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BRIEFING REPORT BY THE U.S.

General Accounting Office

Preliminary Analysis Of The Financial Condition Of The Farm Credit System

UNITED STATES GENERAL ACCOUNTING OFFICE

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UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

GENERAL GOVERNMENT DIVISION

B-220507

To Various Members of Congress

In response to numerous requests from Members of Congress and subsequent agreements with their respective offices we are providing an assessment of the financial condition of the Farm Credit System as of June 30, 1985, as well as a projection of what the System's financial condition might be under two sets of assumptions by June 30, 1986.

This analysis is subject to numerous limitations and it is important that interested parties weigh those limitations carefully in evaluating the significance of the financial projections. Of most importance, projections are for the most part simply extrapolations of current financial trends in the System; two different assumptions have been made about procedures used in establishing provisions and allowances for loan losses. Different assumptions would lead to different results. Finally, the results of the analysis are dependent on the validity of data reported to the Farm Credit Administration. We have certain concerns about the accuracy of some of that data.

In general, the material contained in this briefing report indicates a significant deterioration in the current financial condition of the System. The continued viability of the System depends on whether the trend of growing loan losses can be reversed over the relatively near term, and there is little to indicate that this will occur.

This briefing report was reviewed by officials of the Farm Credit Administration, the Farm Credit Council, and the Federal Farm Credit Banks Funding Corporation. In general, the officials did not disagree with the validity of our depiction of the System's condition as of June 30, 1985, nor did they disagree with our projection of loans in nonaccrual status as of June 30, 1986. They were, however, concerned about potential misinterpretations of the significance of the assumptions underlying our projections of loan reserve establishment scenarios. They believed that misinterpretation could have an adverse impact on the System's ability to fund its operations. We agree with the concerns expressed and emphasize the importance of a careful review of this briefing report's limitations.

Copies of this briefing report are being sent to the Governor of the Farm Credit Administration, Chairman of the Board of Governors of the Federal Reserve System, the Chairman of the Federal Deposit Insurance Corporation, and the Office of the Comptroller of the Currency. We will also make copies available to other interested parties upon request.

If there are any questions regarding the contents of this briefing report call me on (202) 275-8678.

Craig A. Simmons
Associate Director

GAO'S PRELIMINARY ANALYSIS OF THE FINANCIAL CONDITION OF THE FARM CREDIT SYSTEM

This document provides a preliminary analysis of past financial trends of the Farm Credit System (System) and, based largely on these historical trends, provides extrapolations of selected financial data for the 12 months ending June 30, 1986. Additionally, we have prepared some financial trends of the System's Omaha district because of the special interest that the Members of Congress who asked that we undertake this work had in that district.

The analysis has been organized to give the reader a perspective of the current financial condition of the System and its institutions by comparing the relative performance of several factors over a 6 and 1/2 year period beginning January 1, 1979 and ending June 30, 1985. We also project the System's financial performance for the next 12 months based primarily on an extrapolation of these historical trends. Caution must be exercised in interpreting the projections. We discuss the reasons for this and other matters below.

LIMITATIONS OF ANALYSIS

For purposes of assessing the overall financial condition of the Farm Credit System, we have combined the financial data for the banks and associations that comprise the entire System. We have made adjustments for inter-system accounts. More importantly our analysis assumes that the individual banks and associations are, in effect, one large consolidated institution and that funds can be applied where needed. This assumption is based, in part, on regulations which were approved on September 4, 1985 under which the Farm Credit Administration (FCA) may transfer funds among System institutions to assist troubled System banks and associations.

The data contained in this document concerning the System's performance in 1986 are basically projections of historical trends, not predictions of future performance. In making our projections, however, we have made some adjustments to historical trends.

One principal adjustment concerns the level of the allowance for loan losses. The historical trend of the level of allowance for loan losses to gross loans shows a consistent decline since 1979. In view of the declining quality of the loan portfolio, we believe this trend needs to be reversed. When bad loans are charged off, they are charged against the allowance for loan losses. Charge-offs affect earnings only to the extent that a bank or an association should provide enough funds for the allowance for loan losses to cover the charge-offs. The timing and magnitude of losses in the System's loan portfolio cannot be accurately predicted. However, some projection must be made if projections of earnings and adjusted capital for the next 12 months are to be extrapolated.

To give some range of possible future levels of the allowance for loan losses we have made projections of the level of allowance for loan losses on two different bases. To establish a level of allowance for loan losses, we have determined the ratio of the reserve level to nonaccrual[1] loans at June 30, 1985, and applied that ratio to the projected nonaccrual loans at June 30, 1986. Because the level of the allowance for loan losses to nonaccrual loans is lower than that of the commercial banking system, we provide a second basis. The second basis for projecting the allowance level was to use the ratio of allowance for loan losses to nonaccrual loans as reported by all commercial banks as of March 31, 1985, and to apply that ratio to the projected nonaccrual System loans for June 30, 1986[2]. This is not to suggest that the System will adopt this ratio in reserving for problem loans nor is it to suggest that all nonaccrual loans will be charged off as a loss. The allowance for loan losses should reflect the expected losses in the entire loan portfolio. We used the ratio of nonaccrual loans to the allowance for loan losses because they are loans that are not being repayed and may involve some loss to the System and because the definition of nonaccrual loans is the same for the System's institutions as it is for commercial banks.

Another adjustment made in our analysis was to reflect an increase in the System's cost of funds. Investors in System bonds are now requiring a premium of about 1 percent above comparable Treasury securities rates to compensate for the risk that they perceive. Our projections of interest expense for 1986 reflect some added cost because of this risk premium for some low interest System debt that will have to be renewed in 1986.

Our projection did not take into account any cost savings that might occur as a result of actions taken by district banks to consolidate banks or associations or district management because no estimates were available at FCA. FCA officials believe that those savings would be limited.

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[1]Nonaccrual loans are those on which interest accruals are no longer being recorded because they are not considered fully collectible.

[2]Arguments can be made for and against the appropriateness of this ratio as it relates to the Farm Credit System's operation. Most Farm Credit System loans are collateralized. Therefore, liquidation of loans does not imply a full loss of principal because of recoveries on collateral liquidation. On the other hand, commercial banks are considerably more diversified in their lending operations and therefore much less vulnerable to economic problems experienced in a particular sector of the economy. Whether these two factors offset each other is unknown.

Our extrapolations are based on the best available data at the time our analysis was conducted. A major change in the farm economy, the System's customer base, or perceived risk of the System's securities could significantly negate the usefulness of any analysis based on historical trends. The validity of our analysis is also partly dependent upon the validity of the financial data reported by System institutions to FCA. In this regard we have some concerns about the quality of financial data received by FCA. For example, if subsequent credit reviews such as the one conducted by the System at the Omaha Production Credit Associations (PCAs), in connection with their financial assistance plan, show that the quality of loans are significantly worse than reported, this would also affect the results of our analysis.

OVERVIEW

The profitability of the System continued a downward trend (return on assets has consistently declined since 1982) and problem loans continued to mount (nonperforming and nonaccrual loans collectively increased about 40 percent during the 6-month period ending June 30, 1985). Allowances for loan losses were adequate to absorb all bad loans that were charged off during the 12 month period ending June 30, 1985 and adjusted capital (earned surplus plus the allowance for loan losses) continued its 4 year upward trend. The System was able to build up its adjusted capital by increasing its allowance for loan losses from earnings which rose at a faster pace than bad loan write-offs. We believe, however, that there are a number of critical factors, all with negative implications, which collectively will have an adverse effect on the System's performance in the future.

During the first half of 1985, the quality of the Federal Land Banks' (FLB) loan portfolio deteriorated. For example, the amount of nonaccrual loans increased by 66 percent from what existed at the beginning of the period. The FLBs have over two-thirds of the System's loans. The continued deterioration in these loans may require the banks to significantly increase their allowance for loan losses to cover the charge-offs during the year as well as provide an allowance to cover future losses in the loan portfolio. FCA expects future deteriorations in the loan portfolio.

Based on historical trends, future earnings are not going to be sufficient to cover the necessary provision for loan losses. Therefore increases in the allowance for loan losses will require a reduction in the earned surplus accounts. The System will thus be sustaining its operations by drawing on its net worth. The continued viability of the System will depend on the magnitude of its loan losses and the duration of these losses.

There are several factors which make a reversal in the declining earnings trends unlikely. Since the beginning of 1984, the spread between the interest rates paid for loan funds obtained on the bond market and interest rates received on loans made to the System's borrowers has steadily increased. This trend, however, may be reversed during 1986, producing a greater strain on System earnings. The cost of borrowed funds may increase because investors are now requiring a higher yield on System bonds compared to comparable Treasury securities to compensate for risk that they perceive. On the income side, interest rates charged System borrowers may have reached the point where passing these increased borrowing costs through to System borrowers would be counterproductive. According to district bank reports, interest rates charged System borrowers have increased to the point that many districts are concerned about the competitiveness of their lending rates. District bank reports have also pointed to the level of these rates as a reason for the loss of some of their better customers.

If current trends continue through June 1986, the System, with declining earnings, will have to use its earned surplus that it has built up from prior year earnings. During 1986, the extent to which this surplus will be used to increase the allowance for loan losses depends primarily on the level of the allowance for loan losses that is established and the amount of bad loans written off against the allowance. Projecting an allowance for loan losses for June 30, 1986, based on the ratio of the allowance to nonaccrual loans maintained by the System on June 30, 1985, results in a decrease in the level of earned surplus from $6.3 to $3.7 billion. A similar projection using the ratio of allowance for loan losses to nonaccrual loans maintained by commercial banks results in the projected allowance for loan losses of $7.9 billion. In this scenario, the earned surplus would be reduced to zero and the allowance for loan losses would still be $1.2 billion less than the projected level. In the final analysis, the ability of the System to weather its current difficulties without external assistance will depend on the ability of its adjusted capital to absorb losses and how much longer the decline in earnings will last.

In the following table we present some selected consolidated financial data for the System for 1984, 1985, and our projections based on extrapolation of recent trends under the two scenarios for 1986.

Table 1

SELECTED CONSOLIDATED FINANCIAL DATA FOR THE FARM CREDIT SYSTEM

	(Billions)
Gross Loans	
December 31, 1984 (actual)	$83.5
June 30, 1985 (actual)	80.4
June 30, 1986 (extrapolated)	75.2
Nonaccrual Loans	
December 31, 1984 (actual)	2.0
June 30, 1985 (actual)	2.6
June 30, 1986 (extrapolated)	6.1
Allowance for Loan Losses	
December 31, 1984 (actual)	1.3
June 30, 1985 (actual)	1.2
June 30, 1986 (extrapolated based on FCA data)[a]	3.1
June 30, 1986 (extrapolated based on commercial bank ratios)[b]	6.7[c]
Loan Losses	
For the 12 months ending June 30, 1985 (actual)	.7
For the 12 months ending June 30, 1986 (extrapolated)	1.1
Earnings	
For the 12 months ending June 30, 1985 (actual)	.2
For the 12 months ending June 30, 1986 (extrapolated based on FCA data)	-2.6
For the 12 months ending June 30, 1986 (extrapolated based on commercial bank ratios)	-7.4[b]
Earned Surplus	
December 31, 1984 (actual)	6.2
June 30, 1985 (actual)	6.3
June 30, 1986 (extrapolated based on FCA data)	3.7
June 30, 1986 (extrapolated based on commercial bank ratios)	0[b]

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[a]Extrapolated balance based on the ratio of allowance for loan losses to nonaccrual loans for the Farm Credit System as of June 30, 1985.

[b]Extrapolated balance based on the ratio of allowance for loan losses to nonaccrual loans for all commercial banks as of March 31, 1985.

[c]An allowance for loan losses based on the ratio of nonaccrual loans to the allowances maintained by commercial banks would result in a System allowance level of $7.9 billion. The System's earned surplus was only sufficient to establish an allowance level of $6.7 billion, leaving a shortfall in the allowance account of $1.2 billion.

The next sections discuss in more detail our analysis of the profitability of the System, the quality of its loans, the adequacy of capital, the availability of funds to finance the System's lending activities, and customer base retention. The ratios used in our analyses are commonly used by regulators of financial institutions, researchers, and academia to analyze the financial condition of institutions and banking systems.

PROFITABILITY

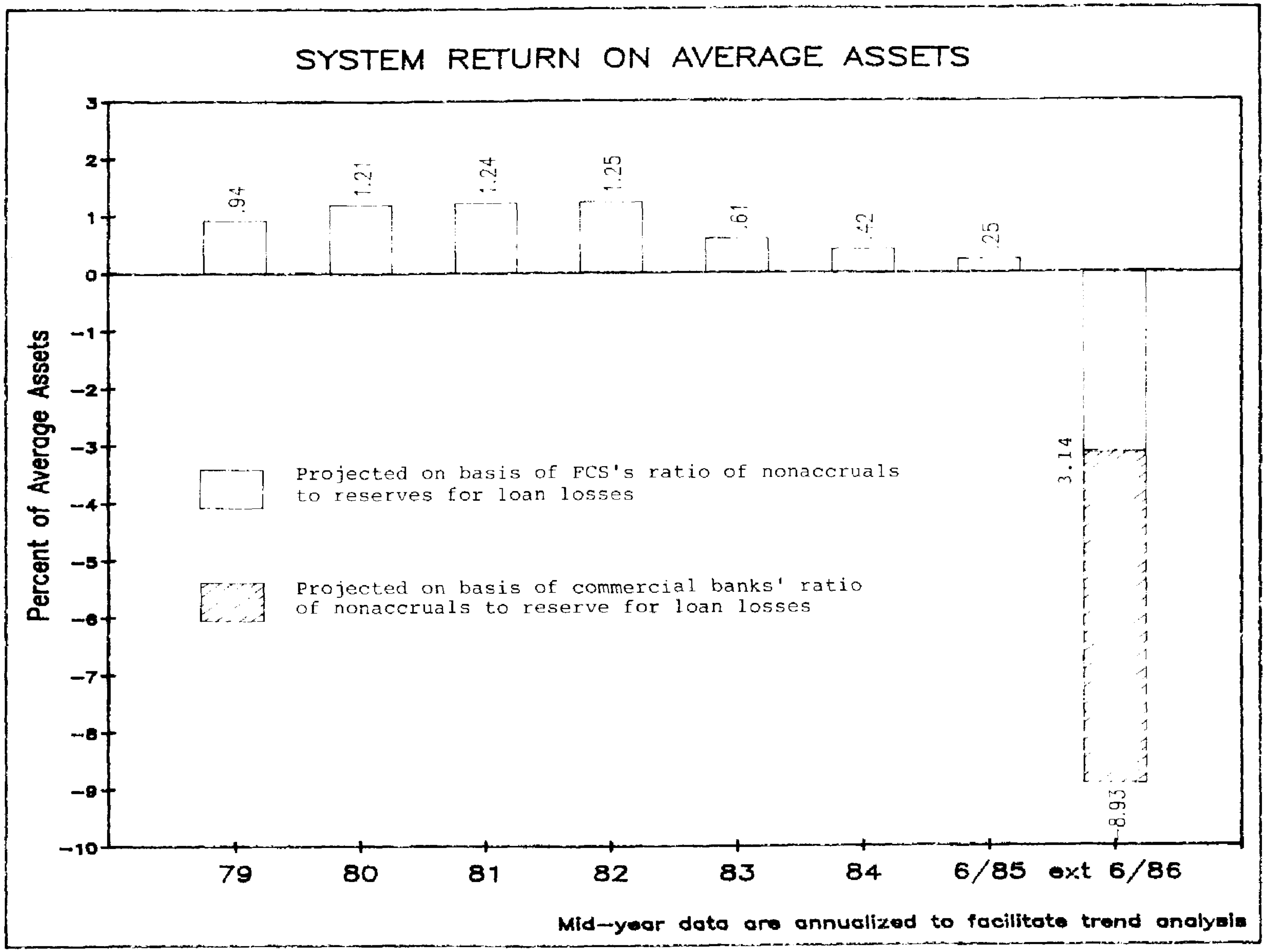
Earnings, as measured by return on assets (ROA) have declined since 1982 for the System collectively (see graph 1) as well as for all components of the System. (See also graphs 2 to 7). In 1982 the System had a ROA of 1.25 percent, which compared very favorably to an average ROA of 1.10 percent for all commercial banks. The System's ROA has steadily declined to a low of 0.25 percent by June 30, 1985, and we project a decline to a new low ranging from a minus 3 percent to a minus 9 percent by June 30, 1986. (See graph 1.) This decline is largely a result of reserving for loan losses in the two scenarios we are using.

We found a difference in the current and past ROA of the different banking systems within the overall Farm Credit System. Graph 2 shows that the PCAs consistently have been the worst performers and the Federal Land Bank Associations (FLBA) have been the best performers. During the 6 and 1/2 years covered by our analysis, the ROA for PCAs never exceeded 0.3 percent. Graph 3 shows ROA data for each of the System's districts for the 12 months ending June 30, 1985. Graphs 4 through 7 show ROA data for the various components with special emphasis on the Omaha district's component institutions.

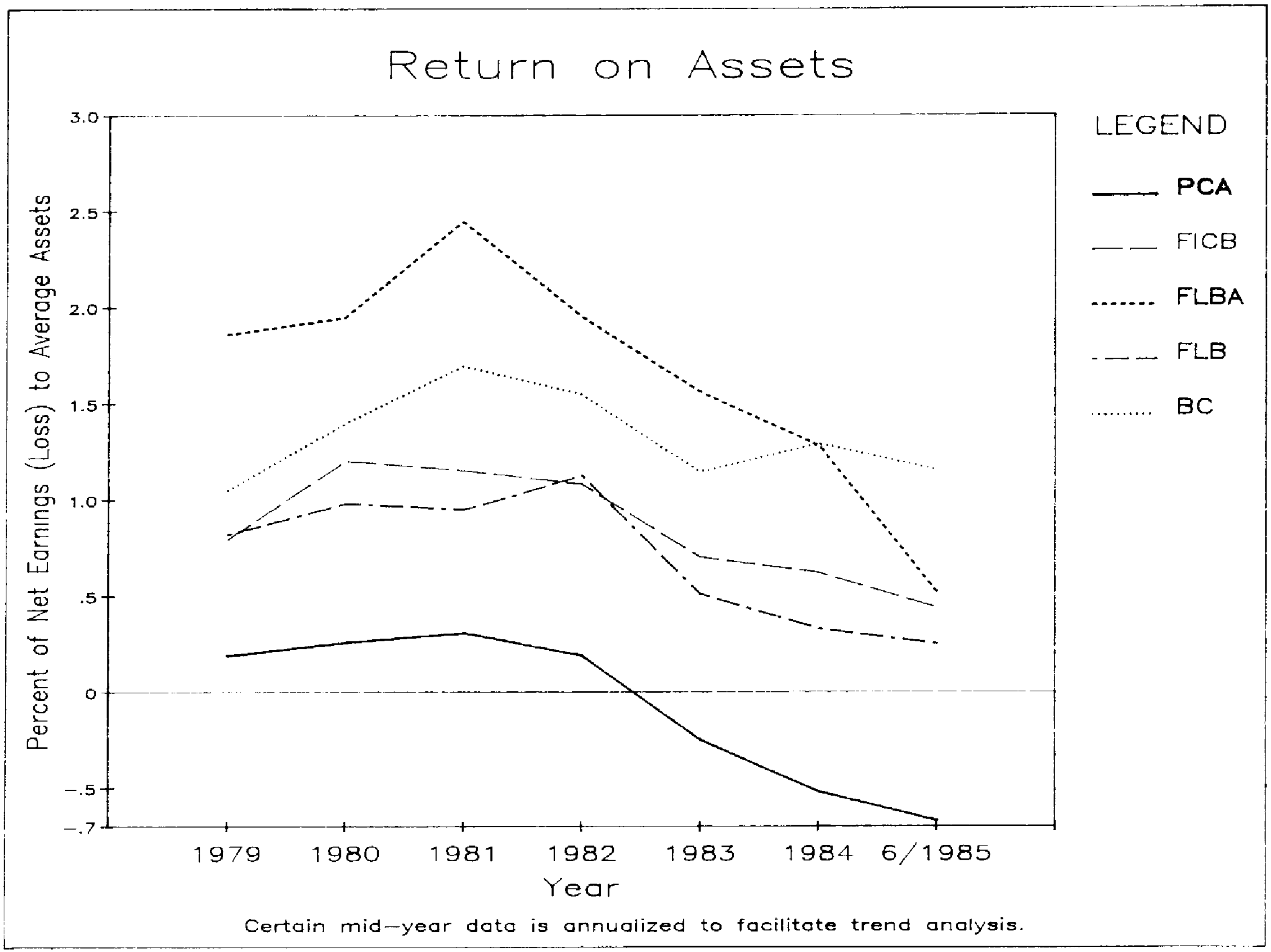
Graphs 8 and 9 show that since 1981, operating expenses and provision for loan losses as a percent of system assets have steadily increased. System net interest margin, however, has not materially increased (see graph 10) resulting in declining operating income for the System (see graph 11). Graphs 12, 13, 14, and 15 show similar financial data for the System's component parts.

While PCAs have consistently increased the spread between interest rates on funds borrowed and funds loaned, (see graph 17), this increase did not offset the loss of interest income resulting from the deterioration in the quality of the loan portfolio and the increase in the amount of nonaccrual loans. Also shown in graph 17, since 1983 the Omaha PCAs have consistently had a larger spread than the national average.

Graph 1

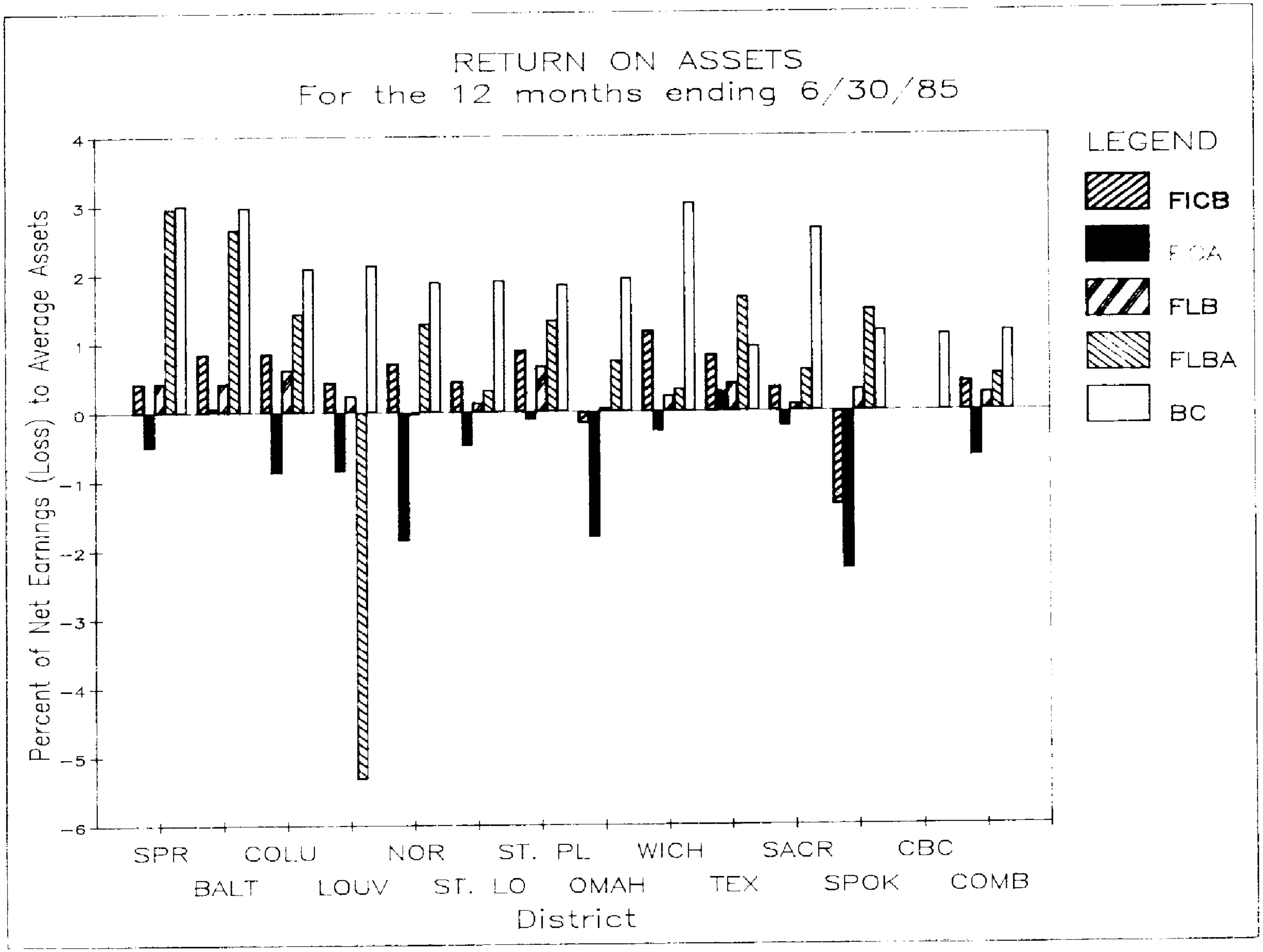

SYSTEM RETURN ON AVERAGE ASSETS
Percent of Average Assets
3
2
1
0
−1
−2
−3
−4
−5
−6
−7
−8
−9
−10
.94
1.21
1.24
1.25
.61
.42
.25
3.14
-8.93
Projected on basis of FCS's ratio of nonaccruals to reserves for loan losses
Projected on basis of commercial banks' ratio of nonaccruals to reserve for loan losses
79
80
81
82
83
84
6/85
ext 6/86
Mid—year data are annualized to facilitate trend analysis

GRAPH 2

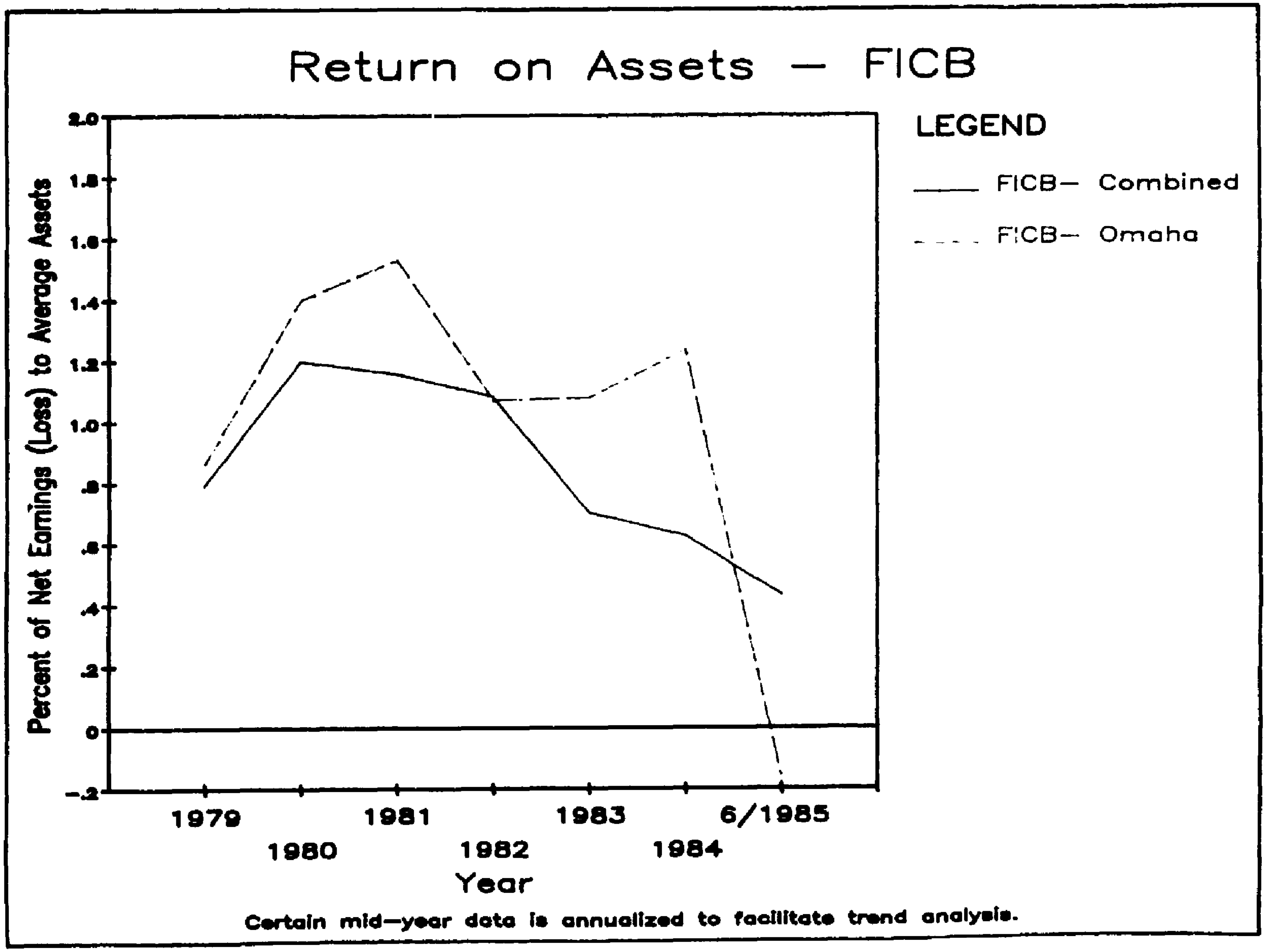


Return on Assets
LEGEND
PCA
FICB
FLBA
FLB
BC
Percent of Net Earnings (Loss) to Average Assets
3.0
2.5
2.0
1.5
1.0
.5
0
-.5
-.7
1979
1980
1981
1982
1983
1984
6/1985
Year
Certain mid-year data is annualized to facilitate trend analysis.

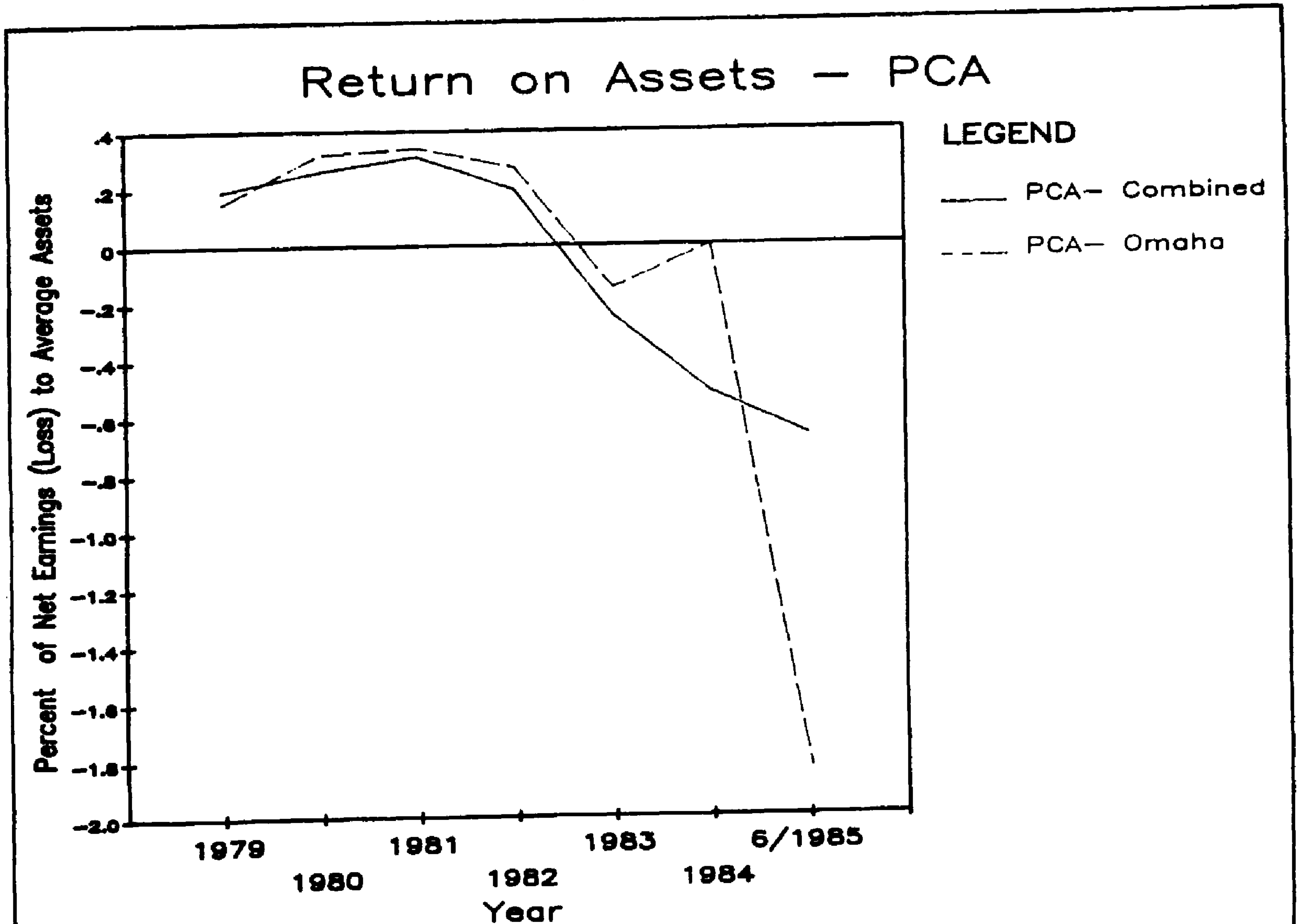
GRAPH 3


RETURN ON ASSETS
For the 12 months ending 6/30/85
Percent of Net Earnings (Loss) to Average Assets
4
3
2
1
0
−1
−2
−3
−4
−5
−6
SPR
BALT
COLU
LOUV
NOR
ST. LO
ST. PL
OMAH
WICH
TEX
SACR
SPOK
CBC
COMB
District
LEGEND
FICB
FLB
FLBA
BC

GRAPH 4

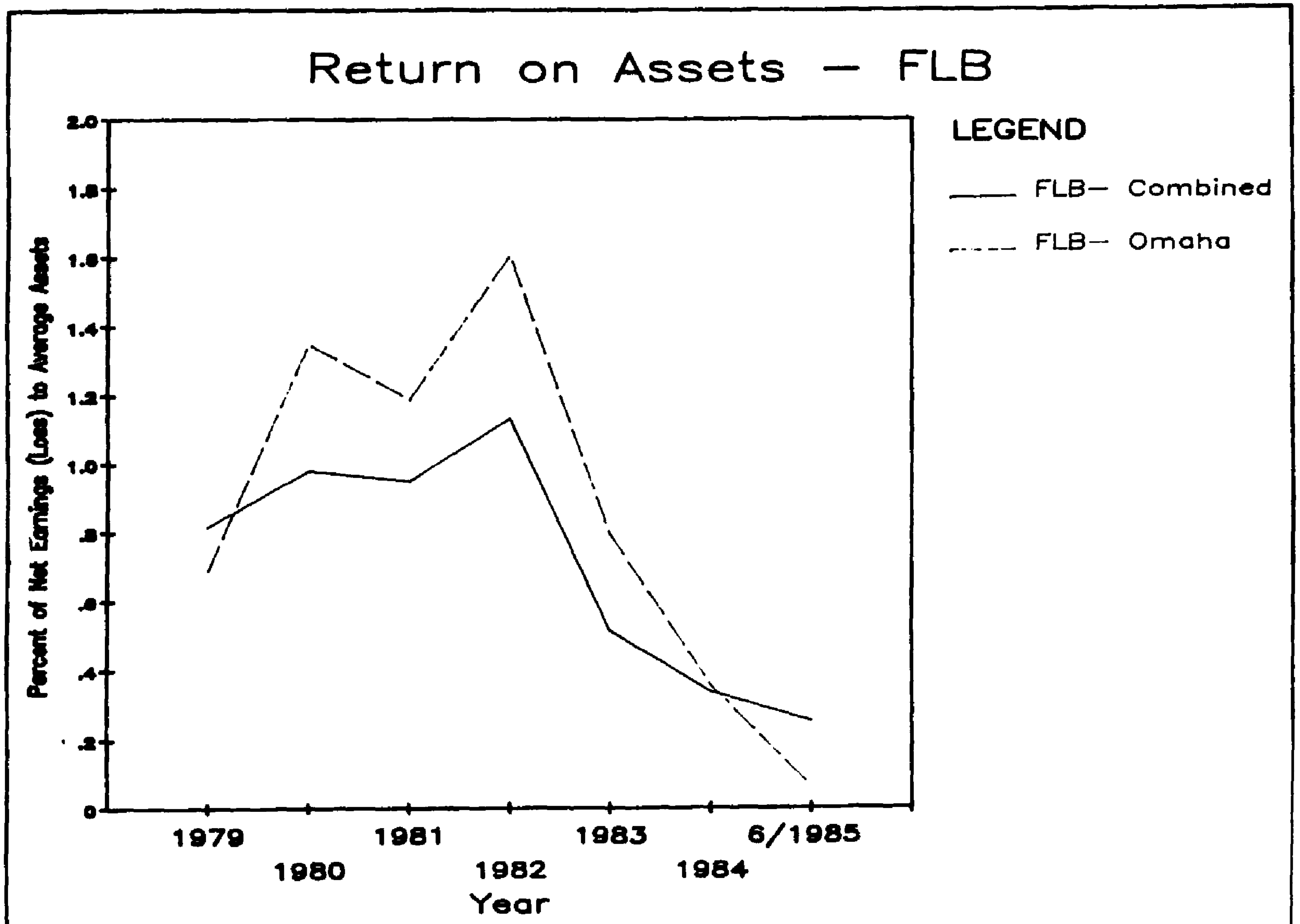

Return on Assets — FICB
LEGEND
FICB— Combined
FICB— Omaha
Percent of Net Earnings (Loss) to Average Assets
2.0
1.8
1.6
1.4
1.2
1.0
.8
.6
.4
.2
0
-.2
1979
1980
1981
1982
1983
1984
6/1985
Year
Certain mid-year data is annualized to facilitate trend analysis.

GRAPH 5



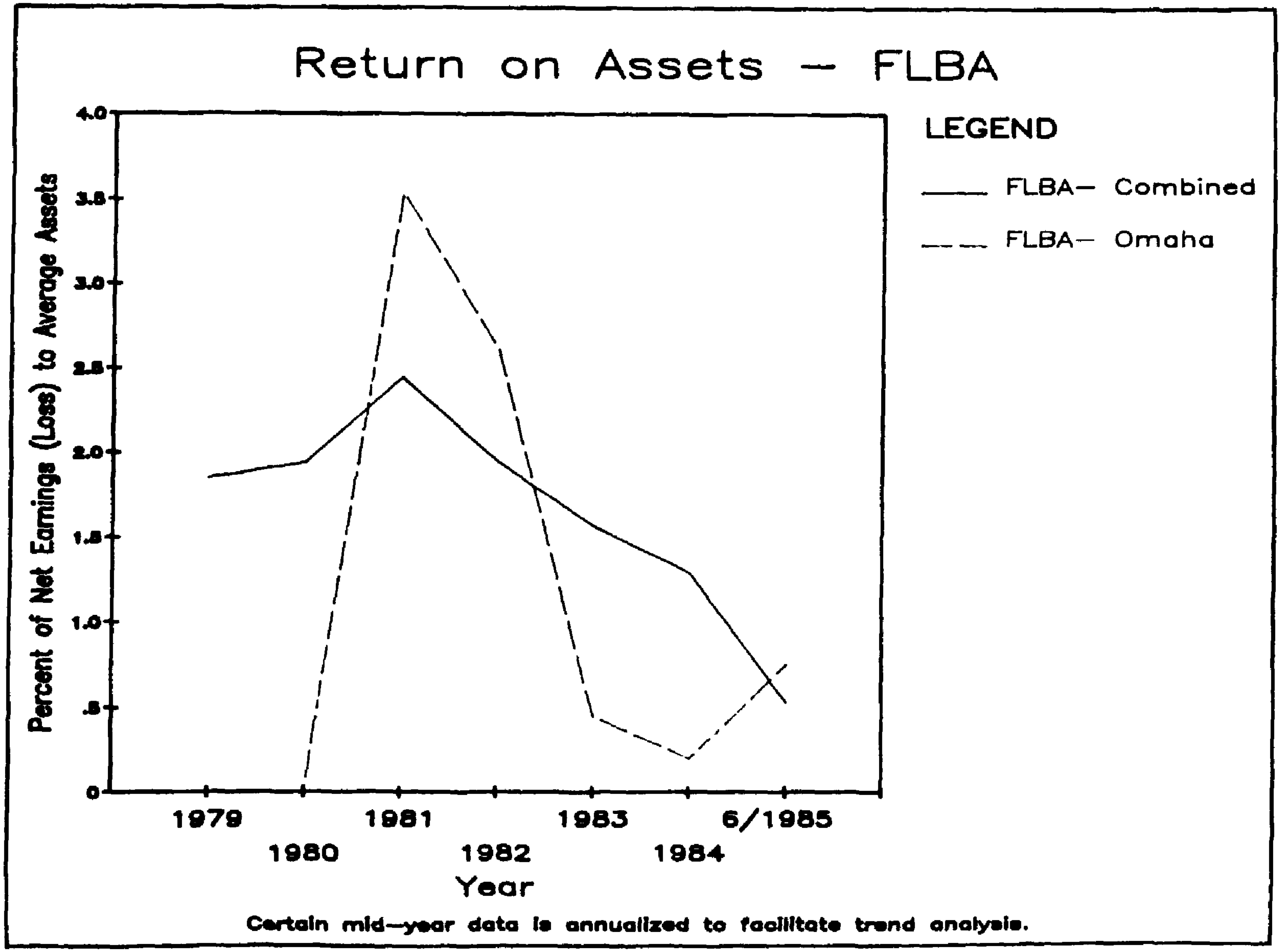
Certain mid—year data is annualized to facilitate trend analysis.

GRAPH 6



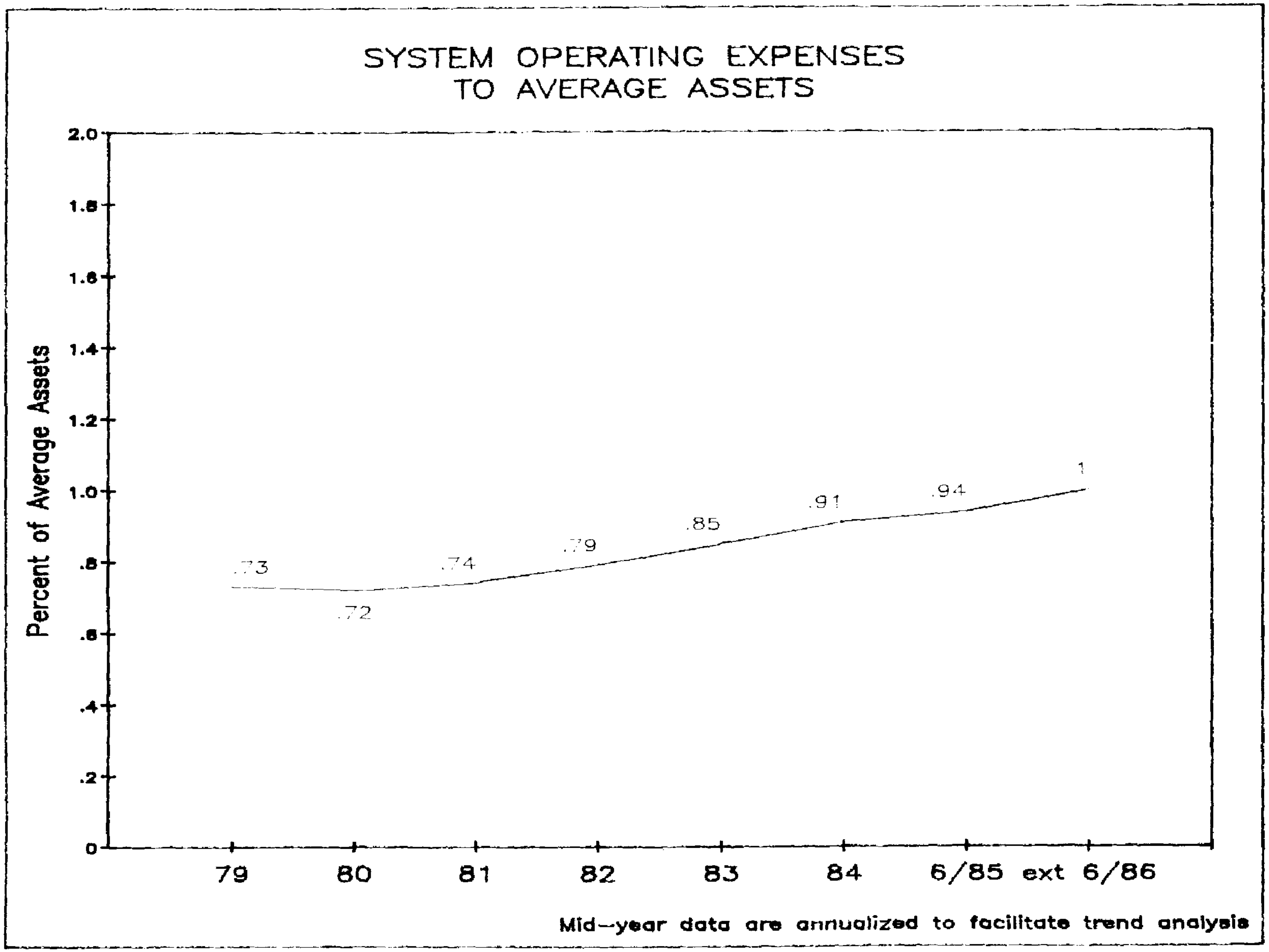
Certain mid-year data is annualized to facilitate trend analysis.

GRAPH 7

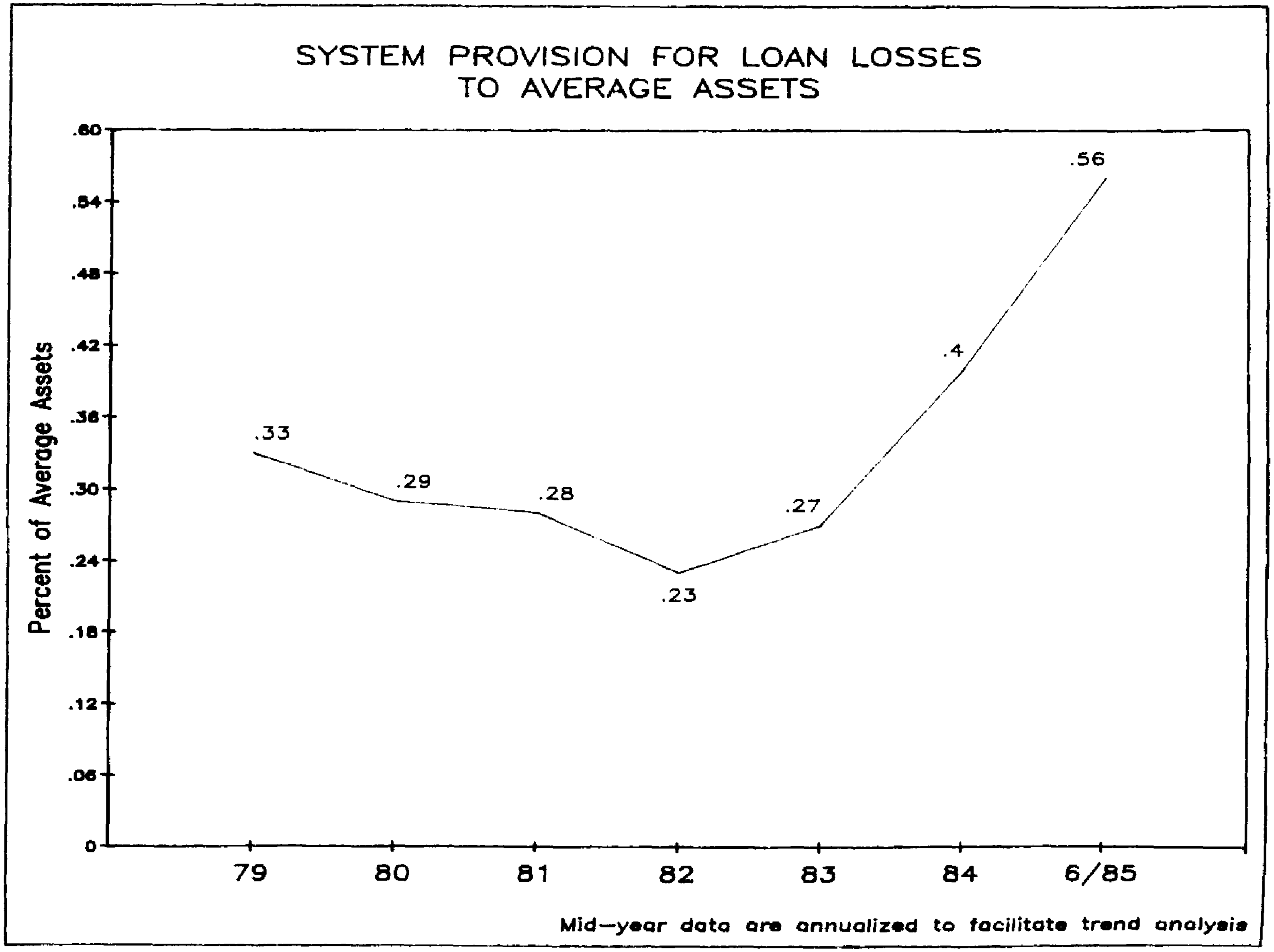


Return on Assets – FLBA
LEGEND
FLBA– Combined
FLBA– Omaha
Percent of Net Earnings (Loss) to Average Assets
4.0
3.5
3.0
2.5
2.0
1.5
1.0
.5
0
1979
1980
1981
1982
1983
1984
6/1985
Year
Certain mid–year data is annualized to facilitate trend analysis.

Graph 8

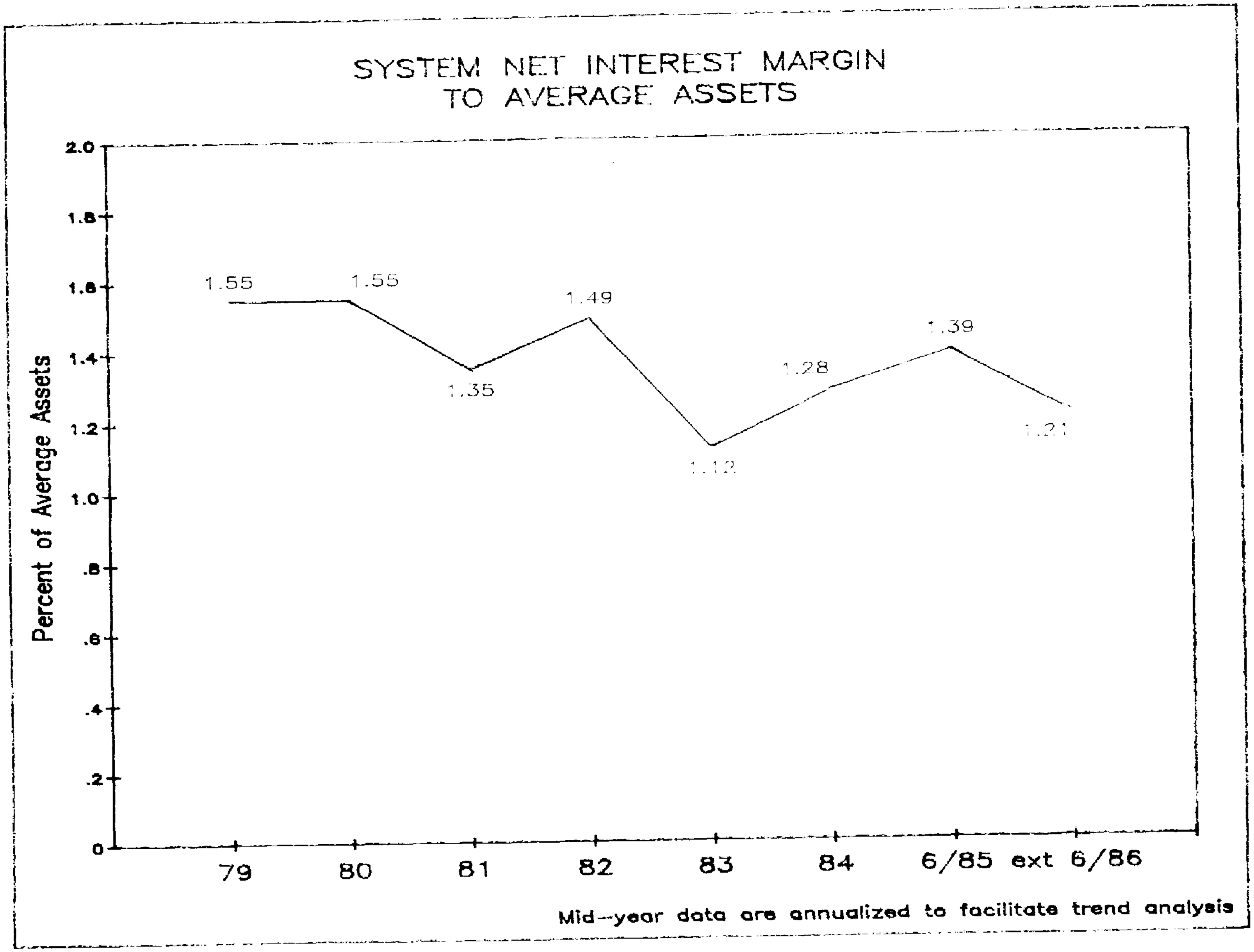

SYSTEM OPERATING EXPENSES
TO AVERAGE ASSETS
Percent of Average Assets
2.0
1.8
1.6
1.4
1.2
1.0
.8
.6
.4
.2
0
.73
.72
.74
.79
.85
.91
.94
1
79
80
81
82
83
84
6/85
ext 6/86
Mid-year data are annualized to facilitate trend analysis

GRAPH 9



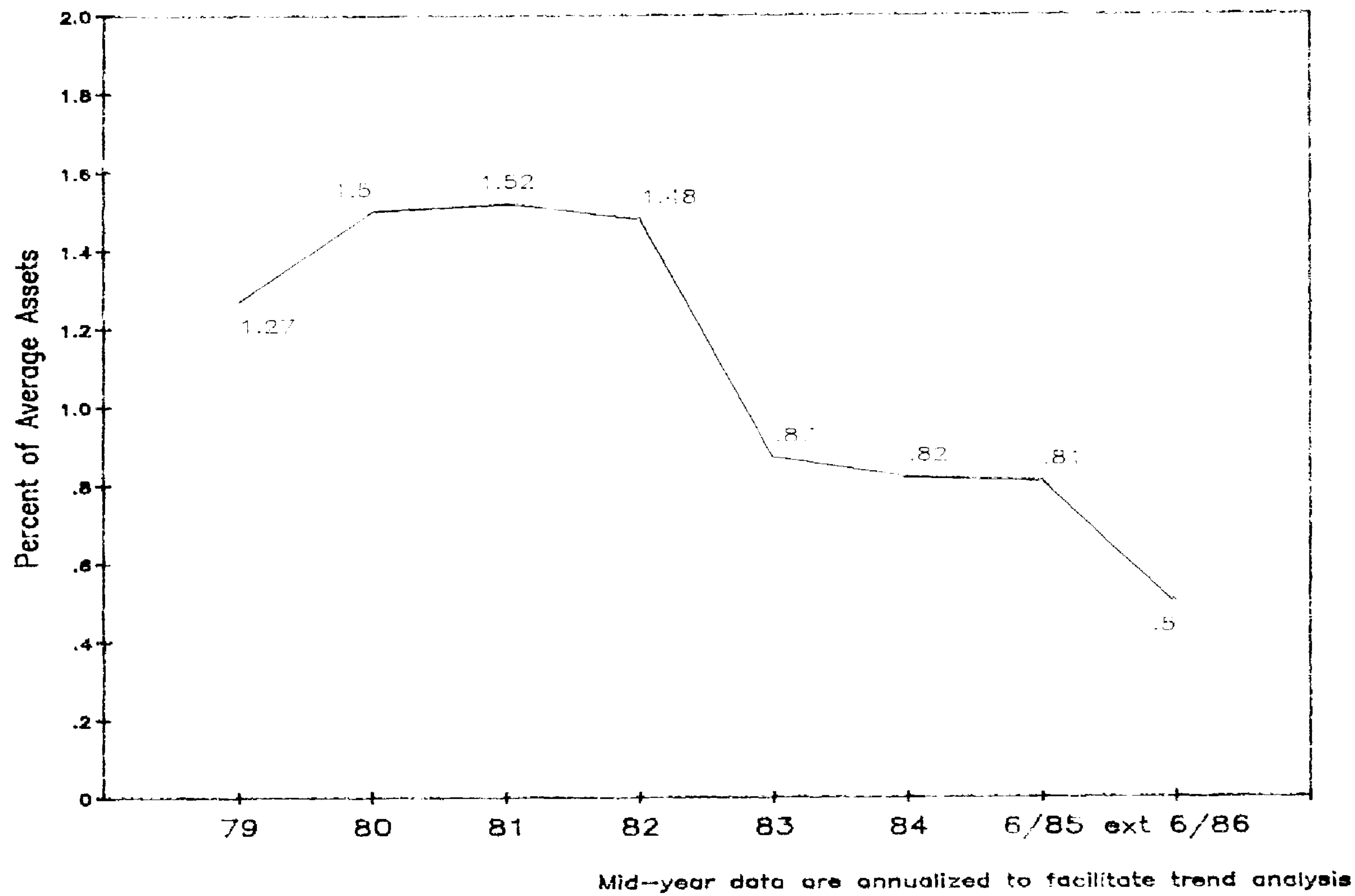
SYSTEM PROVISION FOR LOAN LOSSES
TO AVERAGE ASSETS
Percent of Average Assets
.60
.54
.48
.42
.36
.30
.24
.18
.12
.06
0
.33
.29
.28
.23
.27
.4
.56
79
80
81
82
83
84
6/85
Mid—year data are annualized to facilitate trend analysis

Graph 10

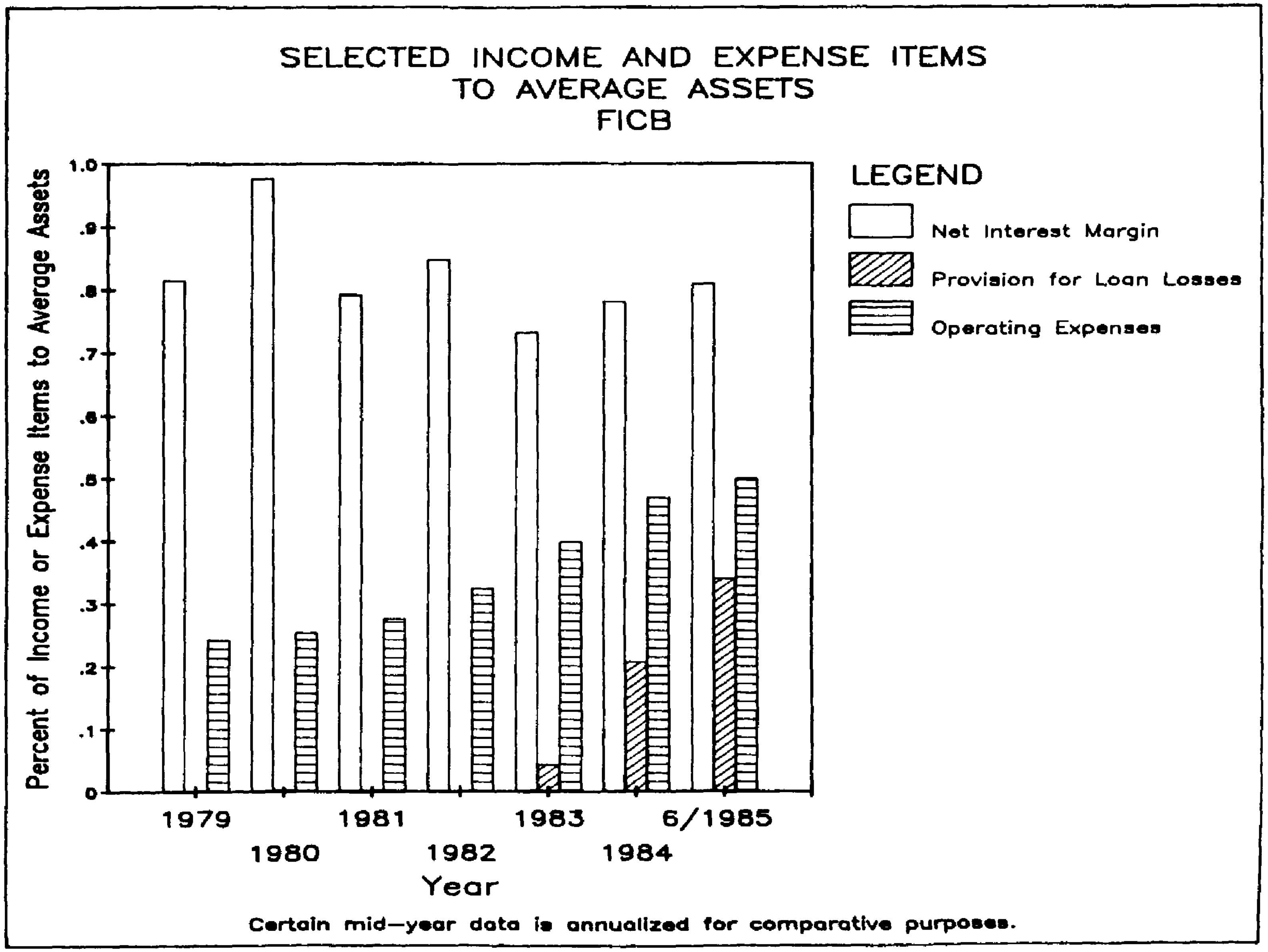

SYSTEM NET INTEREST MARGIN
TO AVERAGE ASSETS
Percent of Average Assets
2.0
1.8
1.6
1.4
1.2
1.0
.8
.6
.4
.2
0
1.55
1.55
1.35
1.49
1.12
1.28
1.39
1.21
79
80
81
82
83
84
6/85
ext 6/86
Mid-year data are annualized to facilitate trend analysis

Graph 11

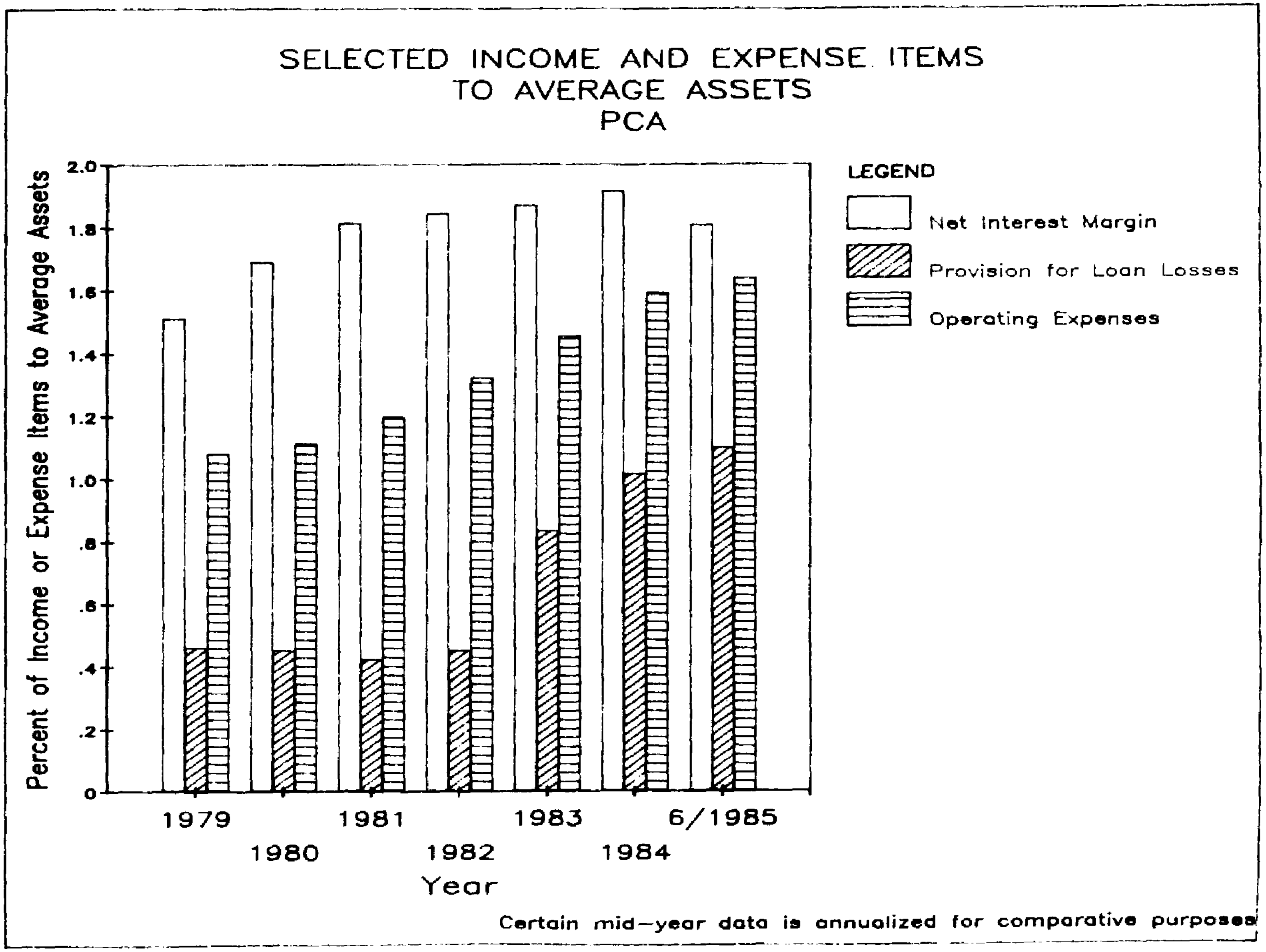
SYSTEM NET OPERATING INCOME
TO AVERAGE ASSETS



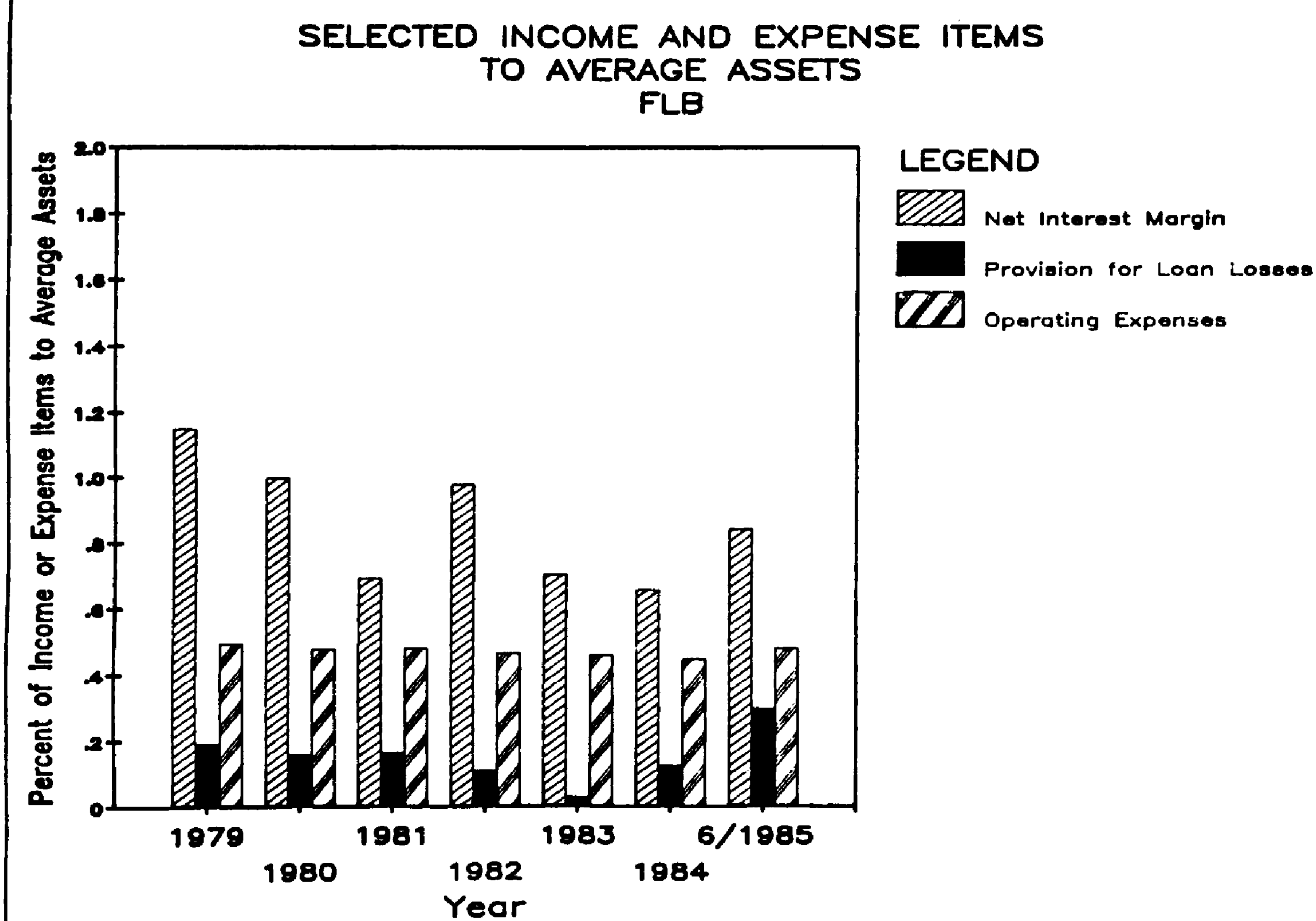
GRAPH 12


SELECTED INCOME AND EXPENSE ITEMS
TO AVERAGE ASSETS
FICB
Percent of Income or Expense Items to Average Assets
1.0
.9
.8
.7
.6
.5
.4
.3
.2
.1
0
1979
1980
1981
1982
1983
1984
6/1985
Year
LEGEND
Net Interest Margin
Provision for Loan Losses
Operating Expenses
Certain mid-year data is annualized for comparative purposes.

GRAPH 13

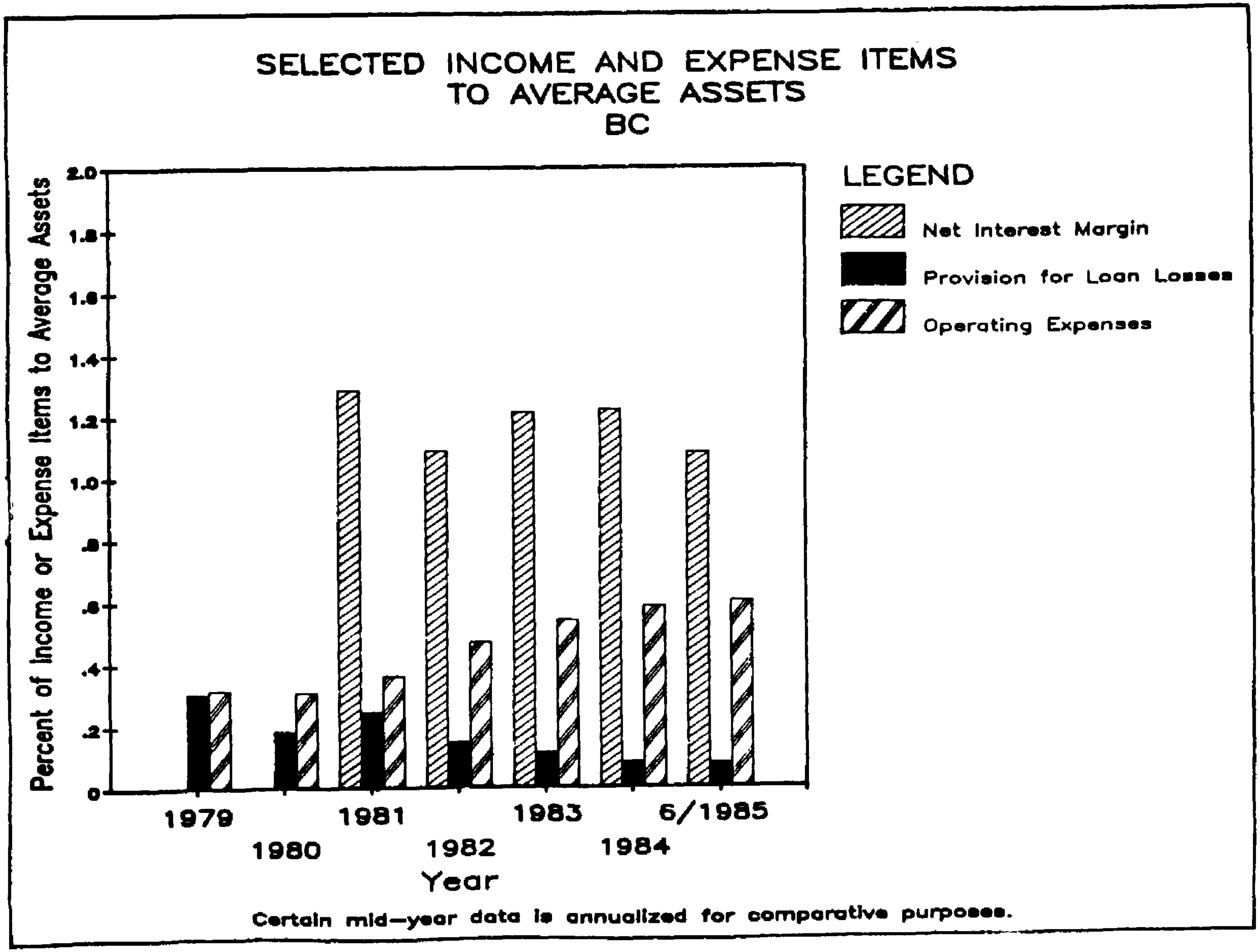

SELECTED INCOME AND EXPENSE ITEMS
TO AVERAGE ASSETS
PCA
Percent of Income or Expense Items to Average Assets
2.0
1.8
1.6
1.4
1.2
1.0
.8
.6
.4
.2
0
1979
1980
1981
1982
1983
1984
6/1985
Year
LEGEND
Net Interest Margin
Provision for Loan Losses
Operating Expenses
Certain mid-year data is annualized for comparative purposes

GRAPH 14



Certain mid-year data is annualized for comparative purposes.

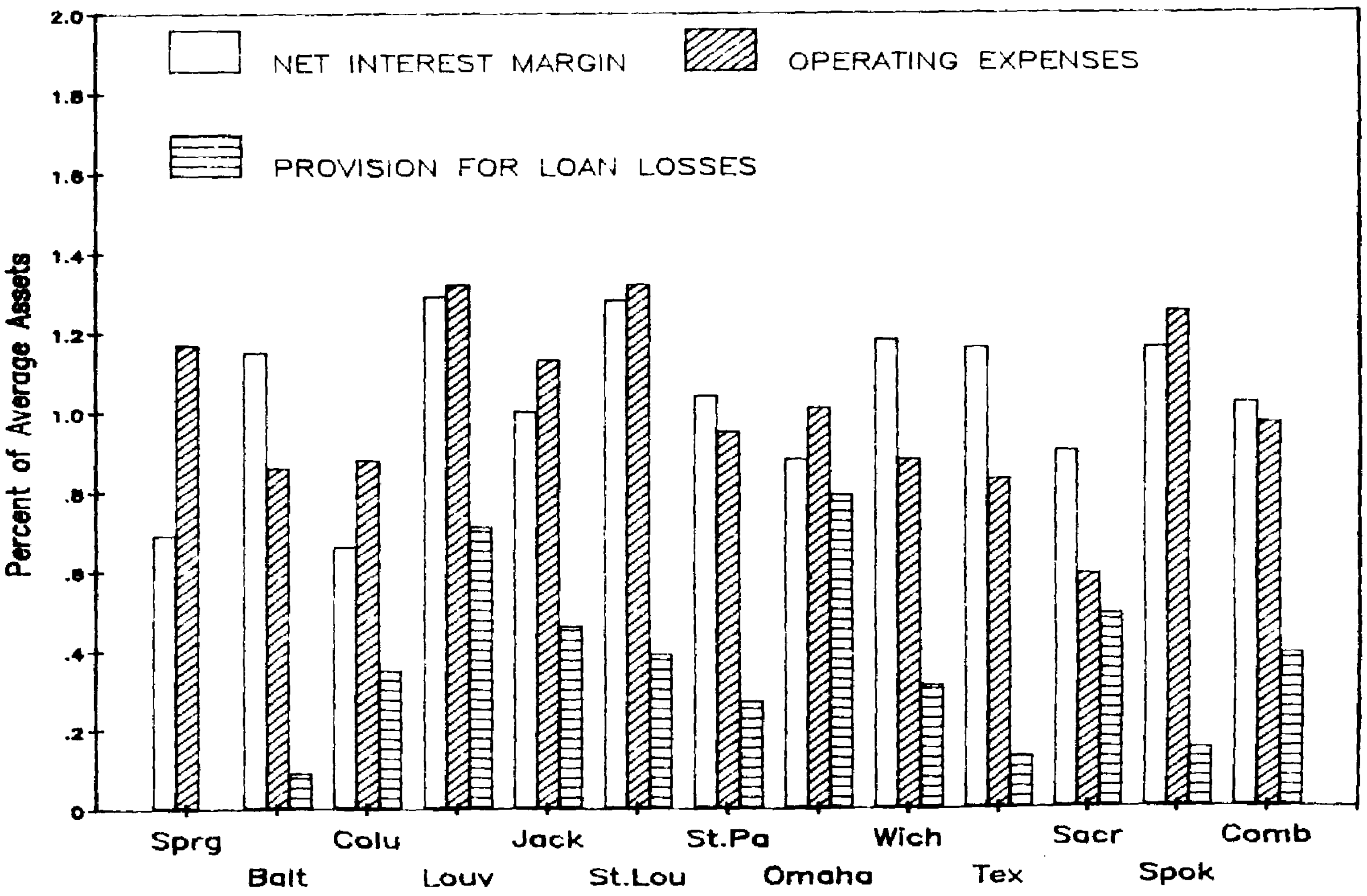
GRAPH 15



SELECTED INCOME AND EXPENSE ITEMS
TO AVERAGE ASSETS
BC
LEGEND
Net Interest Margin
Provision for Loan Losses
Operating Expenses
Percent of Income or Expense Items to Average Assets
2.0
1.8
1.6
1.4
1.2
1.0
.8
.6
.4
.2
0
1979
1980
1981
1982
1983
1984
6/1985
Year
Certain mid-year data is annualized for comparative purposes.

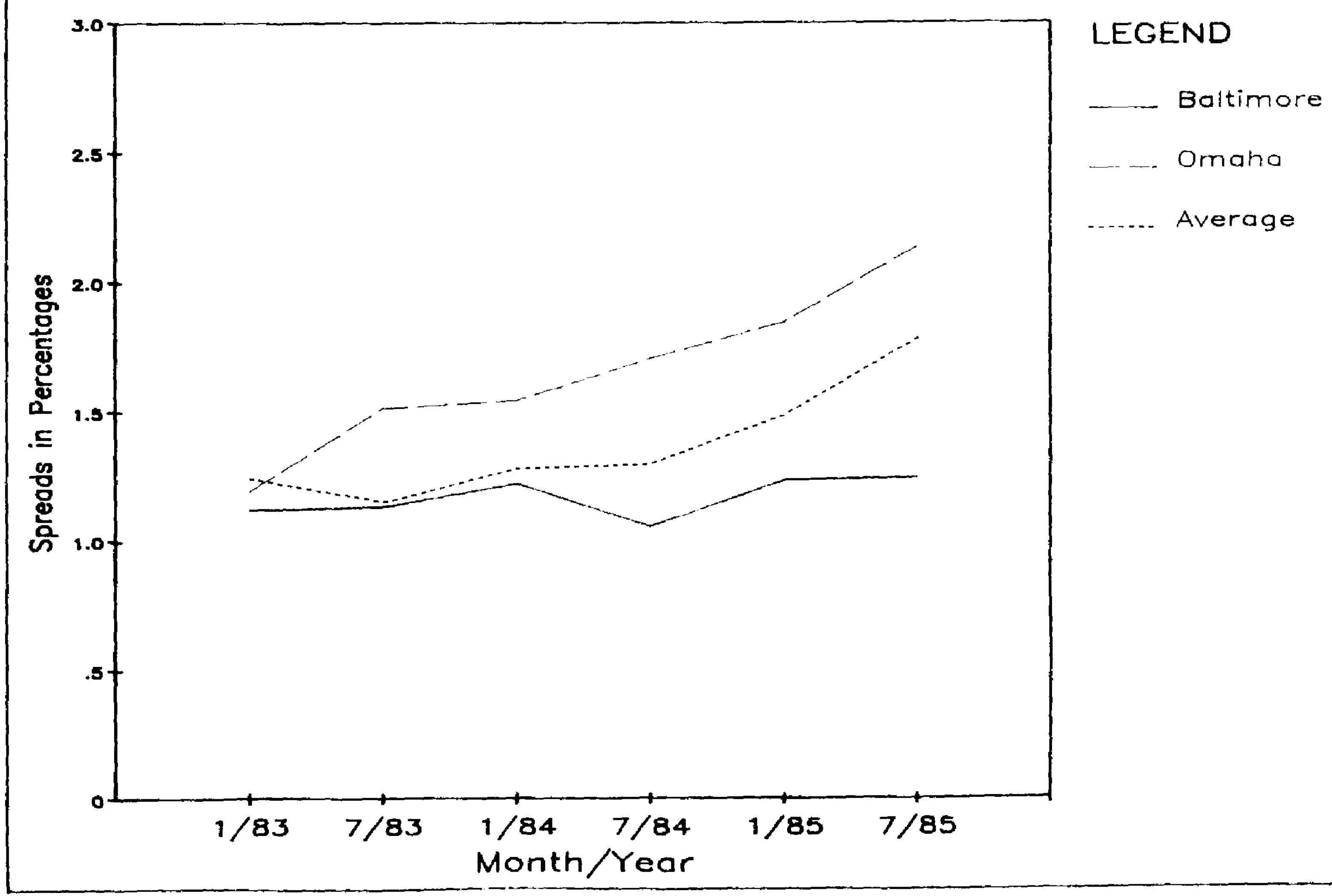
GRAPH 16

SELECTED INCOME AND EXPENSE ITEMS FOR
PCAs JANUARY 1 TO JUNE, 1985



GRAPH 17

DIFFERENCES IN RATES OF FUNDS BORROWED AND FUNDS LOANED
TWO SELECTED PCA DISTRICTS AND SYSTEM AVERAGE



LOAN QUALITY

The most critical factor in analyzing the financial condition of the System is the assessment of the System's loan portfolio. There are many categories used by FCA to depict the quality of loans depending on the degree of risk perceived. Some of these categories have only recently been used by the System. We have used the acceptable, problem, vulnerable, or loss classification system because these are the only categories that have been consistently used over the 6 1/2 years included in our analysis.[3]

We attached a weight to each of the adverse classifications to determine the relative severity of weaknesses in the loan portfolio.[4] (See graphs 18 and 19.) While our analysis showed a continuous deterioration in loan quality, it showed a dramatic deterioration during the first half of 1985. Because there is generally a time lag between the time that a loan is adversely classified and the time when a loss is recognized and charged against the allowance account, it follows that loan losses will significantly increase during the next 12 months.

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[3]Acceptable loans--Loans of highest quality, ranging down to and including those having significant credit weaknesses.

Problem loans--Loans having serious credit weaknesses requiring more than normal supervision but believed to be collectible in full.

Vulnerable loans--High risk loans still considered collectible but involving probability of loss in the event repayment from available sources does not materialize.

Loss loans--loans on which all or any portion is deemed uncollectible.

[4]We weighted the adversely classified loans as follows: 20 percent of problem loans, 50 percent of vulnerable, and 100 percent of loss loans.

Beginning with the December 1984 quarter, FCA began classifying loans as performing, nonperforming, and nonaccruals.[5] Table 2 shows a significant increase from December 31, 1984 to June 30, 1985 in the volume of nonperforming and nonaccrual loans for the Federal Land Banks (FLB). Graphs 20 and 21 show the nonperforming loans as of December 31, 1984 and June 30, 1985 for PCAs and FLBs by district.

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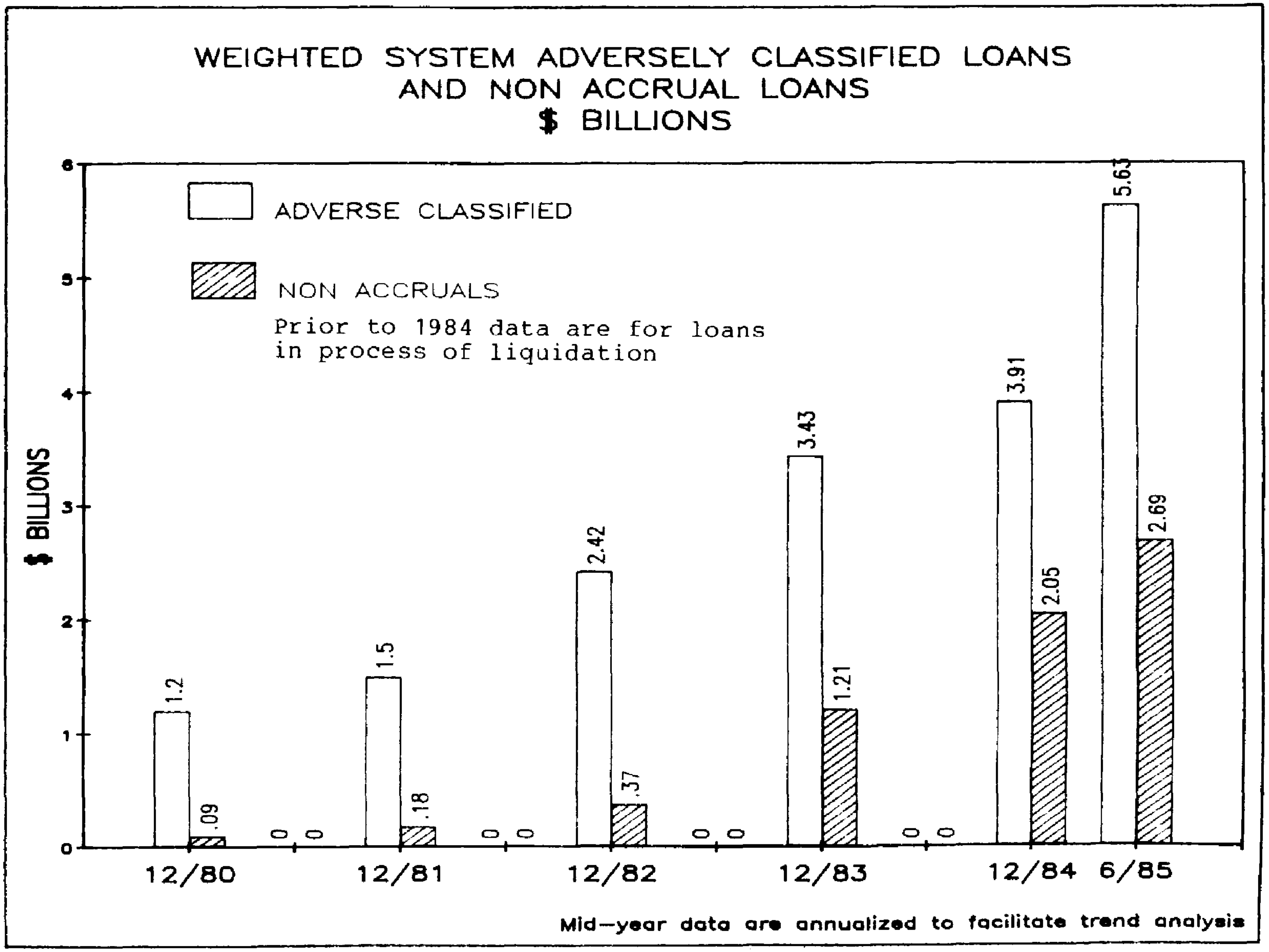
[5] The FCA definition of nonperforming loans includes formally and informally restructured loans on which concessions have been made to borrowers for economic or legal reasons. It also includes other high-risk loans and nonaccrual loans. Other high-risk loans are those past due 90 days or more but adequately secured, loans otherwise in default; loans in bankruptcy or foreclosure; loans classified vulnerable as a result of a periodic credit evaluation; and other loans showing sufficiently severe credit weakness as to require abnormal servicing to ensure performance. Nonaccrual loans are those on which interest accruals have been suspended because they are not considered fully collectible.

GRAPH 18



WEIGHTED SYSTEM ADVERSELY CLASSIFIED LOANS
AND NON ACCRUAL LOANS
$ BILLIONS
ADVERSE CLASSIFIED
NON ACCRUALS
Prior to 1984 data are for loans in process of liquidation
$ BILLIONS
0
1
2
3
4
5
6
1.2
.09
1.5
.18
2.42
.37
3.43
1.21
3.91
2.05
5.63
2.69
12/80
12/81
12/82
12/83
12/84
6/85
Mid-year data are annualized to facilitate trend analysis

GRAPH 19

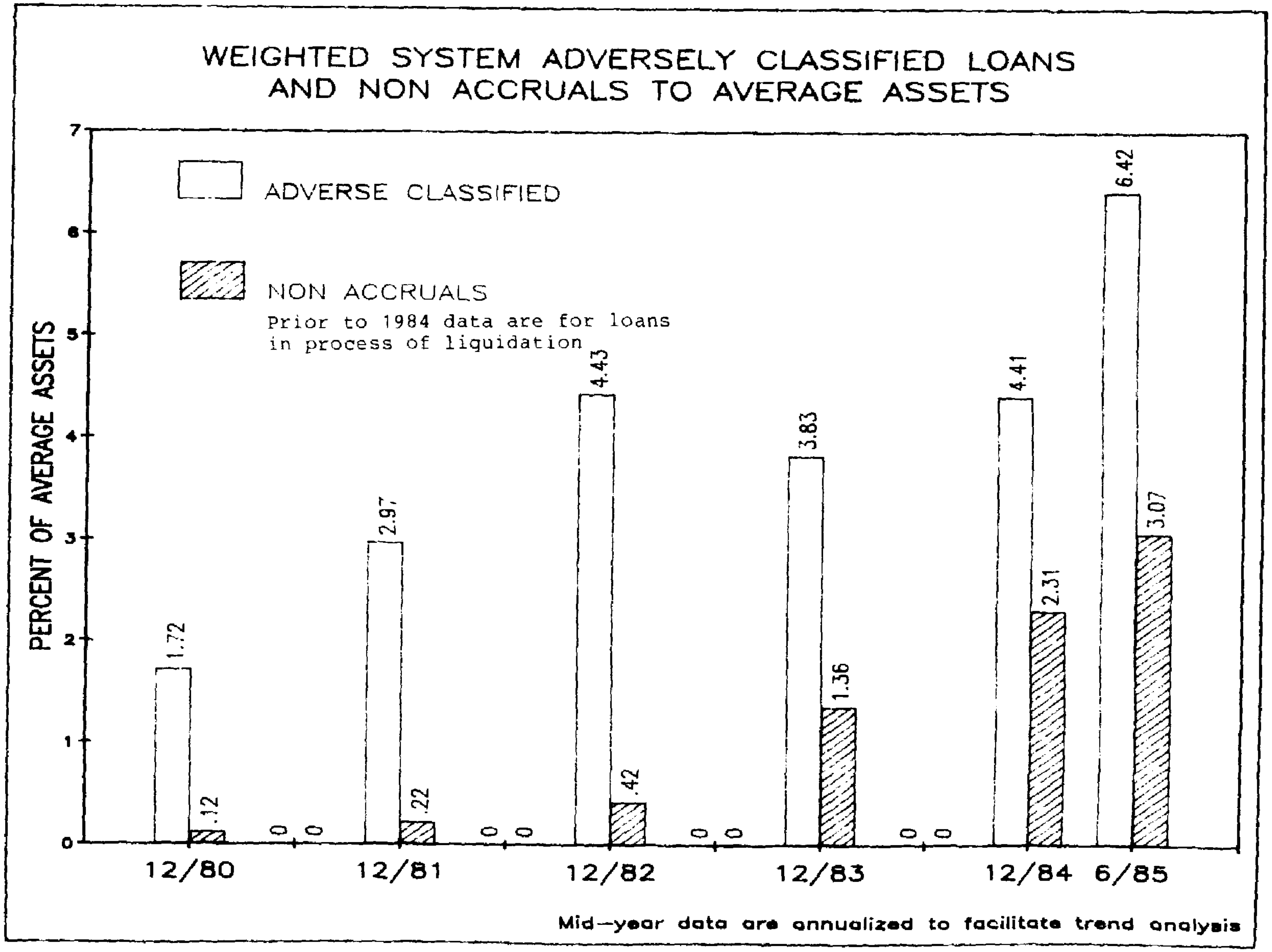

WEIGHTED SYSTEM ADVERSELY CLASSIFIED LOANS
AND NON ACCRUALS TO AVERAGE ASSETS
ADVERSE CLASSIFIED
NON ACCRUALS
Prior to 1984 data are for loans
in process of liquidation
PERCENT OF AVERAGE ASSETS
0
1
2
3
4
5
6
7
1.72
.12
2.97
.22
4.43
.42
3.83
1.36
4.41
2.31
6.42
3.07
12/80
12/81
12/82
12/83
12/84
6/85
Mid-year data are annualized to facilitate trend analysis

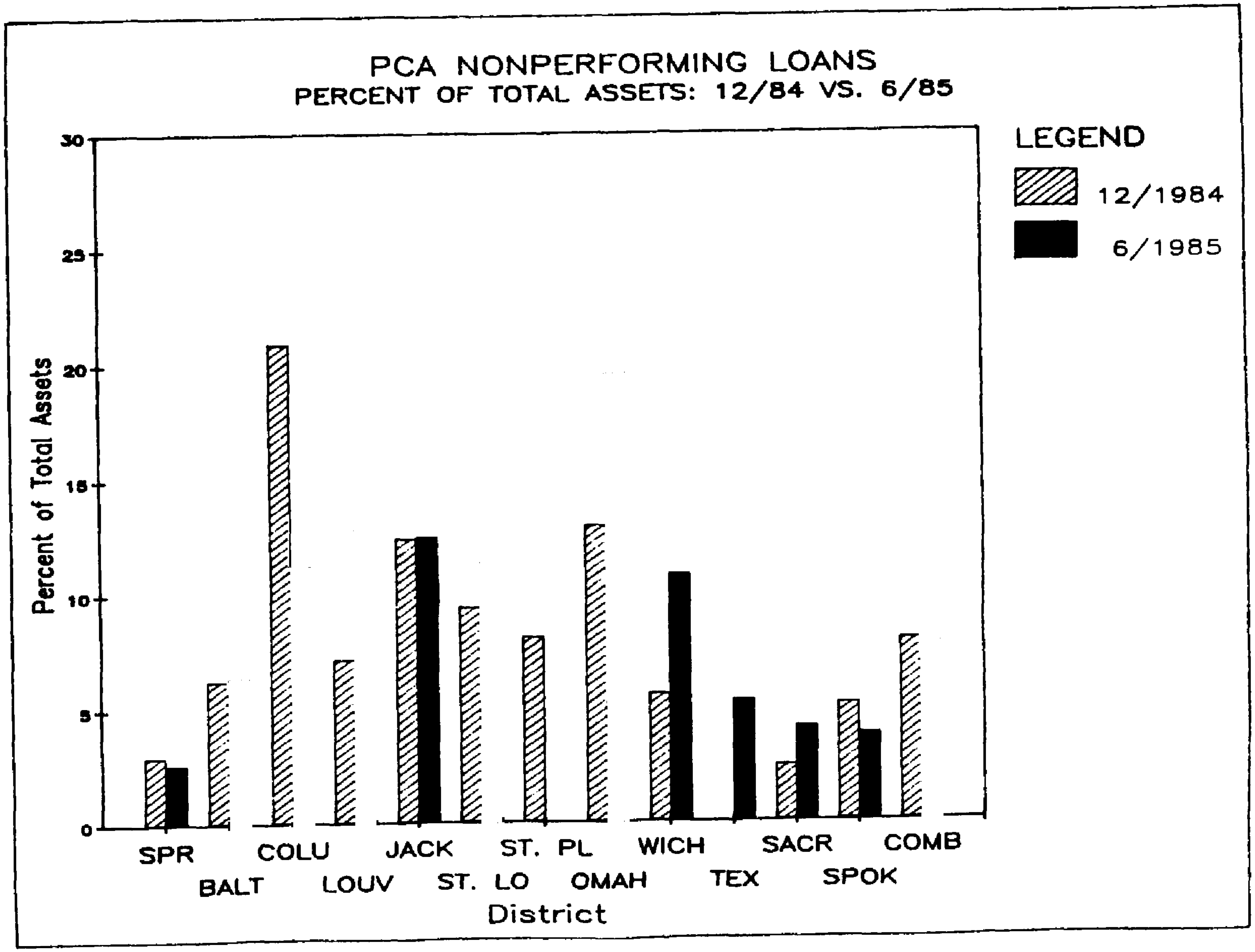
Table 2

	December 31, 1984			March 31, 1985			June 30, 1985		
	loans			loans			loans		
	Performing	Nonperforming	Nonaccrual	Performing	Nonperforming	Nonaccrual	Performing	Nonperforming	Nonaccrual
FLB									
Springfield	1,000,204	31,953	14,100	974,949	46,830	13,400	971,500	43,300	12,500
Baltimore	2,153,362	89,810	17,300	2,131,517	95,319	19,400	2,114,700	106,900	26,800
Columbia	4,946,264	604,880	61,100	4,966,221	523,710	60,300	5,072,100	372,800	84,400
Louisville	4,661,848	218,663	82,900	4,456,149	341,153	105,200	4,266,400	405,400	130,800
Jackson	2,721,052	289,360	103,700	2,556,148	426,285	121,000	2,569,900	352,200	112,800
St. Louis	4,825,602	369,973	131,500	4,602,223	531,159	160,900	4,514,000	552,900	209,300
St. Paul	6,904,593	560,030	213,600	6,617,692	855,012	257,800	6,547,400	904,500	341,000
Omaha	5,755,123	551,792	113,100	5,412,816	781,767	147,800	5,051,000	877,900	279,800
Wichita	4,605,990	643,229	176,200	4,345,025	786,400	257,800	4,370,000	780,000	332,200
Texas	2,649,155	29,184	700	2,661,951	34,997	1,200	2,685,400	72,800	7,900
Sacramento	4,399,601	319,206	98,300	4,162,684	558,314	90,500	4,181,600	547,400	185,700
Spokane	3,411,314	274,576	103,300	3,269,926	403,317	106,000	3,270,400	426,100	130,600
Total	48,034,108	3,982,656	1,115,800	46,157,301	5,384,263	1,341,300	45,614,400	5,442,200	1,853,800
PCA									
Springfield	659,309	19,691	4,753	631,378	22,222	4,575	660,874	8,026	4,682
Baltimore	685,608	56,392	9,646	643,381	79,519	10,121	680,153	66,447	9,706
Columbia	1,386,792	364,208	66,538	1,315,588	426,912	62,730	1,553,731	207,869	82,795
Louisville	1,602,792	170,208	134,748	1,383,272	188,628	130,468	1,395,778	206,722	116,982
Jackson	567,840	108,160	17,576	473,678	107,522	15,692	540,959	91,741	20,879
St. Louis	1,170,364	97,636	36,772	950,393	139,507	42,506	1,024,515	138,385	48,842
St. Paul	2,937,033	329,967	84,942	2,675,598	399,802	89,187	2,717,850	398,950	90,387
Omaha	1,663,068	228,932	96,492	1,406,625	358,275	107,659	1,290,573	302,727	119,498
Wichita	1,064,826	69,174	37,422	973,027	81,173	33,734	902,286	120,714	40,920
Texas	908,463	228,537	13,644	853,404	229,596	14,079	1,014,325	75,175	14,164
Sacramento	2,555,857	287,143	71,075	2,428,008	331,092	91,050	2,434,239	376,661	118,058
Spokane	1,051,671	161,329	63,076	824,405	188,895	63,649	827,910	84,890	11,866
Total	16,253,623	2,121,377	636,684	14,558,757	2,549,843	665,450	15,043,193	2,078,307	678,779

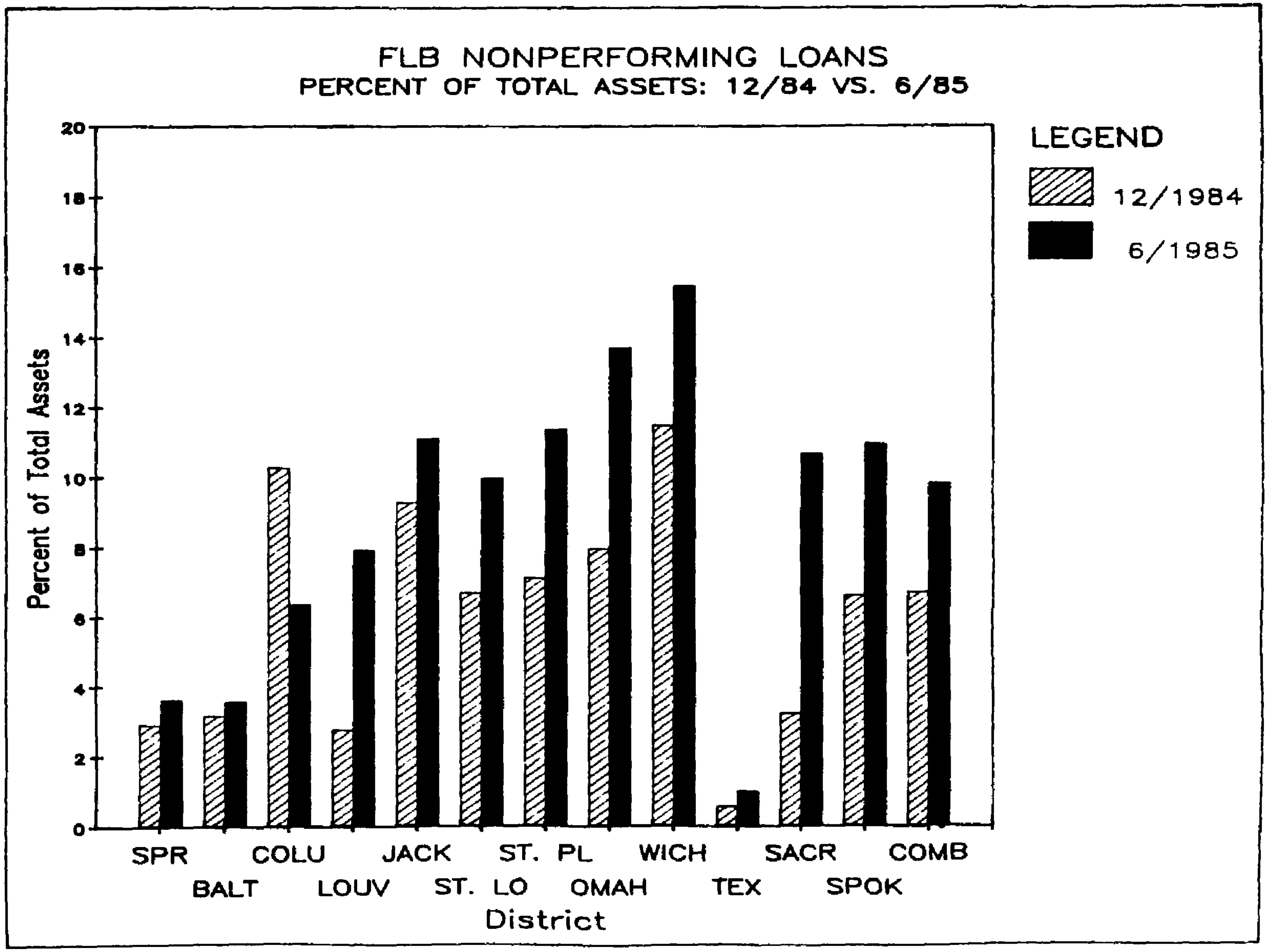
BC	December 31, 1984 Performing loans	December 31, 1984 Nonperforming loans	December 31, 1984 Nonaccrual loans	March 31, 1985 Performing loans	March 31, 1985 Nonperforming loans	March 31, 1985 Nonaccrual loans	June 30, 1985 Performing loans	June 30, 1985 Nonperforming loans	June 30, 1985 Nonaccrual loans
Springfield	137,421	0	0	144,697	0	0	153,600	700	700
Baltimore	76,732	9,713	0	72,015	7,234	0	73,100	1,800	300
Columbia	238,210	34,380	0	219,423	69,560	0	239,000	68,300	2,700
Louisville	495,132	37,737	0	524,464	33,704	0	475,300	2,300	1,400
Jackson	374,343	4,113	900	410,879	2,954	0	349,200	3,100	2,600
St. Louis	418,025	51,724	100	427,050	44,499	0	373,100	37,300	3,400
St. Paul	1,138,122	33,247	1,900	1,203,736	38,943	1,000	1,082,500	42,500	4,100
Omaha	528,894	46,776	8,000	602,677	58,154	6,600	426,700	87,900	7,700
Wichita	382,131	1,608	0	436,640	1,484	0	415,800	10,600	1,200
Texas	186,980	25,329	3,500	152,780	24,102	4,200	144,000	25,400	1,600
Sacramento	576,928	95,755	200	552,877	90,972	0	543,700	84,900	1,800
Spokane	308,694	24,684	0	29,935	34,065	0	281,200	38,800	1,400
CBC	3,698,436	172,817	0	3,587,442	209,866	0	3,233,900	146,300	1,200
Total	8,560,039	537,883	14,600	8,629,615	615,557	11,800	7,791,100	549,900	30,100

Source: FCA

GRAPH 20


PCA NONPERFORMING LOANS
PERCENT OF TOTAL ASSETS: 12/84 VS. 6/85
LEGEND
12/1984
6/1985
Percent of Total Assets
30
25
20
15
10
5
0
SPR
BALT
COLU
LOUV
JACK
ST. LO
ST. PL
OMAH
WICH
TEX
SACR
SPOK
COMB
District

GRAPH 21

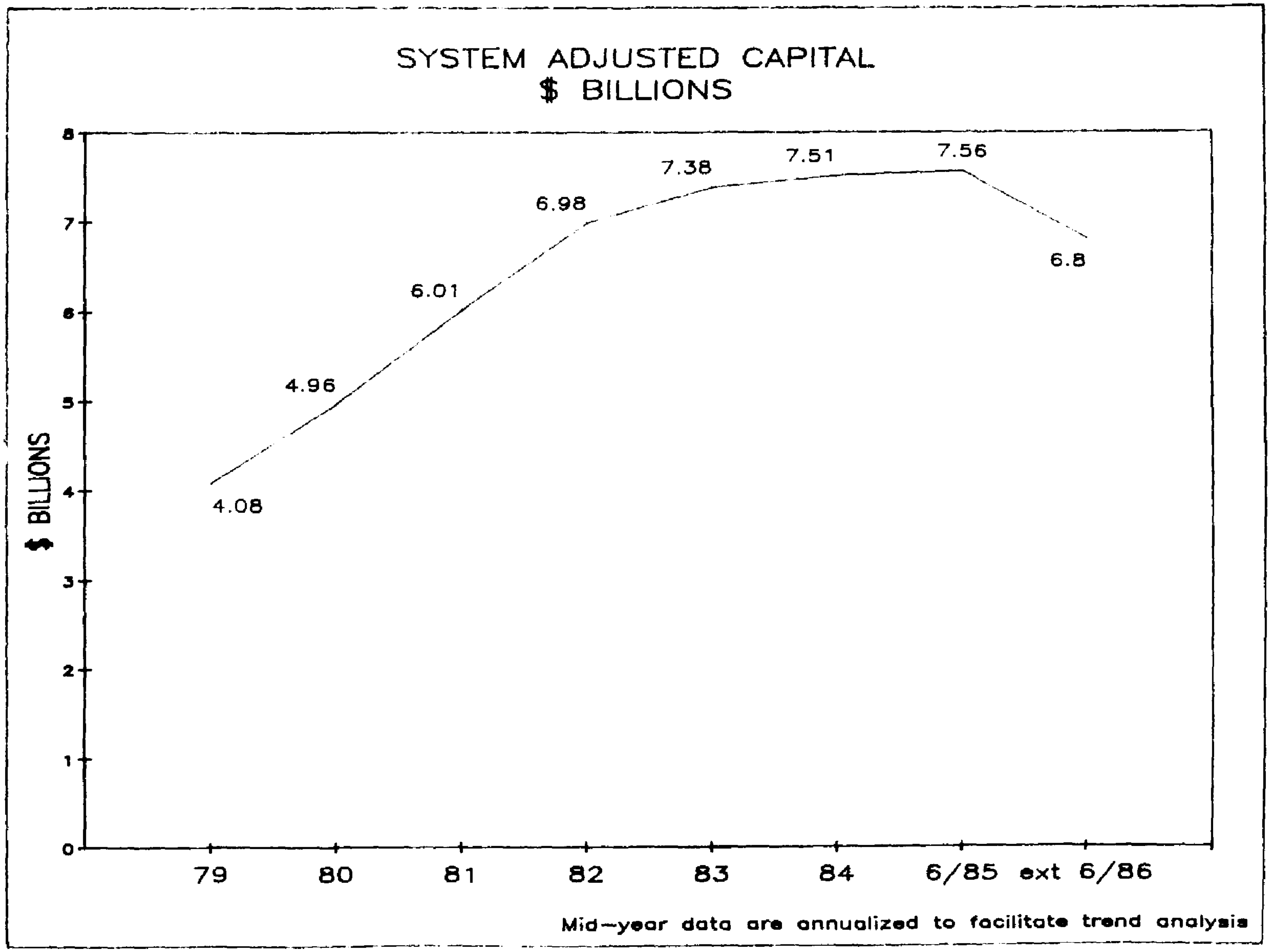

FLB NONPERFORMING LOANS
PERCENT OF TOTAL ASSETS: 12/84 VS. 6/85
LEGEND
12/1984
6/1985
Percent of Total Assets
0
2
4
6
8
10
12
14
16
18
20
SPR
BALT
COLU
LOUV
JACK
ST. LO
ST. PL
OMAH
WICH
TEX
SACR
SPOK
COMB
District

CAPITAL AND ALLOWANCE FOR LOAN LOSSES

Capital and the allowance for loan losses are necessary to absorb operating and loan losses. The System's adjusted capital (earned surplus plus allowance for loan losses) has consistently increased. This increase in adjusted capital is due largely to increases in the provision for loan losses through charges against current earnings. In 1986, based on historical trends, earnings will not be sufficient to increase the allowance for loan losses as has occurred in the past, and the adjusted capital is projected to decline. Graphs 22 through 29 depict these trends for the System as a whole, for its component parts, and the Omaha district as compared with the System.

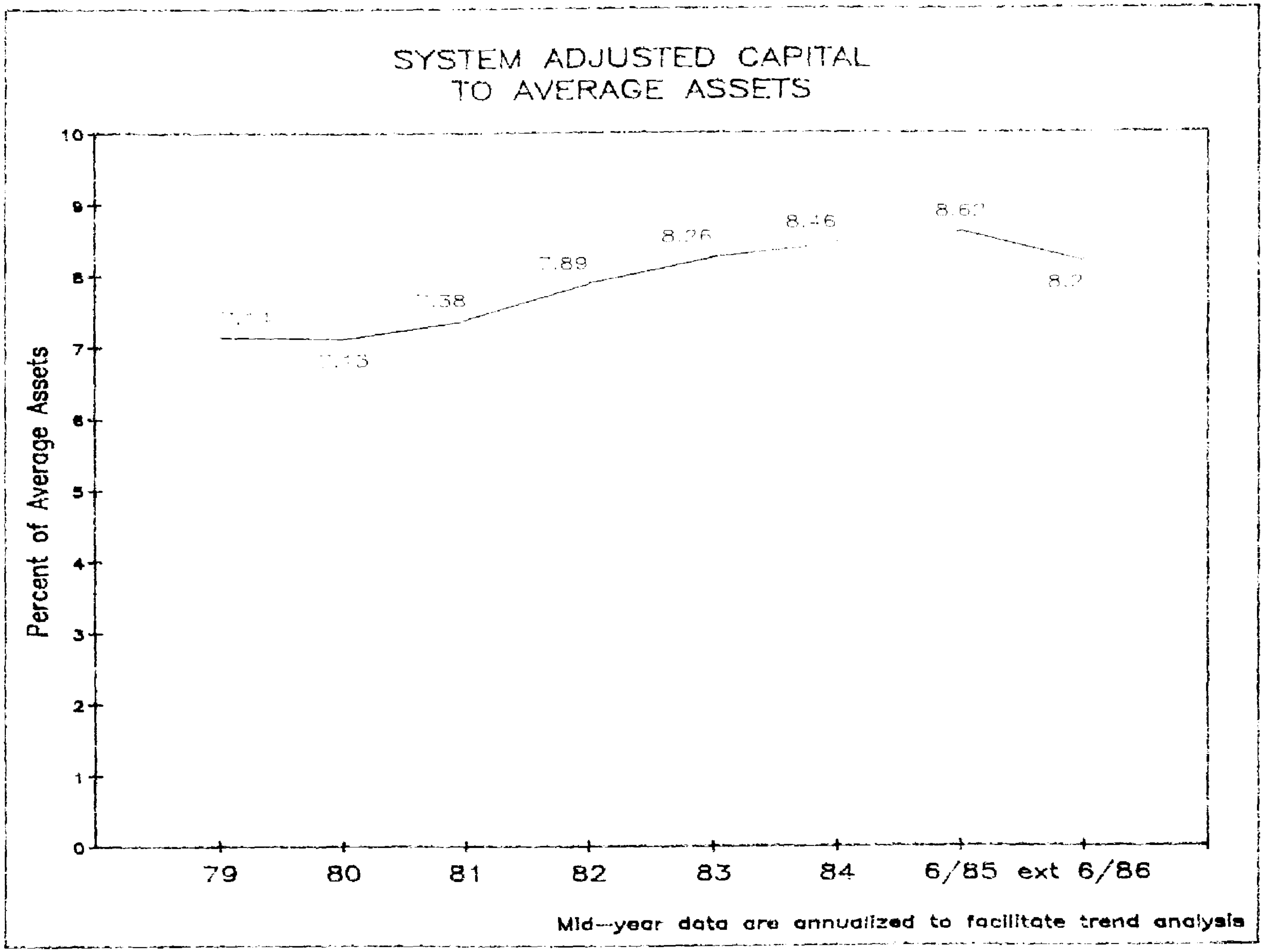
The allowance for loan losses as a percent of gross loans has slightly declined since 1979 (see graph 30) while at the same time the percent of charge-offs continually increased (see graph 31), resulting in a significant decline in the allowance level as a percent of loan losses. (See graph 32). While in 1979 the net operating income was 37 times the annual amount of loan losses, this ratio has continually declined (see graph 33). By June 30, 1985 earnings were just sufficient to cover the annual losses and by June 30, 1986, we extrapolate that income will only be sufficient to cover about one-third the annual losses. In extrapolating loan losses for 1986, we have used historical trends. However, because of the significant deterioration in the quality of loans at the FLBs during the first half of 1985, and our concerns about the reliability of reported data, our extrapolations of loan losses may be significantly understated.

GRAPH 22

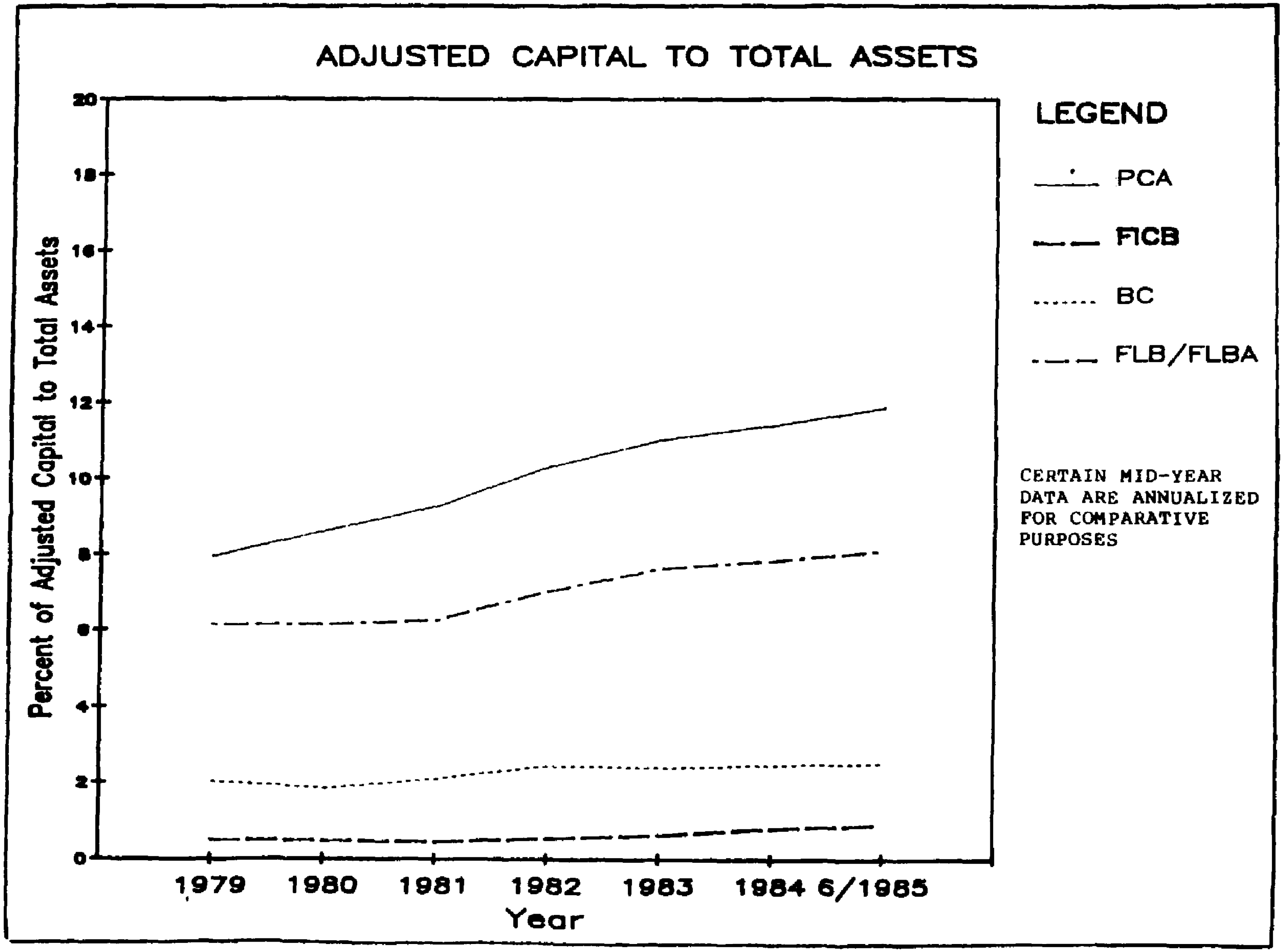


SYSTEM ADJUSTED CAPITAL
$ BILLIONS
$ BILLIONS
0
1
2
3
4
5
6
7
8
4.08
4.96
6.01
6.98
7.38
7.51
7.56
6.8
79
80
81
82
83
84
6/85
ext 6/86
Mid-year data are annualized to facilitate trend analysis

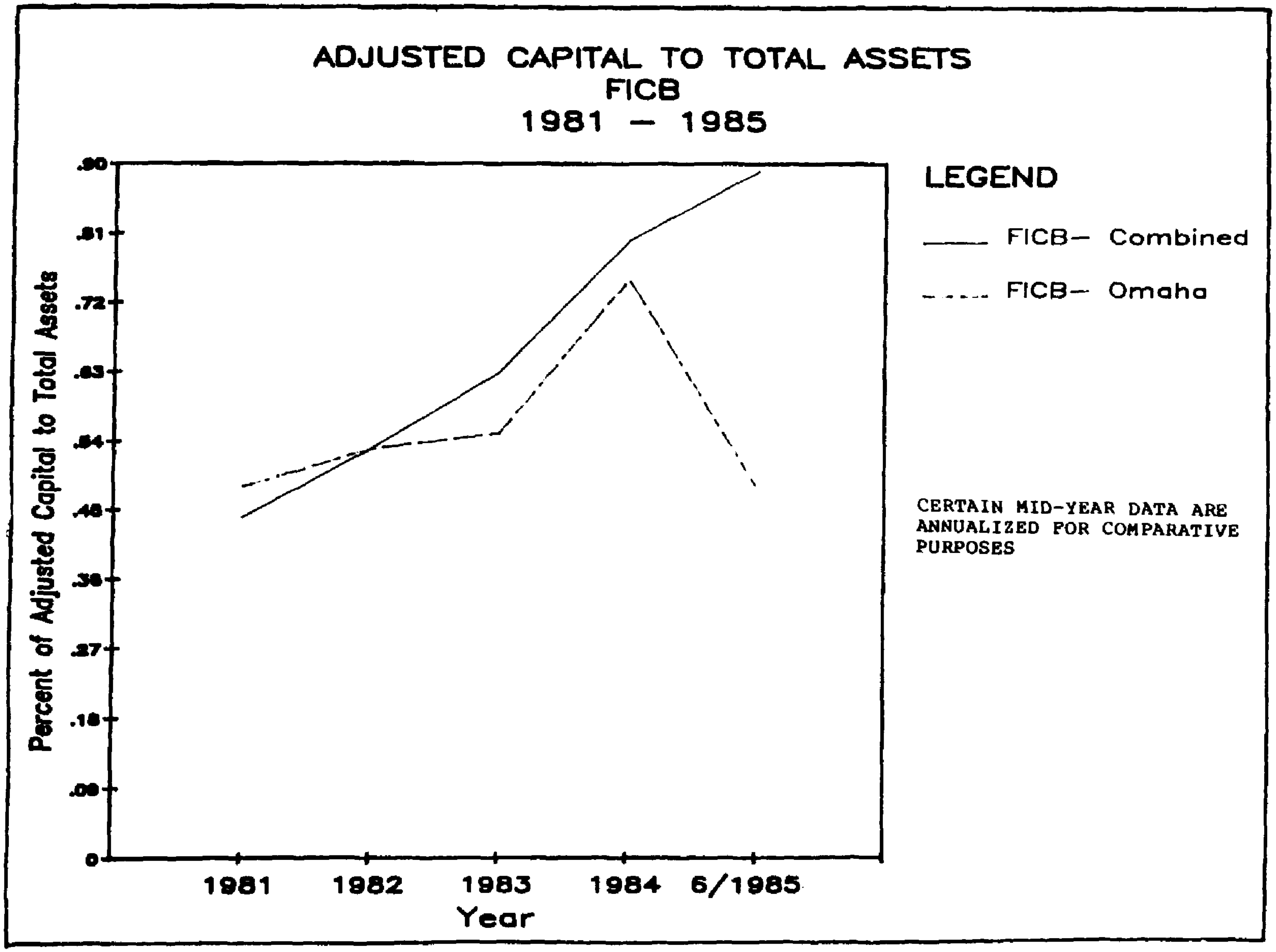
Graph 23


SYSTEM ADJUSTED CAPITAL
TO AVERAGE ASSETS
Percent of Average Assets
0
1
2
3
4
5
6
7
8
9
10
79
80
81
82
83
84
6/85 ext 6/86
7.58
7.89
8.26
8.46
8.2
Mid-year data are annualized to facilitate trend analysis

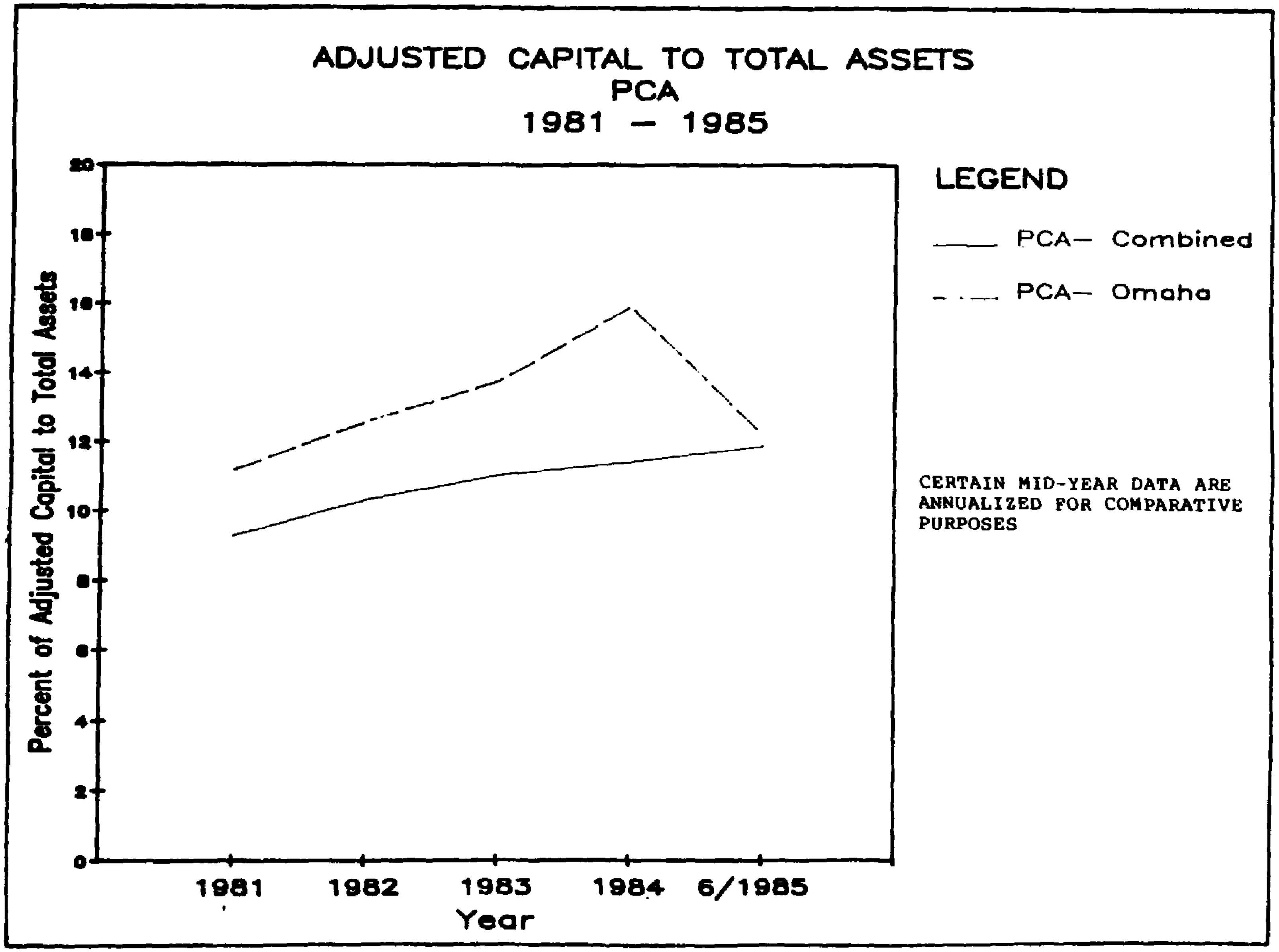
GRAPH 24


ADJUSTED CAPITAL TO TOTAL ASSETS
Percent of Adjusted Capital to Total Assets
0
2
4
6
8
10
12
14
16
18
20
1979
1980
1981
1982
1983
1984
6/1985
Year
LEGEND
PCA
FICB
BC
FLB/FLBA
CERTAIN MID-YEAR
DATA ARE ANNUALIZED
FOR COMPARATIVE
PURPOSES

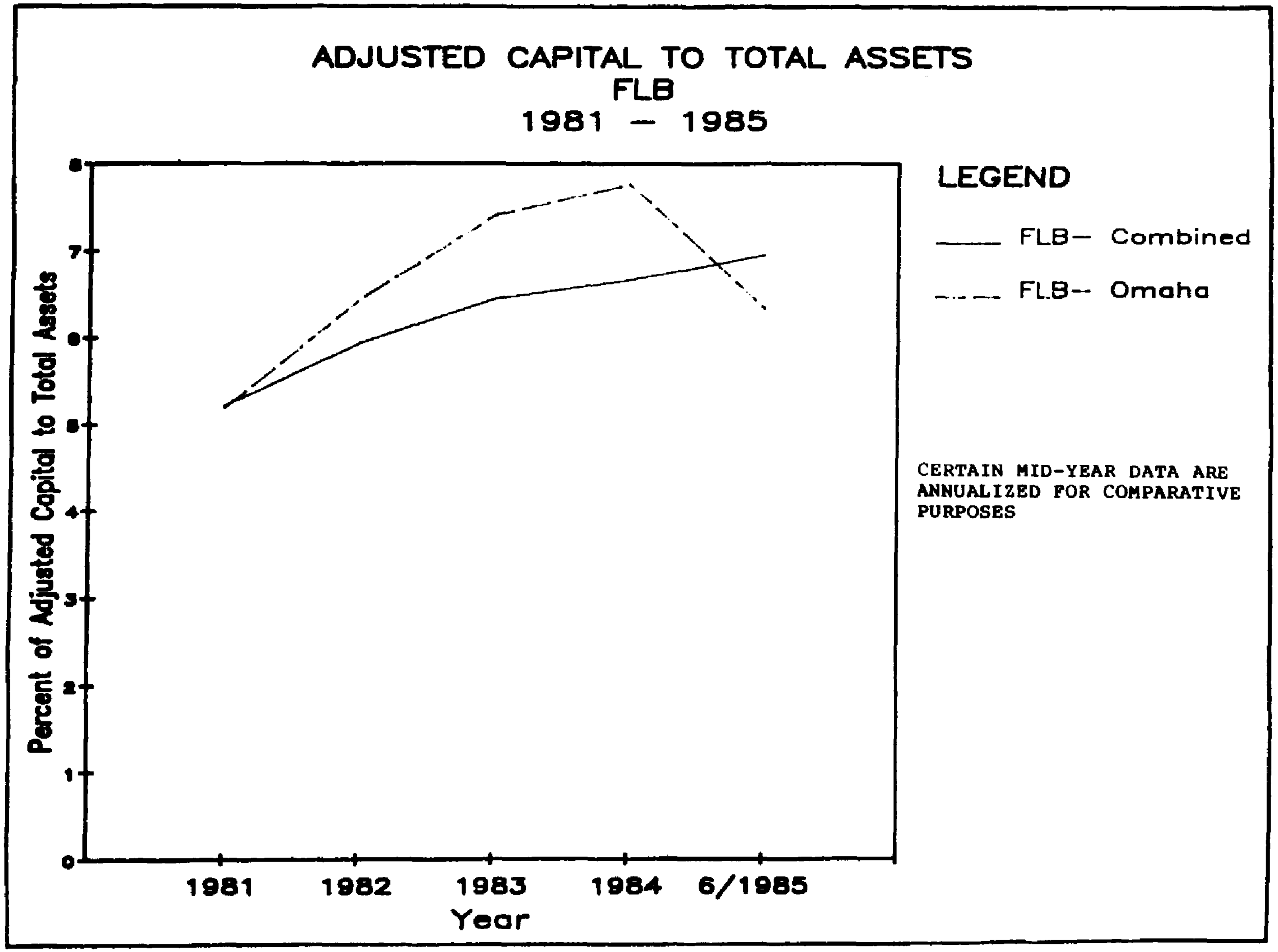
GRAPH 25


ADJUSTED CAPITAL TO TOTAL ASSETS
FICB
1981 — 1985
.90
.81
.72
.63
.54
.45
.36
.27
.18
.09
0
Percent of Adjusted Capital to Total Assets
1981
1982
1983
1984
6/1985
Year
LEGEND
FICB— Combined
FICB— Omaha
CERTAIN MID-YEAR DATA ARE ANNUALIZED FOR COMPARATIVE PURPOSES

GRAPH 26

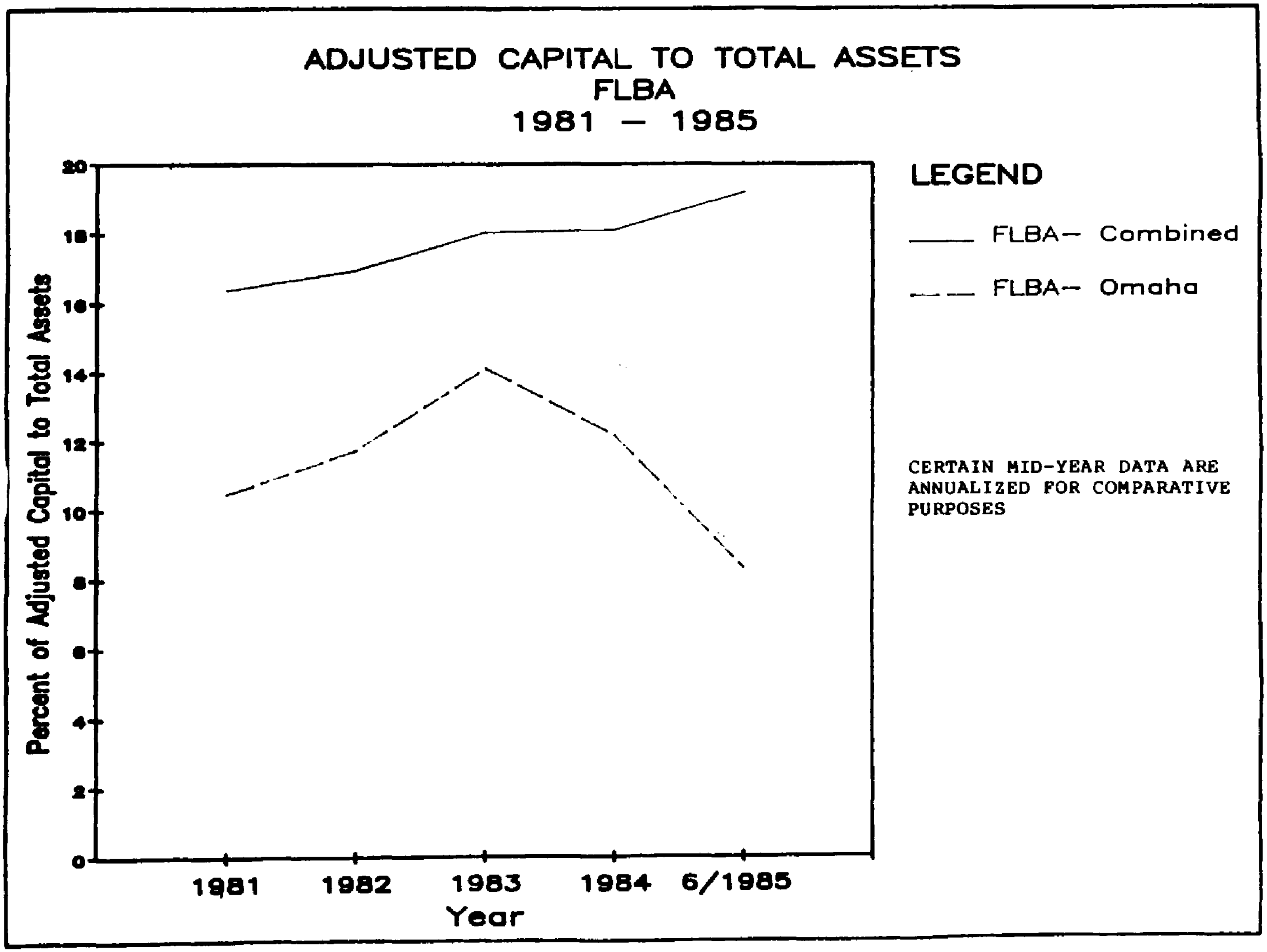

ADJUSTED CAPITAL TO TOTAL ASSETS
PCA
1981 – 1985
LEGEND
PCA– Combined
PCA– Omaha
CERTAIN MID-YEAR DATA ARE ANNUALIZED FOR COMPARATIVE PURPOSES
Percent of Adjusted Capital to Total Assets
0
2
4
6
8
10
12
14
16
18
20
1981
1982
1983
1984
6/1985
Year

GPAPH 27



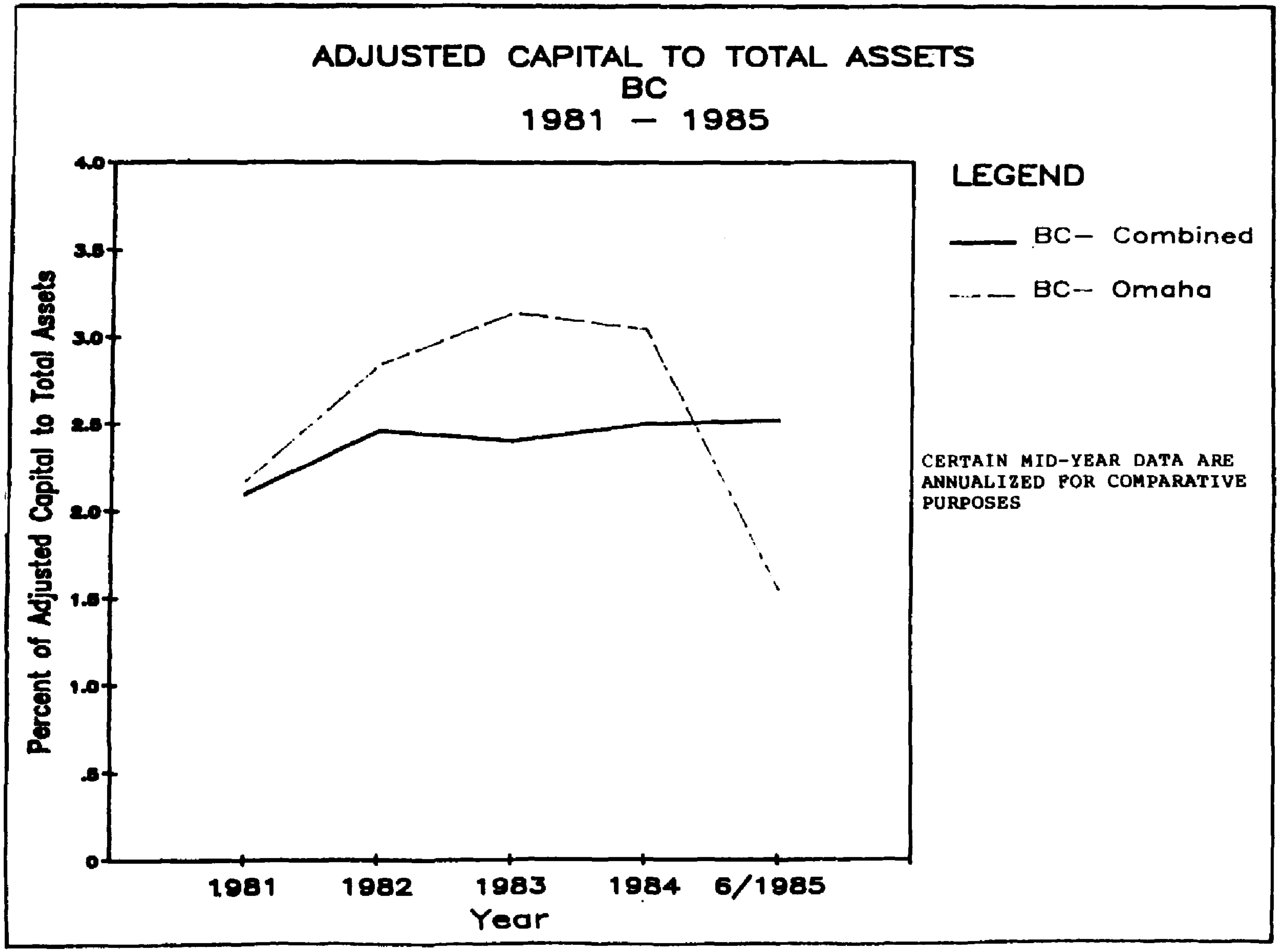
ADJUSTED CAPITAL TO TOTAL ASSETS
FLB
1981 — 1985
LEGEND
FLB— Combined
FLB— Omaha
Percent of Adjusted Capital to Total Assets
0
1
2
3
4
5
6
7
8
1981
1982
1983
1984
6/1985
Year
CERTAIN MID-YEAR DATA ARE ANNUALIZED FOR COMPARATIVE PURPOSES

GRAPH 28



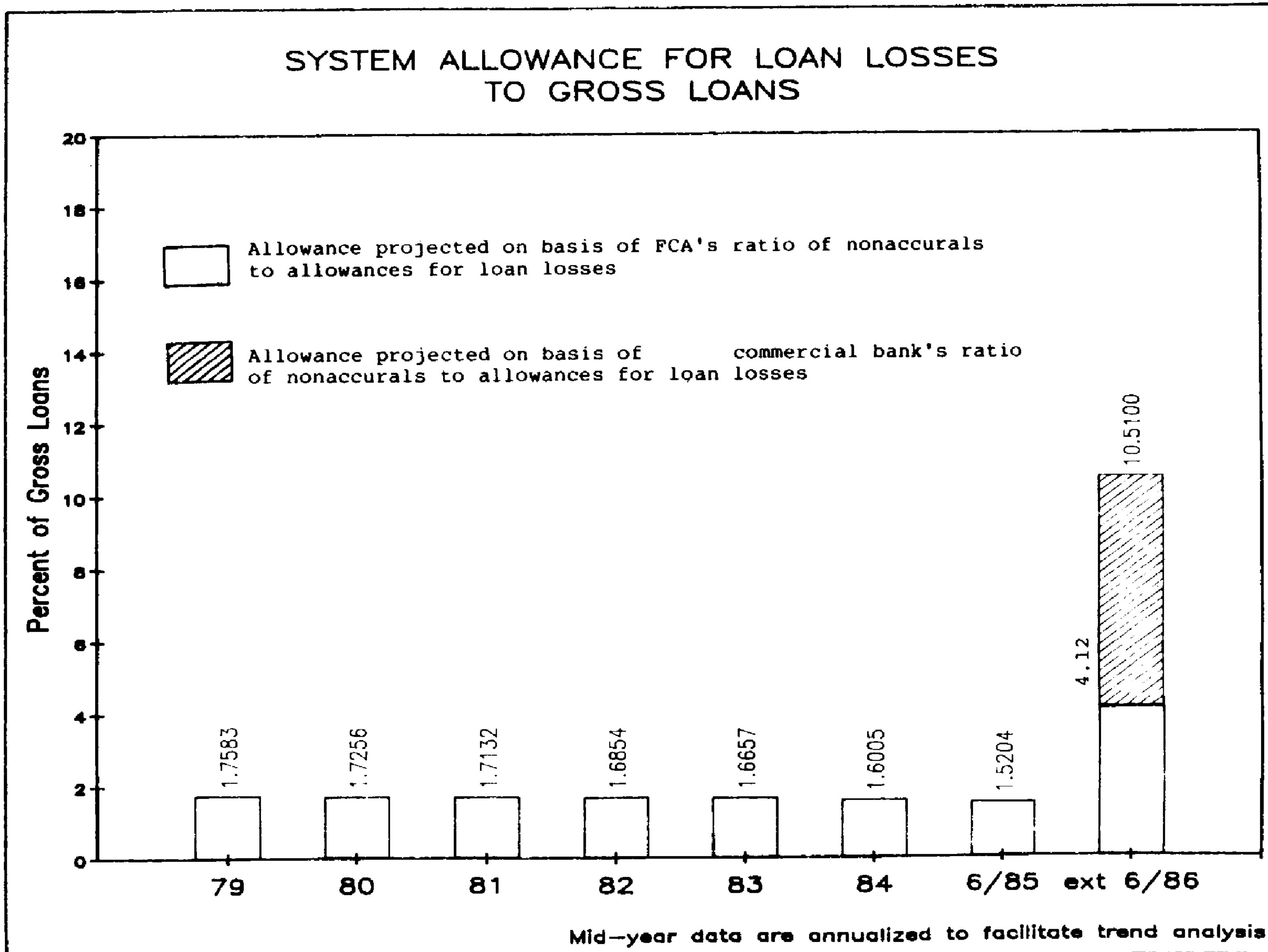
ADJUSTED CAPITAL TO TOTAL ASSETS
FLBA
1981 – 1985
LEGEND
FLBA– Combined
FLBA– Omaha
CERTAIN MID-YEAR DATA ARE ANNUALIZED FOR COMPARATIVE PURPOSES
Percent of Adjusted Capital to Total Assets
0
2
4
6
8
10
12
14
16
18
20
1981
1982
1983
1984
6/1985
Year

GRAPH 29



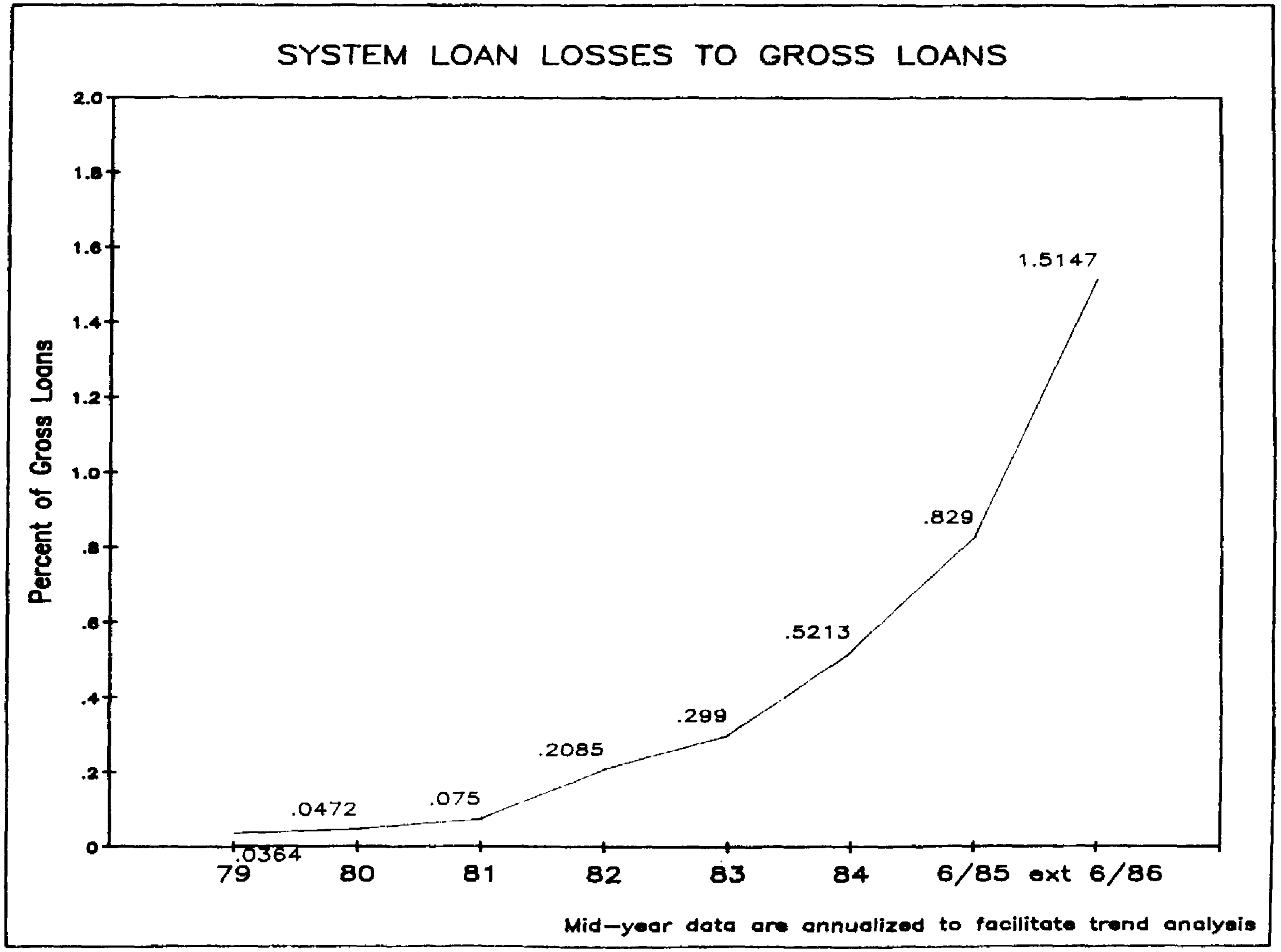
ADJUSTED CAPITAL TO TOTAL ASSETS
BC
1981 — 1985
Percent of Adjusted Capital to Total Assets
4.0
3.5
3.0
2.5
2.0
1.5
1.0
.5
0
1981
1982
1983
1984
6/1985
Year
LEGEND
BC— Combined
BC— Omaha
CERTAIN MID-YEAR DATA ARE ANNUALIZED FOR COMPARATIVE PURPOSES

GRAPH 30

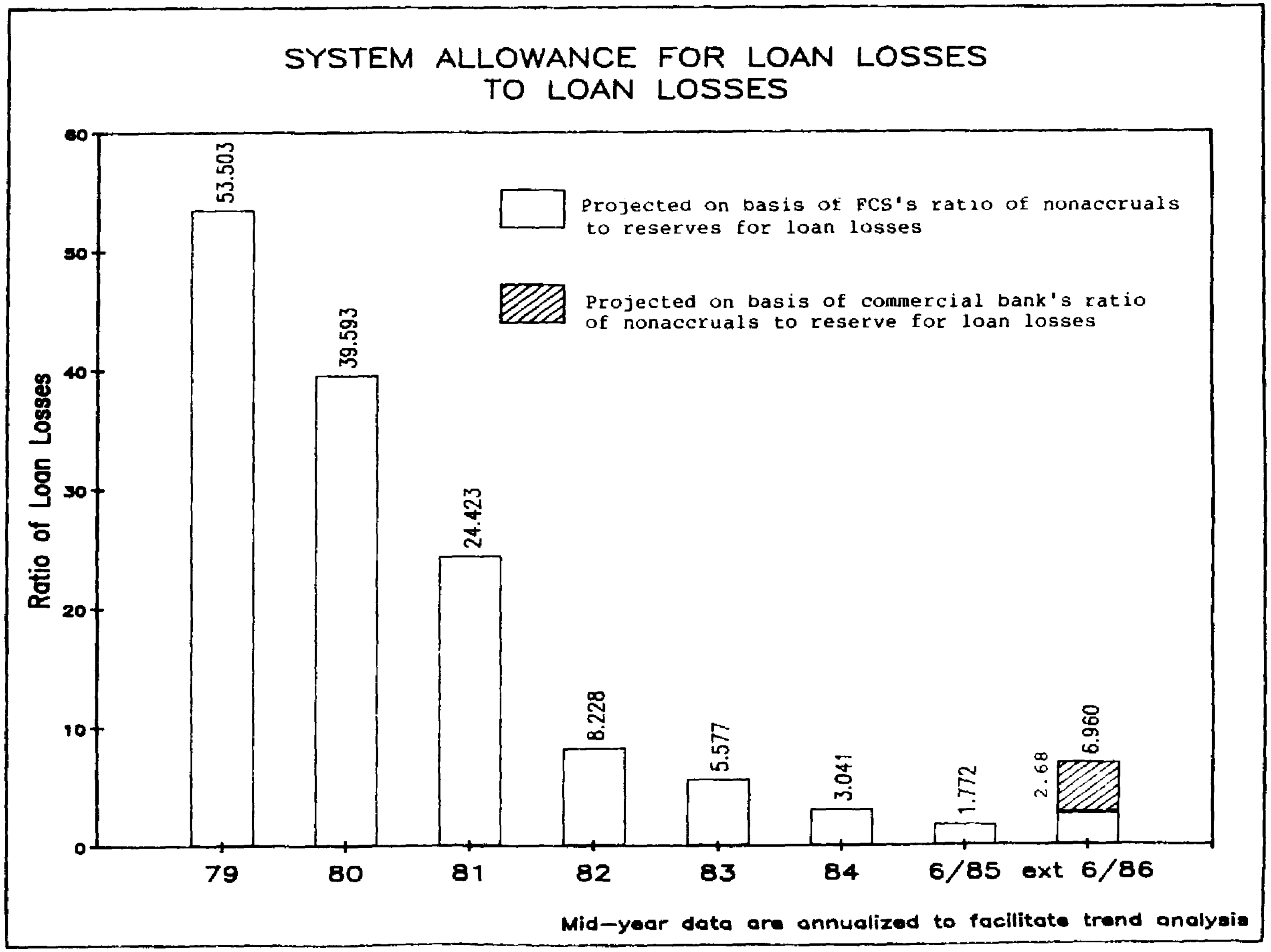


SYSTEM ALLOWANCE FOR LOAN LOSSES
TO GROSS LOANS
Allowance projected on basis of FCA's ratio of nonaccurals to allowances for loan losses
Allowance projected on basis of commercial bank's ratio of nonaccurals to allowances for loan losses
Percent of Gross Loans
0
2
4
6
8
10
12
14
16
18
20
1.7583
1.7256
1.7132
1.6854
1.6657
1.6005
1.5204
4.12
10.5100
79
80
81
82
83
84
6/85
ext 6/86
Mid-year data are annualized to facilitate trend analysis

GRAPH 31

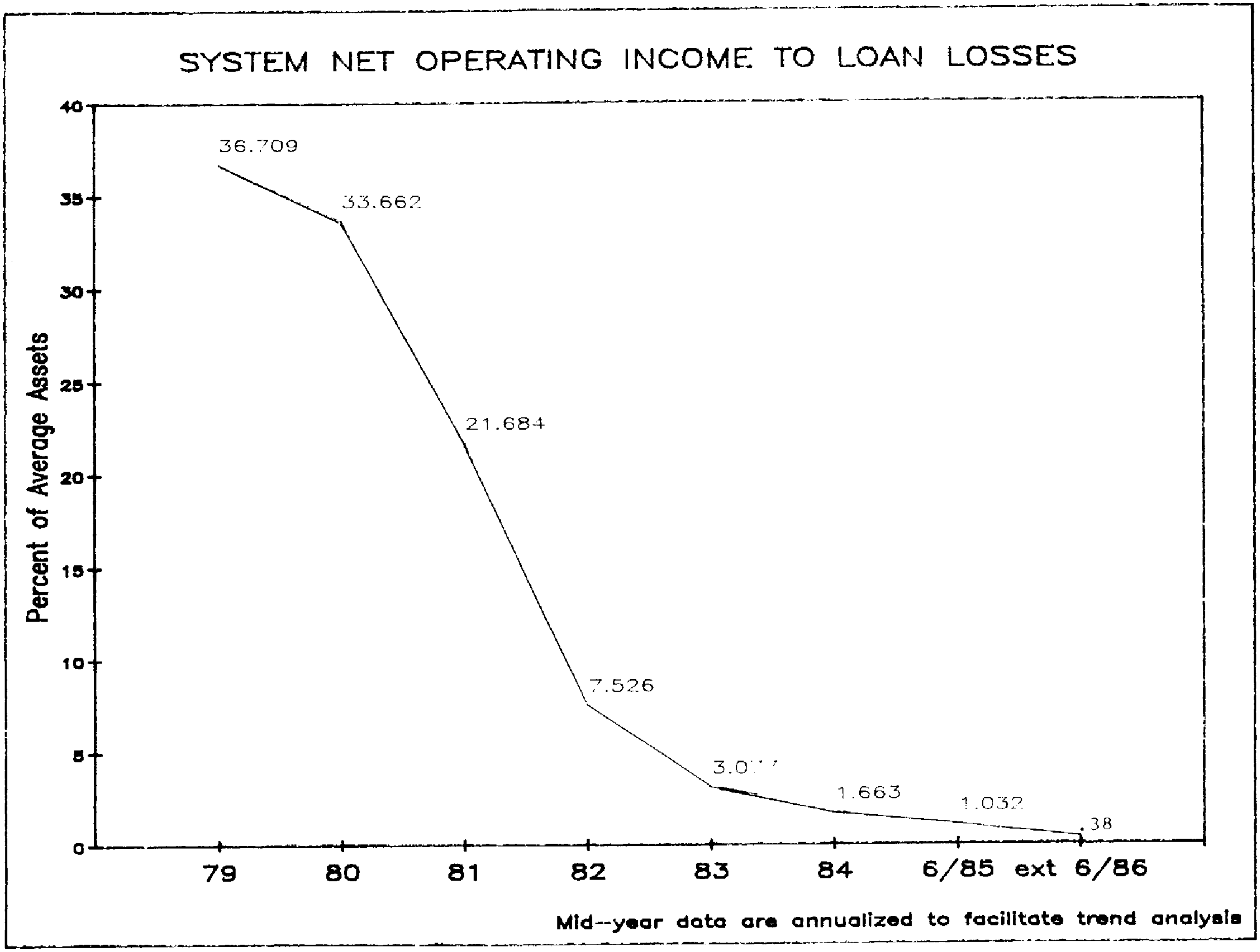

SYSTEM LOAN LOSSES TO GROSS LOANS
Percent of Gross Loans
2.0
1.8
1.6
1.4
1.2
1.0
.8
.6
.4
.2
0
.0364
.0472
.075
.2085
.299
.5213
.829
1.5147
79
80
81
82
83
84
6/85
ext 6/86
Mid—year data are annualized to facilitate trend analysis

GRAPH 32



SYSTEM ALLOWANCE FOR LOAN LOSSES
TO LOAN LOSSES
Ratio of Loan Losses
0
10
20
30
40
50
60
53.503
39.593
24.423
8.228
5.577
3.041
1.772
2.68
6.960
79
80
81
82
83
84
6/85
ext 6/86
Projected on basis of FCS's ratio of nonaccruals to reserves for loan losses
Projected on basis of commercial bank's ratio of nonaccruals to reserve for loan losses
Mid-year data are annualized to facilitate trend analysis

Graph 33


SYSTEM NET OPERATING INCOME TO LOAN LOSSES
Percent of Average Assets
0
5
10
15
20
25
30
35
40
36.709
33.662
21.684
7.526
1.663
1.032
.38
79
80
81
82
83
84
6/85
ext 6/86
Mid--year data are annualized to facilitate trend analysis

AVAILABILITY OF FUNDS

The Farm Credit System's liabilities mature faster than its assets. Therefore, the System must frequently go to the financial market for additional funds for its activities. The funds must be obtained at competitive loan rates. Our analysis of this component of the System compared the rates at which System bonds were sold with those of comparable Treasury instruments. During the period December 31, 1981, to September, 1985, we found no material changes in the spread between the interest rates on System bonds and comparable Treasury bonds. However, beginning in July and to a greater extent in early September 1985, investors began requiring a premium on System securities to compensate for risk that they perceive. (See tables 3 and 4).

Table 3

COMPARISON OF FCS AND U.S. TREASURY INTERMEDIATE AND LONG-TERM BOND YIELD RATES

Farm Credit System		U.S. Treasury		Basis Point
Maturity	Yield	Maturity	Yield	Spread
Pricing - December 31, 1981				
7/85	9.69	8/85	9.61	08
4/86	10.46	3/86	10.10	36
6/87	10.27	8/87	10.46	-19
Pricing - June 25, 1982				
4/85	14.74	3/85	14.91	-17
4/86	14.98	3/86	14.87	11
6/90	15.24	8/90	14.48	76
Pricing - December 27, 1982				
4/86	10.48	3/86	10.22	26
6/87	10.42	8/87	10.54	-12
10/90	10.76	11/90	10.84	-08
Pricing - June 24, 1983				
12/87	10.84	1/88	10.83	01
2/90	10.93	1/90	10.88	05
10/91	11.12	11/91	11.28	-16
Pricing - December 28, 1983				
12/87	11.49	1/88	11.39	10
1/87	11.10	12/86	10.96	14
7/88	11.57	8/88	11.50	07
Pricing - June 26, 1984				
3/87	13.34	2/87	13.26	08
4/89	13.78	4/89	13.69	09
10/91	13.94	11/91	13.72	22
Pricing - July 30, 1985				
1/88	9.70	1/88	9.35	35
4/90	10.55	4/90	10.13	42
1/92	10.91	1/92	10.58	33
Pricing - August 13, 1985				
1/88	9.38	1/88	9.17	21
4/90	10.29	4/90	10.00	29
1/92	10.61	1/92	10.40	21

Farm Credit System		U.S. Treasury		Basis Point
Maturity	Yield	Maturity	Yield	Spread
Pricing - August 28, 1985				
1/88	9.17	1/88	8.99	18
4/90	10.05	4/90	9.71	34
1/92	10.31	1/92	10.06	25
Pricing September 3, 1985				
1/88	9.62	1/88	9.00	68
4/90	10.42	4/90	9.82	60
1/92	10.82	1/92	10.18	64
Pricing - September 4, 1985				
1/88	9.41	1/88	8.94	47
4/90	10.42	4/90	9.75	67
1/92	10.63	1/92	10.11	52
Pricing - September 5, 1985				
1/88	9.68	1/88	9.00	68
4/90	10.42	4/90	9.82	60
1/92	10.82	1/92	10.18	64
Pricing - September 10, 1985				
1/88	10.10	1/88	9.23	87
4/90	10.97	4/90	10.04	93
1/92	11.20	1/92	10.41	79
Pricing - September 17, 1985				
1/88	10.08	1/88	9.16	92
4/90	10.83	4/90	9.95	88
1/92	11.09	1/92	10.33	76
Pricing - September 20, 1985				
1/88	9.96	1/88	9.11	85
4/90	10.66	4/90	9.89	77
1/92	10.89	1/92	10.28	61
Pricing - September 25, 1985				
1/88	9.85	1/88	8.85	1.00
4/90	10.54	4/90	9.69	85
1/92	10.84	1/92	10.14	70

Source: FCA Money and Credit Market Reports for 1981, 1982, 1983, 1984, and 1985. (Random selection of FCS long-term bonds offered on the same date as U.S. Treasury long-term bonds but with slightly differing maturity dates.) Yields reflect pricing of bond on secondary market.

Table 4

COMPARISON OF FCS AND U.S. TREASURY SHORT-TERM BOND YIELD RATES

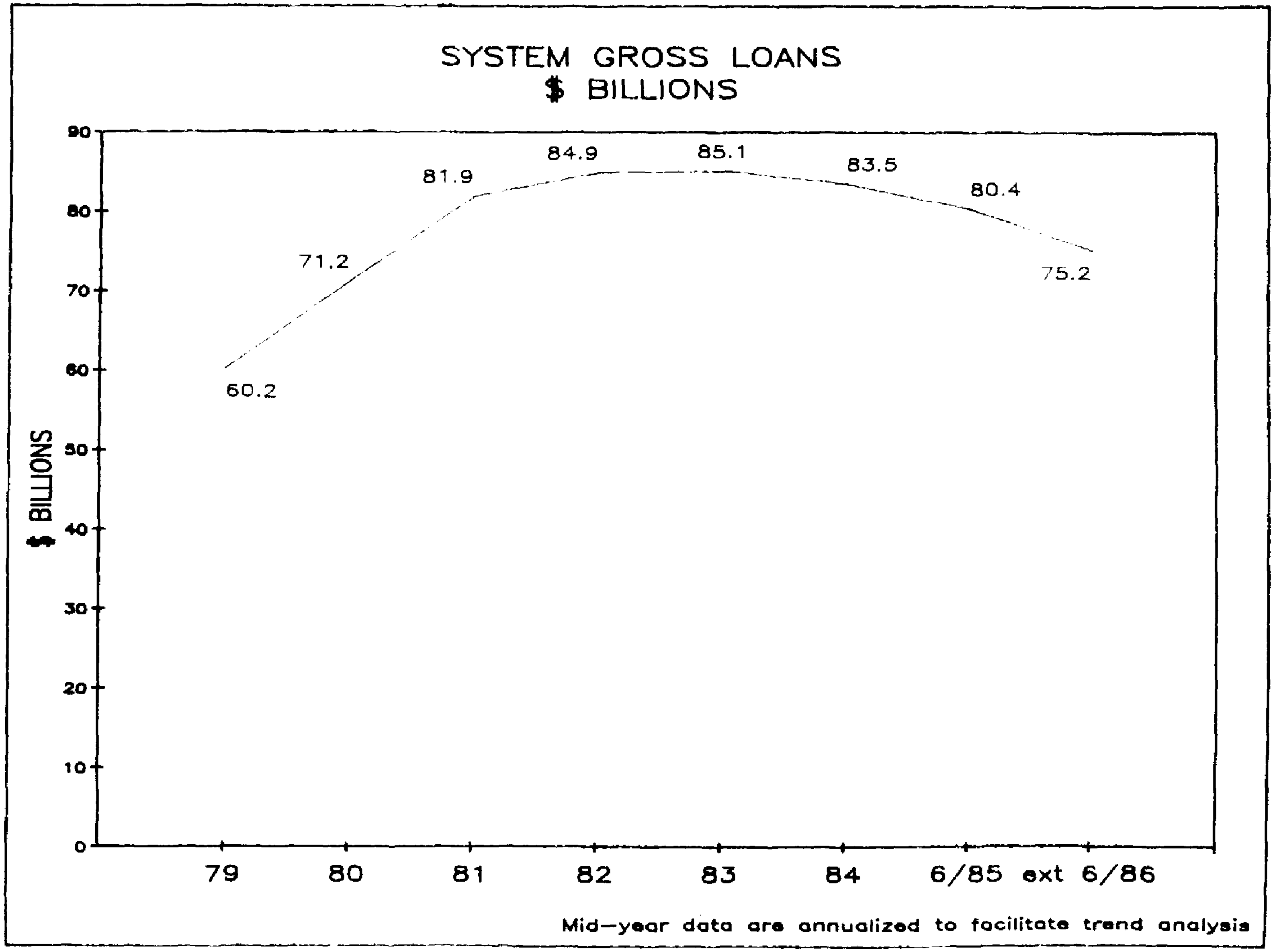
Date	6-Month Treasury Bills	6-Month FCS Securities	Basis Point Spread
June 25, 1981	15.20	15.80	60
December 24, 1981	12.77	12.90	13
June 25, 1982	14.14	14.48	34
December 23, 1982	8.57	8.31	-26
June 24, 1983	9.61	9.09	-52
December 28, 1983	9.74	9.61	-13
June 27, 1984	11.23	11.29	6
December 27, 1984	8.50	8.40	-10
June 12, 1985	7.74	7.80	06
July 10, 1985	7.36	7.30	-06
July 30, 1985	7.79	8.05	26
Auggust 13, 1985	7.75	7.82	07
August 28, 1985	7.59	7.70	11
September 9, 1985	7.78	8.30	52
September 17, 1985	7.7	8.31	61
September 19, 1985	7.63	8.31	68
September 20, 1985	7.61	8.32	71
September 25, 1985	7.06	8.18	1.12

Source: FCA Money and Credit Market Reports 1981, 1982, 1983, 1984, and 1985.

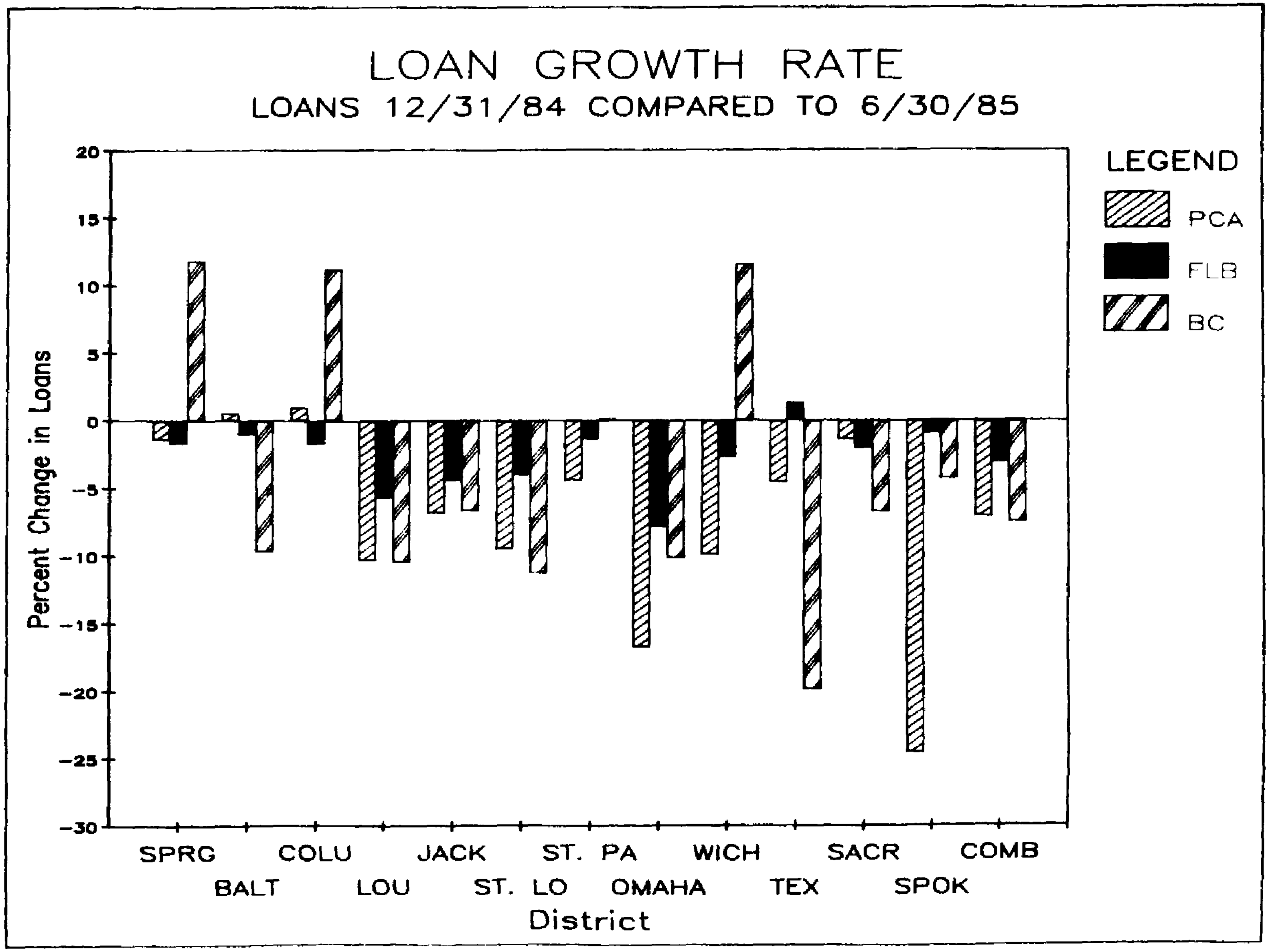
CUSTOMER BASE

While the System's gross loans show a modest decline since 1983 (see graph 34) some banks' (for example, the Omaha, Wichita, and Spokane PCA districts) loan volume significantly decreased (see graph 35 and table 5). District bank reports indicated that some of their borrowers that had a sound credit standing left the System because of high interest rates. Another reason for the decline in loan volume is the write off of bad loans.

GRAPH 34


SYSTEM GROSS LOANS
$ BILLIONS
$ BILLIONS
90
80
70
60
50
40
30
20
10
0
60.2
71.2
81.9
84.9
85.1
83.5
80.4
75.2
79
80
81
82
83
84
6/85
ext 6/86
Mid—year data are annualized to facilitate trend analysis

GRAPH 35



LOAN GROWTH RATE
LOANS 12/31/84 COMPARED TO 6/30/85
LEGEND
PCA
FLB
BC
Percent Change in Loans
20
15
10
5
0
-5
-10
-15
-20
-25
-30
SPRG
BALT
COLU
LOU
JACK
ST. LO
ST. PA
OMAHA
WICH
TEX
SACR
SPOK
COMB
District

Table 5

CHANGES IN LOAN VOLUME BY DISTRICT

	PCA Gross Loan Items (000 omitted) 12/84	PCA Gross Loan Items (000 omitted) 6/85	Percent change
Springfield	$ 688,221	$ 678,588	-1.4
Baltimore	761,993	766,384	0.6
Columbia	1,814,407	1,833,180	1.0
Louisville	1,847,838	1,656,388	-10.4
Jackson	703,556	655,284	-6.9
St. Louis	1,336,531	1,209,097	-9.5
St. Paul	3,343,551	3,194,828	-4.4
Omaha	2,029,853	1,689,175	-16.8
Wichita	1,196,189	1,077,038	-10.0
Texas	1,197,660	1,142,695	-4.6
Sacremento	2,972,108	2,930,514	-1.4
Spokane	1,244,080	937,894	-24.6
Combined	19,135,986	17,771,065	-7.1

	FICB Gross Loan Items (000 omitted) 12/84	FICB Gross Loan Items (000 omitted) 6/85	Percent change
Springfield	$ 614,347	$ 601,120	-2.2
Baltimore	710,258	723,657	1.9
Columbia	1,650,654	1,694,854	2.7
Louisville	1,681,591	1,531,971	-8.9
Jackson	725,893	668,953	-7.8
St. Louis	1,139,348	1,060,868	-6.9
St. Paul	3,094,111	2,934,211	-5.2
Omaha	1,951,008	1,623,491	-16.8
Wichita	1,142,914	1,024,493	-10.4
Texas	1,231,602	1,148,143	-6.8
Sacremento	2,756,509	2,727,259	-1.1
Spokane	1,148,904	903,412	-21.4
Combined	17,847,139	16,642,436	-6.8

	FLB Gross Loan Items (000 omitted)		Percent change
	12/84	6/85	
Springfield	$ 1,052,609	1,033,942	-1.8
Baltimore	2,298,803	2,274,225	-1.1
Columbia	5,789,537	5,688,046	-1.8
Louisville	5,173,220	4,875,980	-5.7
Jackson	3,181,329	3,038,702	-4.5
St. Louis	5,500,961	5,277,835	-4.1
St. Paul	7,823,769	7,711,872	-1.4
Omaha	6,762,636	6,225,499	-7.9
Wichita	5,565,089	5,410,912	-2.8
Texas	2,842,219	2,880,601	-1.4
Sacremento	5,049,154	4,942,757	-2.1
Spokane	3,911,370	3,872,485	-1.0
Combine	54,950,696	53,232,862	-3.1

	BC Gross Loan Items (000 omitted)		Percent change
	12/84	6/85	
Springfield	$ 141,352	158,066	11.8
Baltimore	84,041	75,904	-9.7
Columbia	278,210	309,391	11.2
Louisville	534,879	478,616	-10.5
Jackson	386,736	360,701	-6.7
St. Louis	474,427	420,624	-11.3
St. Paul	1,155,815	1,157,481	0.1
Omaha	593,677	533,200	-10.2
Wichita	393,960	439,583	11.6
Texas	216,869	173,781	-19.9
Sacremento	686,603	639,719	-6.8
Spokane	343,576	328,893	-4.3
Combine	9,232,220	8,539,353	-7.5
Central	3,942,056	3,463,388	-12.1

(233140)

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