FARM CREDIT ADMINISTRATION

Report on the Financial Condition and Performance of the Farm Credit System

1998

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FCA's Mission

The Farm Credit Administration will promote a safe and sound, competitive Farm Credit System to finance agriculture and rural America as authorized by Congress.

CHAIRMAN OF THE FARM CREDIT ADMINISTRATION
1501 Farm Credit Drive
McLean, Virginia 22102-5090

June 25, 1999

The President of the United States Senate
The Speaker of the United States House of Representatives

Gentlemen:

We are pleased to submit the annual Report on the Financial Condition and Performance of the Farm Credit System for the calendar year 1998. The report is provided in accordance with section 5.17(a)(3) of the Farm Credit Act of 1971, as amended (Act).

We are reporting on the manner and extent to which the purposes and objectives of the Act are being carried out. Our report on the condition of the Farm Credit System is based on our examinations, required by section 5.19 of the Act, and on reports submitted to us by the institutions of the Farm Credit System. It also includes a summary and analysis of the reports submitted to us by the Farm Credit Banks and the Agricultural Credit Bank, relating to programs for serving young, beginning, and small farmers and ranchers, required by section 4.19(b) of the Act.

We hope you find this report informative and useful in your oversight of the Farm Credit System and agricultural policy affecting farmers and ranchers and rural America.

Sincerely,

Marsha Pyle Martin
Chairman
Farm Credit Administration Board

Contents

Preface

This report is published in accordance with section 5.17(a)(3) of the Farm Credit Act of 1971, as amended, which requires the Farm Credit Administration (FCA) to make annual reports directly to Congress on the condition of the Farm Credit System (FCS or System) and its institutions. These annual reports also must include a summary and analysis of reports submitted to FCA by Farm Credit banks on programs for serving young, beginning, and small farmers and ranchers.

We made some significant changes to the report this year. This is the first report issued showing the results of the System's reporting under a new policy statement on Farm Credit System Service to Young, Beginning, and Small Farmers and Ranchers and updated definitions and reporting requirements, which were adopted in 1998. We also reorganized the sequence of the information presented and substantially reduced the text and tables.

This report has been produced each year by the Farm Credit Administration since 1933. It is based on a calendar year to coincide with the Farm Credit System's financial reporting cycle. Previously it had been published under the titles: "Farm Credit Administration Annual Report" (1933 to 1956–1957); "Annual Report of the Farm Credit Administration on the Work of the Cooperative Farm Credit System" (1957–1958 to 1965–1966); "Annual Report of the Farm Credit Administration and the Cooperative Farm Credit System" (1966–1967 to 1983); and "Farm Credit Administration Annual Report" (1984 to 1994). Since 1995 it has been published under the title "Report on the Financial Condition and Performance of the Farm Credit System."

This publication is available on FCA's Web site located at **www.fca.gov.** Depending on availability, it may be obtained without charge from:

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
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Overview of Organizations

Farm Credit Administration

The Farm Credit Administration (FCA or Agency), an independent agency in the executive branch of the U.S. Government, regulates and examines the entities of the Farm Credit System (FCS or System), including the Federal Agricultural Mortgage Corporation (Farmer Mac). Created by an Executive order of President Franklin D. Roosevelt in 1933, the Agency derives its powers and authorities from the Farm Credit Act of 1971, as amended. The FCA issues regulations to implement the Act and examines FCS institutions for compliance with applicable statutes, regulations, and safe and sound banking practices. If an institution violates statutes or regulations or operates in an unsafe or unsound manner, the Agency has several options to bring about corrective action. The FCA also annually examines the National Consumer Cooperative Bank (NCB) and its affiliate, the NCB Development Corporation. Reports of examination of the NCB are presented to the U.S. Senate Committee on Banking, Housing, and Urban Affairs and the U.S. House of Representatives Committee on Banking and Financial Services.

The Agency is headquartered in McLean, Virginia. It has field offices at its headquarters and in Bloomington, Minnesota; Dallas, Texas; Denver, Colorado; and Sacramento, California.

Farm Credit Administration Board

FCA policymaking is vested in a full-time, three-person Board appointed by the President with the advice and consent of the U.S. Senate. FCA Board members 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 of the members as Chairman of the Board. The Chairman also serves as the Agency's Chief Executive Officer. Marsha Pyle Martin serves as the FCA Board Chairman and Chief Executive Officer. Board members are Ann Jorgensen and Michael M. Reyna.

Farm Credit System Insurance Corporation

The Farm Credit System Insurance Corporation (FCSIC) was established by the Agricultural Credit Act of 1987 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. By ensuring the repayment of FCS securities to investors, FCSIC helps to maintain a dependable source of funds for farmers, ranchers, and other FCS borrowers. FCA Board members serve ex officio as the Board of Directors for FCSIC. The FCA Board Chairman may not serve as the FCSIC Board Chairman. Michael M. Reyna serves as Chairman.

Farm Credit System

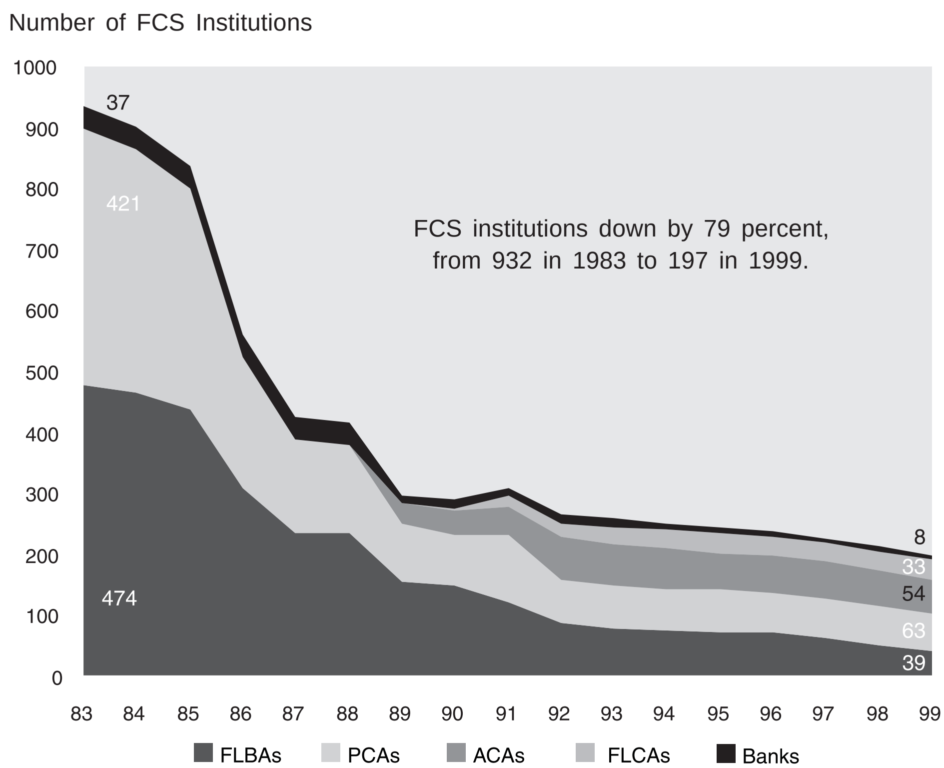
The Farm Credit System is a network of borrower-owned, cooperative financial institutions and related service organizations that serve all 50 states and the Commonwealth of Puerto Rico. Congress created the System in 1916 to provide American agriculture with a dependable source of credit. These institutions specialize in providing credit and related services to farmers, ranchers, producers or harvesters of aquatic products, and farmer-owned cooperatives. They make loans for agricultural processing and marketing activities; rural housing; certain farm-related businesses; agricultural, aquatic, and public utility cooperatives; and foreign and domestic entities in connection with international trade.

All Farm Credit banks and associations are governed as cooperatives by boards of directors elected by member-borrower/stockholders. The directors elected by the member-borrower/stockholders elect or appoint at least one additional director from outside the System.

Over the past 16 years the number of banks and associations has declined from 932 to 197 as System boards have sought to enhance operating efficiencies, reduce commodity and geographic concentration, and expand the services they can offer their borrowers (Figure 1). As of January 1, 1999, the System was composed of the following banks and associations (Figure 2).

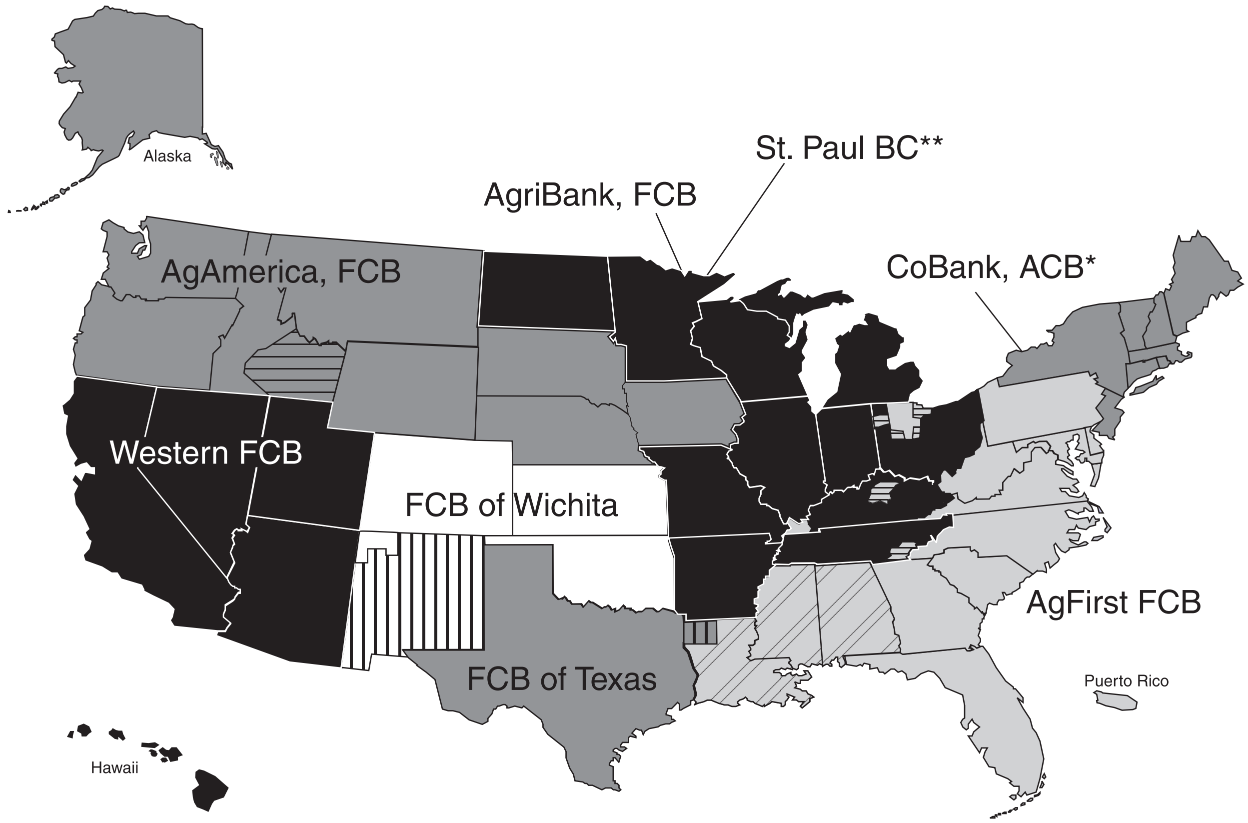
Farm Credit Bank (FCB) — Six Farm Credit Banks provide loan funds to 63 Production Credit Associations (PCAs), 50 Agricultural Credit Associations (ACAs), and 33 Federal Land Credit Associations (FLCAs). These banks also make direct long-term real estate loans through 39 Federal Land Bank Associations (FLBAs). PCAs make short- and intermediate-term loans; ACAs make short-, intermediate-, and long-term loans; FLCAs make long-term loans; and FLBAs act as lending agents for the banks.

Figure 1
Trend in Numbers of Farm Credit Banks and Associations, 1983–1999
(As of January 1)



Source: FCA, Office of Policy and Analysis, Risk Analysis Division.

Figure 2
Farm Credit System Banks Chartered Territories
(As of January 1, 1999)



AgAmerica, FCB	Western FCB	FCB of Wichita	FCB of Texas	AgriBank, FCB	CoBank, ACB	AgFirst FCB
1 ACA	5 ACAs	19 FLBAs	20 FLBAs	8 ACAs	4 ACAs	36 ACAs
1 FLCA	11 FLCAs	3 FLCAs	15 PCAs	18 FLCAs		1 PCA
1 PCA	10 PCAs	18 PCAs		18 PCAs		

The PCA of New Mexico and PCA of Eastern New Mexico are funded by the FCB of Texas. The PCA of Southern New Mexico is funded by the FCB of Wichita.

The FLBAs in Alabama, Louisiana, and Mississippi generate and service loans for the FCB of Texas. The First South PCA is funded by AgFirst FCB.

The Northwest Louisiana PCA is funded by the FCB of Texas.

*The CoBank, ACB is headquartered in Denver, Colorado, and serves cooperatives nationwide and ACAs in the indicated area.

**The St. Paul BC is headquartered in St. Paul, Minnesota, and serves cooperatives nationwide.

The AG CREDIT, ACA (Ohio), Central Kentucky ACA (Kentucky), Chattanooga ACA (Tennessee), and Jackson Purchase ACA (Kentucky) are funded by the AgFirst FCB.

The Mid-America ACA, funded by AgriBank, FCB, is also authorized to lend in this territory.

The Eastern Idaho ACA is funded by the Western FCB.

Source: FCA, Office of Policy and Analysis, Risk Analysis Division.

Bank for Cooperatives (BC) — One Bank for Cooperatives makes loans to agricultural, aquatic, and public utility cooperatives and other persons or organizations owned by or having transactions with such cooperatives.

Agricultural Credit Bank (ACB) — One Agricultural Credit Bank has the combined authorities of a BC and an FCB. In addition to making loans to cooperatives, the ACB provides loan funds to four ACAs. Both the BC and the ACB are authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives.

FCA also examines and regulates the following FCS entities:

The **Federal Farm Credit Banks Funding Corporation (Funding Corporation)** markets debt securities that the banks sell to raise loan funds. The Funding Corporation is owned by the System banks.

The **Farm Credit System Financial Assistance Corporation (FAC)**, chartered in 1988, provided needed capital to the System through the purchase of preferred stock. This stock was issued by certain System institutions that received needed financial assistance as authorized by the Farm Credit System Assistance Board.

The **Federal Agricultural Mortgage Corporation (Farmer Mac)**[1] was created to provide a secondary market for agricultural and rural housing mortgages. Farmer Mac guarantees the timely 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, and on 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).

Service corporations organized under section 4.25 of the Act,[2] which FCA also examines and regulates, include the following:

The **Farm Credit Finance Corporation of Puerto Rico** uses tax incentives offered to investors to provide low-interest funding (other than that from the Funding Corporation) to the Puerto Rico Farm Credit, ACA.

The **Farm Credit Leasing Services Corporation (Leasing Corporation)** provides equipment leasing services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities. The Leasing Corporation is owned by the System banks.

Farm Credit Financial Partners, Inc., provides support services to the four associations affiliated with CoBank, ACB, and 23 of the 26 associations affiliated with the Western FCB.

The **FCS Building Association (FCSBA)** acquires, manages, and maintains facilities to house the FCA's headquarters and field office staff. The FCSBA was formed in 1981 and is owned by the FCS banks. The FCA Board oversees the FCSBA's activities on behalf of its owners.

1. Farmer Mac is established in law as a part of the Farm Credit System. 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 making farm mortgage loans, and other FCS institutions. Non-voting stock may be owned by any class of investor. Farmer Mac is regulated by the Farm Credit Administration through the director of a separate Office of Secondary Market Oversight, who reports directly to the FCA Board.
2. Section 4.25 of the Farm Credit Act provides that one or more FCS banks and/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.

Agricultural Finance Environment of 1998

General Economic Setting Remained Strong

In 1998, the U.S. economy established a record for the longest period of sustained economic growth in its peacetime history. Capping off this remarkable eight-year period, real gross domestic product rose about 4.25 percent last year, marking the third year in a row it has been in the 4 percent range. The collapse of the Russian ruble and its ripple effect disrupted the financial markets in the late summer and fall. However, the Federal Reserve Board responded with a three-step, 75-basis-point reduction in the Federal funds rate and a 50-basis-point drop in the discount rate, which calmed the markets, restored investor confidence, and produced a strong spurt in economic activity by yearend.

U.S. Farm Economy Weakens

The bubble of prosperity that expanded in 1996 and 1997 essentially burst in 1998 as prices for many commodities plummeted from the very high levels recorded in the previous few years. Low commodity prices and weak incomes experienced in some sectors of agriculture today are due to large supplies of crops worldwide combined with flagging demand caused by economic recession in many countries around the globe.

Net farm income is estimated to have declined to $46 billion in 1998, down 7.6 percent from the previous year, in spite of a 2 percent reduction in production expenses.[1] The drop in farm income occurred largely because of a $13 billion decline in cash receipts, most of which was in the crop sector. Livestock receipts dropped just $3.6 billion. Net cash income also fell in 1998, from a record high $60 billion in 1997 to an estimated $57.4 billion — a 5.6 percent decline.[2] Net cash income measures the cash available to service debt or substitute for debt (Figure 3).

The Federal Government played a key role in stabilizing financial conditions in agriculture by boosting direct Government payments to farmers and ranchers in 1998. The U.S. Department of Agriculture estimates that direct Government payments jumped from $7.5 billion in 1997 to $12.8 billion in 1998.

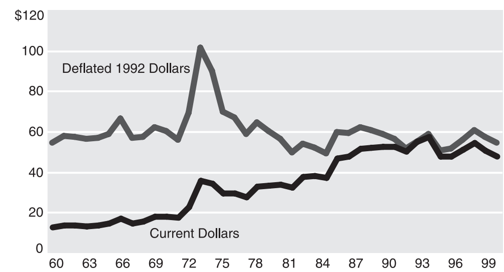
Exports Decline

Exports of farm commodities declined to $53.7 billion in 1998 from $57.4 billion in 1997, a 6 percent drop. Large worldwide production and weak demand were responsible for the decline. The financial crisis in Asia played a pivotal role in the decline in U.S. farm exports, since more than 45 percent of all U.S. farm exports are bound for Asian markets. Farm exports to Asia dropped 17 percent in 1998.

Farm Finances Stressed

The abrupt change in the export outlook for American agriculture, combined with a demonstrated ability of U.S. farmers and that of our competitors to boost production in response to the higher commodity prices of 1996 and 1997, has adversely affected the nation's farm economy. The value of U.S. farm assets grew only an estimated 3.3 percent in 1998, compared with 5.3 percent during each of the previous two years. Farmers' demand for credit also has moderated, as evidenced by a marked slowing in the growth of outstanding debt. USDA estimates that farm-sector debt grew 3 percent in 1998, compared with 3.5 percent in 1996 and 5.9 percent in 1997.

Figure 3
Net Cash Income from Farming, 1960–1999
(Dollars in Billions)

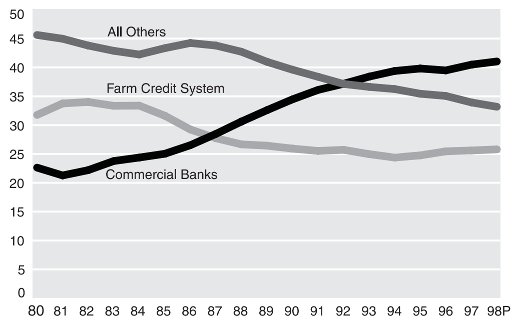


Note: Data for 1998 are preliminary and data for 1999 are forecast.
Source: USDA, Economic Research Service: National Financial Summary-1993, ECIFS 13-1, December 1994, and Agricultural Outlook, AGO-260, April 1999.

1. Net farm income is an accounting of farm income and expenses on an accrual basis. Thus, net farm income has adjustments for inventory changes (to reflect only the current year's output), depreciation as an expense, and recognition of other noncash income and expense items. Overall, income tends to be more stable when expressed on a cash basis because it partly measures how farmers manage to average their sales and expenses from more than one production year.
2. Net cash income is a cash accounting of commodity sales, Government payments, farm-related income, and operating expenses associated with producing that revenue. Neither depreciation nor capital expenditures are deducted.

Figure 4
Total Farm Business Debt, Market Shares, 1980–1998
(As of December 31)

Percentage of Market



Note: "All Others" includes trade credit, seller financing of real estate, life insurance companies, USDA's Farm Service Agency, and Farmer Mac. Data for 1998 are preliminary estimates.
Source: USDA, Economic Research Service: Agricultural Income and Finance Situation and Outlook Report, AIS-71, February 1999.

Farmers' use of credit capacity, which is based on current outstanding debt compared with the debt level that could be serviced with current net cash income before interest, rose to an estimated 54.9 percent in 1998 from 52.4 percent in 1997. This increase is the result of lower income and higher debt servicing obligations. However, farmers are in much stronger financial shape than they were in the 1980s. Today, farmers tend to employ more conservative financial management strategies, they have lower leverage, and have access to more timely information than in the 1980s.

Farm Credit System Market Share Continues to Lag Commercial Banks[3, 4]

USDA estimates that the System's yearend 1998 share of total farm business debt outstanding increased slightly to 25.8 percent, from 25.6 at yearend 1997. This figure compares with a high of 34.0 percent at yearend 1982 and a low of 24.4 percent at yearend 1994 (Figure 4). The upward trend of the past four years comes after more than a decade (1982-1994) of declining market share. The share held by commercial banks grew by a slightly larger amount in 1998, bringing their percentage to 41.0 (from 40.5 at yearend 1997). Commercial banks have gained market share steadily since 1981, when they held 21.3 percent. Since the end of 1987, commercial banks have held the largest share of any lender, a position formerly held by the System.

Total farm debt consists of two components: farm real estate debt (debt collateralized by real estate) and non-real estate debt (short- and intermediate-term debt). About 51 percent of the total outstanding farm debt is farm real estate debt and 49 percent is farm non-real estate debt. The FCS has been the dominant lender for farm real estate debt (32.1 percent market share as of December 31, 1998), while commercial banks have been dominant in the farm non-real estate debt market (52.2 percent market share) (Figures 5 and 6).[5] Market shares vary considerably by state. For example,

3. Market share data provided here do not include loans to farmers made through credit affiliates of cooperatives that are funded by System institutions. Data on market share to agricultural cooperatives are not available.
4. USDA's farm business debt for all lenders is a preliminary yearend estimate (based on September 30, 1998, financial results) and is adjusted to remove debt associated with farm households. The data are derived from USDA, Economic Research Service, Agricultural Income and Finance Situation and Outlook Report, AIS-71, February 1999. The yearend actual change in System loans by category is presented in Table 1, in the section entitled "Farm Credit System Performance Report."
5. Both System and commercial bank share in the farm non-real-estate market are probably slightly higher than USDA data show because of "point-of-sale" credit provided by farm input or equipment suppliers. Often this credit is funded through line-of-credit arrangements with System institutions or commercial banks.

in some states where commercial banks are heavily concentrated (e.g., Midwestern states), the System's non-real estate market share is less than 10 percent.

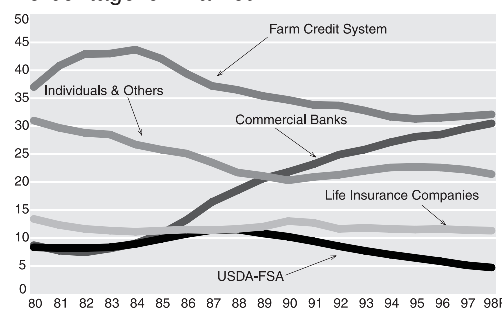
Other institutional lenders to farmers include insurance companies and USDA's Farm Service Agency (FSA). While only six insurance companies are now active in farm lending, they were very active in the farm real estate market in 1998. Insurance companies emphasize larger loans (more than $500,000) and have held about 11 to 12 percent of the farm real estate-secured debt since the early 1980s, or about 6 to 7 percent of overall farm debt.

FSA lending declined to an overall share of 4.8 percent as of yearend 1998. The decline reflects an intentional shift by the FSA from direct-lending programs to guarantees of loans made by other lenders. These guaranteed loans are on the books of either FCS lenders or commercial banks, and they are counted in the shares held by these lenders. More than 90 percent of the System's associations participated in FSA's guaranteed lending programs, but only about 2 percent of the System's farm loans were guaranteed by FSA as of December 31, 1998.

The competition in farm lending markets for creditworthy borrowers is expected to continue in 1999 in spite of the poor conditions in some parts of the agricultural economy. Commercial banks, despite rising loan-to-deposit ratios, generally have the liquidity to be strong competitors in the farm lending arena. Insurance companies are also competing actively for the larger credits. In addition, trade (or point-of-sale) credit appears to be experiencing strong growth. The System, with its renewed financial strength, its status as a Government-sponsored enterprise (GSE), and access to the nation's money markets, is well positioned to be a long-term reliable supplier of the future credit needs of the agricultural sector.

Figure 5
Real Estate Farm Business Debt, Market Shares, 1980–1998
(As of December 31)

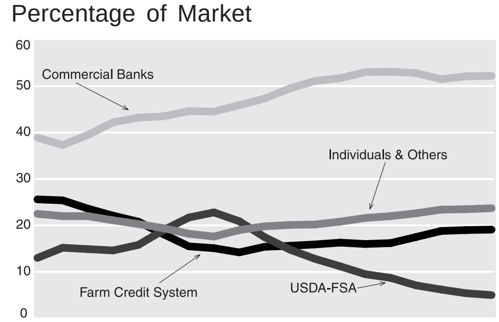
Percentage of Market



Note: "Individuals and Others" is mainly seller financing of real estate, but also includes Farmer Mac loans. USDA-FSA is USDA's Farm Agency Service. Data for 1998 are preliminary estimates.
Source: USDA, Economic Research Service: Agricultural Income and Finance Situation and Outlook Report, AIS-71, February 1999.

Figure 6
Non-real Estate Farm Business Debt, Market Shares, 1980–1998
(As of December 31)

Percentage of Market



Note: "Individuals and Others" is mainly trade credit. USDA-FSA is USDA's Farm Service Agency. Data for 1998 are preliminary estimates.
Source: USDA, Economic Research Service: Agricultural Income and Finance Situation and Outlook Report, AIS-71, February 1999.

8 Farm Credit System Performance[1]

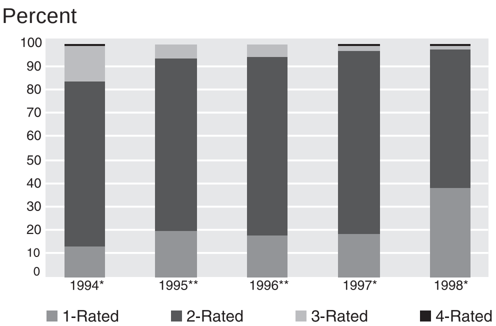
Although financial stress has increased in agriculture because of reduced commodity prices and a more uncertain export outlook, Farm Credit System institutions during 1998 continued to reflect strong financial performance, particularly in earnings and capital growth. The System's financial statements will likely begin to show more of the effects of the economic downturn in 1999. With the build-up in risk-bearing capacity and improved management systems during the 1990s, the FCS is in a strong position to manage the anticipated economic problems.

In 1998, the System banks and associations continued an 11-year trend of improving financial condition and performance. Earnings were down slightly from 1997 but continued at historically high levels — more than $1 billion for the sixth straight year. In the past five years, System capital has increased more than 51 percent, to $12.5 billion, and capital growth continued in 1998. Nonperforming loan volume increased 69 percent in 1998, to $1.4 billion, but most of the increase was due to a few large cooperative borrowers. The overall level of nonperforming loans remained near historical lows.

FCA Rating System

The long-term improving trend in the financial performance and condition of the FCS continued to be evident in the Financial Institutions Rating System (FIRS) ratings given as a result of FCA's examinations.[2] At yearend 1997 and 1998, there were no 5-rated institutions and only one 4-rated institution (Figure 7). The percentage of 3-rated System institutions dropped from 15.4 percent at yearend 1994 to 1.5 percent at yearend 1998. Ten years earlier, at yearend 1988, 23 percent of FCS institutions were 5-rated, 23 percent were 4-rated, and 20 percent were 3-rated.

Figure 7
FIRS Ratings for Farm Credit Banks and Associations, 1994–1998



* At yearend 1994, 1997, and 1998 one institution was 4-rated.
**At yearend 1995 and 1996, no institutions were 4-rated.

Note: FIRS ratings are based on capital, asset quality, management, earnings, liquidity, and sensitivity to market risk. Ratings range from 1 (a sound institution) to 5 (an institution that is likely to fail).
Source: FCA Examination Reports.

Enforcement Activity

FCA uses its various enforcement authorities to ensure that FCS institutions operate on a safe and sound basis and in compliance with applicable statutes and regulations. These authorities include the use of agreements or orders to cease and desist, civil money penalties, and the removal or suspension of officers and directors of FCS institutions.

During 1998, FCA did not enter into any enforcement actions with System institutions. FCA terminated two agreements and one supervisory letter that imposed conditions on a corporate restructuring. At yearend 1998, one order to cease and desist issued upon consent in the prior year remained in effect. The total assets under enforcement action at the end of 1998 were less than 3 percent of the System's assets.

Earnings

Net earnings for 1998 were $1.3 billion, down only slightly (1.3 percent) from 1997. Higher loan and investment volume generated higher net interest income, which was offset by increased provisions for loan losses and lower net interest margins. Net interest income was up 2.4 percent over 1997 to $2.2 billion because of higher loan volumes, partially funded by an increase in loanable funds.[3] The net interest margin fell slightly, from 2.95 percent of average earning assets in 1997 to 2.87 percent in 1998 (Figure 8), because of

1. The information in this section includes all Farm Credit Banks, the Agricultural Credit Bank and their affiliated associations, and the Bank for Cooperatives. References to individual districts include combined financial data for the district bank and its affiliated associations, adjusted to eliminate transactions between institutions in the district. The data used in the overall FCS analysis were provided by the FCS institutions to the Farm Credit Administration, or to the Federal Farm Credit Banks Funding Corporation. The analysis in this report is based on publicly available information and is based on calendar year 1998.
2. In early 1998 the Agency modified the FCA Rating System (commonly referred to as CAMEL) by adopting the Financial Institutions Rating System. FIRS modifies CAMEL by adding a separate "S" rating factor for sensitivity to market risk. This component reflects the degree to which changes in interest rates may affect earnings or market value of an institution's equity. FIRS uses key ratios and statistics as part of its process of assigning institutions to risk categories. Ratings for all System institutions are reviewed and adjusted as needed to reflect conditions existing at the end of each quarter. FIRS ratings range from 1 to 5. A 1-rated institution is sound in every respect. A 2-rated institution is fundamentally sound with minor weaknesses that are correctable in the normal course of business. A 3-rated institution has moderately severe to unsatisfactory weaknesses, but it is strong enough that the likelihood of failure is small. A 4-rated institution has serious problems that could impair its viability and that are not being addressed satisfactorily. A 5-rated institution is at imminent risk of failure.
3. Loanable funds are the excess of interest-earning assets after subtracting interest-bearing liabilities.

lower spreads on loans and decreased interest income recognized on nonaccrual loans. The net interest spread[4] decreased nine basis points to 1.96 percent.

Four banks and their affiliated associations reported modest increases in district income in 1998, and four reported decreases. The St. Paul Bank for Cooperatives reported net income that was 90 percent below 1997, due primarily to increased loss provisions, lower loan volume, and narrower spreads. Systemwide, the return on average assets for the 12 months ended December 31, 1998, was 1.54 percent, compared with 1.65 percent for the 12 months ended December 31, 1997.

Operating expenses for 1998 totaled $954 million, a 7.0 percent increase from 1997. Salaries and employee benefits, the largest portion of expenses, increased 6.6 percent, to $567 million. Occupancy and equipment expenses rose 5.0 percent, to $84 million, and other operating expenses rose 8.2 percent, to $303 million. All districts reported increases in operating expenses. The System's operating expense rate (operating expense as a percentage of gross loans[5]) decreased to 1.40 percent from 1.41 percent in 1997, because loans grew faster than operating expenses. The operating expense rate has been close to 1.4 percent for the past four years (Figure 9).

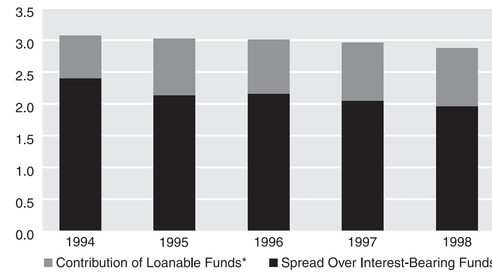
Other noninterest expenses were affected by two offsetting events in 1998: a reduction in assessments by the Farm Credit System Insurance Corporation and an increase in financial assistance expenses resulting from early retirement of debt. The Farm Credit Insurance Fund neared the secure base amount in 1998, causing FCSIC to reduce its premium assessments, which are paid by System institutions. Systemwide premiums paid to FCSIC fell from $71.5 million in 1997 to $19.8 million in 1998. The FCS Financial Assistance Corporation called one of the bonds that it had issued during the 1988–1989 period to provide funds for financial assistance to certain banks. Because interest rates were so much lower in 1998, the FAC and the System banks agreed to call the $240 million issue, which had been issued originally for 15 years with a 9.45 percent coupon. The difference between the amount needed to call the bond and the amount in a trust previously funded by the System banks to repay the debt was $39.5 million. Each bank recorded a proportional share of this amount as a financial assistance expense in 1998.

In 1998, the System made a $150 million provision for loan losses, $58 million more than in 1997. Six of the eight banks increased their provision for loan losses and two reduced their provision.

The provision for income taxes was $180 million, an effective tax rate of 12.6 percent. The provision was $6 million less than last year because of a one-time $15 million tax reduction caused by an association that settled an Internal Revenue Service dispute. Excluding this settlement, the effective tax rate was 13.6 percent for 1998. Because System institutions are cooperatives, they can offset some of their tax liability by declaring patronage distributions, thus returning a portion of their income to the borrowers/owners who then pay taxes, as applicable. In 1998, the System declared $334 million in patronage distributions, of which $137 million was to be paid in cash. Of the remaining $197 million, $138 million was transferred to allocated surplus and $59 million was declared as capital stock.

Figure 8
Net Interest Margins, 1994–1998

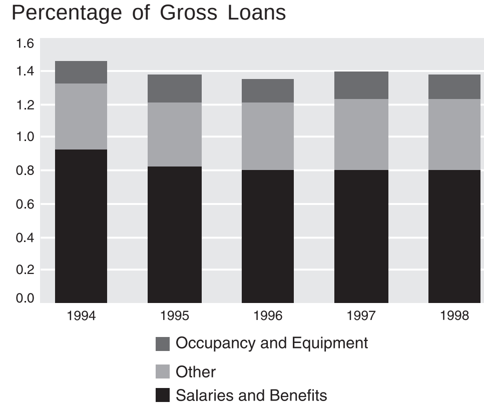
Percentage of Average Earning Assets



*Loanable funds are owned (interest-free) funds that support interest-earning assets.
Source: Federal Farm Credit Banks Funding Corporation Annual Information Statements.

Figure 9
Operating Expenses as a Percentage of Gross Loans, 1994–1998

Percentage of Gross Loans

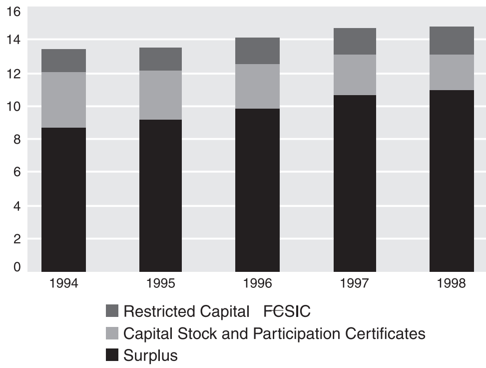


Source: Federal Farm Credit Banks Funding Corporation Annual Information Statements.

4. Net interest spread is the difference between the interest rate charged to borrowers and the interest rate paid by the institution.
5. Gross loans are accrual loans, nonaccrual loans, sales contracts, and notes receivable.

Figure 10
Farm Credit System Capital as a Percentage of Total Assets, 1994–1998

Percentage of Total Assets



Note: Protected stock is not included since it represents a small (0.6 percent) percentage of total capital at yearend 1998.
Source: Federal Farm Credit Banks Funding Corporation Annual Information Statements.

Capital

Total capital grew 7.1 percent, to $12.5 billion in 1998.[6] Total capital declined slightly from 15.0 percent of total assets at yearend 1997 to 14.9 percent at yearend 1998 (Figure 10). Surplus increased $900 million (10.8 percent) and represented 74 percent of total capital, compared with 71 percent at the end of 1997.

Nonperforming loans were 11.1 percent of total capital, compared with 7.1 percent at yearend 1997. Risk funds (allowances for losses, at-risk capital, and surplus) totaled $14.4 billion at yearend 1998 and covered 21 percent of System loans. At yearend 1988, risk funds covered only 8 percent of System loans.

FCA requires each institution to maintain a minimum 7 percent permanent capital to risk-adjusted assets ratio, 7 percent total surplus to risk-adjusted assets ratio, and 3.5 percent core surplus to risk-adjusted assets ratio. As of yearend 1998, all institutions were in compliance with regulatory requirements for their permanent capital ratio and their total surplus ratio. Two institutions did not comply with the requirement for their minimum core surplus ratio. However, these two institutions are operating under FCA-approved capital restoration plans, which puts them in compliance.

Asset Growth

Total assets increased 7.7 percent over yearend 1997 to $84.1 billion. Gross loans of $67.9 billion, which constitute 80.7 percent of assets, increased 7.0 percent (Table 1). Long-term farm mortgage loans were up $1.8 billion, a 6.2 percent increase over 1997. The System also reported a $1.6 billion increase (9.7 percent) in production and intermediate-term loans and a $574 million increase (13.3 percent) in rural utilities lending.

Long-term real estate loans made up 45.5 percent of gross loans at yearend 1998, down from 45.8 percent in 1997.

Table 1
Farm Credit System Gross Loans Outstanding, 1994–1998
(Dollars in Millions)

Loan Category	1994	1995	1996	1997	1998	Percentage Change from 1994
Long-Term Farm Mortgage	$26,440	$26,635	$27,556	$29,085	$30,895	16.8
Production and Intermediate-Term	11,648	13,255	14,659	16,040	17,594	51.0
Domestic Cooperatives	7,700	10,390	9,954	9,764	9,917	28.8
International	3,202	2,759	2,623	2,077	2,291	(28.5)
Rural Utilities	2,927	3,208	3,890	4,301	4,875	66.6
Rural Home	1,680	1,628	1,584	1,554	1,437	(14.5)
Other	1,079	714	912	618	895	(17.1)
Total	**$54,676**	**$58,589**	**$61,178**	**$63,439**	**$67,904**	**24.2**

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

6. Total capital includes protected capital and restricted capital. Protected capital ($76 million at yearend 1998) consists of borrower stock, participation certificates, and allocated equities that were outstanding as of January 6, 1988, or were issued or allocated before October 8, 1988. Protection of certain borrower capital is provided under the Farm Credit Act of 1971, as amended, which requires FCS institutions, when retiring protected borrower capital, to retire such capital at par or stated value regardless of its book value. Restricted capital ($1.41 billion at yearend 1998) represents the total assets under the control of FCSIC, including those that have been identified for estimated insurance obligations ($0.15 billion) and the Insurance Fund balance ($1.26 billion).

Production and intermediate-term loans increased their share of the FCS portfolio from 25.3 percent in 1997 to 25.9 percent in 1998.

All Farm Credit districts contributed to the rise in 1998 loan volume. The largest percentage increases were in the AgAmerica District (14 percent) and the Texas District (12 percent). The St. Paul BC reported a 4 percent decrease in loan volume in 1998, an improvement from the 13 percent decrease in 1997.

The System's investment portfolio, up 11.3 percent from 1997 to $14.0 billion, also contributed to the asset growth. Total investment portfolios of System banks amounted to 20.3 percent of total loans,[7] which was under the 30 percent regulatory maximum that FCA imposes. Systemwide, 50 percent of the investment portfolio consisted of mortgage-backed securities; 21 percent bankers' acceptances, certificates of deposit, and other commercial securities; 9 percent Federal funds and repurchase agreements; and 19 percent, various other types of investments, primarily other asset-backed securities.

Asset Quality

Loan quality deteriorated but remained at historically high levels. Nonperforming loans[8] increased $568 million (69 percent) from 1997 to $1.4 billion at yearend 1998. Nonperforming loans represented 2.0 percent of total loans, compared with 1.3 percent at yearend 1997 and 2.7 percent at yearend 1994 (Figure 11). Nonaccrual loans (the largest component of nonperforming loans) doubled over the year to $1.2 billion, primarily because of problems experienced by a few marketing and processing cooperatives. Of nonaccrual loans, 67.1 percent were current as to principal and interest payments.[9]

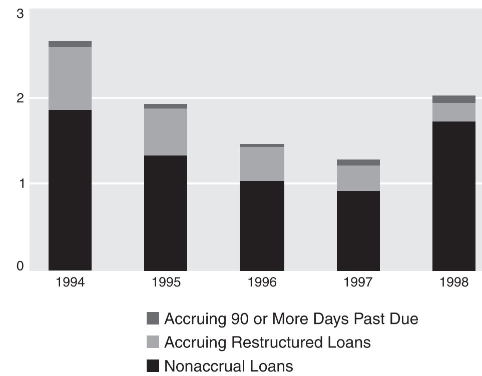
Nonperforming loans increased in 1998 in all districts except Western and AgAmerica, where they declined by 44 and 16 percent, respectively. Nonperforming loans as a percentage of total loans varied from highs of 8.7 percent for the St. Paul BC and 2.7 percent in the Wichita and AgriBank districts to a low of 0.6 percent in the Western district. The largest increases in nonaccrual loan volume occurred in the AgriBank district ($205 million), the CoBank district ($200 million), and the St. Paul BC ($149 million). Loan delinquencies (accruing loans 30 or more days past due) as a percentage of accrual loans increased slightly in 1998 but remained relatively low (less than 1 percent of accrual loans).

The System's allowance for loan losses, expressed as a percentage of gross loan volume, declined slightly to 2.82 percent at yearend 1998 from 2.89 percent at yearend 1997. The allowance averaged 160 percent of the amount of nonaccrual loans, compared with 310 percent in 1997 and only 56 percent in 1988. The allowance as a percentage of nonaccrual loans varied from lows of 35 percent at the St. Paul BC and 110 percent at CoBank to highs of 377 percent in the AgAmerica district and 461 percent in the Western district.

Farm Credit Leasing Services Corporation

The Farm Credit Leasing Services Corporation, chartered in 1983, is a service corporation owned and funded by the FCS banks. The Leasing Corporation's headquarters is in Minneapolis, Minnesota, with sales offices throughout the United States. It specializes in equipment leasing to agricultural producers and their cooperatives, rural electric and telephone organizations, and FCS entities. At September 1998 fiscal

Figure 11
Nonperforming Loans in the Farm Credit System, 1994–1998



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

7. Total loans are gross loans plus interest receivable.
8. Nonperforming loans consist of nonaccrual loans, accruing restructured loans, and accruing loans 90 days or more past due.
9. FCA regulation 621.6(a) states, "A loan shall be considered nonaccrual if it meets any of the following conditions: (1) Collection of any amount of outstanding principal and all past and future interest accruals, considered over the full term of the asset, is not expected; (2) Any portion of the loan has been charged off, except in cases where the prior chargeoff was taken as part of a formal restructuring of the loan; or (3) The loan is 90 days past due and is not both adequately secured and in process of collection." Nonaccrual loans pose the greatest risk of loss.

yearend, the Leasing Corporation had approximately 37,000 lease contracts outstanding to more than 9,200 customers.

Since 1984, Leasing Corporation profitability has increased steadily. Net earnings increased to $9.4 million during fiscal year 1998 from $8.9 million in fiscal year 1997. The Leasing Corporation's total assets increased 12.7 percent to $776.5 million during fiscal year 1998, while capital increased 16.1 percent to $74.6 million. Its capital-to-asset ratio was 9.6 percent at the end of fiscal year 1998, compared with 9.3 percent a year earlier. Its return on equity was 13.9 percent for 1998 and has exceeded 10 percent annually since 1989. The return on assets declined slightly to 1.26 percent at fiscal yearend 1998 from 1.38 percent at fiscal yearend 1997.

Federal Agricultural Mortgage Corporation

Farmer Mac's profitability increased for the third straight year after passage of the Farm Credit System Reform Act of 1996 (1996 Act).[10] Farmer Mac reported $5.7 million of net income for 1998, an increase from $4.6 million reported for 1997. Income growth is attributable to Farmer Mac's efforts to build a secondary market for the agricultural sector through a variety of products and to the performance of its investment portfolio.

Revenues on program-related products increased 21 percent during 1998, compared with 14 percent for 1997. Nonprogram revenues, primarily from investments, increased 33 percent because of growth in nonprogram assets to $1.2 billion at December 31, 1998, compared with $834 million at December 31, 1997. The increase in nonprogram assets is attributable to Farmer Mac's debt issuance strategy, which was expanded in early 1997. The objective of the debt issuance strategy is to increase Farmer Mac's market presence, resulting in an increased investor base, greater liquidity in its securities, and lower issuance costs and spreads. Operating expenses increased by 13 percent to support growth in program-related assets. In addition, the provision for losses increased to $1.6 million in 1998, compared with $1.0 million in 1997, because of increases in program-related assets.

Capital increased in 1998 by $5.9 million to $80.9 million, compared with an increase of $27.9 million to $75.1 million in 1997. The increase in 1998 was due to net income earned during 1998, while the increase in 1997 was due to net proceeds from the sale of 400,000 shares of nonvoting Class C stock and net income earned. Increases in Farmer Mac's retained program-related assets and nonprogram investment portfolio caused the capital-to-assets ratio to decline to 4.2 percent at yearend 1998, compared with 5.6 percent at yearend 1997 and 7.8 percent at yearend 1996. Throughout 1998, Farmer Mac's capital level exceeded the minimum requirements set by statute. The statutory minimum of $50.2 million was exceeded by $30.5 million at yearend 1998.

Farmer Mac operates two principal programs for providing a secondary market for agricultural mortgages. In Farmer Mac I, either Farmer Mac or private institutions form pools of agricultural real estate loans. Securities backed by those loans are called agricultural mortgage-backed securities (AMBS), with Farmer Mac guaranteeing the timely payment of principal and

10. The 1996 Act provided new authorities for Farmer Mac to purchase and pool loans and required Farmer Mac to raise additional capital, but deferred implementation of a risk-based capital regulation until after January 1999.

interest to security holders. In addition to AMBS issuance, the Farmer Mac I program includes three other components: Mortgaged-Backed Bonds ("AgVantage"),[11] which was introduced in 1998; Swap Transactions;[12] and Long-term Standby Commitments to Purchase,[13] which was developed in 1998.

In Farmer Mac II, lenders sell the guaranteed portions of certain kinds of U.S. Department of Agriculture loans to Farmer Mac. Farmer Mac pools the guaranteed portions of those loans and creates securities backed by guarantees of timely payment of principal and interest.

At yearend 1998, $796 million in Farmer Mac I securities were outstanding, of which Farmer Mac held $228.5 million, compared with $570 million outstanding and $184 million held at yearend 1997. At yearend 1998, $337 million in Farmer Mac II securities were outstanding, of which Farmer Mac held $307 million, compared with $273 million outstanding and $250 million held at yearend 1997. These retained securities provided a substantial portion of Farmer Mac's interest income.

Of the loans underlying Farmer Mac I securities, 1.3 percent of the aggregate principal amount was delinquent (past due 90 days or more, in foreclosure, or in bankruptcy). This figure was up from 0.3 percent at yearend 1997 and 0.7 percent at yearend 1996. The majority of delinquent loans were in pools backed by a 10 percent subordinated interest. The overall delinquency trend has been increasing because of adverse conditions in the agricultural economy and the age of mortgages supporting the Farmer Mac I program.

11. Farmer Mac purchases bonds from certified facilities that are secured by mortgages.
12. Swap transactions are an exchange between a lender and Farmer Mac of qualified loans for guaranteed securities backed by such loans.
13. Purchase commitments allow lenders to retain agricultural mortgages. Credit risk is reduced through a commitment by Farmer Mac to purchase loans in the event of default or by request by the lender.

14 Young, Beginning, and Small Farmers and Ranchers

Section 4.19(b) of the Farm Credit Act requires each Farm Credit System bank to report annually on the operations and achievements under programs in its district that benefit young, beginning, and small (YBS) farmers and ranchers. This report represents the first year of a three-year transition to obtain improved data from the System that most appropriately reflect its service to this targeted segment of its portfolio.

FCA Board Acts to Improve Service and Data

On December 10, 1998, the Farm Credit Administration Board adopted a policy statement entitled "Farm Credit System Service to Young, Beginning, and Small Farmers and Ranchers."[1] The FCA Board's objective was that each board of directors within the System should renew its commitment to be a reliable, consistent, and constructive lender to YBS borrowers. The FCA's Office of Examination has included YBS lending activity as a focus area in its examination of each FCS institution. FCA also revised the reporting requirements to obtain data that better represent System service to the YBS borrower in the current farming and ranching environment. This annual report is based on new definitions for reporting on YBS activities that are significantly different from those used previously. As a result, data in this report are not comparable to data in reports from previous years.

A YBS borrower is defined differently. Going forward, the System will use new definitions for YBS borrowers.

- A **young** farmer, rancher, or producer or harvester of aquatic products (farmer) is defined as 35 years old or less at the time the loan is made. This is a slight revision to clarify that the age requirement applies at the time the loan is made.

- A **beginning** farmer is defined as having 10 years or less of farming or ranching experience (previously six years or less). The new definition is consistent with the definition used for the Farm Service Agency's Beginning Farmer Downpayment Loan Program.

- A **small** farmer is defined as normally generating less than $250,000 in annual gross sales of agricultural or aquatic products (previously a "small" farmer was defined as having less than $40,000 in annual agricultural sales **and** less than $100,000 in agricultural assets). The new definition considers inflationary factors and other significant changes in the structure of farming. In addition, it is consistent with a recommendation made by the National Commission on Small Farms in its final report to the Secretary of Agriculture, January 1998.

Loans that benefit young and beginning borrowers are now reported. This year for the first time, loans that benefit a young or beginning borrower are included. This category includes individuals who farm or ranch in partnership with another person if the young or beginning farmer is obligated (on the note) to repay the debt. The previous definitions included only the primary operator.

The definition of a "loan" is broadened. The definition includes leases and loan/lease participation interests to reflect all types of financing options that benefit YBS farmers. Loans to rural homeowners, processing and/or marketing operators, farm-related service

1. Policy Statement PS-75 is located on FCA's Web site, **www.fca.gov,** under the "Publications and Audio Tapes" section.

businesses, farmer cooperatives, rural utilities, and other eligible borrowers under title III of the Act are **not** included for purposes of YBS reporting.

New business with YBS borrowers is emphasized. Historically, YBS reports included the volume of loans outstanding as of a particular yearend. This practice did not take into account the seasonality of production loans and represented a static measurement of loans as of yearend. The definition of gross new money loaned has been revised to reflect all new business conducted with YBS borrowers during the reporting year. This category includes loan and lease originations, refinancings, and purchased participation interests.

A loan is reported in each YBS category that applies. Reporting on YBS loan activity will no longer be in mutually exclusive categories. All borrowers who qualify as young farmers will be reported as such, even if they are also beginning farmers and/or small farmers. The same reporting criteria will apply to both beginning and small farmers. Therefore, reports will reflect lending to young farmers, beginning farmers, and small farmers. Reports will not produce a grand total because of the overlapping that would result.

More information on YBS programs is reported. The new reporting requirements provide more specific information on how YBS programs are managed. Reports also provide information on the System's activities in supporting YBS borrowers that do not involve the extension of credit, such as education or service-related programs. Information reported on System YBS programs will be modified as changes occur and as additional or different data are needed.

Reporting Transition

Many institutions will need to modify their computer systems to fully account for the revised definitions. To avoid interfering with any System institution's efforts to be year 2000 (Y2K) compliant, January 1, 2001, was established as the date when each System institution is required to collect revised data on YBS borrowers. However, System institutions are encouraged to report using the new YBS definitions as soon as practicable.

Two of the seven districts were able to report using all aspects of the new YBS definitions. Only one district reported entirely using the previous definitions and format. The four remaining districts report on some, but not all, aspects of the new definitions. As a result, this year's reports are conservative and likely do not include the System's full lending volume to YBS borrowers. This is because some districts continued to report numbers based on the characteristics of the primary operator and on the more limited previous definition of a small farmer.

Loans Outstanding to YBS Borrowers

The System had 603,322 outstanding loans to farmers and ranchers at yearend 1998. Of this total, 15.7 percent were loans to young farmers, 18.2 percent to beginning farmers, and 56.0 percent to small farmers (Table 2). Respectively, this amounted to 11.6 percent, 16.6 percent, and 36.8 percent of the System's loan volume as reported in the 1998 YBS Call Report. For outstanding loans that were $50,000 or less, 60 percent by number and 52.5 percent by volume benefited small farmers. Of all loans over $250,000, 26.4 percent by number and 19.8 percent by volume benefited small farmers.

Table 2

Loans Outstanding at December 31, 1998, Benefiting Young, Beginning, and Small Farmers and Ranchers[1]

Loan Type	Number of Loans[2]	Percentage of Total Number	Volume of Loans (millions)	Percentage of Total Volume	Average Loan Size
Young Farmers and Ranchers	94,551	15.67	$ 6,271	11.58	$66,324
Beginning Farmers and Ranchers	110,049	18.24	$ 9,007	16.63	$81,845
All Small Farmers and Ranchers	338,032	56.03	$20,087	36.80	$59,434
Loans to Small Borrowers by Loan Size					
Loans $50,000 or less	212,089	60.00	$ 4,080	52.48	$ 19,237
Loans $50,001 – $100,000	72,386	58.80	$ 4,936	58.77	$ 68,190
Loans $100,001 – $250,000	42,610	47.20	$ 6,071	45.93	$142,478
Loans Over $250,000	10,947	26.40	$ 4,999	19.83	$456,655

1. A young farmer is 35 years or less when the loan was made; a beginning farmer has 10 years or less of farming or ranching experience; and a small borrower normally generates less than $250,000 annual gross sales of agricultural or aquatic products.
2. Full reporting under the new definitions is not required until 2001. The values in the table likely underrepresent System YBS activity.

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

Loans Made to YBS Borrowers

Of the total number of loans made during 1998, 13.8 percent were to young farmers, for a total of $1.1 billion (Table 3). In effect, $7.87 of every $100 in loan transactions during 1998 benefited a young farmer. The average size loan during 1998 to a young borrower was $59,235.

As one would expect, more credit was extended to beginning farmers than to young farmers: 57 percent more loans by number (29,514 compared with 18,857) and 162 percent more by volume ($2.930 billion compared with $1.117 billion). Beginning farmers likely include many borrowers who also qualify as young farmers. The $2.9 billion in beginning farmer business volume during the year represented just under 21 percent of the System's new business for 1998. The average loan transaction size for beginning and seasoned farmers was not significantly different in 1998. The average loan to a beginning farmer was $99,275, and the average loan to a more seasoned farmer was $104,691.

Slightly more than half the number of all loans made during 1998 benefited small farmers. This $4.64 billion in loans accounted for 32.6 percent of the dollar volume of all loan transactions. Most of the loans to small farmers during 1998 were $50,000 or less (56.6 percent) and averaged $19,307 per loan transaction. The average size of all loans to small farmers was $66,253. The average size of a loan to farmers who are not considered small was $128,883.

Programs that Benefit YBS Borrowers

This year, a questionnaire was used to obtain program information as well as information on lending activity. As a

Table 3

Loans Made During 1998 Benefiting Young, Beginning, and Small Farmers and Ranchers[1]

Loan Type	Number of Loans[2]	Percentage of Total Number	Volume of Loans (millions)	Percentage of Total Volume	Average Loan Size
Young Farmers and Ranchers	18,857	13.76	$1,117	7.87	$ 59,235
Beginning Farmers and Ranchers	29,514	21.53	$2,930	20.65	$ 99,275
All Small Farmers and Ranchers	70,548	52.03	$4,640	32.59	$ 66,253
Loans to Small Borrowers by Loan Size					
Loans $50,000 or less	45,268	56.61	$ 874	40.15	$ 19,307
Loans $50,001 – $100,000	13,981	51.41	$ 995	50.42	$ 71,168
Loans $100,001 – $250,000	8,628	42.77	$1,263	41.18	$146,384
Loans Over $250,000	2,671	32.31	$1,508	21.48	$564,583

1. A young farmer is 35 years or less when the loan was made; a beginning farmer has 10 years or less of farming or ranching experience; and a small borrower normally generates less than $250,000 annual gross sales of agricultural or aquatic products.
2. Full reporting under the new definitions is not required until 2001. The values in the table likely underrepresent System YBS activity.

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

result, more definitive information about the System's YBS programs is now available. Highlights of the new data include the following:

- 88 percent of FCS institutions coordinate their YBS program with the U.S. Department of Agriculture's Farm Service Agency. For 1998, FCS institutions report 6,178 guaranteed YBS loans totaling $736.9 million.

- 45.5 percent of FCS institutions coordinate with a state program.

- Other coordination partners in declining order of use are: input dealers/ merchants; Farm Credit banks; other FCS associations; farm groups; the Small Business Administration; and commercial/community banks.

- Two-thirds of FCS institutions offer insurance services that their YBS borrowers use.

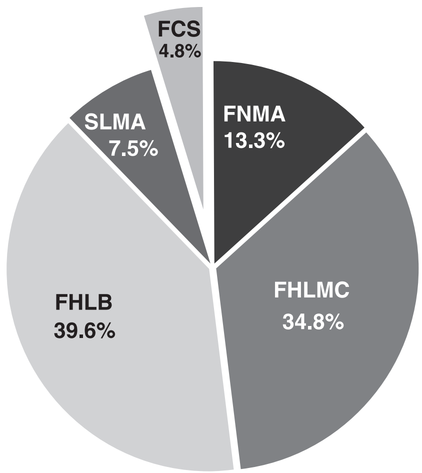
- 50 percent of FCS institutions provide fee appraisal services.

- 42 percent of FCS institutions allow some flexibility in their loan underwriting standards, as long as the borrower exhibits compensating strengths in other standards or the credit risk can be otherwise managed.

- About half of the FCS institutions offer specific training to YBS borrowers. Forty-nine percent offer business and financial skills training. One-third offer leadership training. This training helps YBS borrowers to be better financial managers and helps prepare them for the roles they will play in their communities and agriculture's future.

Funding the Farm Credit System

Figure 12
1998 GSE Debt Issuance*



*Farmer Mac was excluded from this figure because its total debt issuance was less than 0.5 percent of the total GSE debt issuance.

FCS=Farm Credit System
FHLB=Federal Home Loan Bank System
FHLMC=Federal Home Loan Mortgage Corporation or Freddie Mac
FNMA=Federal National Mortgage Association or Fannie Mae
SLMA=Student Loan Marketing Association or Sallie Mae

Source: The Bond Market Association 1st Quarter Report 1999.

The Farm Credit System is able to maintain an effective funding program and obtain funds at levels equal to or slightly better than other Government-sponsored enterprise issuers, even though it is the smallest issuer of the GSEs. In 1998 Farm Credit System issuance was up slightly, to 5 percent of the total GSE issuance. As shown in Figure 12, the Federal Home Loan Bank System (FHLB) was the largest issuer in 1998, followed closely by the Federal Home Loan Mortgage Corporation (FHLMC or Freddie Mac).

FCS banks obtain practically all loan funds through the sale of debt securities. Systemwide debt securities can be issued as discount notes, bonds, medium-term notes, or global debt. Under the Farm Credit Act of 1971, as amended, all issues of Systemwide debt securities are subject to approval of the Farm Credit Administration.

The debt securities are not obligations of, nor are they guaranteed by, the United States or any agency or instrumentality thereof, other than the FCS banks. Systemwide debt securities are the joint and several obligations of the Agricultural Credit Bank, the six Farm Credit Banks, and the Bank for Cooperatives, and are backed by their combined resources and insured by the Farm Credit System Insurance Corporation. Any uninsured bonds issued directly by individual banks would be the sole obligations of the issuing bank. Because the System is a GSE issuer, its debt carries certain favorable attributes, such as interest exemption from state and local taxes, eligibility for Federal Reserve Board open market operations, and eligibility for unlimited purchase by national banks, state bank Federal Reserve members, and thrifts.

Each FCS bank is required to maintain specified eligible assets at least equal in value to the total amount of debt securities outstanding for which it is primarily liable. As of December 31, 1998, the combined FCS banks reported eligible assets of approximately $75.9 billion and debt securities and accrued interest payable of $70.0 billion. For the comparable period a year ago, the banks reported a combined $70.4 billion in eligible assets and $64.6 billion in debt securities and accrued interest payable.

Funding activities are handled by the Federal Farm Credit Banks Funding Corporation, which offers securities to the public through a selling group of investment dealers and dealer banks. The chief investors in Systemwide securities are municipalities, money market funds, investment advisors, insurance companies, and commercial banks.

Average Spreads

Interest rate spreads of GSEs over comparable maturity U.S. Treasury rates widened considerably during 1998, even while interest rates declined. This unusual occurrence reflected the Federal Reserve Board's expansionary monetary policy to "stabilize" the capital markets after the turmoil experienced in late 1998. However, System debt continued to trade at spreads similar to those of other GSEs in this unusual environment.

The average spread for all Systemwide debt issued during 1998 was 42 basis points above comparable U.S. Treasury securities, an increase from the 26-basis-point average spread experienced during 1997 (Figure 13). The widening in the average spread is largely attributable to turmoil in the international capital markets, especially during fall 1998, which caused strong demand for U.S.

Treasury securities by international investors. In addition, the Federal budget surplus has reduced the volume of U.S. Treasury issues.

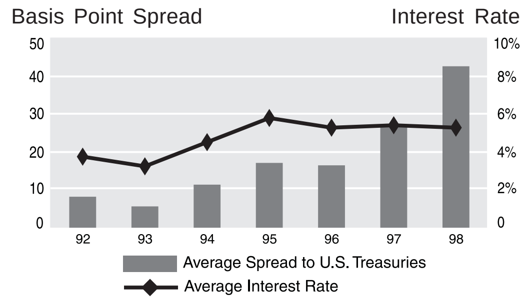
Interest rates on Systemwide debt securities issued during 1998 were relatively stable, although they did decline at the long end of the yield curve. The average rate on Systemwide debt securities issued during 1998 was 5.32 percent, a decrease of 12 basis points from 1997 (Figure 13). The remaining maturity of Systemwide debt securities at yearend 1998 was 21.6 months (1.8 years), compared with 19.2 months (1.6 years) at yearend 1997.

Debt Securities Outstanding

Debt securities outstanding at yearend 1998 totaled $68.6 billion, compared with $63.2 billion at yearend 1997, an increase of 8.5 percent. The $5.4 billion debt increase was used mainly to fund loan growth and investments. Total issuance of Systemwide debt securities was a record $300.9 billion in 1998, up $56.1 billion from the issuance of $244.8 billion in 1997 (Figure 14). The increase is attributable, in part, to growth in assets and increased discount note usage during fall 1998 in response to greater market volatility.

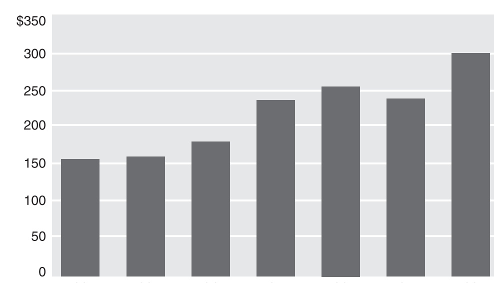
In 1998, the System did not issue any global debt because of the instability of financial conditions overseas and a general lack of funding opportunities for the types of structures and maturities preferred by System banks. However, the System still maintains a global market presence, and foreign investors purchase large portions of the calendar bond issues.

Figure 13
Farm Credit System Debt, 1992–1998
Average Rates and Spreads on Total Debt



Source: Federal Farm Credit Banks Funding Corporation Annual Reports.

Figure 14
Trend in Total Debt Issued, 1992–1998
(Dollars in Billions)



Source: Federal Farm Credit Banks Funding Corporation Annual Reports.

Potential Risks for the Farm Credit System

In carrying out its responsibilities, the Farm Credit Administration actively monitors systemic risks associated with Farm Credit System operations and the agricultural, financial, and economic environment within which System institutions operate. These analytical risk-monitoring responsibilities have become more important as Federal agricultural programs have given farm producers more managerial flexibility and more risk management responsibility. Because of this increased risk management responsibility, agricultural lenders are now more exposed to the various risks faced by their borrowers. Moreover, the U.S. Department of Agriculture's forecast suggests that U.S. farmers will be more vulnerable to risks in the 1999 and 2000 crop years. Several risks will bear close scrutiny over the next six months to two years.

World Agricultural Trade Risks

Supply/demand imbalances for agricultural commodities are not expected to moderate in the near term, leaving U.S. agricultural producers to face continued low prices caused by weak market demand and increased foreign production.

Prolonged Asian Economic Crisis — While the Asian economic crisis has now bottomed out, a return to the purchasing patterns of the past will be slow. Soft global markets generally translate into lower commodity prices, which can affect the debt-servicing capacity of System farmers and their cooperatives. Most likely to be affected by the Asian trade slump are the Western and Midwestern states, where exports to Asian countries are relatively more important than in other parts of the country.

Global Oversupply — Over the past several years, producing countries compounded the problem of slow growth in market demand by increasing crop output in response to the high prices of the mid-1990s. According to the World Bank, world food production has increased by more than 25 percent during the 1990s, with most of this growth occurring during the past several years.

Foreign Exchange Rates — Last year's worldwide recession also affected foreign exchange rates in the Asian countries, in Russia and Brazil, and in several energy-producing countries. As their economies faltered, so did their currency valuations relative to the U.S. dollar. The twofold effect was that (1) competing exporters with devalued currencies caused world prices to drop even more as they sold commodities on the international market and (2) purchasing countries with devalued currencies had less purchasing power to buy U.S. commodities. These conditions will continue to be a drag on foreign demand for U.S. farm products for several years.

Agricultural Trade Policies — Agricultural producers are increasingly exposed to programs and policies that affect their ability to compete in domestic and foreign markets. The World Trade Organization negotiations that begin this fall in Seattle, Washington, will be of significant interest to U.S. farmers. U.S. farmers have a lot at stake in these negotiations since there continue to be substantial barriers to export trade, whose removal would have a positive impact on the demand for U.S. farm products.

Effective Utilization of Agricultural Risk Management Tools

Since passage of the 1996 Farm Bill,[1] the combined effect of Federal agricultural policies has been to reduce planned Government outlays to agriculture, transfer responsibility for risk management to individual producers, and minimize the Federal farm safety net.

1. The formal name of the 1996 Farm Bill is the Federal Agricultural Improvement and Reform Act of 1996.

These policies, combined with an unanticipated world economic crisis and a series of natural disasters for certain U.S. producers, exposed weaknesses in the farm safety net last year. Despite the 1998 emergency relief to farmers, the Federal farm safety net now covers fewer farm-sector risks than prior farm programs did. Even with 1998's ad hoc relief package, the Government safety net through crop loans, direct payments, and insurance provides coverage for less than half the farm sector as measured by farm cash receipts.

The insurance component of the farm safety net is likely to change considerably in the next two years as means are found to expand traditional crop insurance to cover revenue and price risks, more crops and livestock, and multiple-year losses. Insurance, as well as other risk management tools such as hedging and contracting, will become even more important as ways for individual producers to manage risk. These tools are likely to become more varied and more complex. Farmers will need to understand how to customize an assortment of these tools to suit their individual risk exposure. Any failure on their part to use the appropriate risk management tools will transfer additional risk to farm lenders.

Environmental Risk

U.S. agricultural producers are increasingly being subjected to environmental standards, which are placing more restrictions on farming activities. These environmental constraints can increase production costs and decrease productivity. Environmental issues are being addressed increasingly at the state level, where producers' interests were expected to prevail; however, public tolerance for air, water, and sensory pollution has declined. Federal guidelines make state governments responsible for achieving minimum standards for water quality, and agriculture is increasingly being called upon to participate in improving water quality. Failure by states such as North Carolina to meet minimum water quality levels has led to rules against additional pollutants, which affect any further economic development and activities, including agriculture. Water quality issues are also a significant concern for California agricultural producers and a growing concern in several other states.

Competitive Pressures in the Financial Services Sector

Three relatively new developments — taxation, Federal Home Loan Banks funding, and expanded services offered by commercial lending institutions — are changing the competitive landscape for agricultural lenders. In addition, ongoing competitive pressures in the financial services sector require financial institutions to improve service and reduce rates to retain and attract customers. Institutions unable to meet these challenges are merging to form larger institutions that can. System lenders are recognizing these pressures and the need to make changes of their own to ensure their continued competitiveness.

About half of the taxable Farm Credit institutions currently take advantage of their cooperative status to file taxes under Subchapter T of the Internal Revenue Code, thereby avoiding double taxation at both the corporate and patron levels. Small commercial banks now have a similar tax advantage. Under the Small Business Jobs Protection Act of 1996, commercial banks and thrifts that meet qualifying criteria can file their tax returns under Subchapter S of the Internal Revenue Code, thereby receiving tax benefits comparable to cooperatives filing under Subchapter T. In the past two years, more than a thousand commercial banks (60 percent of which are located in six Midwestern farm states) have taken advantage of this tax benefit. These conversions will reduce bank costs, increase competition, and ultimately, through competition, should benefit agricultural producers.

Federal Home Loan Banks are making it easier for community banks to borrow for small business and agricultural lending. As a result, the cost of funds will decline. The FHLBs essentially provide a convenient Government-sponsored enterprise source of funding to community banks. Tightening loan-to-deposit ratios no longer need be a constraint in the funding of agricultural loans. Much of the interest in this funding seems to come from rural banks in the Midwest. While the funding advantage of System institutions is lessened, the competition provides benefits for agricultural producers.

Financial modernization proposals before Congress provide that commercial banks and thrifts will be able to engage in securities and insurance business activities currently restricted by law. This expansion of financially related services through banks will include some risk management tools, such as crop, casualty, life, and health insurance and hedging activities that farmers need. While their small size makes it unlikely that community banks will be able to fully develop these lines of business, larger banks probably will be able to develop these specialized products and services. This competitive risk is expected to be most prevalent in areas served by major banks that specialize in agricultural lending, such as California. This will represent a unique new competitive situation for Farm Credit institutions, because the financial modernization proposals under consideration do not include modifications to the Farm Credit Act.

Recognizing a need for strategic change if the System is to remain viable, the FCA Board adopted a philosophy statement on competition on July 14, 1998. The statement affirms the Board's belief that competition is beneficial for the customer and the System. Under this philosophy statement, the FCA Board intends to provide System institutions greater flexibility to adjust their structure, address inefficiencies, exercise authorities permitted under the Act, and give customers a choice of FCS service providers in order to better serve agricultural borrowers.

Technology Risk

The most immediate technology risk to FCS institutions is how the millennial date change will affect computerized operations. The so-called year 2000 problem affects not only FCS institutions but their borrowers as well. System institutions continue to make satisfactory progress in identifying, correcting, and testing affected components of mission-critical systems. More than 90 percent of System institutions were rated satisfactory by FCA examiners as of December 31, 1998, and 80 percent of the System's "high-profile" institutions, including the Funding Corporation, were rated satisfactory. No System institution was rated unsatisfactory as of yearend 1998.

Farmers are also vulnerable to the Y2K problem. A recent United Nations report noted that "almost all of the supplies and services essential for agricultural production" are vulnerable. It concludes that the entire agricultural process could be affected. The shipping industry is considered to be especially vulnerable and largely unprepared for the millennial date change. This risk could affect the important U.S. export trade.

Farm Credit System Financial Tables

The financial tables that follow provide a financial overview of the Farm Credit System's major components: Farm Credit banks, direct lender associations, Federal Land Bank Associations, and the FCS on a combined basis. The tables all provide a five-year data series that shows the trends in financial performance from 1994 through 1998. As the System continues to consolidate and restructure, we will consider alternate approaches for displaying financial data in the most useful format. In addition, we always welcome input from the public regarding the most useful approach for displaying this data.

The financial tables were developed from Call Report data submitted by each FCS institution to the Farm Credit Administration. The Call Report information is routinely reviewed for accuracy and is used by FCA in the oversight of FCS institutions. Because of significant intercorporate relationships between FCS institutions, financial data presented in this report for each group of like institutions cannot be added to obtain data for the combined FCS. Instead, we provide some combined data on the System in Financial Table 1. We refer the reader to quarterly and annual information statements issued by the Federal Farm Credit Banks Funding Corporation (see page 35) for additional information on the System's combined financial statements. These statements contain combined Systemwide quarterly and audited annual financial statements and disclosure to investors as required by regulation.

Financial Table 1

Major Financial Indicators for the Farm Credit System, Annual Comparison[1]

(Dollars in Thousands)

As of December 31	1998	1997	1996	1995	1994
Gross Loan Volume	67,904,000	63,439,000	61,178,000	58,589,000	54,675,911
Formally Restructured Loans[2]	150,000	200,000	246,000	320,000	409,146
Accrual Loans 90 or More Days Past Due	46,000	36,000	28,000	29,000	30,543
Nonaccrual Loans	1,200,000	592,000	645,000	801,000	1,036,236
Nonperforming Loans[3]	2.06%	1.31%	1.50%	1.96%	2.70%
Total Bonds and Notes	69,664,000	64,479,000	62,343,000	59,778,000	55,793,199
Total Capital/Total Assets[4]	14.88%	14.96%	14.32%	13.81%	13.53%
Total Surplus/Total Assets	10.95%	10.64%	9.91%	9.20%	8.68%
Total Net Income	1,251,000	1,267,000	1,201,000	1,165,000	1,005,000
Return on Assets	1.54%	1.65%	1.62%	1.69%	1.54%
Return on Equity	10.20%	11.19%	11.50%	12.14%	11.49%
Net Interest Margin	2.87%	2.95%	2.99%	3.03%	3.07%

1. Some of the previously published data have been restated to include subsequent adjustments.
2. Excludes loans past due 90 days or more.
3. Nonperforming Loans are defined as Nonaccural Loans, Formally Restructured Loans, and Accrual Loans 90 or More Days Past Due.
4. Total capital includes protected borrower stock and restricted capital (amount in the Farm Credit Insurance Fund).

Source: Federal Farm Credit Banks Reports to Investors of the Farm Credit System.

Financial Table 2

Farm Credit System Banks Combined Statement of Financial Condition[1]

(Dollars in Millions)

As of December 31	1998	1997[2]	1996[2]	1995[2]	1994[2]
Assets					
Loans	$63,289.3	$59,237.9	$57,300.7	$55,231.9	$51,563.9
Allowance for Losses	737.5	736.1	729.7	707.0	801.0
Net Loans	62,551.8	58,503.8	56,571.0	54,524.9	50,762.9
Cash and Investments in Securities	13,306.4	11,969.0	11,234.2	10,509.1	9,710.3
Other Property Owned	5.7	7.4	21.1	33.3	52.9
Other Assets–Net	718.3	643.9	723.3	686.6	778.6
Total Assets	**76,582.1**	**71,124.1**	**68,549.7**	**65,753.9**	**61,304.8**
Liabilities					
Systemwide Notes and Bonds Outstanding	67,708.3	62,335.3	60,156.8	57,992.8	53,609.4
Other Liabilities	2,751.9	2,720.3	2,594.8	2,131.9	2,318.7
Total Liabilities	**70,460.2**	**65,055.6**	**62,751.6**	**60,124.6**	**55,928.1**
Net Worth					
Capital					
Capital Stock and Participation Certificates–Protected	0.5	0.5	0.5	0.5	2.7
Capital Stock and Participation ` Certificates–Unprotected	2,762.3	2,781.8	2,748.3	2,715.1	2,329.1
Preferred Stock–Financial Assistance Corporation	0.0	0.0	0.0	0.0	388.2
Other Capital	400.0	401.6	383.0	429.8	227.4
Total Capital	**3,162.8**	**3,183.9**	**3,131.8**	**3,145.4**	**2,947.2**
Earned Net Worth	2,962.1	2,863.8	2,660.6	2,477.5	2,531.2
Total Net Worth	6,121.9	6,068.5	5,798.1	5,629.3	5,376.7
Total Liabilities and Net Worth	**$76,582.1**	**$71,124.1**	**$68,549.7**	**$65,753.9**	**$61,304.8**

1. Includes six Farm Credit Banks, one Agricultural Credit Bank, and one Bank for Cooperatives. Figures for 1994 through 1998 are not comparable to previous years because of mergers of Federal Land Bank Associations and Production Credit Associations into Agricultural Credit Associations, and creation of Federal Land Credit Associations and downloading of farm real estate loans from Farm Credit Banks.
2. Some of the previously published annual data have been restated to include subsequent adjustments.

Note: Totals may not add because of rounding.

Financial Table 3

Farm Credit System Banks Combined Statement of Income and Expense[1]

(Dollars in Millions)

For the Year Ended December 31	1998	1997	1996	1995	1994
Interest Income					
Loans	$4,093.2	$4,048.2	$3,981.7	$3,904.4	$3,283.5
Investments and Other	712.0	670.4	641.8	595.9	404.9
Total Interest Income	**4,805.2**	**4,718.6**	**4,623.5**	**4,500.3**	**3,688.5**
Interest Expense					
Systemwide Notes and Bonds	3,708.1	3,544.9	2,669.2	2,442.8	1,882.5
Other	61.4	92.3	834.1	1,012.2	721.2
Total Interest Expense	**3,769.4**	**3,637.2**	**3,503.2**	**3,455.0**	**2,603.7**
Net Interest Income	1,035.7	1,081.4	1,120.3	1,045.3	1,084.7
Less: Provision for Loan Losses	74.0	39.0	83.0	(7.8)	17.4
Net Interest Income after					
Provision for Loan Losses	961.7	1,042.4	1,037.4	1,053.1	1,067.3
Other Income	107.5	113.5	87.4	82.7	74.3
Operating Expenses					
Salaries and Employee Benefits	123.1	117.5	124.6	120.3	147.0
Occupancy and Equipment Expenses	22.7	24.0	25.3	27.9	32.8
Other Operating Expenses	148.5	168.8	207.2	250.7	311.0
Total Operating Expenses	**294.3**	**310.3**	**357.1**	**398.9**	**490.7**
Other Expenses	186.9	154.2	146.6	138.2	180.7
Extraordinary Items	(10.3)	0.5	1.2	(43.3)	(2.7)
Net Income	**$ 577.7**	**$ 691.9**	**$ 622.2**	**$ 555.3**	**$ 467.6**

1. Includes six Farm Credit Banks, one Agricultural Credit Bank, and one Bank for Cooperatives. Figures for 1994 through 1998 are not comparable to previous years because of mergers of Federal Land Bank Associations and Production Credit Associations into Agricultural Credit Associations, and creation of Federal Land Credit Associations and downloading of farm real estate loans from Farm Credit Banks.

Note: Totals may not add because of rounding.

Financial Table 4

Farm Credit System Banks Combined Trends in Selected Financial Measures[1]

(Dollars in Millions)

As of December 31	1998	1997[2]	1996	1995	1994
Loan Performance					
Performing[3]	$62,207.3	$58,730.8	$56,733.0	$54,547.6	$50,607.0
Formally Restructured[3]	237.4	278.0	307.5	337.1	397.4
Nonaccrual	824.9	224.8	253.9	338.4	524.8
Loans Past Due 90 Days or More	19.6	6.3	6.3	8.8	34.7
Net Chargeoffs on Loans	**$54.7**	**$11.2**	**$30.7**	**($7.9)**	**($0.8)**
Selected Ratios					
Return on Assets (%)	0.80	1.00	0.92	0.89	0.78
Return on Equity (%)	9.30	11.57	10.77	10.04	8.70
Net Interest Margin (%)	1.45	1.59	1.68	1.71	1.84
Capital as a Percentage of Assets	7.99	8.53	8.46	8.56	8.77
Debt-to-Capital Ratio	11.51	10.72	10.82	10.68	10.40

1. Includes six Farm Credit Banks, one Agricultural Credit Bank, and one Bank for Cooperatives. Figures for 1994 through 1998 are not comparable to previous years because of mergers of Federal Land Bank Associations and Production Credit Associations into Agricultural Credit Associations, and creation of Federal Land Credit Associations and downloading of farm real estate loans from Farm Credit Banks.
2. Some of the previously published annual data have been restated to include subsequent adjustments.
3. Excludes loans past due 90 days or more.

Financial Table 5

Direct Lender Associations Combined Statement of Financial Condition[1]

(Dollars in Millions)

As of December 31	1998	1997[2]	1996	1995	1994
Assets					
Loans	$41,029.9	$37,594.3	$34,771.2	$31,627.2	$29,365.6
Allowance for Losses	1,099.7	1,017.3	955.3	886.3	748.5
Net Loans	39,930.2	36,577.0	33,815.8	30,740.9	28,617.1
Cash and Investments in Securities	260.9	175.2	170.1	166.0	115.8
Other Property Owned	26.6	24.0	33.5	30.6	47.3
Other Assets–Net	2,586.8	2,495.1	2,437.2	2,418.5	2,302.1
Total Assets	**42,804.5**	**39,271.2**	**36,456.6**	**33,355.9**	**31,082.3**
Liabilities					
Systemwide Notes and Bonds Outstanding	N/A	N/A	N/A	N/A	N/A
Other Liabilities	35,802.1	32,792.3	30,372.0	27,646.7	25,710.4
Total Liabilities	**35,802.1**	**32,792.3**	**30,372.0**	**27,646.7**	**25,710.4**
Net Worth					
Capital					
Capital Stock and Participation Certificates–Protected	70.7	101.5	122.2	150.3	190.0
Capital Stock and Participation Certificates–Unprotected	826.9	919.0	1,034.1	1,138.6	1,267.8
Preferred Stock–Financial Assistance Corporation	0.1	0.0	0.0	0.0	0.0
Other Capital	13.5	14.4	15.5	15.2	14.9
Total Capital	**911.2**	**1,034.8**	**1,171.9**	**1,304.1**	**1,472.8**
Earned Net Worth	6,091.1	5,444.1	4,912.6	4,405.1	3,899.2
Total Net Worth	7,002.4	6,478.9	6,084.5	5,709.2	5,371.9
Total Liabilities and Net Worth	**$42,804.5**	**$39,271.2**	**$36,456.6**	**$33,355.9**	**$31,082.3**

1. Includes Production Credit Associations, Agricultural Credit Associations, and Federal Land Credit Associations. Figures for 1994 through 1998 are not comparable to previous years because of mergers of Federal Land Bank Associations and PCAs into ACAs, and creation of FLCAs and downloading of farm real estate loans from Farm Credit Banks.
2. Some of the previously published annual data have been restated to include subsequent adjustments.

Notes: Totals may not add because of rounding. N/A = Not applicable.

Financial Table 6

Direct Lender Associations Combined Statement of Income and Expense[1]

(Dollars in Millions)

For the Year Ended December 31	1998	1997[2]	1996	1995	1994
Interest Income					
Loans	$3,329.7	$3,100.3	$2,878.2	$2,745.7	$2,258.9
Investments and Other	5.0	2.4	3.7	5.5	0.9
Total Interest Income	**3,334.6**	**3,102.8**	**2,882.4**	**2,751.2**	**2,259.7**
Interest Expense					
Systemwide Notes and Bonds	N/A	N/A	N/A	N/A	N/A
Other	2,085.8	1,927.8	1,769.9	1,690.2	1,301.2
Total Interest Expense	**2,085.8**	**1,927.8**	**1,769.9**	**1,690.2**	**1,301.2**
Net Interest Income	1,248.9	1,174.9	1,112.0	1,061.0	958.6
Less: Provision for Loan Losses	96.7	56.2	57.7	51.6	46.7
Net Interest Income after Provision for Loan Losses	1,152.1	1,118.7	1,054.3	1,009.3	911.9
Other Income	399.7	356.2	361.9	345.1	326.4
Operating Expenses					
Salaries and Employee Benefits	407.9	376.3	356.3	352.1	348.0
Occupancy and Equipment Expenses	56.5	51.9	48.9	45.7	42.7
Other Operating Expenses	203.9	224.0	218.7	212.1	193.3
Total Operating Expenses	**668.3**	**652.2**	**623.9**	**609.9**	**584.0**
Other Expenses	179.6	175.0	169.3	148.4	132.6
Extraordinary Items	0.1	0.0	0.2	0.2	0.0
Net Income	**$ 704.0**	**$ 647.7**	**$ 623.7**	**$ 596.4**	**$ 521.7**

1. Includes Production Credit Associations, Agricultural Credit Associations, and Federal Land Credit Associations. Figures for 1994 through 1998 are not comparable to previous years because of mergers of Federal Land Bank Associations and PCAs into ACAs, and creation of FLCAs and downloading of farm real estate loans from Farm Credit Banks.
2. Some of the previously published annual data have been restated to include subsequent adjustments.

Notes: Totals may not add because of rounding. N/A = Not applicable.

Financial Table 7

Direct Lender Associations Combined Trends in Selected Financial Measures[1]

(Dollars in Millions)

As of December 31	1998	1997	1996	1995	1994
Loan Performance					
Performing[2]	$40,556.6	$37,115.0	$34,270.5	$31,035.1	$28,704.1
Formally Restructured[2]	71.4	89.1	88.0	108.1	129.6
Nonaccrual	375.8	367.1	390.9	462.4	513.4
Loans Past Due 90 Days or More	26.1	23.1	21.8	21.6	18.5
Net Chargeoffs on Loans	**$14.4**	**$15.8**	**$17.4**	**$3.2**	**$4.5**
Selected Ratios					
Return on Assets (%)	1.72	1.73	1.79	1.86	1.74
Return on Equity (%)	10.40	10.25	10.51	10.68	9.95
Net Interest Margin (%)	3.27	3.38	3.46	3.63	3.51
Capital as a Percentage of Assets	16.36	16.50	16.69	17.12	17.28
Debt-to-Capital Ratio	5.11	5.06	4.99	4.84	4.79

1. Includes Production Credit Associations, Agricultural Credit Associations, and Federal Land Credit Associations. Figures for 1994 through 1998 are not comparable to previous years because of mergers of Federal Land Bank Associations and PCAs into ACAs, and creation of FLCAs and downloading of farm real estate loans from Farm Credit Banks.
2. Excludes loans past due 90 days or more.

Financial Table 8

Federal Land Bank Associations Combined Statement of Financial Condition[1]

(Dollars in Millions)

As of December 31	1998	1997	1996	1995	1994
Assets					
Loans[2]	N/A	N/A	N/A	N/A	N/A
Allowance for Losses[3]	N/A	N/A	N/A	N/A	N/A
Net Loans	N/A	N/A	N/A	N/A	N/A
Cash and Investments in Securities	$731.3	$658.8	$528.3	$447.7	$318.0
Other Property Owned	N/A	N/A	N/A	N/A	N/A
Other Assets–Net	320.8	377.1	415.3	400.1	219.4
Total Assets	**1,052.0**	**1,035.9**	**943.6**	**847.8**	**537.4**
Liabilities					
Systemwide Notes and Bonds Outstanding	N/A	N/A	N/A	N/A	N/A
Other Liabilities	62.2	61.6	61.2	46.6	35.5
Total Liabilities	**62.2**	**61.6**	**61.2**	**46.6**	**35.5**
Net Worth					
Capital					
Capital Stock and Participation Certificates–Protected	4.7	8.5	8.2	9.8	11.6
Capital Stock and Participation Certificates–Unprotected	106.8	116.1	133.2	164.9	189.0
Other Capital	0.0	0.0	0.0	0.0	0.0
Total Capital	**111.5**	**124.5**	**141.4**	**174.7**	**200.6**
Earned Net Worth	878.3	849.8	741.0	626.4	301.4
Total Net Worth	989.8	974.4	882.4	801.2	502.0
Total Liabilities and Net Worth	**$1,052.0**	**$1,035.9**	**$943.6**	**$847.8**	**$537.4**

1. Figures for 1994 through 1998 are not comparable to previous years because of mergers of FLBAs and Production Credit Associations into Agricultural Credit Associations, and creation of Federal Land Credit Associations and downloading of farm real estate loans from Farm Credit Banks.
2. The FLBAs act as agents for the FCBs (formerly Federal Land Banks) in the lending process but do not hold loans themselves.
3. FLBAs in some districts have liability for losses on FCB (formerly Federal Land Bank) loans. Because FLBAs do not make loans, the FLBA allowance for loan losses is included in FLBA liabilities.

Notes: Totals may not add because of rounding. N/A = Not applicable.

Financial Table 9

Federal Land Bank Associations Combined Statement of Income and Expense[1]

(Dollars in Millions)

For the Year Ended December 31	1998	1997[2]	1996[2]	1995	1994
Interest Income					
Loans	N/A	N/A	N/A	N/A	N/A
Investments and Other	$ 29.5	$ 26.8	$ 22.0	$ 24.3	$ 15.7
Total Interest Income	**29.5**	**26.8**	**22.0**	**24.3**	**15.7**
Interest Expense					
Systemwide Notes and Bonds	N/A	N/A	N/A	N/A	N/A
Other	N/A	N/A	N/A	N/A	N/A
Total Interest Expense	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**
Net Interest Income	29.5	26.8	22.0	24.3	15.7
Less: Provision for Loan Losses	3.0	2.6	4.0	0.0	(2.7)
Net Interest Income after Provision for Loan Losses	26.6	24.2	17.9	24.3	18.4
Other Income	200.9	175.2	161.8	335.1	79.4
Operating Expenses					
Salaries and Employee Benefits	39.7	38.5	37.7	36.1	35.2
Occupancy and Equipment Expenses	5.8	5.5	4.9	4.7	4.9
Other Operating Expenses	28.2	32.3	15.3	14.8	15.9
Total Operating Expenses	**73.8**	**76.4**	**58.1**	**55.8**	**56.1**
Other Expenses	0.1	0.1	0.1	0.1	0.1
Extraordinary Items	0.0	0.0	0.0	0.0	0.0
Net Income	**$153.7**	**$123.0**	**$121.7**	**$303.7**	**$41.8**

1. Figures for 1994 through 1998 are not comparable to previous years because of mergers of FLBAs and Production Credit Associations into Agricultural Credit Associations, and creation of Federal Land Credit Associations and downloading of farm real estate loans from Farm Credit Banks.
2. Some of the previously published annual data have been restated to include subsequent adjustments.

Notes: Totals may not add because of rounding. N/A = Not applicable.

Glossary

A

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

Agricultural Credit Bank (ACB) — 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 Farm Credit System.

B

Bank for Cooperatives (BC) — A BC provides lending and other financial services to farmer-owned cooperatives, rural utilities (electric and telephone), and rural sewer and water systems. It also is authorized to finance U.S. agricultural exports and provide international banking services for farmer-owned cooperatives. As of December 31, 1998, the St. Paul (Minnesota) BC is the only BC in the Farm Credit System.

F

Farm Credit Act (the Act) — The Farm Credit Act of 1971, as amended, is the statute under which the Farm Credit System operates. The Act recodified all previous acts governing the Farm Credit System.

Farm Credit Bank (FCB) — On July 6, 1988, the Federal Land Bank and the Federal Intermediate Credit Bank in 11 of the 12 Farm Credit districts merged to become FCBs. The mergers were required by the Agricultural Credit Act of 1987. FCBs generally provide services and funds to local associations that, in turn, lend those funds to farmers, ranchers, producers or harvesters of aquatic products, rural residents for housing, and some agriculture-related businesses. As of January 1, 1999, there were six FCBs: AgAmerica, FCB; AgFirst Farm Credit Bank; AgriBank, FCB; Farm Credit Bank of Texas; Farm Credit Bank of Wichita; and Western Farm Credit Bank.

Farm Credit Leasing Services Corporation (Leasing Corporation) — The Leasing Corporation is a service entity owned by Farm Credit System banks to provide equipment leasing and related services to eligible borrowers, including agricultural producers, cooperatives, and rural utilities.

Farm Credit System Assistance Board (Assistance Board) — The Assistance Board was created by the Agricultural Credit Act of 1987 to provide assistance to financially troubled Farm Credit Banks, protect the stock of System borrowers, restore FCS banks to economic viability, and preserve their ability to provide credit at reasonable and competitive rates. The Assistance Board terminated on December 31, 1992.

Farm Credit System Insurance Corporation (FCSIC) — The 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 Farm Credit System banks. The FCA Board serves ex officio as the Board of Directors for FCSIC; however, the chairman of the FCA Board is not permitted to serve as the chairman of the FCSIC Board of Directors.

Federal Agricultural Mortgage Corporation (Farmer Mac) — Farmer Mac, created by the Agricultural Credit Act of 1987, provides guarantees for the timely repayment of principal and interest on securities backed by agricultural real estate or rural housing loans and on securities backed by the "guaranteed portions" of U.S. Department of Agriculture-guaranteed loans. Farmer Mac is regulated and examined by the Farm Credit Administration and is defined by statute as a Farm Credit System institution.

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

Federal Land Bank Association (FLBA) — FLBAs are lending agents for Farm Credit Banks. FLBAs make and service long-term mortgage loans to farmers and ranchers and to rural residents for housing. FLBAs do not own loan assets but make loans only on behalf of the Farm Credit Bank with which they are affiliated.

Federal Land Credit Association (FLCA) — An FLCA is a Federal Land Bank Association that owns its loan assets. An FLCA borrows funds from a Farm Credit Bank to make and service long-term loans to farmers, ranchers, and rural residents for housing.

G

Government-sponsored enterprise (GSE) — 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 credit to agriculture, education, or housing. GSEs are usually created because the private markets did not satisfy a purpose that the 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, referred to as GSE attributes, to allow it to overcome the barriers that prevented purely private markets from developing. Sometimes the public assistance is only to get started, at other times it is ongoing.

P

Production Credit Association (PCA) — The Farm Credit Act of 1933 authorized farmers to organize PCAs that could discount notes with Federal Intermediate Credit Banks. PCAs are Farm Credit System entities that deliver only short- and intermediate-term loans to farmers and ranchers. A PCA borrows money from its Farm Credit Bank to lend to farmers. PCAs also own their loan assets.

Additional Information

A discussion of the performance and financial condition of the Farm Credit Administration may be found in the *Farm Credit Administration Annual Report.* This publication is available on FCA's Web site located at **www.fca.gov.** Depending on availability, it may be obtained without charge from:

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 Farm Credit System Annual Report to Investors, the System's Annual and Quarterly Information Statements, and the System's combined financial statements contained therein, with the support of the System banks. The Funding Corporation's Web site is located at **www.farmcredit-ffcb.com.** Copies of the publications are available for inspection at, or will be furnished, without charge, upon request to the Funding Corporation.

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, which ensures the timely payment of principal and interest on insured securities issued by FCS banks, publishes an annual report. Copies are available from:

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

In addition, FCS banks and associations are required by regulation to prepare annual and quarterly financial disclosure reports. Copies of these documents are available for public inspection at FCA headquarters in McLean, Virginia.

Copies are Available From:
Office of Congressional
and Public Affairs
Farm Credit Administration
1501 Farm Credit Drive
McLean, VA 22102-5090
703.883.4056
http://www.fca.gov

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