, of the total dollar amount of loans outstanding.[8] The FCS had more than 800,000 loans and approximately 471,000 stockholders in 2007. Approximately 85 percent of the stockholders were farmers or cooperative associations with voting stock. The remaining 15 percent were nonvoting stockholders, including rural homeowners and other financing institutions (OFIs) that borrow from the System.

The aggregate total of loans outstanding at FCS banks and associations (net of lending between System banks and associations) grew by $19.5 billion, or 15.8 percent, during the year ended December 31, 2007. Although the dollar volume increase in 2007 was larger than the gain in 2006, the percentage increase was smaller. In 2006, gross loans grew 16.2 percent, which followed gains of 10.3 percent in 2005 and 3.9 percent in 2004. Since year-end 2003, total System loans outstanding have increased by $50.1 billion, or 54.0 percent.

As of December 31, 2007, 44.4 percent of the System's loans outstanding were in long-term real estate loans, 22.6 percent in short- and intermediate-term loans to agricultural producers, and 19.6 percent in agribusiness loans. Agribusiness loans are broken down further into 11.1 percent for cooperatives, 6.8 percent for processing and marketing enterprises, and 1.7 percent for farm-related businesses. Loans to finance rural utilities represented 7.6 percent of the System's loan volume, while rural residential and real estate loans made up about 2.8 percent of the System's total loans. International loans (export financing) represented 1.5 percent of the System's loan portfolio, and lease receivables accounted for 1.2 percent of the overall portfolio. Finally, loans outstanding to other financing institutions represented a small but growing segment of the System's portfolio.

The System's increased loan volume over the past 12 months stemmed primarily from agribusiness loans (up $7.0 billion, or 32.9 percent), long-term real estate loans (up $7.0 billion, or 12.3 percent), and short- and intermediate-term loans (up $3.5 billion, or 12.3 percent). Within the agribusiness category, loans to cooperatives increased $3.6 billion, or 29.7 percent, from year-end 2006 because of an increase in loan demand from cooperative customers to finance high-priced grain inventories and hedging activities. With the exception of international loans,[9] all components of the System's loan portfolio experienced positive growth rates last year, and most of them were at double-digit levels.

Several factors facilitated the System's strong loan growth in 2007. The overall funding environment, weakening credit markets, and the demand for System securities allowed the System to meet its GSE mission by offering competitive interest rates to its customers and expanding patronage programs. System institutions also mounted effective marketing campaigns to finance more integrated operations and bioenergy plants—mostly ethanol—through processing and

8. 1 This amount does not include loans to "rural homeowners" (as defined in section 613.3030 of the FCA regulations) and leases.

9. In recent years, the level of international lending activity has been constrained by the amount of funding for loan guarantees. A majority of the System's international portfolio is guaranteed by the Commodity Credit Corporation through USDA's GSM-102 and GSM-103 export credit guarantee programs.

marketing loans. Moreover, a number of System institutions used loan participations and syndications, both inside and outside the System, to make use of their strong capital base and to diversify their portfolios and reduce risk. But the biggest driver of loan demand in 2007 was the sharp run-up in commodity prices, including oil. This development led to higher land values in the heartland; increased input costs for fuel, fertilizer, and feed; and a greater need to finance grain elevator inventories and attendant hedging operations.

FUNDING FOR OTHER LENDERS

Other Financing Institutions

Under the Farm Credit Act, System banks may further serve the credit needs of rural America by providing funding and discounting services to non-System lending institutions known as "other financing institutions." OFIs include commercial banks, thrifts, credit unions, trust companies, agricultural credit corporations, and other specified agricultural lenders. System banks can fund and discount short- and intermediate-term loans for OFIs that are significantly involved in lending to agricultural and aquatic producers and harvesters if these OFIs demonstrate a need for additional funding to meet the credit needs of eligible borrowers. OFIs benefit by using the System as an additional source of liquidity for their own lending activities and by capitalizing on the System's expertise in agricultural lending to make safe, sound, and constructive loans.

As of December 31, 2007, the System served 26 OFIs, the same number as the year before. Outstanding loan volume to OFIs was $436 million at year-end, up $10 million, or 2.3 percent, from 2006. However, OFI loan volume continues to be a very small part of the System's loan portfolio (less than 0.5 percent); it was only 1.35 percent of the System's production and intermediate-term loan volume to farm producers in 2007. About 75 percent of the System's OFI loan volume is in the Midwest.

Rising Loan Participations and Syndications with Non-FCS Lenders

Under conditions prescribed by the Farm Credit Act, System banks and associations have authority to work with commercial banks and other lending institutions in making loans to agriculture and rural America. Financial institutions primarily use loan participations and syndications to reduce credit risk and to resolve lending limit issues, but they also use them to manage and optimize capital, earnings, and liquidity. For example, a financial institution with a high concentration of production loans for a single commodity could use participations or syndications to diversify the loan portfolio, or it could use them to sell loans that are beyond its credit limit.

Activity from loan participations and syndications with non-System lenders has been growing rapidly in recent years. Figure 6 clearly shows this. The first group of bars shows gross loan syndication activity by FCS banks and associations as of December 31 for the past four years. The second and third groups of bars show net participation activity for those years.[10] The second group shows net loan participations that are not of the similar-entity type, and the third group shows net loan participations that are of the similar-entity type. Note that lending activity represented by the first group of bars in the figure, gross syndication originations, gives rise to much of the lending volume in the second group.[11]

Gross syndication originations by the System with non-System lenders totaled $8.7 billion at year-end 2007, almost 50 percent higher than the $5.9 billion in gross syndication volume at year-end 2006, and more than triple the $2.7 billion figure posted for 2005. As a result, syndication volume continued to expand in relation to the System's loan portfolio, rising from 4.8 percent of gross loans at the end of 2006 to 6.0 percent a year later. This development reflects general market trends in which commercial credits are becoming

10. 1 Loan purchase and sales transactions between System institutions and with non-System lenders are reported for several asset categories. The figure shows overall net participation volumes on the books at year-end; these are net purchases from non-System institutions.

11. The category of "gross syndication originations" refers to gross transactions resulting from direct contractual relationships with eligible borrowers. Typically, some of this volume is subsequently sold, and this is reported as part of net loan transactions (purchases less sales) with non-FCS lenders. Net loan transactions include traditional loan participations and assignments or other interest in loans.

Table 5

FCS Gross Loans Outstanding, 2003–2007

As of December 31

Dollars in Millions

Loan category	2003	2004	2005	2006	2007	Percent change from 2003
Production agriculture						
Long-term real estate mortgage loans	46,480	47,695	51,690	56,489	63,458	36.5
Short- and intermediate-term loans	21,058	22,789	24,935	28,731	32,267	53.2
Agribusiness loans[a]	12,094	12,053	14,673	21,141	28,091	132.3
Rural utility loans	6,451	7,200	8,063	9,569	10,846	68.1
Rural residential and real estate loans	2,278	2,482	2,950	3,408	3,965	74.1
International loans	2,795	2,624	2,277	2,183	2,135	(23.6)
Lease receivables	1,323	1,168	1,290	1,489	1,708	29.1
Loans to other financing institutions	311	356	394	426	436	40.2
Total	**92,790**	**96,367**	**106,272**	**123,436**	**142,906**	**54.0**

Sources: Federal Farm Credit Banks Funding Corporation Annual Information Statements.

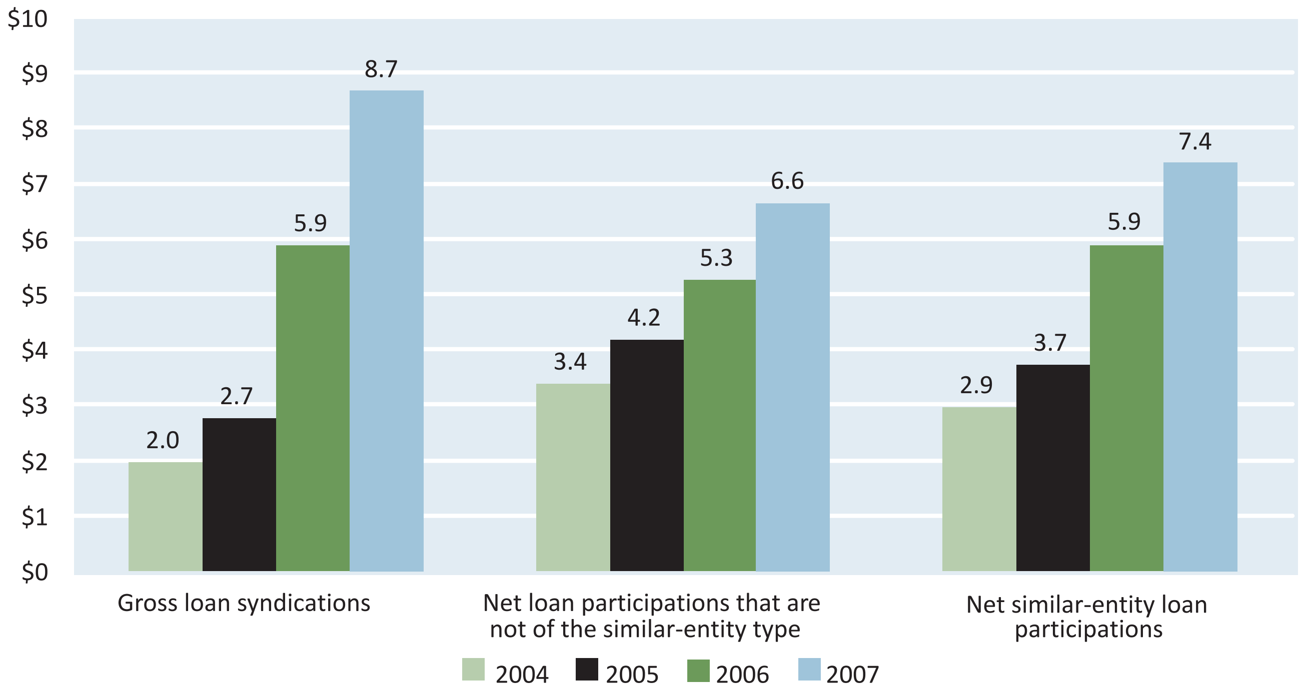
a. At December 31, 2007, agribusiness loans consisted of loans to cooperatives of $15.8 billion, processing and marketing loans of $9.8 billion, and farm-related business loans of $2.5 billion.

Figure 6

Syndications and Net Loan Participations Involving Non-System Lenders, 2004–2007

As of December 31

Dollars in Billions



more complex. In effect, lenders are switching from single-lender originators with participation sales to other institutions to syndicates where a group of lenders originates the loan.[12] This allows multiple lenders to have a direct contractual agreement with the customer as a way to manage risk while satisfying the credit needs of their customers.

In addition to participating in loans to eligible borrowers, FCS institutions have authority to work with non-System lenders that originate "similar-entity" loans (third group of bars in figure 6). A similar-entity borrower is not eligible to borrow directly from an FCS institution, but because the operation is functionally similar to that of an eligible borrower, the System can participate in these loans (the participation interest must be less than 50 percent). At the end of 2007, the net amount of similar-entity participations in the System amounted to $7.4 billion, up $1.5 billion, or 25 percent, from 2006. The net total of similar-entity loan participations and other loan participations between the System and non-System institutions was $14.0 billion at year-end 2007 compared with $11.2 billion the year before.

Although the unsettled situation in credit markets may slow new activity, the ongoing partnering between System and non-System lenders is an important development that is expanding the availability of credit to rural America.

MARKET SHARE OF FARM DEBT

According to USDA data, total farm debt for the year ended December 31, 2007, was a record $219.9 billion (nominal dollar basis), up 6 percent from year-end 2006. After accounting for inflation, farm debt for 2007 is still 39 percent below the peak level of 1980. Only in recent years has farm debt reached record-high levels on a nominal basis. Farm debt previously peaked at $189 billion at the end of 1984 and then fell during the farm financial crisis to $131 billion by the end of 1989. After the crisis, farm debt increased steadily, eventually surpassing the 1984 nominal record at the end of 2002 when it rose to $193 billion. Farm debt has continued to increase briskly in recent years in response to rising land values and higher production costs. USDA expects farm debt to increase another 3.6 percent in 2008 to reach $227.9 billion.

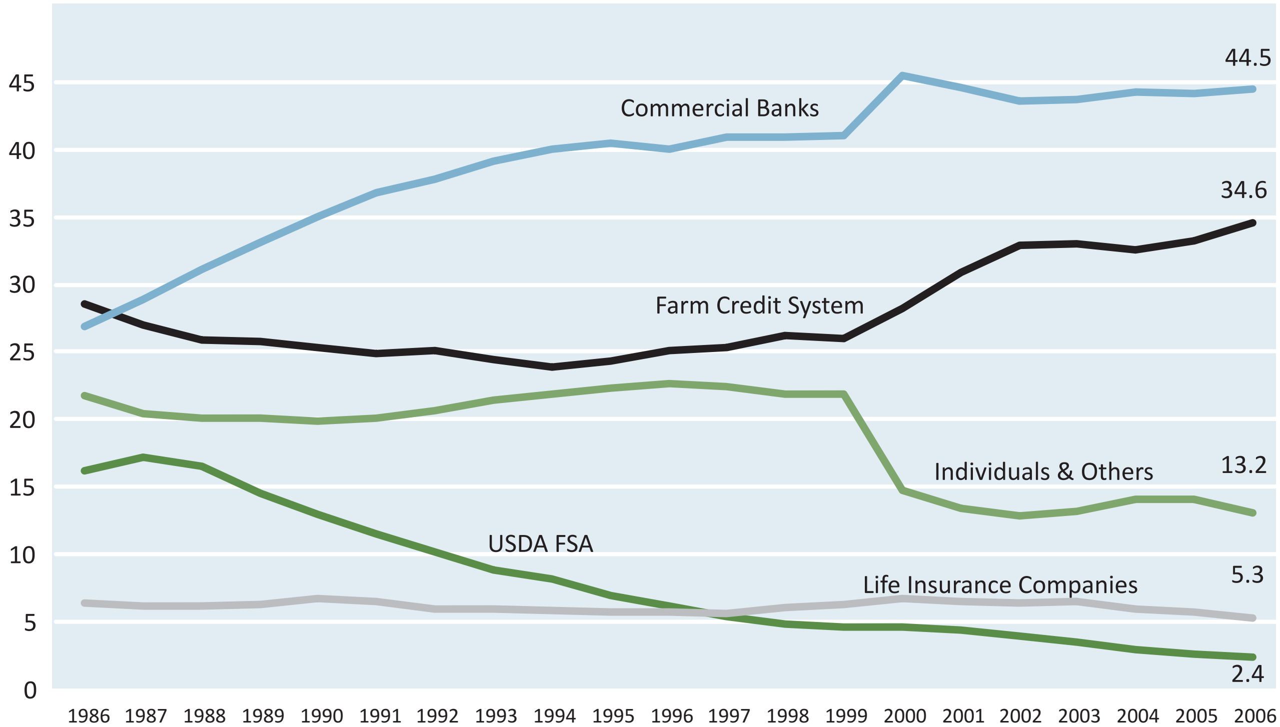
The most current market share information from USDA is for year-end 2006. The information for 2007 will not be available until USDA issues its planned update in August 2008. Total farm business debt was $207.3 billion at the end of 2006. USDA estimated that commercial banks held 44.5 percent of this debt, while the System's share was 34.6 percent. Both lender groups enjoyed market share increases in 2006 as they expanded their business more than other lenders, such as life insurance companies, the Farm Service Agency, and merchants and dealers, did. When the information is released for 2007, the System's overall market share will likely show another increase, given the 12 percent increase in its farm real estate and production credit loans in 2007. (Figure 7 shows market share shifts for the major lenders since 1986.)

Except for the unusual period of the 1980s and a brief time in the 1990s, the FCS has typically been the dominant lender for farm real estate mortgages, enjoying the largest market share. Commercial banks have always dominated non-real estate lending. The System's share of debt secured by farm real estate increased to 40.3 percent at year-end 2006 from 39.2 percent in 2002, continuing the steady upward trend of the past 10 years. The System's share of non-real estate farm debt was 28.4 percent at year-end 2006, compared with 25.0 percent at year-end 2002 and slightly less than 20 percent in the late 1990s.

In 2000, after several years of steady gains, commercial banks edged ahead of the System in the debt market secured by farm real estate, with a 35.1 percent share. However, their share slipped during the next four years before climbing to 37.2 percent at the end of 2006, a few percentage points behind the System. In the non-real estate market, the market share held by commercial banks was 52.6 percent at the end of 2006, essentially unchanged from 2005, but down from 56.6 percent in 2000, when the

12. See the Glossary for additional distinctions between "loan participation" and "loan syndication"; typically syndicate members participate out some of the volume to other lenders.

Figure 7
Market Shares of U.S. Farm Business Debt, 1986–2006



Sources: USDA, Economic Research Service, Web site, September 4, 2007.

Note: Year-end 2006 figure is a preliminary estimate.

FCS was still regaining its financial footing from the crisis of the mid-1980s.

FARMER MAC AS A SECONDARY MARKET

Farmer Mac was created to provide a secondary marketing arrangement for agricultural real estate and rural housing mortgage loans and greater liquidity and lending capacity to agricultural lenders. In USDA's estimates of farm sector debt by lender, Farmer Mac's purchases of farm real estate loans from various lenders (about $4.1 billion outstanding as of December 31, 2007) are included as a subcategory that USDA labels "Individuals and Others."

Farmer Mac also plays a role in the farm debt market through AgVantage securities and the Long-Term Standby Purchase Commitment program (Standby). The off-balance-sheet AgVantage securities are bonds issued by Farmer Mac's counterparties. The timely payment of principal and interest on AgVantage securities is guaranteed by Farmer Mac. This guarantee is secured by eligible loans and an obligation of the counterparty. AgVantage volume accounted for approximately $2.5 billion of total program volume as of December 31, 2007. Under a Standby, a financial institution acquires a Farmer Mac guarantee for an annual fee on a loan pool that the institution retains. While Farmer Mac's Standby product is available to agricultural lenders generally, System institutions accounted for nearly all ($1.9 billion) of the outstanding volume in Standbys as of December 31, 2007.[13]

Since not all farm mortgages are eligible for Farmer Mac funding, Farmer Mac calculates its market share by estimating the portion of the total farm real estate debt market that would qualify as eligible mortgages under Farmer Mac's underwriting criteria. According to these calculations, program volume outstanding ($8.5 billion) is about 17 percent of the eligible farm real estate debt market.

13. The AgVantage and Standby guaranteed amounts by Farmer Mac are reported in USDA's farm business debt estimates as being provided by the originating lender because, while they are guaranteed by Farmer Mac, they are collateralized by eligible loans that reside with the primary lender. This is also how approximately $10 billion in loans guaranteed by the Farm Service Agency (FSA) are treated; that is, the share reported for USDA/FSA is just for its direct-lending activity.

SERVING YOUNG, BEGINNING, AND SMALL FARMERS AND RANCHERS

Providing sound and constructive credit and related services to young, beginning, and small (YBS) farmers and ranchers is a legislated mandate and a priority for the System. Loans to YBS borrowers help ensure a smooth transition of agribusiness to the next generation and a continued diversified customer base, from very small enterprises to large commercial operations, for the Farm Credit System. Through its regulatory agenda, special reports, disclosure requirements, and examination activities, FCA is strongly committed to ensuring that the System fulfills its responsibility to support this important segment of the agricultural industry.

As the percentage of retirement-age farmers continues to rise, the System's potential role in helping young and beginning farmers finance the purchase of agricultural assets sold by those who are exiting the business becomes more important. The U.S. Department of Agriculture 2002 Census of Agriculture[14] found that 26.2 percent of principal operators are 65 years old or older, compared with 21.4 percent in 1987. The census also reported a continuing sharp decline in the percentage of young operators. Principal operators aged 34 or younger dropped from 13.3 percent in 1987 to 5.8 percent in 2002. Other USDA surveys and studies show that potential YBS borrowers have a heavy and increasing reliance on off-farm income, plus a wide range of credit needs beyond their agricultural production activities. Such changing demographics and economic conditions in many areas of rural America pose challenges for System institutions in meeting their YBS program goals.

Each System bank is required to adopt written policies that direct each association board to have a program for furnishing sound and constructive credit and financially related services to YBS borrowers. The Farm Credit Act stipulates that associations must coordinate with other Government and private sources of credit in implementing their YBS programs. In addition, each institution is required to report yearly on its operations and achievements in its YBS program. FCA's oversight and examination activities encourage System institutions to assess their performance and market penetration in the YBS area; this assessment, in turn, increases the mission awareness of System institutions and prompts them to earmark resources to serve this important market segment. Finally, FCA continues to review and implement various policy options for supporting the System's YBS programs. The Agency issued a Bookletter to System institutions in August 2007 that clarified various terms in the regulations and provided other guidance for the System's YBS lending programs.

YBS LENDING RESULTS

In calendar year 2007, the overall trends for YBS lending for each of the three borrower categories continued to be positive, with loans made during the year and year-end loans outstanding showing solid gains from 2006 levels.[15] Table 6A contains information on loans outstanding in each category at the end of 2007; table 6B provides information on new loans made during the year. Loans to YBS farmers include real estate loans and short- and intermediate-term loans.

In the section on YBS borrowing trends (on page 26), FCA provides information on the progress in YBS lending activity since 2001, which was the first year institutions were required to report their results using the current definitions for young, beginning, and small farmers and ranchers.

Young—At the end of 2007, the System had 148,901 loans outstanding to young farmers, totaling $17.3 billion. A "young" farmer is defined as one who is 35 years old or younger when the loan is made. During 2007, 50,550 new loans totaling $6.3 billion were made to young borrowers. These new loans represented 16.6 percent of all new farm loans the System made for the year and 10.7 percent of the new loan dollar volume. The average new loan size was $124,108. New loans made during the year, rather than loans outstanding at year-end, are a good measure of current service to YBS borrowers. The number of new loans made to young farmers during 2007 was 8.8 percent higher than in 2006, and the dollar volume of new loans was 14.7 percent higher.

14. Results from the 2007 Census of Agriculture will not be available until 2009 and 2010.

15. System data on service to YBS farmers and ranchers cover the calendar year and are reported at year-end. The statistics show loans made during the year (both number of loans and dollar volume of loans), as well as loans outstanding at year-end (both number and dollar volume). The volume measure includes loan commitments to borrowers, which typically exceed actual loan advances.

Table 6A

YBS Loans Outstanding

As of December 31, 2007

Dollars in Millions

Loan type	Number of loans	Percentage of total number[a]	Volume of loans	Percentage of total volume[a]	Average loan size
Young farmers/ranchers	148,901	18.2	$17,299	11.6	$116,179
Beginning farmers/ranchers	205,891	25.1	$29,336	19.7	$142,485
Small farmers/ranchers, by loan size[b]					
$50,000 or less	267,988	65.6	5,069	64.5	18,915
$50,001–$100,000	99,038	61.5	6,884	61.0	69,504
$100,001–$250,000	83,251	54.2	12,493	52.7	150,065
More than $250,000	28,063	28.9	15,245	14.3	543,237
Total loans to small farmers/ranchers[c]	478,340	58.3	$39,691	26.6	$82,975

Table 6B

YBS New Loans Made During 2007

As of December 31

Dollars in Millions

Loan type	Number of loans	Percentage of total number[a]	Volume of loans	Percentage of total volume[a]	Average loan size
Young farmers/ranchers	50,550	16.6	$6,274	10.7	$124,108
Beginning farmers/ranchers	64,178	21.1	$10,385	17.8	$161,811
Small farmers/ranchers, by loan size[b]					
$50,000 or less	93,658	64.9	1,590	63.2	16,978
$50,001–$100,000	28,915	52.6	1,898	54.5	65,650
$100,001–$250,000	23,148	44.9	3,571	46.8	154,288
More than $250,000	9,433	17.7	5,935	13.2	629,162
Total loans to small farmers/ranchers[c]	155,154	51.0	$12,994	22.2	$83,754

Sources: Annual Young, Beginning, and Small Farmer Reports submitted by each System lender through the Farm Credit banks.

Note: A "young" farmer/ rancher is defined as 35 years old or younger when the loan is made; a "beginning" farmer /rancher has been operating for not more than 10 years; and a "small" farmer/rancher generates less than $250,000 in annual sales of agricultural or aquatic products. Since the totals are not mutually exclusive, one cannot add across young, beginning, and small categories to count total YBS lending.

a. The first two percentages and the last percentage in these columns indicate the percentage of the total number of loans and the percentage of the total volume of loans outstanding for loans made by the associations as of year-end 2007. Each of the four percentages in the other rows indicates percentages for loans to small farmers in the respective loan size range.

b. The small farmers and ranchers group is broken into categories according to the size of their loans, not according to the amount of their annual sales.

c. Total loans represent all lending by associations.

Beginning—At the end of 2007, the System had 205,891 loans outstanding to beginning farmers, totaling $29.3 billion. "Beginning" farmers are those with 10 or fewer years of farming experience. During 2007, 64,178 new loans totaling $10.4 billion were made to beginning farmers. These represented 21.1 percent of all new loans and 17.8 percent of new loan dollar volume. The average new loan size was $161,811. The number of new loans made during 2007 was 11.0 percent higher than in 2006, and the volume of new loans was 12.1 percent higher than in the previous year.

Small—At the end of 2007, FCS institutions had 478,340 loans outstanding to small farmers, totaling $39.7 billion. "Small" farmers are defined as those with annual gross sales of less than $250,000. During 2007, 155,154 new loans were made to small borrowers for a total of $13.0 billion. New loans to small farmers represented 51.0 percent of all new loans and 22.2 percent of new loan volume. The average new loan size was $83,754. The number of new loans made during 2007 was 4.8 percent higher than in 2006, and the volume of new loans was 12.3 percent higher than in the previous year.

The YBS information is reported separately for each of the three YBS borrower categories because some borrowers fit into two or even all three categories. Therefore, the sum of the numbers in the categories should not be used to measure the System's YBS lending activity.

ASSESSMENT OF YBS RESULTS FOR INDIVIDUAL ASSOCIATIONS

Individual associations vary significantly in their YBS lending results. Some institutions may have a high number or dollar volume of loans in one category and be low in another, while activity levels for other institutions may be just the opposite. However, every FCS institution reported at least some activity in each category in 2007. The lowest figure was from an association reporting that only 2.9 percent of its new loans went to young farmers, while the highest figure came from an association reporting that 88.2 percent of its loans outstanding were to small farmers.

Over time, the rankings of a given association likely will shift as top-ranked associations in one year are replaced by different institutions in the following year. In 2007, 65 out of 95 associations increased their dollar volume of new lending to young farmers, and the same number of associations accomplished this feat for beginning farmers. Both of these numbers were up from the figures posted in 2006 (59 and 58 associations, respectively). Also, about two-thirds of the associations increased their dollar volume of new lending to small farmers in 2007, an improvement from 2006 when slightly over half the associations posted declines in new lending volume to small farmers. Beginning with 1999, specific YBS data by institution, by district, and for the System as a whole are available on FCA's Web site at www.fca.gov.

Differences among institutions' YBS results are to be expected, given the significant diversity in farm types and sizes and farmer demographics across the United States. For example, in 2006 the average value of farm production in four States was more than $250,000 per farm, compared with 17 other States with average production values of less than $100,000 per farm. Census of Agriculture data also show that the average age of farmers varies considerably from State to State. Such differences make comparisons among individual associations difficult, and they explain why YBS regulations do not specify fixed goals but require individual institutions to establish YBS targets appropriate for their lending territories. Other factors—such as the competitiveness of the local lending market and the availability of State and USDA/Farm Service Agency guarantees—play a role in individual association results.

The 2002 Census of Agriculture classified about 93 percent of all U.S. farms as small, using the same definition for a small farm as that used for YBS reporting. The census found that fewer than half of all small farms had "interest paid" as a farm business expense, which meant that

more than half of them had no farm debt on the date of the census and, therefore, would be unlikely to seek FCS funding. Another interesting fact is that, according to the census, nearly 39 percent of all farms had annual sales of $2,500 or less. Most of these farms would have little or no need for agricultural credit.

As noted earlier, the System reported that loans to small farmers represented almost 60 percent of the total number of loans in association portfolios at the end of 2007. Moreover, 51 percent of System loans made in 2007 were to small farmers. Since small farms are less likely to carry debt than large farms, these statistics reveal a strong commitment by the System to serve the credit needs of small producers.

YBS BORROWING TRENDS, 2001–2007

FCA now has seven years of System YBS results under the definitions and reporting requirements that became mandatory in 2001. In addition, all institutions have had examinations of their YBS reporting. In some cases, these examinations have resulted in corrections of previously reported YBS data. The information in figures 8A, 8B, and 8C shows fairly strong upward trends in dollars of loans outstanding and dollars of loans made for each of the three categories from 2001 to 2007. (Similar trends exist for the number of loans in each category.)

Although the volume of loans outstanding in the young, beginning, and small categories over the past seven years suggests a strong upward trend, YBS results as a percentage of total loans outstanding present a slightly different picture. Basically the percentages for all three categories have either dipped a few points or remained relatively flat over the past four years. However, given the downward trend in the percentages of young and small farm operators in agriculture, the System's YBS dollar results are noteworthy in that institutions have managed to expand loan volume in a shrinking market segment. What's more, the downward trend in the percentage of YBS loans in the System's total loan portfolio is a byproduct of the System's strong lending activity in 2006 and 2007, when loans outstanding surged by more than a third.

Comparisons in YBS lending cannot be made between FCS institutions and other lenders because other Federal regulators do not require reporting on young and beginning farmer loans. While large banks are required to report on small farm loans, small farm lending is defined in terms of loan size (a loan of less than $500,000 is considered a small farm loan) rather than in terms of the borrower's annual sales. In addition, because of differences in data definitions and data collection methods, annual YBS data are not comparable with Census of Agriculture data, which are collected only once every five years.

YBS PROGRAMS

Because of its status as a Government-sponsored enterprise, the FCS is in a unique position to develop YBS programs; to coordinate these programs with other Government programs, which reduces risk; and to make a continuing commitment to lend to YBS borrowers. Institutions may use a variety of tools to fulfill their commitment to YBS lending. Associations may offer less stringent underwriting standards or reduced interest rates to make it easier for potential YBS borrowers to qualify for loans. The differential underwriting standards often include higher loan-to-value ratios or lower debt coverage requirements for YBS borrowers. Some institutions establish special risk pools in which capital is segregated to support YBS lending. One institution recently launched a starter farmer program under investment authorities approved by the Agency (see page 36). Almost all programs involve coordinating with Federal or State sources to obtain guarantees on loans to qualifying YBS borrowers.

Most of the loan concessions made by System institutions to YBS borrowers favor the young and the beginning categories. Obviously these borrower groups face many challenges in raising enough capital to enter the industry and remain viable. During 2007, 32 associations offered interest rate concessions to their young borrowers. In addition, Figures 8A, 8B, and 8C

Loans Made to, and Loans Outstanding for, YBS Farmers and Ranchers, 2001–2006

As of December 31

Figure 8A

Young Farmers and Ranchers

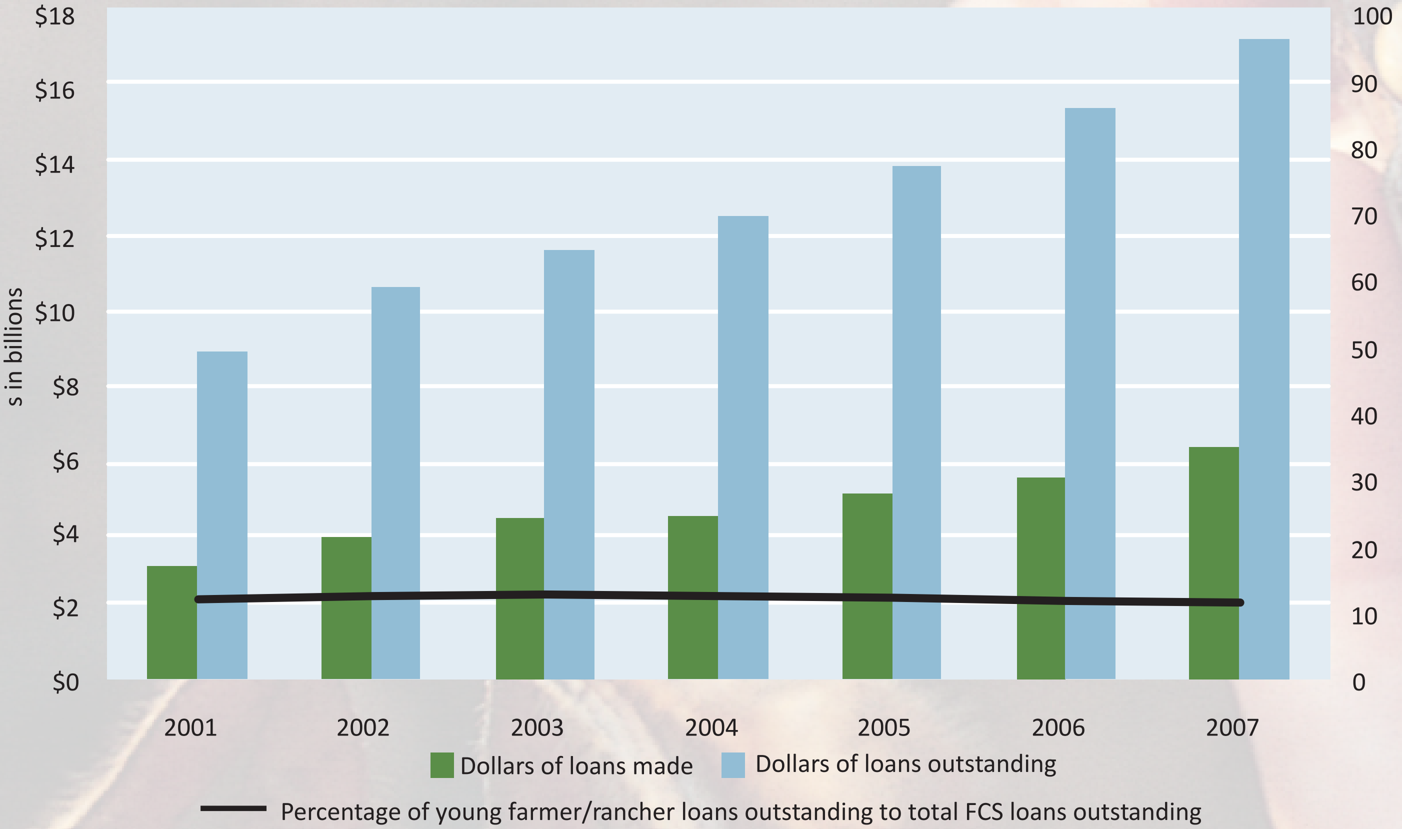


Figure 8B
Beginning Farmers and Ranchers

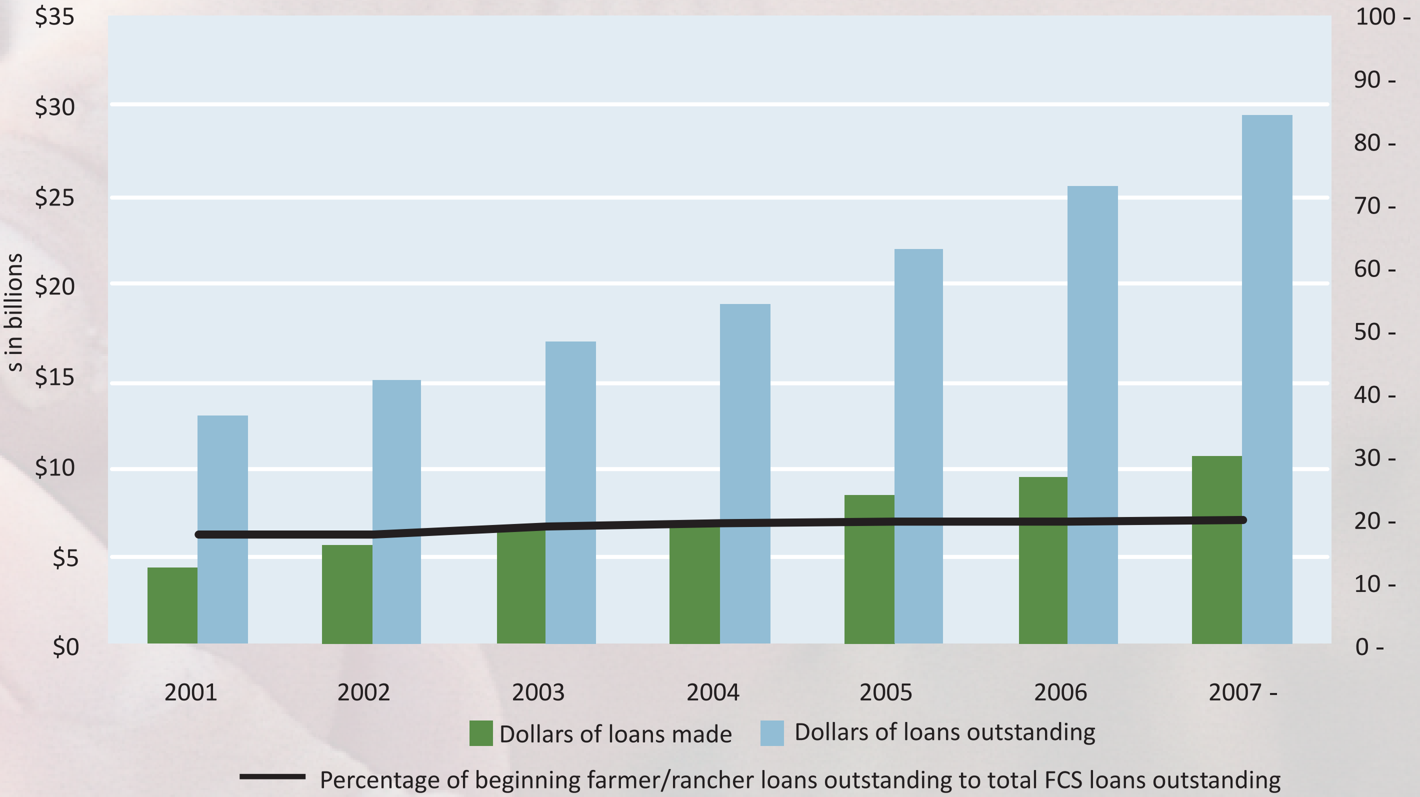
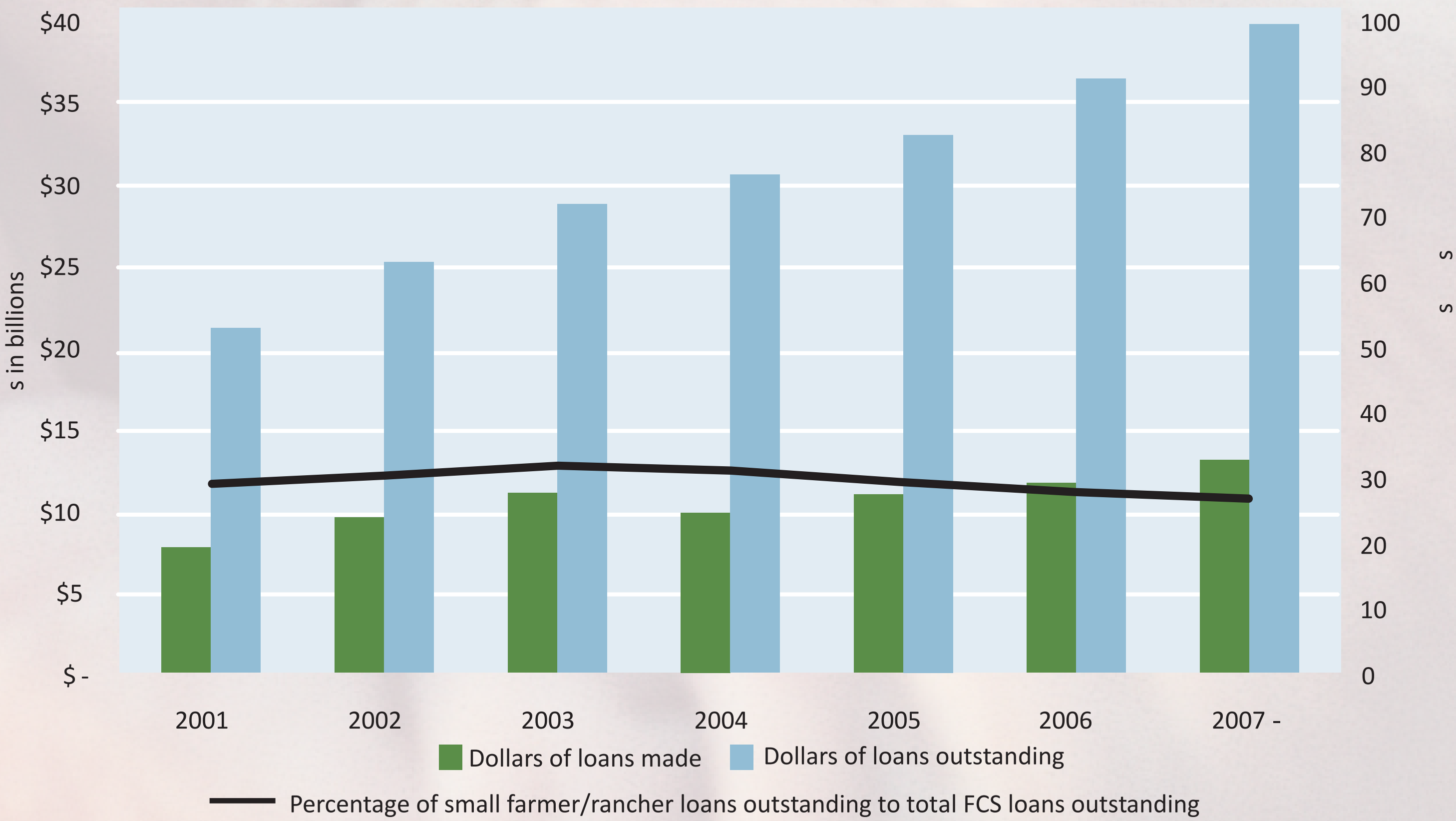


Figure 8C
Small Farmers and Ranchers



Sources: Annual YBS reports submitted by System lenders through the FCS banks.

32 associations provided exceptions to their underwriting standards, 22 associations charged lower loan fees, and 11 associations offered differential loan covenants. Altogether, 49 out of the System's 95 associations provided some form of special assistance to young borrowers in 2007. In addition, 47 of the 95 institutions applied one or more of these four features to the beginning category. Fewer institutions (39 out of the 95) used one or more of these four features for small farmers.

Some YBS borrowers are assisted by the various State and Federal programs that provide interest rate reductions or guarantees to help commercial lenders and FCS institutions reduce credit risks for borrowers. Without such concessions and guarantees, credit would not be extended to some YBS borrowers because of excessive repayment or collateral risks. USDA's Farm Service Agency is the primary provider of Government-guaranteed loans for farmers, although a small portion of guaranteed loans is made through the Small Business Administration (SBA) and various State programs. In 2007, 83 of the 95 FCS associations used FSA guarantees for YBS lending, while 20 associations used SBA guarantees and 11 associations used State and local programs.

FCS institutions actively use FSA's guaranteed lending program for both conventional and YBS lending. Agency surveys indicate that about 36 percent of the System's overall volume of FSA-guaranteed loans outstanding was to young farmers; about 42 percent was to beginning farmers; and about 51 percent was to small farmers (numbers are not additive). However, the volume of YBS loans with FSA guarantees represents a small percentage (roughly 3 to 4 percent) of the overall YBS program figures. At year-end 2007, the guaranteed loan volume figures for young, beginning, and small farmer/rancher loans were $766 million, $888 million, and $1.095 billion, respectively.

An increasing number of associations offer a growing array of training programs and other services that benefit YBS farmers and ranchers. The most common training program focuses on leadership; more than two-thirds of the associations offered this training as of year-end 2007. The development of business and financial management skills is another important training objective, and in 2007 approximately two-thirds of the associations provided training in this area. FCS associations also offer training opportunities in estate planning, recordkeeping, tax planning and preparation, and farm business consulting. In some cases, they discount or waive the cost of these programs for YBS borrowers.

Other outreach activities are offered in conjunction with such organizations as State or national young farmer groups, colleges of agriculture, State or national cooperative association leadership programs, and local chapters of 4-H and of the National FFA Organization. Many associations also provide financial support for college scholarships and for FFA, 4-H, and other agricultural organizations.

At year-end 2007, 34 associations reported that they had revised their YBS policies and procedures in the past year. A particularly noteworthy finding was that 25 associations indicated that by the end of 2007 they had already used guidance issued in an August 2007 FCA Bookletter to make these revisions. While this rapid incorporation of Agency guidance was noteworthy, most institutions are expected to have incorporated the new guidance by the next reporting period. FCA's oversight activities are accomplishing the goal of helping institution management and boards stay focused on this important mission area.

REGULATORY POLICY AND APPROVALS

FCA routinely issues regulations, policy statements, and other documents to ensure that the Farm Credit System complies with the law, operates in a safe and sound manner, and efficiently carries out its statutory mission. The regulatory philosophy of FCA is to establish a flexible regulatory environment that enables the System to offer high-quality, reasonably priced credit and related services to farmers and ranchers, their cooperatives, rural residents, and other entities on which farming operations depend.

The Agency makes every effort to develop balanced, well-reasoned, and flexible regulations whose benefits outweigh their costs. FCA's objectives are (1) to enhance the System's relevance in the marketplace and in rural America while remaining consistent with the law and safety and soundness principles, and (2) to promote participation by member-borrowers in the management, control, and ownership of these Government-sponsored enterprises.

REGULATORY ACTIVITY IN 2007

The following paragraphs describe some of FCA's regulatory efforts in 2007, along with several projects that will remain active in 2008.

Farmer Mac Risk-Based Capital Stress Test Revisions—The FCA Board approved a proposed rule in September 2007 that would revise FCA regulations governing the Risk-Based Capital Stress Test (RBCST) for the Federal Agricultural Mortgage Corporation (Farmer Mac). The RBCST calculates the minimum amount of regulatory capital that Farmer Mac is required to hold. The proposed version of the RBCST (1) adds a component to recognize the risk-reducing characteristics of structures such as off-balance-sheet AgVantage, a new loan product that accounts for a growing percentage of Farmer Mac's program volume; (2) adds a component to recognize counterparty risk on nonprogram investments; and (3) revises the estimated carrying costs of nonperforming loans.

Capital Adequacy—Basel Accord—The Agency issued an advance notice of proposed rulemaking (ANPRM) in October 2007 that considers possible modifications to its risk-based capital rules for FCS institutions that are similar to the standardized approach delineated in the New Basel Capital Accord. In view of the recent mortgage crisis and the complexity of the questions asked in the ANPRM, FCA extended the comment period to December 31, 2008.

Joint and Several Liability, Priority of Claims—FCA approved a final rule in September 2007 that amended the priority of claims regulations to give the same subrogation rights to a System bank that makes a joint and several liability payment under a written agreement as the bank has under a statutory joint and several call. The final rule was developed in response to a regulatory petition.

Subordinated Debt, Priority of Claims—The FCA Board approved a direct final rule in September 2007 that amended the priority of claims regulations to clarify that subordinated claims are to be paid after the claims of general creditors are paid.

Investments in Rural America—FCA continues to evaluate how System partnerships and investments could help increase the availability of funds to agriculture and rural America. FCA is reviewing rural community investments made under pilot projects to determine if these investments assist institutions in fulfilling mission objectives. FCA considered projects emanating from this review as support for a proposed rule on Rural Community Investments, which the FCA Board approved on May 8, 2008. These projects will also be considered in future rulemakings.

Annual Report to Shareholders—The FCA Board approved a final rule in December 2007 that extends the time allowed for System institutions to prepare and distribute their annual report to shareholders from 75 days to 90 days but retains the requirement that institutions must, within 75 calendar days, post the report to their Web site and file it electronically with FCA. The amendment promotes high-quality and timely reporting and disclosure by System institutions to shareholders and FCA.

Disclosure and Reporting—The FCA Board approved a direct final rule in October 2007 that amended Agency regulations governing an external auditor's assessment of internal control over financial reporting in the Systemwide annual report to investors. Consistent with industry practices, the amended rule requires the Federal Farm Credit Banks Funding Corporation (Funding Corporation) to have its external auditor express an opinion on the effectiveness of internal control over financial reporting instead of reporting on management's assessment of this control.

Lending Program Requirements— The Agency completed its review of existing statutory and regulatory guidance on lending programs that System institutions are authorized to offer their customers, as well as its review of appropriate underwriting criteria. Projects emanating from this review will be considered as new rulemakings.

Nominating Committee—FCA issued a Bookletter that provides guidance to FCS banks and associations on how to organize their nominating committees for director elections. The Bookletter also provides guidance on a nominating committee's authority to select a slate of candidates for all open stockholder-elected director positions and the permissible activities of directors, officers, employees, and agents in working with nominating committees.

Rural Home Financing—FCA issued an Informational Memorandum to clarify the definition of "moderately priced" housing for rural home financing. Included in the guidance are frequently asked questions that address specific issues relating to the regulatory definition of moderately priced housing, the criteria for identifying moderately priced housing values, and acceptable data for establishing those values.

Regulatory Capital Treatment—FCA published a Bookletter that revised regulatory capital requirements for certain electric cooperative assets. Under the revised regulations, FCA will apply a lower regulatory capital risk weight to certain loans and leases to cooperatives involved in the generation, transmission, and distribution of electricity.

Significant Asset Growth—The Agency issued an Informational Memorandum to alert the System of the potential risk of significant asset growth during a less favorable lending environment. This communication, which was in response to the System's strong growth of the past two years, reminded boards of directors to ensure that they have policies in place to minimize risk to their asset portfolios from adverse trends in real property values.

National Oversight and Examination Program for 2008—FCA issued an Informational Memorandum discussing oversight and examination focus areas and associated planned activities in 2008. This guidance emphasizes the proactive, national approach the Agency is taking for the oversight and examination of material risks and emerging issues in the FCS.

Communicating Expectations to System Institutions—FCA issued an Examination Bulletin that defines what the Agency means when it uses the terms "best practices," "recommended actions," and "required actions" in its communications with System institutions. The Examination Bulletin ensures that examiners and institution management and boards have a consistent understanding of expectations when responding to examination findings.

Loan Syndications and Assignment Markets Study—FCA continued to study loan syndication and assignment markets to determine whether its regulations should be modified to reflect significant changes in the markets.

Young, Beginning, and Small Farmers—The Board acted to ensure that all System institutions assist YBS farmers to enter, grow, or remain in agricultural or aquaculture production. A revised Bookletter issued in August provides guidance to all FCS institutions on interpreting the phrase "sound and constructive credit" when applied to YBS farmers and ranchers and on extending credit to part-time YBS farmers who demonstrate a commitment to be full-time

agricultural producers. The Bookletter further encourages System lenders to provide credit enhancements so that YBS farmers can qualify for financing, and it encourages System lenders to mitigate the risk of lending to YBS farmers by increasing coordination with other lending entities and sharing best practices.

CORPORATE ACTIVITY IN 2007

The number of corporate applications submitted for FCA Board approval decreased from the previous year. In 2007, FCA analyzed and approved 6 applications, compared with 11 applications processed in 2006.

1. On February 1, 2007, an ACA affiliated with the Farm Credit Bank of Texas changed its name and the names of its Production Credit Association and Federal Land Credit Association subsidiaries. It also moved its headquarters.

2. On December 1, 2007, an ACA affiliated with AgFirst Farm Credit Bank changed its name and the names of its PCA and FLCA subsidiaries.

3. On January 28, 2007, the FCA Board approved an amendment to the articles of incorporation of the Farm Credit Leasing Services Corporation (Leasing Corporation). The amendment allows the Leasing Corporation to reduce its board size from three to two directors. The third director is optional and may be appointed, and he or she is not required to be an outside director. As a service corporation organized and chartered under section 4.25 of the Act, the Leasing Corporation is not required to have an outside director. The Corporation is wholly owned and controlled by CoBank, which has two outside directors.

4. On June 18, 2007, the FCA Board issued an amended and restated charter to CoBank, the System's agricultural credit bank, to reconcile the bank's statutory powers and obligations under Titles I and III of the Farm Credit Act of 1971, as amended. The amended and restated charter was effective retroactive to January 1, 2007.

5. On September 27, 2007, two ACAs affiliated with AgriBank, FCB, received FCA final approval to consolidate their operations into a single ACA and to merge the ACAs' respective subsidiaries. The consolidation took effect on January 1, 2008, following stockholder approval.

6. On December 14, 2007, an ACA affiliated with AgriBank, FCB, was authorized to merge its two PCA subsidiaries and two FLCA subsidiaries to create a single ACA operating with one PCA subsidiary and one FLCA subsidiary. These mergers did not require stockholder approval and took effect at the close of business on December 31, 2007.

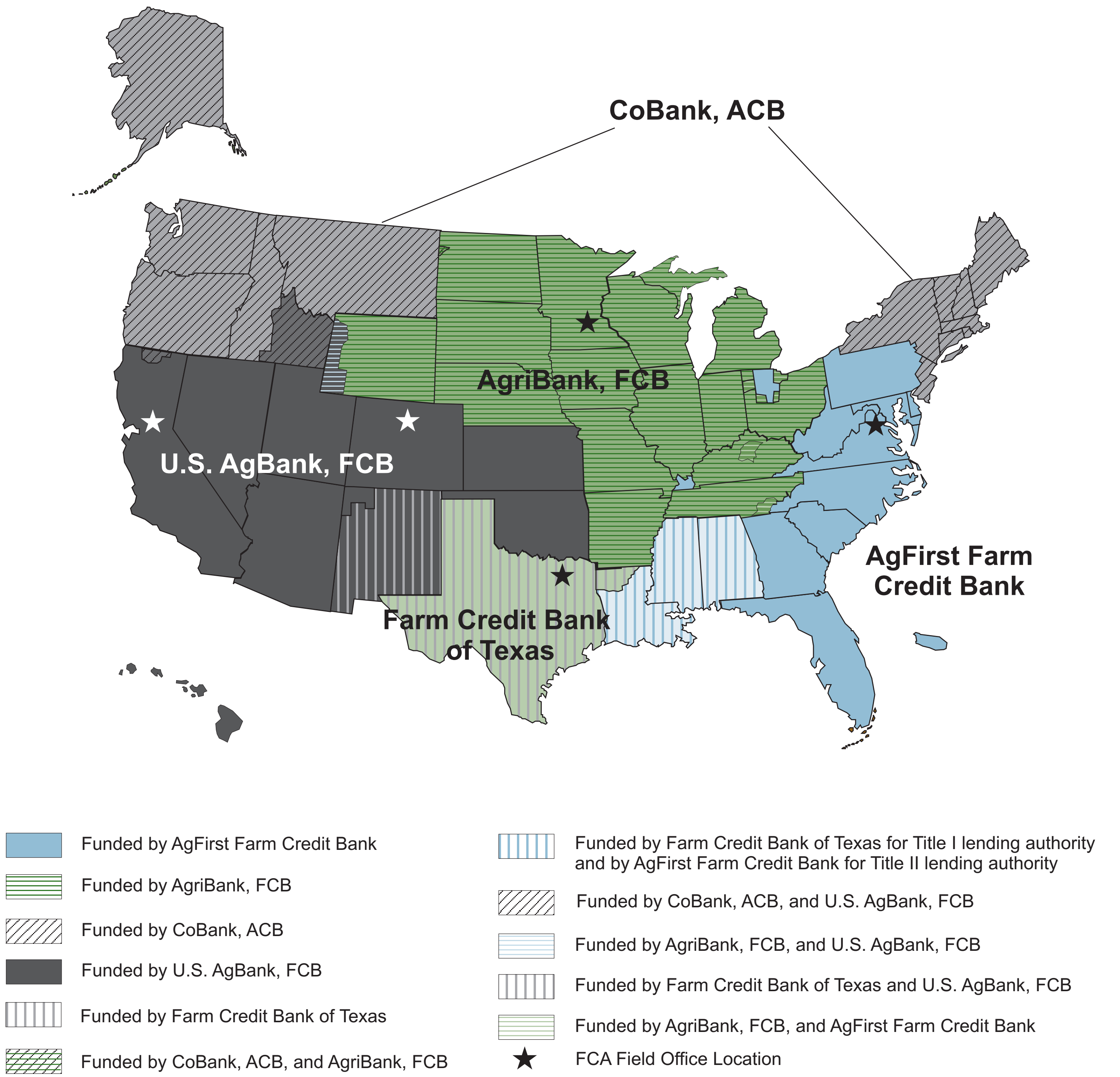
The total number of associations remained at 95 as of December 31, 2007, although a merger that took effect January 1, 2008, reduced the number to 94. The number of banks remains at five. Figure 9 shows the chartered territory of each FCS bank. Details about specific corporate applications are available on FCA's Web site at www.fca.gov.

FUNDING ACTIVITY

The System funds its loans with a combination of consolidated Systemwide debt and capital. The Funding Corporation, the fiscal agent for the five System banks, sells debt securities such as discount notes, master notes, bonds, and designated bonds on behalf of the System.[16] This process allows funds to flow from worldwide capital-market investors to agriculture and rural America, providing rural communities with efficient and expansive access to global resources. At year-end 2007, outstanding Systemwide debt was $154.4 billion, up from $133.6 billion a year earlier, representing a 15.6 percent increase. The $20.8 billion increase in outstanding debt funded the $19.5 billion, or 15.8 percent, increase in gross loans outstanding, with the balance going primarily to fund investments for liquidity and other purposes.

16. The primary function of the Funding Corporation, whose headquarters are in Jersey City, New Jersey, is to issue, market, and handle debt securities on behalf of the System's five banks. In addition, the Funding Corporation assists the banks with a variety of asset/liability management and specialized funding activities. The Funding Corporation is responsible for financial disclosure and the release of public information concerning the financial condition and performance of the System as a whole.

Figure 9
Chartered Territories of FCS Banks



Note: CoBank funds 5 associations in the indicated areas and serves cooperatives nationwide; U.S. AgBank, FCB, funds 29 associations; Farm Credit Bank of Texas funds 20 associations; AgriBank, FCB, funds 18 associations; and AgFirst Farm Credit Bank funds 23 associations. The FCS contains a total of 100 banks and associations.

FCA has various responsibilities pertaining to System funding activities. As required by the Farm Credit Act, the System must obtain FCA approval before distributing or selling debt issuances. FCA has systems and processes that enable it to respond to these requests quickly and efficiently. For example, FCA established a program whereby the System may issue discount notes at any time up to a maximum of $40 billion, as long as it provides FCA with periodic reports on this activity. FCA approves the majority of longer-term debt issuances through a monthly "shelf" approval program. For 2007, FCA approved $100 billion in longer-term debt issuance requests.

To participate in the issuance of an FCS debt security, a System bank must maintain, free from any lien or other pledge, specified eligible assets (available collateral) that are at least equal in value to the total amount of its outstanding debt securities. Securities subject to the available collateral requirements include Systemwide debt securities for which the bank is primarily liable, investment bonds, and other debt securities, which the bank may have issued individually. As a safe and sound practice, FCA regulations require the five System banks to maintain a net collateral ratio (primarily assets divided by liabilities) of not less than 103 percent. All System banks have managed their operations to achieve net collateral ratios that are higher than the required minimum, with 104.8 percent being the lowest ratio for any single bank as of December 31, 2007.

The Funding Corporation and the System banks have also entered into voluntary agreements to provide for mutual protection in the support of joint and several liability on Systemwide debt obligations. The Amended and Restated Market Access Agreement establishes certain financial thresholds that provide the Funding Corporation with operational oversight and control over the System banks' participation in Systemwide debt obligations. The Amended and Restated Contractual Interbank Performance Agreement establishes certain measures that monitor the financial condition and performance of each System bank district. The System banks have also adopted a Common Liquidity Standard as part of their ongoing effort to ensure their collective ability to meet their obligations under these mutual agreements.[17]

Between 2002 and 2005, the volume of new issuances declined as System banks extended the maturity of debt to comply with the Common Liquidity Standard and to capitalize on historically low interest rates. In recent years, debt issuances have increased as a result of favorable economic conditions in agriculture and strong loan demand from System borrowers. For the 12 months ended December 31, 2007, the System issued $484 billion in debt securities, compared with $387 billion for 2006 and $288 billion for 2005.[18]

The FCS continued to extend its debt maturities throughout 2007. The System's weighted-average remaining maturity for all outstanding insured debt increased to 3.6 years as of December 31, 2007, compared with 2.9 years as of December 31, 2006, and 2.7 years as of December 31, 2005. The weighted-average interest rates for the insured debt decreased from 4.9 percent as of December 31, 2006, to 4.7 percent as of December 31, 2007.

MISSION-RELATED INVESTMENTS

FCA is committed to helping ensure a dependable and affordable flow of funds to agriculture and to rural areas so that farmers, ranchers, and rural communities can flourish. Agriculture and rural America face new and unique challenges that require innovative solutions. Investments in rural communities can help create infrastructure improvements that promote the economic vitality of these communities for current and future generations of American farmers and rural residents. Farming families will increasingly benefit from investment projects that promote rural development and off-farm income opportunities. Investments in rural communities also play an important role in attracting and retaining YBS farmers and other rural entrepreneurs who provide essential services for agricultural production.

17. 1 The Common Liquidity Standard requires each bank to maintain a minimum of 90 days of liquidity to guard against a possible interruption in its access to the capital markets.

18. Payment of principal and interest on Systemwide debt securities is insured by the Farm Credit System Insurance Corporation's Farm Credit Insurance Fund to the extent provided in the Farm Credit Act. Some FCS debt ($852 million outstanding as of December 31, 2007) was issued by individual banks of the FCS. These individual banks are solely liable for the principal payments on this uninsured debt.

FCA's current regulations allow System institutions to make certain mission-related investments. Examples include investments in farmers' notes; certain debt obligations issued or guaranteed by Federal agencies or State or local municipalities for rural utilities and other economic development; and agricultural mortgage-backed securities (AMBS), which Farmer Mac issues or guarantees. As of December 31, 2007, the mission-related investment securities held under these regulatory authorities totaled $3.1 billion, including $1.8 billion in AMBS. In addition, in 2005 FCA approved System institution holdings of investments in successor-in-interest contracts created as a result of the Tobacco Transition Payment Program.[19] As of December 31, 2007, investments in successor-in-interest contracts totaled $807.8 million.

The Agency realizes, however, that these investment vehicles may no longer be sufficient to meet the growing and changing demands of agriculture and of rural communities for dependable, affordable, and flexible financing in the 21st century. In particular, FCA recognizes that rural areas have an essential and growing need for additional sources of capital to support economic growth and infrastructure improvements. In response, FCA issued guidance giving System institutions a provisional opportunity to make additional mission-related investments through pilot programs supporting investments in rural America (see FCA Informational Memorandum dated January 11, 2005, on Investments in Rural America—Pilot Investment Programs, which is available on the FCA Web site at www.fca.gov).

The pilot programs are intended to strengthen the System's mission to provide for an adequate and flexible flow of funds, under specified conditions, to agriculture and to rural communities across the country. Further, the pilot investment programs are intended to provide FCS institutions greater flexibility to partner with Government agencies and other agricultural and rural lenders in fulfilling their mission objectives. Through these pilot investment programs, FCA is looking to gain a better understanding of the diverse financing needs of agriculture and rural communities and of how FCS institution investments can help increase the availability and efficiency of funds to these markets.

FCA has placed a significant number of controls on these pilot investment programs to ensure their legal sufficiency, safety and soundness, and consistency with the FCS mission. These controls include participation criteria to ensure that only well-managed and strongly capitalized institutions may participate in the programs. The controls also specify the investment purposes that the programs should fulfill, impose program and risk limits, require prudent investment management standards, and limit the pilot period to one to three years. These programs are also subject to special examination and reporting.

Since 2005, FCA has approved 10 pilot programs involving the following investment areas and structures.

- 1 Rural Housing Mortgage Securities—During 2007, three Farm Credit banks were authorized to purchase and hold rural housing mortgage securities (RHMS) under a three-year pilot program. RHMS must be fully guaranteed by a Government agency or another GSE. The rural housing loans backing the RHMS must be conforming, first-lien residential mortgage loans originated by non-System lenders in "rural areas" (as defined by the Farm Security and Rural Investment Act of 2002). These pilot programs are intended to provide additional liquidity for rural housing loans by providing economic incentives to lenders to create RHMS for sale in the secondary market. In turn, these programs will create more cost-effective credit for rural homeowners. As of December 31, 2007, the investment securities of the FCS banks participating in this program included $1.1 billion in RHMS classified as held to maturity.

19. On October 22, 2004, Congress enacted the Fair and Equitable Tobacco Reform Act of 2004 as part of the American Jobs Creation Act of 2004. The Tobacco Act repeals the Federal tobacco price support and quota programs, provides payments to tobacco quota owners and producers for the elimination of the quota, and includes a provision that allows the quota holders to assign to a financial institution the right to receive contract payments under a contract with the Secretary of Agriculture. FCA determined that FCS institutions meet the Tobacco Act's financial institution criteria and are therefore eligible to participate in the Tobacco Transition Payment Program.

- Agriculture and Rural Community Bonds and Securities—During 2007, all FCS institutions were authorized to participate, under specific conditions, in pilot programs that provide funding for economic development, infrastructure, essential community facilities, and revitalization and stabilization projects that are necessary to maintain a vibrant American agriculture and strong rural communities. A key objective of these pilot programs is to stimulate FCS partnerships and alliances with other agricultural and rural lenders that will increase the availability of cost-effective funds to agriculture and to rural communities. As of December 31, 2007, FCS institutions had $254.1 million of investments under these programs.

- 1 Equity Investments—FCA has approved several mission-related equity investments, including an investment in a starter farmer program for beginning farmers and producers, as well as investments in regional venture capital funds focusing on rural areas. In addition, since the Farm Security and Rural Investment Act of 2002 authorized any FCS institution, under limited conditions,[20] to invest in rural business investment companies (RBICs) to promote economic development and job opportunities in rural areas, several FCS institutions have made equity investments in RBICs. As of December 31, 2007, the aggregate amount of mission-related equity investments outstanding totaled $1.3 million.

20. The Farm Security and Rural Investment Act of 2002 authorizes any FCS institution to establish and invest in RBICs, provided that such investments are not greater than 5 percent of the capital and surplus of the FCS institution. Further, if FCS institutions (alone or collectively) hold more than 15 percent of the shares of an RBIC, the RBIC may not provide equity investments or financial assistance to entities that are not otherwise eligible to receive financing from the FCS under the Farm Credit Act.

MAINTAINING A DEPENDABLE SOURCE OF CREDIT FOR FARMERS AND RANCHERS

As federally chartered agricultural lending cooperatives, the institutions of the Farm Credit System are limited-purpose lenders exposed to risk in making loans and investments to benefit their borrower-stockholders and meet their public mission. As a Government-sponsored enterprise, the FCS benefits from preferred access to the capital markets, but the Federal Government does not subsidize or back it directly.

For FCS institutions to keep providing a dependable source of credit and financially related services for rural America, they must operate profitably and appropriately manage and control risk. That is why FCA deploys examination and supervisory resources to monitor systemic risk in the FCS and specific risk in each institution.

This "risk-based" examination and supervisory program requires examiners to determine how existing or emerging issues facing an institution or the agriculture industry may affect the nature and extent of risk in that institution. To evaluate whether an institution is meeting its public mission, examiners determine if it is operating in compliance with applicable laws and regulations and if it is responsive to the credit needs of all types of agricultural producers and cooperatives that are eligible for credit, which include YBS farmers and ranchers. This risk-based approach helps to ensure that FCA provides the most effective and efficient regulatory oversight to the System.

CONDUCTING A RISK-BASED EXAMINATION AND OVERSIGHT PROGRAM

FCA's examination and oversight program is designed to maximize its effectiveness and efficiency while addressing FCS risk. In establishing and implementing oversight and examination plans for each FCS institution, FCA assigns highest priority to institutions at greatest risk. This approach considers the ability of FCS institutions to identify and manage both institution-specific and systemic risks. When institutions are either unable or unwilling to address unsafe and unsound practices or to comply with applicable laws and regulations, FCA takes appropriate supervisory action.

Through its oversight practices, the Agency ensures that FCS institutions have the programs, policies, procedures, and controls to effectively identify and manage risks. The oversight programs also ensure compliance with laws, regulations, and FCA policies. For example, FCA regulations require FCS institutions to have effective loan underwriting and loan administration processes. Agency examiners test those FCS processes, and Agency analysts compare banking industry trends with System results to determine relative performance. FCA also has specific regulations requiring FCS institutions to maintain strong asset-liability management capabilities. For approximately 20 years, FCA has used a comprehensive regulatory and supervisory framework for ensuring System safety and soundness. FCS institutions, on their own and in response to FCA efforts, have developed appropriate risk management systems.

MEETING STATUTORY EXAMINATION REQUIREMENTS

The Farm Credit Act requires FCA to examine each FCS institution at least once every 18 months. In addition to meeting this minimum requirement, the Agency has embraced an examination approach in which it conducts ongoing monitoring and interim examination activities in each institution as risk and circumstances warrant. FCA then integrates identified systemic risks into its national oversight strategies to mitigate such risks Systemwide. This approach provides differential risk-driven examination activities for all institutions. As of December 31, 2007, FCA was overseeing and examining 95 FCS direct-lender associations; 4 FCBs; 1 Agricultural Credit Bank; 5 service corporations and 1 special-purpose entity; Farmer Mac; and the National Consumer Cooperative Bank (NCB), which is not an FCS institution.[21] FCA's examination approach emphasizes the importance of proactive, constructive communication with regulated institutions through a combination of communication methods.

21. The National Consumer Cooperative Bank Act of 1978, as amended, provides for FCA to examine and report on the condition of NCB. Since the passage of this law, FCA has conducted safety and soundness examinations of NCB and issued reports to the bank's board.

The Small Business Administration (SBA) and the U.S. Department of Agriculture (USDA) continued to use FCA's examiner expertise in 2007. SBA contracted with FCA to have the Agency conduct examinations of financial companies licensed by SBA to make guaranteed loans to small businesses. USDA contracted with FCA to have the Agency conduct examinations of financial companies authorized to make guaranteed loans under USDA's Business and Industry Guaranteed Loan program and Community Facilities Guaranteed Loan program. FCA examiners also completed reviews of the Business and Industry Guaranteed Loan program operations at selected USDA State Rural Development offices. During 2007, as part of these contracted activities, the Agency issued 11 Reports of Examination on SBA- and USDA-guaranteed lenders and provided other agreed-upon deliverables on the operations of 10 USDA State Rural Development offices. While the safety and soundness of the FCS remains FCA's principal focus and responsibility, the Agency has found that enabling its examiners to assist SBA and USDA has broadened its examiners' skills and experiences.

IDENTIFYING AND RESPONDING TO POTENTIAL THREATS TO SAFETY AND SOUNDNESS

Because of the dynamics and risks in the agricultural and financial industries, FCA must ensure that FCS institutions have the culture, policies, procedures, and management controls to effectively identify and manage risks. To be fully effective in meeting this challenge, the Agency has various risk supervision processes for evaluating and responding to systemic risks that can affect an institution, a group of institutions, the System as a whole, agriculture, and the financial industry. These risk supervision processes emphasize taking a proactive, nationally focused approach to addressing material risks and emerging issues. While several important risks and emerging issues are being addressed, the following topics have been receiving particular emphasis:

- Asset growth, including quality, source, and related risk management and controls
- Capital markets lending activity, with emphasis on due diligence and management of shared assets
- Internal audit and credit review programs, with emphasis on program reliability

MEASURING THE SYSTEM'S SAFETY AND SOUNDNESS

The Financial Institution Rating System (FIRS) is a key risk rating methodology used by FCA to indicate the safety and soundness threats in each institution. Similar to the systems used by other Federal financial regulators, it is a "CAMELS"-based system, with component ratings for capital, assets, management, earnings, liquidity, and sensitivity all factoring into an overall composite rating. The FIRS provides a general framework for evaluating and assimilating all significant financial, asset quality, and management factors. It assigns component and composite ratings to each institution on a scale of 1 to 5. A composite rating of 1 indicates an institution is sound in every respect. A rating of 3 means an institution displays a combination of financial, management, or compliance weaknesses ranging from moderately severe to unsatisfactory. A 5 rating represents an extremely high, immediate or near-term probability of failure.[22]

Through its ongoing monitoring and oversight programs, FCA examiners continually evaluate institutional risk and regularly review and update FIRS ratings to reflect current risks and conditions. The Agency maintains both quantitative and qualitative benchmarks as general examiner guidelines to facilitate consistent application of the FIRS process. FCA discloses the FIRS composite and component ratings to the institution's board to provide perspective on relative safety and soundness. Examination reports and other communication also provide the institution board with an assessment of management's performance, the quality of assets, and the financial condition and performance of the institution.

FIRS ratings continued to reflect strong FCS financial condition and performance during 2007. As shown

22. See the Glossary for a complete description of the FIRS ratings.

in figure 10, FIRS ratings have been relatively static for the past few years. At December 31, 2007, 83 FCS institutions were rated 1, 14 were rated 2, and 3 were rated 3. Notably, there were no 4- or 5-rated institutions. (The System only applies FIRS ratings to its banks and associations, not to its service corporations and Farmer Mac.) Such ratings reflect a financially safe and sound FCS. The overall financial strength maintained by the System reduces the risk to investors in FCS debt, to the Farm Credit System Insurance Corporation (FCSIC), and to FCS institution stockholders.

In addition to using the FIRS process, FCA examiners began using a new set of risk assessment criteria in 2006. The risk areas are credit, interest rate, liquidity, operational, compliance, strategic, and reputation. This tool is used, along with FIRS ratings and other information, to assist the Office of Examination in allocating resources to where the risks are highest.

PROVIDING DIFFERENTIAL SUPERVISION AND ENFORCEMENT

FCA uses a risk-based supervisory and enforcement program to differentially respond to the risks and particular oversight needs of FCS institutions. Risks are inherent in lending, and managing risks associated with a single sector of the economy, such as agriculture, presents an additional challenge for FCS lenders. If FCA discovers unwarranted risks, it takes action to ensure that the identified risks are appropriately mitigated. Corrective actions include reducing risk exposures; increasing capital, which improves an institution's ability to bear risk; and strengthening risk management.

The Agency uses a three-tiered supervision program: normal supervision, special supervision, and enforcement actions. Institutions under normal supervision are generally performing in a safe and sound manner and operating in compliance with applicable laws and regulations. These institutions are able to correct identified weaknesses in the normal course of business. For those institutions displaying more serious or protracted weaknesses, FCA shifts from normal to special supervision, and its examination oversight increases accordingly. Under special supervision, institutions are given clear and firm regulatory guidance to address identified weaknesses, and the institution is allowed time to correct the problems. If less formal supervisory approaches have not been or are not likely to be successful, FCA will use its formal enforcement authorities to ensure that the operations of FCS institutions are safe and sound and are in compliance with laws and regulations. Enforcement action may be required for a number of reasons, including (1) a situation that threatens an institution's financial stability, (2) uncorrected safety and soundness problems or violations of laws or regulations, and (3) the inability or unwillingness of the institution's board and management to correct identified problems.

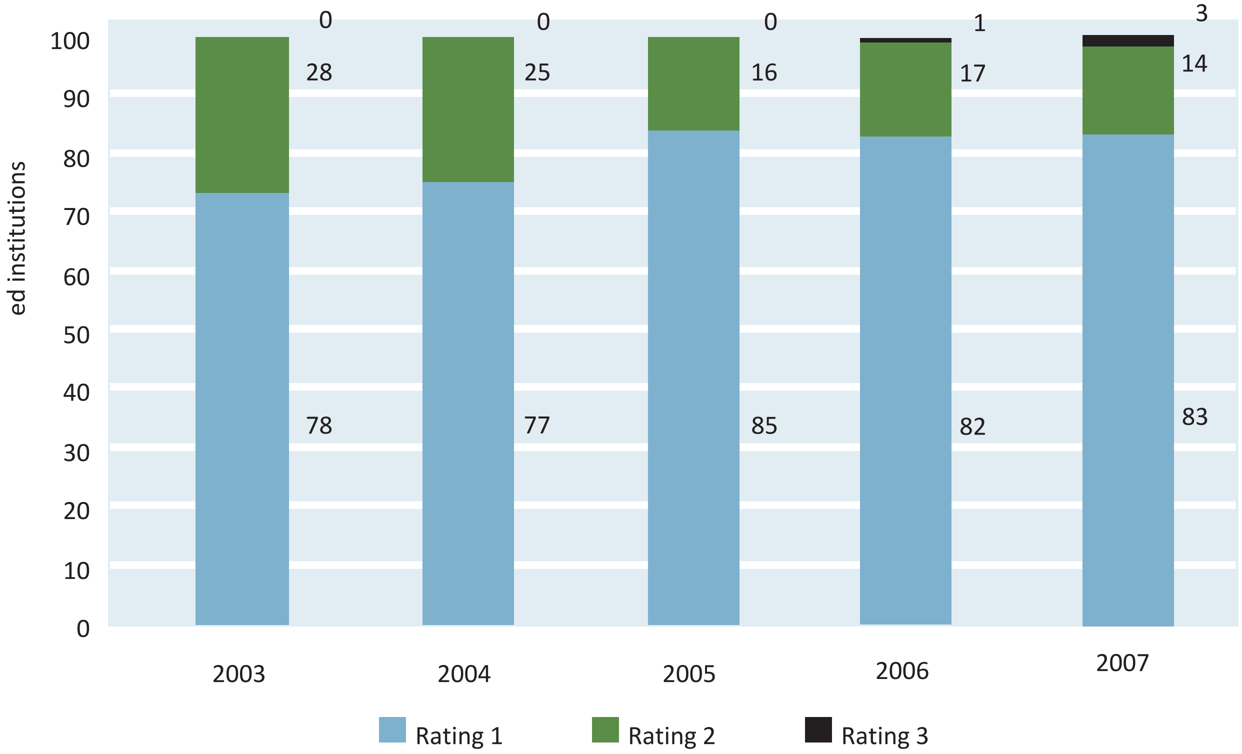
FCA's enforcement authorities include the power to enter into formal agreements; to issue orders to cease and desist; to levy civil money penalties; and to suspend or remove officers, directors, and other persons. If an enforcement action is taken, the FCS institution must operate under the Agency's enforcement program and report back to FCA. FCA's examiners oversee the institution's performance to ensure compliance with the enforcement action. It has not been necessary for FCA to use its formal enforcement authorities during the past nine years.

WORKING WITH FINANCIALLY STRESSED BORROWERS

Agriculture involves significant inherent risks and volatility because of many factors, including adverse weather, changes in Government programs, international trade issues, fluctuations in commodity prices, and crop and livestock diseases. Such conditions can make it difficult for borrowers to repay loans. Unlike other lenders, the System (under provisions of the Farm Credit Act) provides borrowers certain rights when they apply for loans and when they have difficulty repaying loans. For example, the Act requires FCS institutions to consider restructuring an agricultural loan before initiating foreclosure. It also provides borrowers an opportunity to seek review of certain credit and restructuring decisions. If a loan is foreclosed on, the Farm Credit Act also provides borrowers the opportunity to buy back their property at the fair market value.

FCA enforces the borrower rights provisions of the Farm Credit Act and examines institutions to make sure that they are complying with these provisions. It also receives and reviews complaints from borrowers regarding their rights as borrowers. Through these efforts, FCA ensures compliance with the law and helps FCS institutions continue to provide sound and constructive credit and related services to eligible farmers and ranchers.

Figure 10
Financial Institution Rating System (FIRS) Composite Ratings for the FCS, 2003–2007
As of December 31



Sources: Farm Credit Administration Reports of Examination.

Note: FIRS ratings are based on capital, asset quality, management performance (including the board of directors), earnings, liquidity, and sensitivity to interest rate risk. Ratings range from 1 (a sound institution) to 5 (an institution that is likely to fail).

CONDITION OF FARMER MAC

The Federal Agricultural Mortgage Corporation (Farmer Mac) is a stockholder-owned, federally chartered instrumentality of the United States. It was created in 1988 to establish a secondary market for agricultural real estate and rural housing mortgage loans. Farmer Mac conducts its business primarily through three core programs: Farmer Mac I, Farmer Mac II, and the AgVantage program.

Under Farmer Mac I, Farmer Mac purchases, or commits to purchase, qualified loans, or obligations backed by qualified loans, that are not guaranteed by any instrumentality or agency of the United States. Under Farmer Mac II, Farmer Mac purchases the guaranteed portions of farm ownership and farm operating loans, rural business and community development loans, and certain other loans guaranteed by USDA. Under the AgVantage program, Farmer Mac buys or guarantees securities issued by agricultural mortgage lenders.

Farmer Mac is regulated by FCA through the Office of Secondary Market Oversight (OSMO), which was established in 1992 by Public Law 102-237. This office provides for the examination and general supervision of Farmer Mac's safe and sound performance of its powers, functions, and duties. The statute requires that OSMO constitute a separate office that reports directly to the FCA Board and that its activities, to the extent practicable, be carried out by individuals not responsible for supervising the banks and associations of the FCS.

Through this office, the Agency performs annual examinations of Farmer Mac's capital adequacy, asset quality, management performance, earnings, liquidity, and sensitivity to interest rate risk; supervises Farmer Mac's operations; and evaluates its safety and soundness and mission achievement. Throughout the year, OSMO reviews Farmer Mac's compliance with the risk-based capital regulations and monitors its operations and condition.

Farmer Mac's overall condition and performance remain sound. Farmer Mac has grown during the past two years, with a majority of that growth from core business. Throughout that period, credit quality continued to improve and financial indicators are positive.

Table 7 summarizes Farmer Mac's balance sheets at the end of the year for 2002 to 2007. Please note that, because Farmer Mac issued a financial restatement in late 2006 for several reporting periods, certain prior-year amounts will differ from the amounts published in certain earlier FCA Annual Reports. The restatement was required because Farmer Mac had determined that it was not appropriately applying hedge accounting in accordance with Statement of Financial Accounting Standard 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). Farmer Mac completed the financial restatements during the fourth quarter of 2006 and eliminated the use of hedge accounting.

CAPITAL

By statutory design, secondary market Government-sponsored enterprises like Farmer Mac operate with lower statutory capital margins than do primary market lenders. Accordingly, monitoring the capital levels of Farmer Mac is a central component of FCA's oversight programs.

On December 31, 2007, Farmer Mac's net worth (i.e., equity capital determined using generally accepted accounting principles [GAAP]) was $223.6 million, compared with $248.5 million a year earlier. The drop is attributable to, among other things, a combination of unrealized losses on available-for-sale securities and costs associated with the Corporation's common stock repurchase program. Net worth was 4.5 percent of on-balance-sheet assets as of December 31, 2007. When Farmer Mac's off-balance-sheet program assets (i.e., guarantee obligations) are added to the on-balance-sheet assets, capital coverage is 1.9 percent. In August 2004, Farmer Mac established a new common stock dividend policy and a stock repurchase program, both of which continued through 2007. While these policies affect outstanding common equity and number of shares, Farmer Mac is expected to continue to exceed statutory and regulatory capital requirements.

Farmer Mac's core capital (the sum of the par value of outstanding common stock, the par value of outstanding preferred stock, paid-in capital,

Table 7
Farmer Mac Condensed Balance Sheets, 2002–2007
As of December 31
Dollars in Millions

	2002 Restated	2003 Restated	2004 Restated	2005 Restated	2006 Restated	2007	Percentage growth rate 2006–2007
Total assets	4,222.0	4,299.7	3,847.4	4,341.4	4,953.7	4,977.6	0.5
Total liabilities	4,039.3	4,089.2	3,612.2	4,095.4	4,705.2	4,754.0	1.0
Net worth or equity capital	182.7	210.5	235.2	246.0	248.5	223.6	(10.0)

Sources: Farmer Mac's Securities and Exchange Commission Form 10-Ks.

and retained earnings) remained above the statutory minimum requirement, and its regulatory capital (core capital plus allowance for losses) exceeded the required amount of regulatory capital as determined by the Risk-Based Capital Stress Test (RBC Model). Farmer Mac's core capital, as of December 31, 2007, totaled $226.4 million, exceeding the statutory minimum capital requirement[23] of $186.0 million by $40.4 million. Farmer Mac's regulatory capital totaled $230.3 million as of December 31, 2007, exceeding the regulatory risk-based capital requirement of $42.8 million by $187.5 million. Regulatory capital was 3.4 percent of total Farmer Mac I program volume (on and off the balance sheet). Table 8 offers a historical perspective on capital and capital requirements for 2004 to 2007.

In 2007, FCA published a proposed rule revising the risk-based capital regulations that originally became effective in 2002. The revisions updated the RBC Model in response to changing financial markets, new business practices, and the evolution of the loan portfolio at Farmer Mac, as well as continued development of best industry practices among leading financial institutions. In April 2008, the FCA Board adopted a final rule revising the risk-based capital regulations to take into account off-balance-sheet AgVantage securities, counterparty risk, and the carrying cost of nonperforming loans.

In addition to supporting program assets, Farmer Mac's capital supports nonprogram investment needs as well. Nonprogram investments provide liquidity in the event of a short-term disruption in the capital markets that prevents Farmer Mac from issuing new debt. Nonprogram investments are investment securities, cash, and cash equivalents. FCA regulations governing Farmer Mac's nonprogram investments and liquidity became effective in the third quarter of 2005. Farmer Mac's policy is to maintain nonprogram investments at levels that provide liquidity for a minimum of 60 days of maturing obligations, with a target of 90 days. Farmer Mac was in compliance with its liquidity policy throughout the year.

23. The statute requires minimum capital coverage of 2.75 percent for on-balance-sheet assets and of 0.75 percent for off-balance-sheet obligations.

Table 8

Farmer Mac Capital Positions, 2004–2007

As of December 31

Dollars in Millions

	2004 Restated	2005 Restated	2006	2007
GAAP equity	$235.2	$246.0	$248.5	$223.6
Core capital	$204.0	$230.8	$243.5	$226.4
Regulatory capital	NA	$239.4	$248.1	$230.3
Statutory requirement	$128.9	$142.5	$174.5	$186.0
Regulatory requirement	NA	$29.5	$42.9	$42.8
Excess over statutory or regulatory requirement[a]	$75.0	$88.3	$69.0	$40.4
Capital margin excess > minimum	58.2%	62.0%	39.6%	21.7%

Sources: Farmer Mac's Securities and Exchange Commission Form 10-Ks.

NA = not available (because line items have not been restated for prior periods or because regulatory capital rulemaking had not yet been implemented)
> = greater than

a. Farmer Mac is required to hold capital at the higher of the statutory minimum capital requirement or the amount required by FCA regulations as determined by the Risk-Based Capital Stress Test.

PROGRAM ACTIVITY

Farmer Mac's total program activity increased over the past year to $8.5 billion on December 31, 2007, from $7.2 billion a year earlier (see figure 11). Farmer Mac attributes the increase in program activity to successful implementation of its marketing strategies to target large, higher-quality asset transactions with commensurately lower compensation for the assumption of credit risk and to cover administrative costs.

A large portion of Farmer Mac's recent program growth was driven by off-balance-sheet AgVantage program activity with the Metropolitan Life Insurance Company. Off-balance-sheet AgVantage transactions are guaranteed by Farmer Mac. Farmer Mac's guarantee is backed by an obligation of the issuer and collateralized by eligible agricultural mortgage loans.

Farmer Mac's Long-Term Standby Purchase Commitment product has been another primary source of growth in program activity since its introduction. Under Farmer Mac Standbys, a financial institution pays an annual fee in return for Farmer Mac's commitment to purchase loans in a specific pool at the option of the institution under specified conditions. The Standby product grew significantly between its introduction in 1999 and 2006, though outstanding Standby commitments shrank slightly in 2007. Lenders may elect to exchange Standby commitments for securities guaranteed by Farmer Mac. Standbys were down 1 percent in 2007 to $1.9 billion.

Off-balance-sheet program activity consists of Standbys, certain AgVantage securities, and agricultural mortgage-backed securities sold to investors. At the end of December 2007, 76 percent of program activity consisted of off-balance-sheet obligations[24] (see figure 12).

ASSET QUALITY

The quality of Farmer Mac program assets has continued to improve. On December 31, 2007, the Farmer Mac I program had $31.9 million in nonperforming loans, or 0.63 percent of the principal balance of all loans purchased, guaranteed, or committed to be purchased since enactment of the Farm Credit System Reform Act of 1996 (1996 Act).[25] This compares with $39.2 million, or 0.82 percent, on December 31, 2006. Nonperforming assets are (1) those that are 90

24. 1 This amount will not tie precisely to AMBS, Standbys, and AgVantage program activity in figure 11 because of a small portion of on-balance-sheet AgVantage activity.

25. Farmer Mac assumes 100 percent of the credit risk on post-1996 Act loans, whereas pre-1996 Act loans are supported by mandatory 10 percent subordinated interests, which mitigate Farmer Mac's exposure. For that reason, pre-1996 Act loans are excluded from analysis for comparison purposes. These amounts also exclude loans underlying AgVantage guaranteed securities, whose risk is significantly mitigated by the general obligation of the issuer.

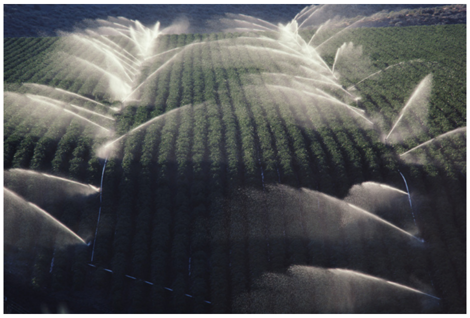
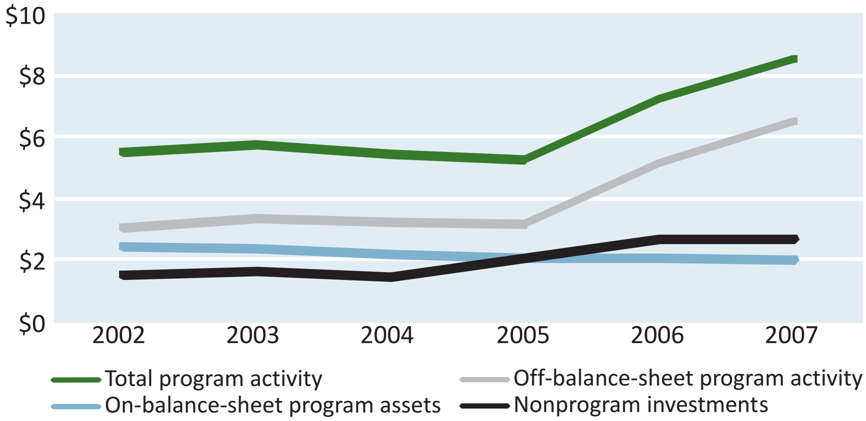


Figure 11

Farmer Mac Program Activity and Nonprogram Investment Trends

As of December 31

Dollars in Billions

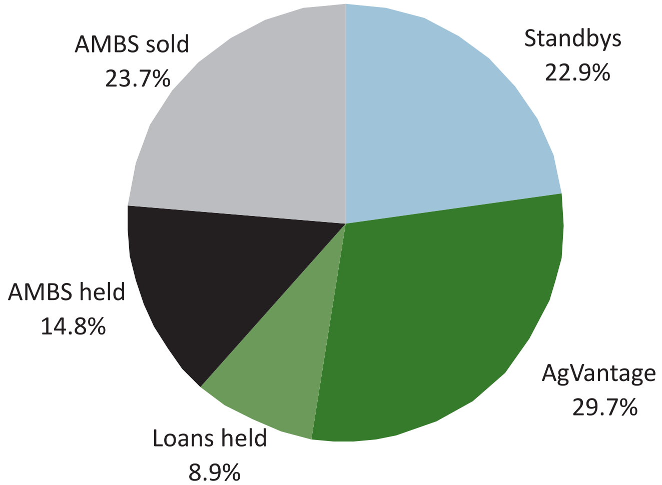


Sources: Farmer Mac's Annual Reports on Securities and Exchange Commission Form 10-Ks.

Figure 12

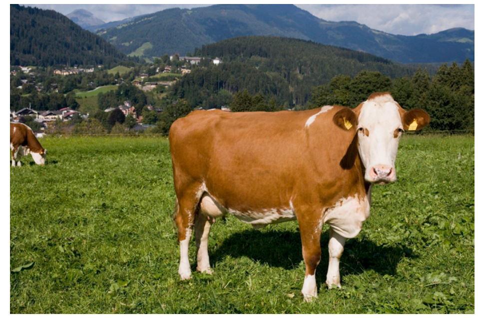
Farmer Mac Total Program Activity

As of December 31



Source: Farmer Mac's Annual Report on Securities and Exchange Commission Form 10-K.

AMBS = agricultural mortgage-backed securities



or more days past due, in foreclosure, or in bankruptcy, or (2) real estate property acquired by Farmer Mac through foreclosure. Real estate owned as of December 31, 2007, was $590,000, down from $2.1 million a year earlier. The total dollar amount and percentage of nonperforming assets continued to decline in 2007. As of year-end 2007, Farmer Mac estimated that $1.4 billion (27 percent) of loans and loans underlying Standbys and guaranteed securities were in their peak default years—approximately three to five years after origination.

On December 31, 2007, Farmer Mac's allowance for losses totaled $3.9 million, compared with $4.6 million on December 31, 2006. Farmer Mac attributes the decrease in the allowance for losses primarily to reversals in the provision for loan losses and charge-offs recognized during the year. Figure 13 shows the level of Farmer Mac's allowance and nonperforming assets relative to outstanding post-1996 Act program volume.

EARNINGS

Net income computed according to GAAP that was available to common stockholders for the year ended December 31, 2007, was $4.4 million, down $25.4 million (85.3 percent) from 2006 net income available to common stockholders. This significant decrease in earnings is attributable to mark-to-market losses on derivatives and trading assets and a reduced level of net reversals to the allowance for loan losses. Core earnings[26] for 2007 were $29.9 million, an increase of 15.4 percent from 2006.

Net interest income, which excludes guarantee fee income, was $44.7 million in 2007, up 16.7 percent from 2006 restated net interest income. Guarantee fee income, at $25.2 million, was 15.7 percent higher in 2007 than in 2006. The increase reflects the significant growth in the average balance of outstanding guaranteed securities. However, fee income growth did not keep pace with guaranteed securities because of new marketing strategies referenced in the "Program Activity" section above. Nonprogram investments accounted for an estimated 59 percent of interest income for 2007, up from 51 percent for 2006. The increase resulted from a rise in the average rates earned on the investments. Table 9 shows a six-year trend in key income components.

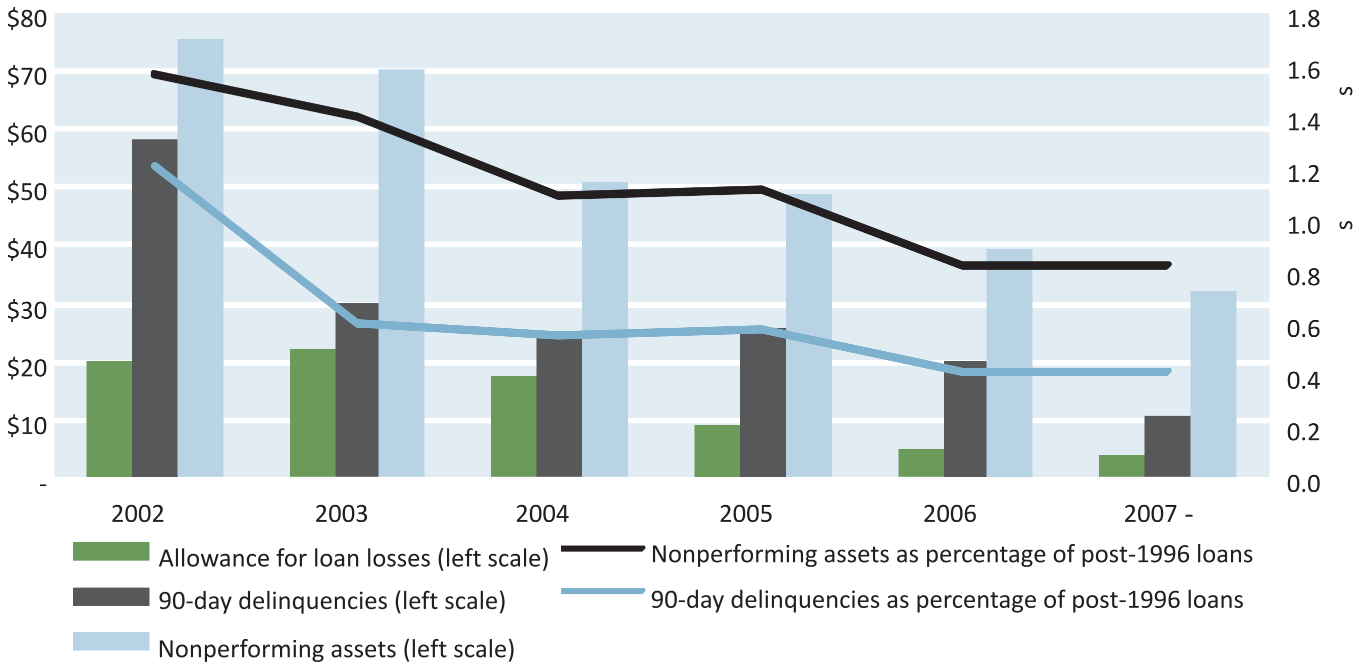
26. Core earnings is a non-GAAP measure of financial results that excludes the effects of certain unrealized gains and losses and nonrecurring items. Farmer Mac began reporting core earnings to present an alternative measure of earnings performance. The components included in core earnings calculations are at the reporting entity's discretion.

Figure 13

Allowance, Nonperforming Assets, and Delinquency Trends, 2002–2007

As of December 31

Dollars in Millions



Sources: Farmer Mac's Annual Reports on Securities and Exchange Commission Form 10-Ks.

Table 9

Farmer Mac Condensed Statements of Operations, 2001–2007

As of December 31

Dollars in Millions

	2001 Restated	2002 Restated	2003 Restated	2004 Restated	2005 Restated	2006	2007	Growth rate 2006–2007
Total revenues	18.7	(16.9)	76.3	77.3	83.9	67.8	31.4	(53.7%)
Total expenses	16.6	6.1	37.3	38.3	36.8	38.0	27.0	(29.0%)
Net income available to shareholders	2.1	(23.0)	39.0	39.0	47.0	29.8	4.4	(85.2%)
Core earnings	17.1	22.9	23.0	27.4	28.7	25.9	29.9	15.4%

Sources: Farmer Mac's Annual Reports on Securities and Exchange Commission Form 10-Ks.

CHALLENGES FACING AGRICULTURE AND THE FCS

The Farm Credit System enjoyed another year of solid earnings and asset growth in 2007. However, several challenges, both domestic and foreign, could affect the System's long-term ability to profitably finance the agricultural industry. The System's capacity to bear risk, absorb losses, and sustain operations remains strong as a result of its high capital levels, but rapid asset growth continues to erode key capital ratios in many institutions. Looking ahead, a number of risks and uncertainties that are largely beyond the control of the System could introduce both positive and negative outcomes for FCS institutions.

Agriculture is inherently risky because its production processes are biological. Random weather events, crop and livestock diseases, and food safety concerns are major risks to these processes. The possibility of a catastrophic event in one or more of these areas is a constant threat to producers and the safety and soundness of the FCS. Fortunately, both groups have a good understanding of these risks and use various risk management practices or special financial strategies to reduce risk exposure. However, the challenge of managing these risks is never easy because, in any given year, individual producers can still suffer substantial losses from natural or market-driven events and be unable to repay their loans.

In the following paragraphs, FCA identifies some of the immediate and longer-term challenges facing the System. The list covers the outlook for the economy, key developments in the farm income picture, new public policy directions for agriculture, and important structural changes in the industry. FCA will continue to use a strong surveillance system in its regulatory and examination activities to monitor and address these challenges.

PROSPECTS FOR THE GENERAL ECONOMY

Although the outlook for the economy calls for sluggish growth in 2008, many observers believe that the risk of a recession is high and that, indeed, the economy may already be in one. However, recent monetary actions by the Federal Reserve and the fiscal stimulus package are designed to forestall this outcome by stabilizing financial markets and bolstering consumer confidence and spending. Notwithstanding these stimulative measures, the risks to the economy are still great.

Even if a recession is avoided, the economy is not likely to rebound quickly because of continued uncertainty about the ultimate size of home mortgage losses and potential spillover effects on other economic sectors from the liquidity and credit concerns in financial markets. Also, the growing financial pinch that consumers are feeling from higher energy and food prices, along with the reduced wealth effect from falling home prices, is curtailing purchases for both durable and nondurable goods.

The outlook for several key economic indicators remains mixed. The economic slowdown may push the unemployment rate above 5.5 percent in 2008. Inflation, which accelerated briskly last year and continues to make headlines as gasoline marches toward $5 per gallon, will probably be between 3 and 4 percent in 2008. The news for core inflation—a measure that excludes energy and food prices—is more encouraging as it is expected to remain anchored in the 2.0 to 2.5 percent range. Also, the trade picture is improving, which should help boost the economy. The weak dollar, coupled with economic growth in developing countries, is stimulating our exports and reducing the size of the trade deficit.

Basically, the economic outlook has two important implications for the FCS. One is that the easing of monetary policy has lowered the System's funding costs, which should translate into somewhat lower interest rates on farm loans in 2008. Because the System has not been affected by the subprime financial debacle and has experienced only minor losses from the structured securities in its investment portfolio, investors have been willing purchasers of System securities, reflecting the flight to quality in today's capital market.

The second implication is less favorable for the FCS. About 80 percent of farm households receive more than half of their income from off-farm employment, outside business interests, and other investments. Thus, an economic slowdown, especially one that stretches out longer than expected, could hurt families relying on outside sources of income to repay their loans from the System. Although the farm income and loan repayment prospects are favorable for 2008, the System must remain vigilant about credit quality and the challenges of managing its portfolio in a slow economy.

ECONOMIC SETTING FOR AGRICULTURE

How long will agriculture's current prosperity last? This is the uppermost question in the minds of producers, policymakers, and the FCS. Driven by the boom in renewable fuels, the surge in exports from a weakening dollar, and generally tight worldwide grain supplies, commodity prices and net incomes are at record highs. In addition, the longer-term outlook for agriculture remains positive. Net farm income in 2008 is expected to surpass last year's record of $88.7 billion, and net cash income—a second income measurement—could jump almost 10 percent above the record $87.6 billion set in 2007. On balance, the basic supply and demand fundamentals for the foreseeable future point to a continuation of favorable farm income levels and asset values.

Yet the financial picture for agriculture is clouded by the price/cost squeeze in the livestock sector, the ratcheting up of production costs for all producers, narrow profit margins in the ethanol industry, and extreme volatility in commodity prices. These factors are a recipe for a sharp reversal in the fortunes of agriculture. History teaches us that rising commodity prices often overshoot the mark and then retreat to more "normal" levels as markets adjust. Unfortunately, producers are frequently left with permanently higher overhead and production costs in this environment, which exposes them to potential losses if market prices fall too far.

The farm income picture shows that most of the gains are concentrated among a few enterprises, such as corn, soybeans, wheat, and rice in the grain sector and eggs, broilers, and dairy in the livestock sector. For a large segment of agriculture, representing well over half of total cash receipts, net income may actually decline in 2008 as most of the livestock industry, fruits and vegetables, and other farm enterprises wrestle with volatile commodity prices, mounting labor supply issues, and rising input costs driven by feed, fertilizer, and fuel. These conditions complicate risk management strategies for farmers and increase the challenges for the FCS.

UNCERTAINTY OVER POLICY AND TRADE

Two important policy forces will help shape the farm income picture in the period ahead. Government-sponsored farm programs establish the support prices for key commodities, and new agreements from the World Trade Organization (WTO) set the rules for international trade.[27] While a new farm bill lowering most farm programs through fiscal year 2012 became law in late May 2008, there is little evidence that a new WTO agreement is in the offing.

Farm Policy Concerns—The commodity titles in the new farm bill[28] authorize the continuation of direct payments for program crops (largely feed and food grains, cotton, and oilseeds). Producers will receive these payments regardless of how much or how little they produce each year. They will also remain eligible for the countercyclical program (including a new countercyclical option providing total crop revenue protection) and loan deficiency payments on their actual production. The new bill also provides more benefits for environmental, nutrition, food security, conservation, and rural development purposes. While these changes do not significantly affect the Federal safety net, which includes countercyclical programs, target price supports, crop insurance, disaster assistance, and other protective measures for agriculture, the increasing cost structure of agriculture remains a growing risk if

27. The WTO is a voluntary association of 151 countries that meets periodically (in what are known as "rounds" of negotiations) to set rules in international trade to which all of its members agree to adhere. The Doha Round of trade negotiations, launched in 2001 in Doha, Qatar, is the most recent series of meetings. Although trade rounds may take several years to complete, negotiations in the Doha Round are stretching out over an unusually long time.

28. 1 The Food, Conservation, and Energy Act of 2008 (PL 110-234).

safety net programs are not able to keep pace with these costs.

Foreign Trade Issues—One fundamental fact of American agriculture is that our domestic markets cannot possibly absorb all that is produced each year. Thus, exports are a critical part of the farm income picture. Fortunately, the news on this front is good. Following a record year in 2007, farm exports are projected to surpass $100 billion in fiscal year 2008, a phenomenal development when viewed from a historical perspective. As recently as 2004–05, sales were running around $60 billion per year. Due to this spurt in foreign sales, the net surplus from agricultural trade, after shrinking over several years to almost zero, is now on the rise.

Although foreign sales are growing, due in part to a weak dollar, trade agreements remain important to the welfare of farmers. If the Doha Round is not brought to a successful conclusion, export growth could slow or reverse, thus negatively impacting farm prices and increasing credit risk in the FCS. The current farm income picture probably is alleviating lender concerns about the lack of a new WTO agreement, but eventually it will become important. For most producers, an agreement would help eliminate a large piece of uncertainty in the farm picture, allowing them to make better production and investment decisions for their operations and more accurately gauge their repayment capacity, obviously a matter of interest to the FCS.

RENEWABLE FUELS

In recent years, the most substantial change in the picture for agriculture and rural America has been the growth of the biofuels industry. More corn is now going into ethanol production than into exports despite solid growth in foreign corn shipments. Much of the optimism in the farm income picture stems from new energy policies to increase ethanol production from corn to 15 billion gallons by 2015—almost double current production levels—and total biofuel production to 36 billion gallons by 2022. Most of the added increase in biofuel output (beyond 15 billion gallons) is expected to come from cellulosic sources. However, the new fuel standards do not guarantee a national demand for ethanol at these high levels. Instead policymakers are counting on individual states to establish new blending requirements to achieve this outcome. However, fewer than 10 states have such fuel blending mandates today, and some are reconsidering their mandates in light of higher food and feed prices.

At the end of 2007, the System's loan commitments to the biofuels industry totaled $4.4 billion, almost 50 percent above the figure a year earlier. Of the total commitments, System institutions had funded $2.3 billion at year-end 2007, suggesting that the System's biofuel loans could double in the next two years without any additional commitments to the industry. Although total commitments at year-end represented 16.8 percent of the System's capital, ethanol loans outstanding were 8.6 percent of capital and only 1.6 percent of total loan volume. These are both relatively small numbers when compared to the System's exposure in other areas, but these risks are spread over a relatively small number of borrowers (estimated at fewer than 100). In addition to its loan holdings in the ethanol industry, the System also originates and participates out a substantial amount of debt to non-System lenders.

As we look ahead, the two most immediate concerns in the ethanol industry are the potential supply/demand mismatch for ethanol in the Midwest—reflecting transportation infrastructure bottlenecks—and the narrow profit margins in the production facilities. The optimism about ethanol's future belies the fact that this industry still requires large tax incentives, import protections, and mandated blending requirements to remain viable. Even if ethanol profits improve, the System will continue to face a challenge in financing these enterprises in a safe and sound manner because energy policies can suddenly change. For this reason,

FCA will be closely watching System institutions for loan underwriting practices that do not fully consider the risks associated with the ethanol boom.

CHALLENGES POSED BY STRONG LOAN GROWTH

Financial institutions like to grow in order to make greater returns on equity, provide service to communities, and provide a firm foundation for local economies. However, financial regulators start to worry when growth rates accelerate to double-digit levels and remain high for a protracted period. The concern is that rapid growth may contribute to increased risk during a potentially less favorable lending environment, especially if the growth is occurring in new business lines.

The System's loan portfolio was $142.9 billion at December 31, 2007, a 15.8 percent gain for the year and a two-year increase of more than a third. This strong growth came from many sources, including its primary business lines of originating farm real estate loans and short- and intermediate-term loans for production credit. However, the fastest growing segments of the loan portfolio were agribusiness loans and loans to energy and water utilities and waste disposal facilities.

The sharp rise in commodity prices in late 2007 (and continuing in 2008) caused the System's agribusiness loans (mostly originated and participated out by CoBank) to spike as grain elevators scrambled to meet margin calls in their hedging operations. While the System is meeting the growing credit demands of its customers and expects to continue to do so, the huge expansion in elevator financing has caused System institutions to monitor their accounts more closely. Many have adjusted their credit administration practices and other terms and conditions to ensure that these accounts continue to perform satisfactorily. FCA will continue to monitor how the System responds to the grain financing challenge it currently faces.

Loan participation and syndication activity is an important source of System loan growth and a growing challenge. Loan participations in new business lines contribute to the diversity of an institution's loan portfolio and help mitigate risk if the practice is managed properly. However, institutions may be adding risk to their balance sheets if the new business lines go beyond their level of expertise, lending controls, and underwriting standards. Another risk is that, in some instances, institutions may be tempted to rely too much on the expertise of the lead lender and assume the credit risk is being properly controlled and managed by that lender. History shows that the failure to exercise appropriate due diligence and independent credit judgment on new business lines often results in financial losses. With this lesson in mind, FCA will continue to focus resources on monitoring and evaluating the underlying sources of loan growth, the overall quality of the System's assets, and management's ability to manage the associated risks of significant asset growth.

OTHER CHALLENGES

Although the FCS is in solid financial health and can withstand a number of shocks before its viability is endangered, several forces will continue to challenge the System's ability to grow and prosper in the coming years.

1. **Commodity Price Volatility—** Commodity prices for grains and oil seeds have soared during the past year, but they have also been highly volatile. In early 2008, prices were sensitive to prospective changes in export demand, worldwide acreage changes, weather events, and trade restrictions. In this volatile market, the farmer is having to shoulder more marketing risk as grain elevator operators, facing high margin costs and increasing risks, have had to limit marketing options offered to their farmer customers. Over the longer term, many analysts believe we have reached a new, higher level of demand, with high crop prices into the forseeable future, but considerable uncertainty exists about this forecast. Volatility on the downside would increase if, for example, demand

from developing countries slowed significantly, worldwide production sharply expanded, or the dollar rose in value. A sharp and lasting downward movement in commodity prices could affect the safety and soundness of the FCS and Farmer Mac.

2. **Land Values—**About 45 percent of the System's loan portfolio is collateralized by a first mortgage on farm real estate. The value of farmland has been climbing continuously for 20 years since the collapse of the land market in the mid-1980s. While the farm income picture points to further rises in real estate values in 2008 and beyond, the fact remains that capitalization rates—a measure of economic returns to land—are declining. If farm income were to drop significantly over a period of three to five years, or if capitalization rates were to increase to reflect rising opportunity cost levels (e.g., better returns in the housing or stock markets), farm real estate values could decline significantly in many areas. Some evidence already exists that land values are dropping in parts of the East and West coasts because of drought in the Southeast, declining timber values, a slowdown in residential development, and other economic factors. As a result, it is critical for the System to be able to manage the risk of a sharp and prolonged decline in land values.

3. **Maintaining Market Flexibility—**The most important strategic risk facing any financial institution is not being able to offer the products and services the market demands. Certainly, the System's GSE status and its access to attractive funding mechanisms allow FCS institutions to be a reliable source of funds to agriculture and rural America in both good times and bad. However, for the past three decades, the FCS has attempted to respond to strong global banking trends and the evolving needs of rural America without major revisions to its statutory authorities. Periodically, most financial institutions require both legal and market-based adjustments to maintain their flexibility in the marketplace.

4. **Borrower Characteristics—**Dynamic forces are changing the structure of agriculture at a rapid pace, creating tremendous diversity in size, income and wealth, and operator characteristics. The magnitude of these changes continues to challenge the System's creativity in meeting the financial needs of its rural customer base. For example, the growing significance of off-farm income to the welfare of farm families is causing the System to redesign the approaches it uses to satisfy the credit needs of its rural customer base. In addition, the mandate to serve the needs of YBS farmers and ranchers will continue to be a challenge for the System because this group is increasingly dependent on the off-farm economy to sustain its financial health and ability to live in rural areas.

APPENDIX

FARM CREDIT ADMINISTRATION OFFICES

The 256 full- and part-time employees of FCA work together to ensure that the FCS remains a dependable source of credit for agriculture and rural America. The following paragraphs explain the functions of each of the Agency's offices, and figure 14 shows the organizational structure.

The **FCA Board** approves the policies, regulations, charters, and enforcement activities that ensure a strong FCS. The Board also provides for the examination and supervision of the FCS and Farmer Mac and oversees the activities of the FCS Building Association, which acquires, manages, and maintains FCA headquarters and field office facilities.

The **Secretary to the Board** ensures that the FCA Board complies with statutory, regulatory, and internal operation procedures and requirements. The Secretary to the FCA Board also serves as Secretary to the FCSIC Board and as Parliamentarian and Sunshine Act Official for the FCA Board.

The **Office of the Chief Executive Officer** enforces the rules, regulations, and orders of the FCA Board. The CEO directs the implementation of policies and regulations adopted by the FCA Board. The office plans, organizes, directs, coordinates, and controls Agency operations and leads the Agency's efforts to achieve and manage a diverse workforce.

The **Office of Congressional and Public Affairs (OCPA)** serves as the Agency's principal point of contact for Congress, the media, other Government agencies, FCS institutions, System borrowers, and the public. OCPA develops and monitors legislation pertinent to FCA and the FCS, serves as the Agency's congressional liaison, and prepares testimony for the Chairman and other staff members. The office provides information to external audiences through news releases, information brochures and fact sheets, the annual FCA Performance and Accountability Report, and other publications. OCPA manages media relations regarding Agency activities and the content of the FCA Web site. The office also coordinates special meetings, briefings for international visitors, and field hearings.

The **Office of Examination** is responsible for examining and supervising each FCS institution in accordance with the Farm Credit Act and applicable regulations. The office develops oversight plans; conducts examinations; monitors the System's condition, risks, and emerging risks; and develops supervisory strategies to ensure that the System operates in a safe and sound manner and fulfills its public policy purpose. The FCA Board further defines the Office of Examination's role in Policy Statement 53, available at www.fca.gov.

The **Office of General Counsel** provides the FCA Board and staff with legal counsel as well as guidance on general corporate, personnel, ethics, and administrative matters. The office supports the Agency's development and promulgation of regulations, civil litigation, enforcement of applicable laws and regulations, and implementation of conservatorships and receiverships. The office serves as the liaison to the Federal Register, creates and maintains the Agency's public rulemaking files, and handles the Agency's submission of the Unified Agenda of Federal Regulatory and Deregulatory Actions. The office also handles Freedom of Information Act requests and matters pertaining to the Privacy Act.

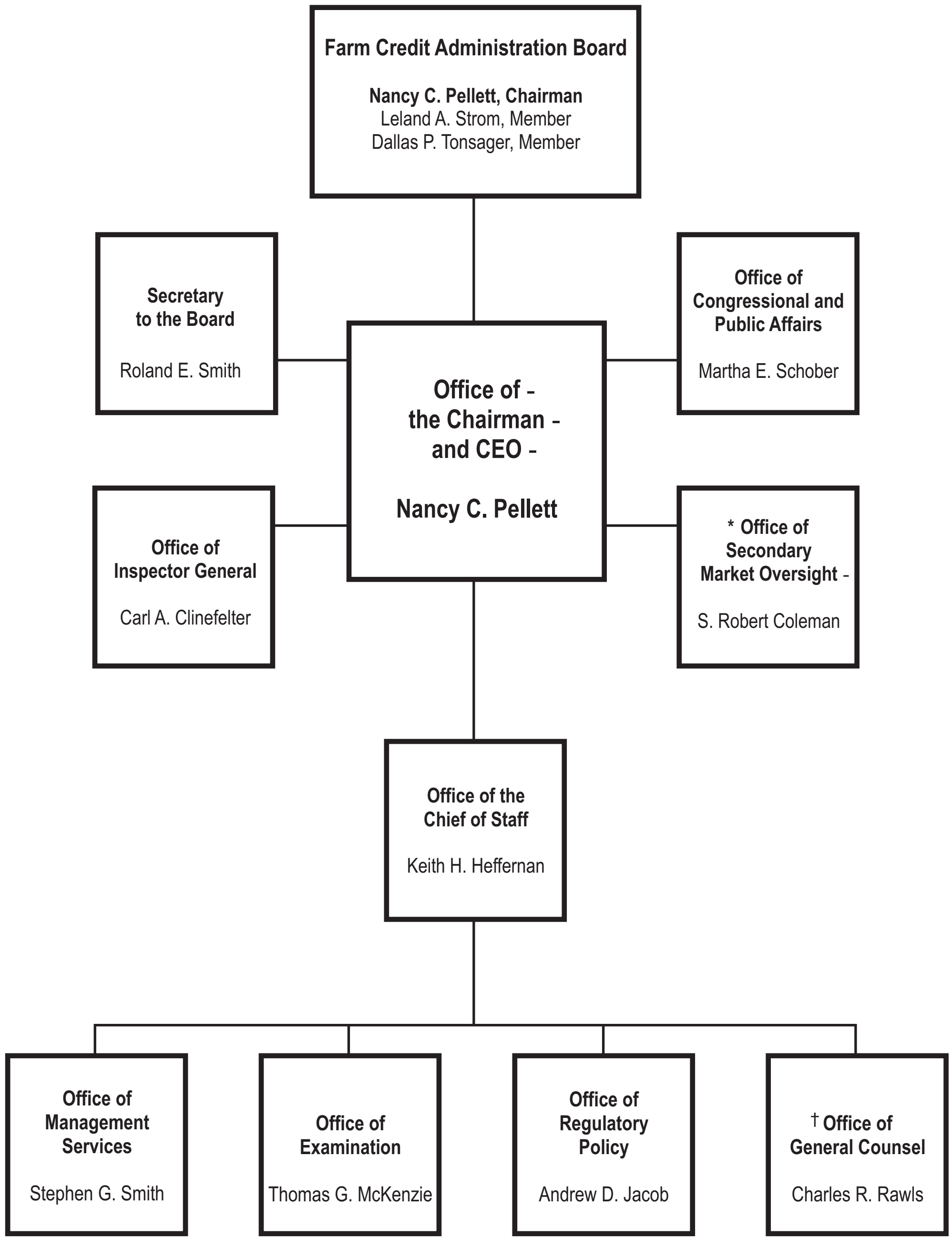
The **Office of Inspector General** provides independent and objective oversight of Agency programs and operations through audits, inspections, investigations, and the review of proposed legislation and regulations. The office promotes economy and efficiency within FCA and seeks to prevent and detect fraud, waste, and abuse in the Agency's programs and operations.

The **Office of Management Services** manages and delivers FCA's information technology, financial, human capital, and administrative services. The office coordinates Agency planning efforts, including those for managing information resources, security, human capital, and finances. By centrally planning, managing, and delivering resource services, the Office of Management Services enables the Agency's program offices to fully focus their time and attention on their respective mission-related responsibilities.

The **Office of Regulatory Policy** is responsible for developing regulations and policy positions that implement applicable statutes, promote the safety and soundness of the FCS, and support the System's mission as a dependable source of credit and related services for agriculture and rural America. Developing policies and regulations involves analyzing strategic risks to the System by considering economic trends and other risk factors. The office also evaluates all regulatory and statutory prior-approval requests from System institutions on behalf of the FCA Board. These prior-approval requests relate to mergers, charters, funding, and other corporate activity.

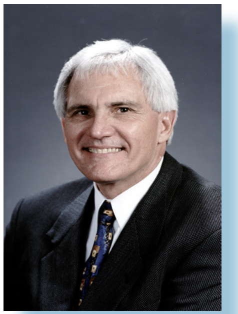
The **Office of Secondary Market Oversight** provides for the examination, regulation, and supervision of the activities of Farmer Mac to ensure its safety and soundness and the accomplishment of its public policy purpose as authorized by Congress. It also ensures that Farmer Mac complies with applicable laws and regulations, and it manages FCA's enforcement activities with respect to Farmer Mac.

Figure 14
FCA Organizational Structure



* Reports to the Board for policy and to the CEO for administration.
† Maintains a confidential advisory relationship with each of the Board members

AGENCY OFFICIALS



Carl A. Clinefelter is Inspector General and is under the general supervision of the Chairman of FCA. Before assuming this position in July 2005, Mr. Clinefelter served as Acting Director of the Office of Communications and Public Affairs and Acting Director of the Office of Congressional and Legislative Affairs. He also served as Director of the Office of the Ombudsman and as Director of the Office of Secondary Market Oversight. Prior to this, Mr. Clinefelter was Executive Assistant to FCA Board member Doyle Cook, Assistant Director of the Office of Policy and Analysis, a regional supervisory officer in the Office of Supervision, and an Associate Regional Director in the Office of Examination and Supervision. Before joining FCA in 1980, he was employed by the Federal Intermediate Credit Bank of New Orleans as assistant vice president.

S. Robert Coleman, CFA, is Director of the Office of Secondary Market Oversight. Mr. Coleman served as Director of the Agency's Regulation and Policy Division before being named to his present post in September 2005. Mr. Coleman joined FCA in 1986 as an associate examiner in the Office of Examination and became a commissioned examiner in 1990. He held various positions in that office and provided technical and analytical support to the FCA field offices and to the Policy Development and Planning Division. In 1994, Mr. Coleman transferred to the Office of Policy Analysis, where he served as a policy analyst specializing in regulation development, and then as a senior policy analyst. He was named Director of the Regulation and Policy Division in June 2003. Mr. Coleman holds the Chartered Financial Analyst® designation, which the CFA Institute awarded him in 2000.

Keith H. Heffernan is Chief of Staff. He is responsible for planning, organizing, and directing the broad range of day-to-day activities for the Agency. Before joining FCA in July 2004, he served as Chief of Staff for the Under Secretary for Rural Development at USDA. His previous experience includes serving as assistant director of the Center for Agricultural and Rural Development at Iowa State University. From 1983 to 1989, he served the State of Iowa as deputy director of the Iowa Development Commission, as administrative assistant to Governor Terry Brandstad, and as director of the Department of Commerce. He also served as executive director of the Iowa Corn Growers Association from 1977 to 1983.

William J. Hoffman is Executive Assistant to Nancy C. Pellett, Chairman and CEO of FCA. His duties include advising the Chairman on policy, administrative, and management issues affecting FCA, the FCS, and the Farm Credit System Insurance Corporation. Before attaining this position, he served as Associate Director of the Office of Secondary Market Oversight. Mr. Hoffman began his career as a credit representative in the Louisville Farm Credit District. He joined FCA in 1976 as a credit and operations officer and went on to serve in various management positions, including Associate Deputy Governor for the former Office of Examination and Supervision. In 1986 he joined the St. Louis Farm Credit Bank as vice president of risk assets and later served as the CEO of PennWest Farm Credit, ACA. Before rejoining FCA in 2004, he was involved in agricultural finance in the private sector and in several international projects.

Andrew D. Jacob, CFA, is Director of the Office of Regulatory Policy. Before being named to this position in July 2005, he served as Director of the Office of Secondary Market Oversight, a position he assumed in 2004. Mr. Jacob joined the Agency in 1986 as a credit examiner in the Sacramento field office. In 1988, he transferred to FCA's headquarters in McLean, Virginia, where he served as a commissioned FCA examiner, as an information systems examiner, and as a capital markets specialist in the Office of Examination. In 1997, he transferred to the Office of Policy and Analysis, where he served as a senior policy analyst and a senior financial analyst before becoming the Assistant Director of the office in 1999. Mr. Jacob holds the Chartered Financial Analyst® designation, which the CFA Institute awarded him in 2000.

Thomas G. McKenzie is Chief Examiner and Director of the Office of Examination. Mr. McKenzie has also served as director of both the Office of Secondary Market Oversight and of the Office of Policy and Analysis. He has held regional and division director positions in the Office of Examination and the former Office of Supervision. As a regional director he oversaw field office operations in Albany, Atlanta, Dallas, Denver, and Sacramento. Before joining FCA in 1979, he was a regional manager for a Federal Land Bank; a manager and CEO of a Federal Land Bank Association; and a financial analyst for a Bank for Cooperatives, where he began his career in agricultural credit in 1971.

Charles R. Rawls is General Counsel. Before joining FCA in March 2003, Mr. Rawls was general counsel and vice president for legal, tax, and accounting at the National Council of Farmer Cooperatives. During the consideration of the 2002 farm bill, he served as General Counsel of the Senate Committee on Agriculture, Nutrition, and Forestry. From 1998 to 2001, Mr. Rawls was General Counsel for USDA, and from 1993 to 1998, Chief of Staff to the Deputy Secretary of Agriculture. From 1988 to 1993, he was Legislative Director and then Administrative Assistant to Congressman Martin Lancaster. From 1985 to 1988, Mr. Rawls was Associate General Counsel of the House Committee on Agriculture and, from 1983 to 1985, Counsel to the House Agriculture Subcommittee on Forests, Family Farms, and Energy.

Martha E. Schober is Director of the Office of Congressional and Public Affairs. Prior to her appointment to this post, Ms. Schober served as a congressional liaison in the Office of Congressional Relations at USDA. She also served as a confidential assistant to the administrator at USDA's Risk Management Agency. Before entering Government service, Ms. Schober was the director of congressional relations at the American Cotton Shippers Association.

Roland E. Smith is Secretary to the FCA Board, having assumed that position in January 2006. He coordinates the call for agenda items and materials for the Board and serves as the Parliamentarian during Board meetings. In addition, Mr. Smith serves as the Audit Followup Official for FCA, ensuring that the Agency responds appropriately to resolve issues identified by internal and external audits of its operations and programs. He also coordinates quarterly reporting on FCA's strategic plan goals and performance measures. Mr. Smith began his career with the FCS in 1974 when he became a loan officer for a System association in Greenville, North Carolina. He later served as a loan officer and credit reviewer for the Farm Credit Banks of Columbia, South Carolina. In 1979, Mr. Smith joined FCA as an examiner in the St. Louis regional office and was promoted to Associate Regional Director in 1984. He later managed FCA's Oklahoma City field office and then the Denver field office. In 1996, he was named Chief Examiner and Director of the Office of Examination. Mr. Smith served as the Agency's Executive Director of Planning and Projects from August 2004 until January 2006.

Stephen G. Smith is Chief Financial Officer and Director of the Office of Management Services. In the past, Mr. Smith served as the Agency's Inspector General. He joined FCA in 1981 as a technical specialist, became an examiner in 1984, and later served as staff assistant for the Chief Examiner. In 1989, he was named Associate Regional Director for the Agency's New York field office and then served as Senior Staff Director for the Chief Examiner before being named Director of the Technical and Operations Division. In 1993, he assumed new responsibilities as Director of the Information Resources Division. He was named Chief Information Officer in 1996 and directed all technology and information operations for FCA. Before joining the Agency, he worked at the North Central Jersey Farm Credit Associations.

GLOSSARY

A

Agricultural Credit Association—An ACA results from the merger of a Federal Land Bank Association or an FLCA and a PCA and has the combined authority of the two institutions. An ACA borrows funds from an FCB or ACB to provide short-, intermediate-, and long-term credit to farmers, ranchers, and producers and harvesters of aquatic products. It also makes loans to these borrowers for certain processing and marketing activities, to rural residents for housing, and to certain farm-related businesses.

Agricultural Credit Bank—An ACB results from the merger of a Farm Credit Bank and a Bank for Cooperatives and has the combined authorities of those two institutions. An ACB is also authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives. CoBank is the only ACB in the FCS.

B

Bank for Cooperatives—A BC provided lending and other financial services to farmer-owned cooperatives, rural utilities (electric and telephone), and rural sewer and water systems. It was also authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives. The last remaining BC in the FCS, the St. Paul Bank for Cooperatives, merged with CoBank on July 1, 1999.

F

Farm Credit Act—The Farm Credit Act of 1971, as amended, (12 U.S.C. §§ 2001–2279cc) is the statute under which the FCS operates. The Farm Credit Act recodified all previous acts governing the FCS.

Farm Credit Bank—FCBs provide services and funds to local associations that, in turn, lend those funds to farmers, ranchers, producers and harvesters of aquatic products, rural residents for housing, and some agriculture-related businesses. On July 6, 1988, the Federal Land Bank and the Federal Intermediate Credit Bank in 11 of the 12 then-existing Farm Credit districts merged to become FCBs. The mergers were required by the Agricultural Credit Act of 1987. As of September 30, 2004, there were four FCBs: AgFirst Farm Credit Bank; AgriBank, FCB; Farm Credit Bank of Texas; and U.S. AgBank, FCB.
Farm Credit Leasing Services Corporation—The Leasing Corporation is a service entity owned by CoBank, ACB. It provides equipment leasing and related services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities.

Farm Credit System Insurance Corporation—FCSIC was established by the Agricultural Credit Act of 1987 as an independent U.S. Government-controlled corporation. Its purpose is to ensure the timely payment of principal and interest on insured notes, bonds, and other obligations issued on behalf of FCS banks and to act as conservator or receiver of FCS institutions. The FCA Board serves ex officio as the Board of Directors for FCSIC. The chairman of the FCSIC board of directors must be an FCA Board member other than the current Chairman of the FCA Board.

Federal Agricultural Mortgage Corporation—Farmer Mac was created with the enactment of the Agricultural Credit Act of 1987 to provide a secondary market for agricultural real estate and rural housing mortgage loans.

Federal Farm Credit Banks Funding Corporation—The Funding Corporation, based in Jersey City, New Jersey, manages the sale of Systemwide debt securities to finance the loans made by FCS institutions. It uses a network of bond dealers to market its securities.

Federal Intermediate Credit Bank—The Agricultural Credits Act of 1923 provided for the creation of 12 FICBs to discount farmers' short- and intermediate-term notes made by commercial banks, livestock loan companies, and thrift institutions. The Farm Credit Act of 1933 autho-

rized farmers to organize PCAs, which could discount notes with FICBs. As a result, PCAs became the primary entities for delivery of short- and intermediate-term credit to farmers and ranchers. The FICBs and the Federal Land Banks in all Farm Credit districts merged to become FCBs or the ACB. Thus, no FICBs remain within the FCS.

Federal Land Bank—The Federal Farm Loan Act of 1916 provided for the establishment of 12 Federal Land Banks to provide long-term mortgage credit to farmers and ranchers, and later to rural home buyers. All Federal Land Banks and FICBs have merged to become FCBs or part of the ACB. Thus, no Federal Land Banks remain.

Federal Land Bank Association— These associations were lending agents for FCBs. Federal Land Bank Associations made and serviced long-term mortgage loans to farmers, ranchers, and rural residents for housing. The associations did not own loan assets but made loans only on behalf of the FCB with which they were affiliated. As of October 1, 2000, there were no remaining Federal Land Bank Associations serving as lending agents for FCBs.

Federal Land Credit Association—An FLCA is a Federal Land Bank Association that owns its loan assets. An FLCA borrows funds from an FCB to make and service long-term loans to farmers, ranchers, and producers and harvesters of aquatic products. It also makes and services housing loans for rural residents.

Financial Institution Rating System—The FIRS is similar to the Uniform Financial Institutions Rating System used by other Federal banking regulators. However, unlike the Uniform Financial Institutions Rating System, the FIRS was designed to reflect the nondepository nature of FCS institutions. The FIRS provides a general framework for assimilating and evaluating all significant financial, asset quality, and management factors to assign a composite rating to each System institution. The ratings are described below.

Rating 1—Institutions in this group are basically sound in every respect; any negative findings or comments are of a minor nature and are anticipated to be resolved in the normal course of business. Such institutions are well managed, resistant to external economic and financial disturbances, and more capable of withstanding the uncertainties of business conditions than institutions with lower ratings. Each institution in this category exhibits the best performance and risk management practices for its size, complexity, and risk profile. These institutions give no cause for regulatory concern.

Rating 2—Institutions in this group are fundamentally sound but may reflect modest weaknesses correctable in the normal course of business. Since the nature and severity of deficiencies are not material, such institutions are stable and able to withstand business fluctuations. Overall risk management practices are satisfactory for the size, complexity, and risk profile of each institution in this group. While areas of weakness could develop into conditions of greater concern, regulatory response is limited to the extent that minor adjustments are resolved in the normal course of business and operations continue in a satisfactory manner.

Rating 3—Institutions in this category exhibit a combination of financial, management, operational, or compliance weaknesses ranging from moderately severe to unsatisfactory. When weaknesses relate to asset quality or financial condition, such institutions may be vulnerable to the onset of adverse business conditions and could easily deteriorate if concerted action is not effective in correcting the areas of weakness. Institutions that are in significant noncompliance with laws and regulations may also be accorded this rating. Risk management practices are less than satisfactory for the size, complexity, and risk profile of each institution in this group. Institutions in this category generally give cause for regulatory concern and require more than normal

supervision to address deficiencies. Overall strength and financial capacity, however, still make failure only a remote possibility if corrective actions are implemented.

Rating 4—Institutions in this group have an immoderate number of serious financial or operating weaknesses. Serious problems or unsafe and unsound conditions exist that are not being satisfactorily addressed or resolved. Unless effective actions are taken to correct these conditions, they are likely to develop into a situation that will impair future viability or constitute a threat to the interests of investors, borrowers, and stockholders. Risk management practices are generally unacceptable for the size, complexity, and risk profile of each institution in this group. A potential for failure is present but is not yet imminent or pronounced. Institutions in this category require close regulatory attention, financial surveillance, and a definitive plan for corrective action.

Rating 5—This category is reserved for institutions with an extremely high, immediate, or near-term probability of failure. The number and severity of weaknesses or unsafe and unsound conditions are so critical as to require urgent external financial assistance. Risk management practices are inadequate for the size, complexity, and risk profile of each institution in this group. In the absence of decisive corrective measures, these institutions will likely require liquidation or some form of emergency assistance, merger, or acquisition.

G

Government-sponsored enterprise—A GSE is a federally chartered corporation that is privately owned, designed to provide a source of credit nationwide, and limited to servicing one economic sector. Each GSE has a public or social purpose: to improve the availability of credit to agriculture, education, or housing. GSEs are usually created because the private markets did not satisfy a purpose that Congress deems worthy—either to fill a credit gap or to enhance competitive behavior in the loan market. Each is given certain features or benefits (called GSE attributes) to allow it to overcome the barriers that prevented purely private markets from developing. In some cases, the GSE receives public assistance only to get started; in other cases, the assistance is ongoing. The FCS is the oldest financial GSE.

P

Participation—A loan participation is usually a large loan in which two or more lenders share in providing loan funds to a borrower to manage credit risk or overcome a legal lending limit for a single credit. One of the participating lenders originates, services, and documents the loan. Generally, the borrower deals with the institution originating the loan and is not aware of the other participating institutions.

Production Credit Association—PCAs are FCS entities that deliver only short- and intermediate-term loans to farmers and ranchers. A PCA borrows money from its FCB to lend to farmers. PCAs also own their loan assets. As of January 1, 2003, all PCAs were eliminated as independent, stand-alone, direct-lender associations. All PCAs are now subsidiaries of ACAs.

S

Syndication—A loan syndication (or "syndicated bank facility") is a large loan in which a group of banks work together to provide funds for a borrower. Usually one bank takes the lead, acting as an agent for all syndicate members and serving as the focal point between them and the borrower. All syndicate members are known at the outset to the borrower and they each have a contractual interest in the loan.

ACRONYMS AND ABBREVIATIONS

ACA—Agricultural Credit Association
ACB—Agricultural Credit Bank
AMBS—agricultural mortgage-backed securities
CAMELS—capital, assets, management, earnings, liquidity, and sensitivity
CEO—chief executive officer
Farm Credit Act, the Act—Farm Credit Act of 1971, as amended
Farmer Mac—Federal Agricultural Mortgage Corporation
FCA—Farm Credit Administration
FCB—Farm Credit Bank
FCS—Farm Credit System
FCSIC—Farm Credit System Insurance Corporation
FIRS—Financial Institution Rating System
FLCA—Federal Land Credit Association
FSA—Farm Service Agency
GAAP—generally accepted accounting principles
GSE—Government-sponsored enterprise
OFIs—other financing institutions
PCA—Production Credit Association
RBC—Risk-Based Capital (Model)
RBIC—rural business investment company
SBA—Small Business Administration
USDA—U.S. Department of Agriculture
WTO—World Trade Organization
YBS—young, beginning, and small (farmers and ranchers)

ADDITIONAL INFORMATION

The Farm Credit Administration 2007 Annual Report is available on FCA's Web site at www.fca.gov. For questions about this publication, contact

Office of Congressional and Public Affairs
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090
Telephone: 703-883-4056
Fax: 703-790-3260
E-mail: info-line@fca.gov

The Federal Farm Credit Banks Funding Corporation prepares the financial press releases, the System's Annual and Quarterly Information Statements, and the System's combined financial statements contained therein, with the support of the System banks. These documents are available on the Funding Corporation's Web site at www.farmcredit-ffcb.com. Copies can also be obtained from

Federal Farm Credit Banks Funding Corporation
10 Exchange Place, Suite 1401
Jersey City, NJ 07302
Telephone: 201-200-8000

The Farm Credit System Insurance Corporation's annual report is available on its Web site at www.fcsic.gov. Copies of this report can also be obtained from

Farm Credit System Insurance Corporation
1501 Farm Credit Drive
McLean, VA 22102
Telephone: 703-883-4380 1

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Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102
703-883-4056
www.fca.gov

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