Opening Remarks by
The Honorable Leland A. Strom
Regulator Roundtable on Farm Real Estate Collateral Risk
McLean, VA
February 17, 2011

Good morning. On behalf of my colleagues on the Farm Credit Administration Board, Kenneth Spearman and Jill Long Thompson, I want to welcome you to our Regulators' Roundtable on a much discussed topic – rising farmland values and the effect on collateral risk. I also want to acknowledge the participants from our fellow financial regulators: the FDIC, Office of Comptroller of the Currency, the Board of Governors of the Federal Reserve System and the Federal Reserve Banks. Thank you for coming, and we hope to make this a very interesting and worthwhile conference.

Our purpose today is to facilitate a discussion among staff at the financial regulators with an interest in agriculture, especially agricultural land values and associated risks to loan collateral. We also want to encourage continued information sharing and foster a productive working relationship for the future. I'm pleased that staff from your examination, supervision, policy, and research units are here with us today. This group represents regulators responsible for about 80 percent of the farm business debt to the farm sector. That broad base of expertise fits with the purpose of the conference, as we are seeking a broad-based interchange on the risks and on the appropriate regulator response to these risks.

There has been much press in recent months on the rapid rise in farmland prices, especially in the Midwest, where reports of double-digit annual gains are common. Given the importance of farmland values to the agricultural economy and the lenders we regulate, it is important that we consider the underlying collateral risk associated with the loans that are backed by farmland. Farmland accounts for about 85 percent of all farm assets. We know that substantial downward adjustments to the value of farmland can occur. History has shown us that. We witnessed a severe correction in the 1980s that reshaped farming and agricultural lending alike. While conditions are quite different today, and we have learned many valuable lessons from the past, as regulators we need to be ever diligent about the effect of changes in the farm economy and farmland markets on the financial institutions we oversee.

The associations of the Farm Credit System are the largest source of farm mortgages in the U.S., with a market share estimated by USDA at about 44 percent. Farm real estate debt held by the Farm Credit System has increased by almost 80 percent since the

beginning of 2003, and the average Farm Credit association has over 55 percent of its loan portfolio in farmland mortgages.

Farm commodity markets have become more volatile in the last five years and are whipsawed by economic, political, and weather events. The volatility we now experience is no more evident than in the single biggest U.S. crop – corn – which, because of its size, has a significant influence on the pricing of U.S. farmland. In just the last eight months the spot price of corn has doubled in value, driving the latest surge in cropland prices. But just over two years ago we also experienced volatility on the downside as corn plunged from record highs.

We are now in an optimistic period for U.S. agriculture in spite of the sluggish general economy. There have been good reasons to be optimistic about the value of agricultural real estate, as world and domestic demand for commodities has been coupled with very low interest rates. Not surprisingly, profitability and expectations for further growth in returns have been bid into the value of U.S. farmland. Overall, average U.S. farmland values rose some 67 percent from 2003 to 2008, only to flatten in 2008 and 2009 as commodity prices slumped and the U.S. economy entered a major recession. It is worth noting that transitional lands near metro areas experienced significant declines in value from the 2007 highs as unsustainable residential real estate property values fell, thus affecting values of nearby agricultural lands that, to a lesser degree, had followed the increase of transitional land values. Farm loan performance suffered in these areas. It is also true that marginally productive lands, pasture land, and recreational lands have not participated in the most recent surge in farmland values.

There is considerable media attention comparing today's farmland market with that of the 1970s/80s. That period was characterized by some as a "bubble." We studied the land markets of both periods, and while there are a few similarities, important differences were identified; foremost is the level of debt or leverage used to purchase farmland. While it is true that today's farming sector is significantly less leveraged than in the early 1980s, the numbers readily available and reported include farmers who have no debt on their farmland. And with much of the land purchased today made with cash, the overall numbers do look quite good. We hope to take a more in-depth look at these numbers today as we learn more from our speakers about how debt leverage is changing in the farm sector and how it is distributed for those farmers who do borrow to buy farmland.

Finally, we need to think carefully about how conditions today could change the drivers that have propelled farmland prices upwards. As regulators, what are we doing in terms of supervision and guidance to ensure the safety and soundness of our regulated

institutions that are lending into these rising farmland markets? We can all benefit by comparing actions taken or planned, and by sharing our analysis and concerns about conditions.

This afternoon at the roundtable discussion among the regulators, we hope to have a thorough discussion where we can share our insights, concerns, and actions taken to address collateral risk in agricultural portfolios. While you will hear details from our own staff about how FCA is addressing collateral risk, I wanted to provide a few highlights as I conclude my remarks this morning. Because of our concerns about the risk associated with collateral tied to land values, we have been taking action on four different fronts: regulatory and other policy guidance to the institutions we regulate, examination of the institutions, improvements in our data collection, and ongoing monitoring and analysis.

Regarding System institutions, we established our collateral evaluation regulations in 1994. In recent years, we issued guidance to System institutions on evaluating the safety and soundness of real estate lending, especially the need for identification and control of collateral risk. Last year, we issued additional guidance regarding stress testing, and identified land and collateral values as factors that should be stressed.

Regarding examinations, collateral risk management is a part of our National Oversight Plan providing guidance on examination focus areas covering all institutions. In addition to issuing an examination bulletin for our examiners on real estate lending, we are working on a new exam module on collateral risk management.

For our internal analysis, we are improving the loan level data from System institutions that can help us better analyze emerging lending risks, especially regarding real estate collateral. We are now able to provide information to Agency managers and examiners that give both a Systemwide perspective as well as institution-specific loan information on loan-to-value exposures and asset quality components.

Lastly, our monitoring and analysis of that data, as well as other external data on land value trends, is a key priority. For example, the FCA Board recently received two presentations from staff. One focused on trends in farm real estate prices, real estate debt, and the drivers affecting these prices. The other provided institution-specific information on loan-to-value ratios for mortgage loans. Overall, the preliminary data gave us some comfort in the vast majority of the System’s mortgage loans. This data will assist us in planning our examination oversight and future guidance.

Again, thank you for your participation today, and we look forward to an interesting and productive meeting.