



Mission-Related Investments Annual Report - 2008

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Agenda

- I. Introduction
- II. Investment Framework and Legal Issues
- III. Mission-Related Investments
- IV. Investments in Rural America



Investment Framework and Legal Issues

**Howard Rubin
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Statutory and Regulatory Framework

- **Farm Credit Act authorizes System banks to invest in U.S. Government and government guaranteed obligations and other investments authorized by FCA**
- **Farm Credit Act authorizes associations to invest their funds as approved by their funding bank under FCA regulations**
- **FCA Investment Regulations authorize System banks and associations to invest in specific types of marketable securities to meet liquidity reserve requirements, to manage short-term funds, and to manage interest rate risk**
- **Rules also authorize certain other investments**
- **FCA investment rules ensure safety and soundness and mission focus**



Mission Investments

- **Opportunities under current rules include:**
 - **Farmer Mac Securities**
 - **Investments in farmers' notes**
 - **USDA guaranteed obligations and certain other governmental obligations benefitting rural areas**
 - **Certain municipal securities, agricultural equipment securities and asset-backed securities**
 - **Other investments approved by the FCA on a case-by-case basis**



Pilot Program Overview

- **Since 2005, FCA approved “Investments in Rural America” pilot programs for all System institutions**
 - **District-wide and institution-specific programs**
- **Program established with an initial 3-year pilot period; continue until FCA Board acts to modify or terminate the programs**
- **Conditions of Approval designed to ensure:**
 - **Safe and sound investment management at each FCS institution**
 - **Agricultural lending remains primary focus through investment portfolio, obligor, and maturity limits**
 - **Investments are made in and benefit rural communities**
 - **Obligations purchased are structured as investment securities**



Legal Issues

- **Size, nature, and method of rural community-based investing requires appropriate and meaningful investment criteria**
- **Conditions of Approval require securities purchased must be structured as investment securities commonly recognized in the debt markets as a vehicle for investment**
 - **Specifically excludes any transaction more similar to a commercial loan transaction than to a traditional investment transaction**
- **Conditions also specifically provide that the program does not authorize FCS institutions to make or purchase loans**
- **May 1, 2008 written clarification to FCS provided additional guidance and a general framework for investment decisions**
- **Staff currently studying all pilot program investments, including effectiveness and appropriateness of conditions**



Rural Community Investments – Proposed Rule

- Received significant number of comments
- Studying issues raised in letters:
 - Legal issues
 - Investment purposes
 - Safety and soundness issues, including limits
 - Rural areas
 - Equity investments
 - Case-by-case approval authority
 - System ability to further its mission



Mission-Related Investments/ Investments in Rural America

Dawn Johnson
Senior Policy Analyst
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Mission-Related Investments

Investment Type	Total Volume 12/31/08	Total Volume 12/30/07	Change	Percent Change
Investments made under regulatory authorities				
Farmer Mac Securities	1,461,320	1,821,860	(360,540)	-19.8%
Tobacco Buyout Securities	771,586	807,809	(36,223)	-4.5%
Asset-backed Securities	647,436	477,615	169,821	35.6%
Farmers' Notes	16,392	7,438	8,954	120.4%
Subtotal	\$2,896,734	\$3,114,722	(\$217,988)	-7.0%
Investments made under prior approval authorities				
Rural Housing Mortgage Securities	\$1,552,005	\$1,124,855	\$427,150	38.0%
Rural Development Debt Securities	361,462	178,897	182,565	102.1%
Agribusiness Investments	115,983	66,760	49,223	73.7%
Credit Linked Agricultural Notes	13,951	8,433	5,518	65.4%
Equity Investments	2,992	1,322	1,670	126.4%
Subtotal	\$2,046,393	\$1,380,267	\$666,126	48.3%
Total all mission investments	\$4,943,127	\$4,494,989	\$448,138	10.0%

Amounts in Thousands



Investments in Rural America— Objectives

Rural Housing Mortgage Securities

- Improve the liquidity in the rural home financial markets to reduce rural home ownership costs

Agribusiness Investments

- Help agribusinesses obtain access to debt markets through collaboration with commercial banks and secondary market purchases

Credit Linked Agricultural Notes

- Support agricultural lenders through purchase of notes linked to pools of long-term agricultural real estate loans

Equity Investments

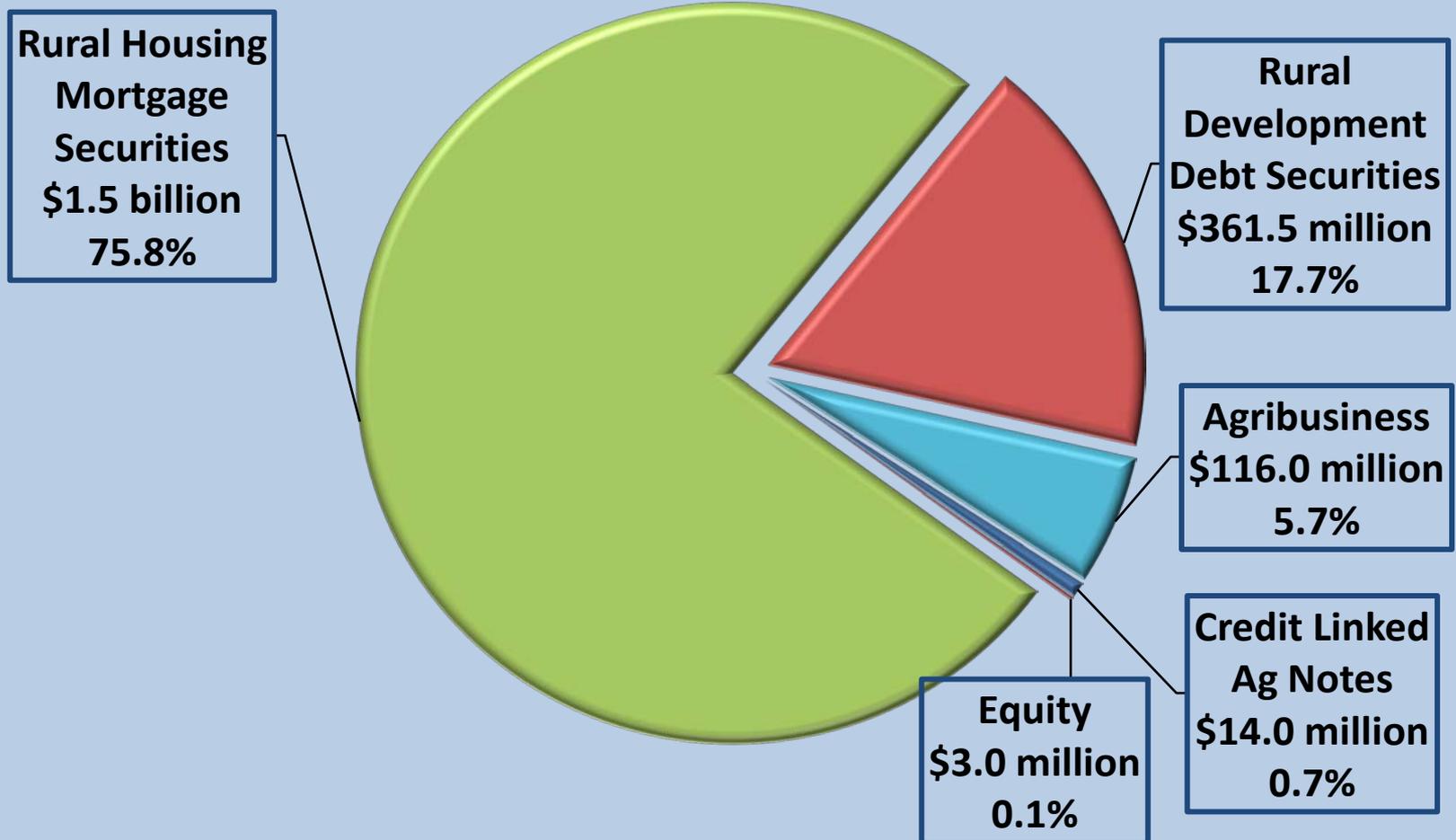
- Support starter farmer and cooperative programs and rural entrepreneurs with seed capital

Rural Development Debt Securities

- Provide flexible flow of funds to rural America for rural development and infrastructure projects

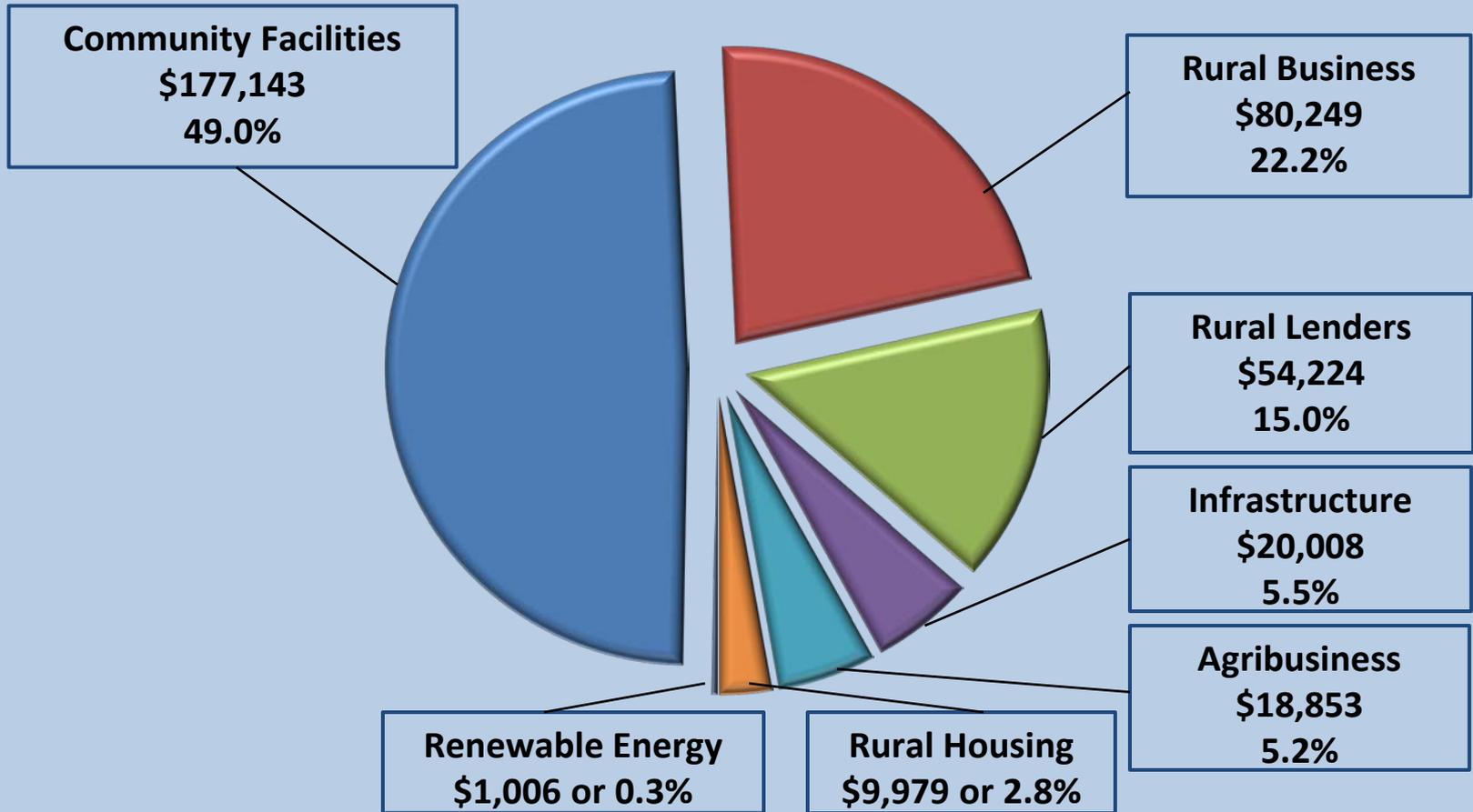
Investments in Rural America

Total \$2.0 billion



Rural Development Debt Securities

Total \$361.5 million



Amounts in Thousands

Rural Development Debt Securities

Community Facilities

- 38 investments totaling \$177.1 million in variety of projects:
 - Critical access hospitals (6), medical facilities (12)
 - Assisted living centers (7), public fairground facilities (2)
 - Schools, youth shelters, and youth camp (6), library (1)
 - Marina supporting native American museum (1)
 - Disabled/disadvantaged citizens facilities (2), fire truck(1)
- USDA Community Facilities Program – Key Partner
 - 70 % of volume or 12 investments totaling \$124.3 million
- Increased reliance on non-profits and private businesses for essential health and human services
- Community facilities support the quality of life in rural areas



Rural Development Debt Securities

Rural Business

- 30 investments totaling \$80.2 million
- Examples include—5 investments totaling \$20.1 million in affiliation with USDA Rural Development programs
- Economic development authorities important to projects in coordinating rural interests
- Community Impact—Investments helped preserve and create jobs in rural areas



Rural Development Debt Securities

Rural Lenders

- 19 investments totaling \$54.2 million made in partnerships with 9 banks
- Commercial bank involvement in projects
 - construction financing, credit enhancement for portion of public issuance, operating financing, trustee services, and other bank services
- Benefits of rural lender partnerships—Rural communities obtain greater access to longer term funds and increase capacity to finance larger rural development projects

Rural Development Debt Securities

Rural Infrastructure

- 5 investments totaling \$20.0 million
- Examples include hydroelectric, water and sewer, and securities issued by economic development authorities (EDA) on behalf of a government entity in support of rural economies
- 3 investments totaling \$13.3 million issued by EDA backed by a general obligation or tax revenue
 - Industrial plants (2)
 - Historic park
- Community impact – Investments helped preserve and create jobs and supported local inputs and provided communities with a key source of scarce financing during current economic downturn

Rural Development Debt Securities- Common Threads

Capital and time intensive projects

- Economic downturn has increased rural communities need for access to reasonable cost funding alternatives for a growing backlog of projects
- Projects require community investment and pledges that instill pride and ownership and ensure future viability
- Considerable time from start to completion of projects
- Projects intended to enhance the general public welfare

Projects often require multiple financial and government partners

- Over half of the volume of investments relied on third party involvement for finalization
- USDA Rural Development Programs (17) totaling \$144.4 million
- Economic Development Authorities (8) totaling \$52.6 million
- Non-profits (25) totaling \$143.7 million or 40% of volume
 - Community facilities, human services and agricultural organizations

Rural Development Debt Securities- Common Threads

Rural communities often contract for essential services

- States and municipalities rely heavily on non-profits and private entities to provide essential services in rural areas

Fixed term funding most sought

- Average project maturity is 14 years; Hospital project term preferred is 30 years
- Municipalities and private entities fulfilling public needs seek fixed term financing to manage costs and budget constraints

Project funding goes directly to rural areas

- 80% of FCS investments provided funding for projects located in rural areas with populations of 20,000 or less

Rural Development Debt Securities- Common Threads

Credit enhancements often used

- Use of credit enhancements reduced risk and assisted System institutions in managing capital
- Small municipal issuances benefited from credit enhancements provided by System

Significant government financial support

- Subordinated debt or below market rate financing for a portion of the project
- Tax incentives, rebates, and dedicated sales tax revenues
- Direct investments, grants and community pledges



Observations

- Opportunity for the System to broaden its involvement in rural development networks
- New relationships with USDA state and local offices and economic development authorities provided insights to rural development in System institution's local service area
- FCS employee involvement in rural community initiatives complemented the program
- System philosophy remains conservative with focus on projects with ample equity, government support, and credit enhancements
- Considerable costs and resources are necessary to gain expertise in rural development projects



Observations

- Several System institutions developed successful relationships in working with commercial banks
- System investors face challenges across districts because of importance of local focus and different pricing structures
- Private placement financing is becoming increasingly important for rural communities as financial markets tighten and issuers face additional obstacles and increasing costs to access tax-exempt public markets
- Investments in rural America remain an important aspect of supporting and enhancing rural economies on which agricultural producers depend



Going Forward

Over the next six months we plan to:

- Maintain our on-going reporting and oversight processes to monitor System pilot programs and individual investments
- Monitor general economic conditions that are adding stress to some projects, which may necessitate adjustments to original projects and our oversight
- Continue to implement examination guidance for mission-related investments and pilot programs to:
 - Evaluate compliance with the Conditions of Approval and FCA Regulations
 - Ensure programs are managed in a safe and sound manner



Mission-Related Investments

Questions?

Thank you