



Plain Dirt Financing

Financial Information for Amish Farmers

May 2008

Trying to Understand Interest Rates

By Larry Bachman

Whether you read, watch or hear the various media, there are numerous reports on the condition of our economy. There are those who say the economy is in a slow down period; then there are those who say the economy is in a recession. Many economists define a recession as at least two consecutive quarters of decline in the country's Gross National Product (GNP).

Whether the economy is growing or declining, it is the responsibility of the Federal Reserve Board (FRB) and its seven member Board of Governors led by Chairman Ben Bernanke to set economic policy for the country. The FRB Open Market Committee generally meets every six weeks to evaluate how the economy is performing. It gathers and evaluates many pieces of economic data and determines what action it needs to implement.

One of the ways this is done is by controlling the money supply, primarily by setting the Federal Discount Rate which is the rate the Federal Reserve charges member banks for loans. High rates discourage borrowing and low rates encourage borrowing, each action impacting the economy in different ways. The FRB also sets the Federal Funds Rate (FFR) which is the base rate banks charge each other for loans. The FFR is the rate that impacts the prime rate.

What is prime rate? Prime is the acronym for "Prescribe Right to Income and Maximum Equity." Prime is a variable rate increasing or decreasing as the FRB adjusts the FFR. It is the rate lenders generally charge their most credit worthy customers. It can be adjusted by lenders to take into consideration the cost of funds, market conditions, and the credit worthiness of a borrower.

When the FRB dropped interest rates (FFR) by $\frac{3}{4}\%$ in March 2008, the prime rate decreased accordingly. Many people expect that mortgage rates and shorter term fixed rates will decrease consistent with the decrease in prime, but this is not necessarily the case.

Mortgage rates are not directly impacted by the Federal Reserve rates. When the FRB moves interest rates, they are not dealing with the index that mortgages are priced against, which are U.S. Treasuries. U.S. Treasury bills are affected by bond prices. As bond prices increase, bond yields decrease and that is what would cause mortgage rates to drop.

The Farm Credit System sells short-term notes on a discounted basis and Federal Farm Credit Systemwide bonds on a monthly basis with six and nine month maturities through a national syndicate of securities dealers. Rates are set by the Federal Farm Credit Bank. The sale of these notes and bonds is what impacts shorter term fixed rates.

At present, the condition of the U.S. economy is such that investors are increasingly cautious and expecting increased spreads on investments which is causing shorter term fixed rates not to decrease in the same proportion as the decreases in prime rate.

So, how do we measure the health of our economy? Economists look at a number of different indicators commonly called the Index of Leading Economic Indicators which includes reports for measuring various indicators such as: orders for durable goods, new factory orders, jobless claims, jobs created, housing starts, sales and re-sales, Consumer Confidence [includes personal income, unemployment rate, producer prices, growth or decline of gross domestic products]; Consumer Price Index (includes cost for housing, food, transportation, medical care, clothing, entertainment and other).

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Start Right—Program for Young, Beginning, Small farmers

By Jerry Phillips

The young, beginning, and small (YBS) market is an important one for MidAtlantic Farm Credit. The long-term success of our association and our community depends on new individuals entering the agriculture industry. Unfortunately, the demands for funding as well as farm and financial management skills make it increasingly difficult to start a business today. With that in mind, we have created a new program that will better enable Farm Credit to provide those individuals with access to credit, and to encourage them to participate in activities that improve farm and financial management skills.



In recent weeks MAFC has rolled out our new **Start Right** program designed to better enable young and beginning farmers to attain the necessary funds to begin, expand, and improve their operations. A couple of definitions are in order to better explain this program:

- This program is for new money (not refinancing existing MAFC relationships)
- **Young** is defined as being under 35 years of age
- **New** is defined as being in business less than 10 years
- **Small** is defined as having less than two million dollars of gross farm income
- **Start Right** term loans can be up to a maximum of \$500,000 and up to 25 years; with interest rate locked for five years
- **Start Right** operating loans up to \$250,000; with a term of up to three years
- **Start Right** best management practices loans for such things as improving water quality, approved agricultural conservation practices, manure management and other best management practices are also available for YBS farmers. These loans can be up to \$75,000, with terms up to seven years
- **Start Right** Farmland Financing loans to better enable the transition of farms from one generation to the next can grant an interest only period at the beginning of the loan (up to three years) to allow applicants to keep debt service low while the applicant is seeking easement funds

In addition to providing a number of new loan programs, MidAtlantic will, in the near future; be offering a Start Right Mentoring program in which advisory committees will be formed to periodically meet to keep the association informed of challenges and obstacles that our beginning farmers face. Additionally, we will be offering a program to make available mentors for young farmers that request them. The intent would be to meet twice a year to review and discuss what's going on with your operation.

Since its beginnings in 1916, the Farm Credit System has shown a commitment to agriculture in both good times and tough times. We have been there for farmers of all ages, and all types of farming operations. We have demonstrated faithfulness to our mission to be a reliable lender; and to be a cooperative leader in the communities we serve. Our new **Start Right** program continues that commitment and faithfulness.

Trying to Understand Interest Rates Continued from Page 1

Other factors can include: sub-prime mortgage issues, rate of inflation, world markets and demand or lack thereof for U.S. products, increasing energy costs and the value of the U.S. dollar. Many of these factors will affect what investors are willing to pay for U.S. Treasury Bonds, Notes and Bills and subsequently Farm Credit System Notes and Bonds.

Put all these factors together and what do you get? I liken it to dumping a large puzzle on a table, all the pieces fall out face down, the puzzle is round with no corners or straight lines and there is no picture on the box to guide you. A challenge, yes, but not insurmountable.

Whether or not interest rates have bottomed or will go lower is an ongoing topic for debate. What we do know is this; rates are not as low as the historic lows experienced in 2003 and 2004 but they are still lower than prior highs.

At the end of the day, after commercial banks, mortgage lenders, institutional and other investors have retreated from the bond markets – Farm Credit will continue to be a reliable source of credit to rural America as it has been for more than 90 years.

Financing for Residential Rental Properties

By Dale Peifer

We've often been asked if we can provide financing for residential rental/investment properties. If you're a full-time farmer, the answer is "yes." If you're not, the answer is "maybe." For full-time farmers we can do the loan with our standard loan programs. The other option is our residential loan program. This option offers better long-term fixed rates. The residential loan program is the only option for non farmers.

There are some conditions that need to be met:

- There can't be more than four units
- it must have electric
- commercial hazard insurance is required and
- you would need to have a credit score.

The rates for investment properties are about a point higher than for owner occupied homes. The reason for this is investors look at rental property mortgages being more risky. Typically, tenants aren't as particular with property care and maintenance as a homeowner.

Another thing to keep in mind is that we can't use the projected rental income to qualify a borrower. The current income stream would need to be strong enough to service the debt. The only exception would be UNLESS you have a history of owning a residential rental property, in which case the projected rental income could be used.

Rental Property Residential Mortgage Rates

Effective—April 28, 2008

15 year fixed	6.375%	APR 6.406%
20 year fixed	6.625%	APR 6.650%
30 year fixed	6.625%	APR 6.644%

Owner Occupied Residential Mortgage Rates

Effective—April 28, 2008

15 year fixed	5.8750%	APR 5.906%
20 year fixed	6.125%	APR 6.150%
30 year fixed	6.125%	APR 6.144%

Patronage – How does it work?

By John Mylin

Those of you who are MidAtlantic customers will have received a patronage check by the time you are reading this issue of *Plain Dirt*. We receive many questions about how patronage works. Understanding patronage can seem complicated, but it is simply a distribution of Farm Credit profit to our stockholders. If you have a loan with Farm Credit, you are a stockholder with up to \$1,000 invested in stock. As a stockholder, you have an ownership interest in MidAtlantic and are eligible to share in the profit.

So how does it work? An example of a customer with \$100,000 loan will help to make patronage easier to understand. An interest rate of 6% results in total interest accrued of \$6,000 in 2007.

\$100,000	Loan Amount
<u>x 6%</u>	Interest rate
\$ 6,000	2007 Interest

The patronage check you receive is based on the amount of interest that accrued on your loan in 2007. In the example above, the customer accrued a total of \$6,000 of interest in 2007. The total patronage distribution for MidAtlantic was slightly above \$28 million in 2007 which equals approximately 21% of interest paid by our customers in 2007.

In our example the total patronage distribution in 2007 is shown below.

\$6,000	2007 Interest
<u>x 21%</u>	
\$1,260	Total patronage distribution for 2007

In the past it has been the practice of MidAtlantic to make a 30% cash distribution in April for the preceding year followed by distribution of the remaining 70% targeted for five years later. If the check you just received seems larger than previous years, it is likely because the initial cash distribution was increased from 30% to 43% for 2007. The remaining balance of 57% is targeted for distribution in five years.

In our example the customer just received a check for \$541.00:

\$1,260	
<u>x 43%</u>	
\$ 541	Cash distribution

The balance of \$719 (\$1,260 – 541) is targeted for distribution in five years

Each year MidAtlantic Farm Credit, much like our farm customers, make projections and sets goals for profit. Just like our farm customers, Farm Credit cannot guarantee from year-to-year how much our profit will be. Our history of generating profit for distribution has been consistent; however we cannot guarantee from year-to-year what our profit and patronage will be. Our goal has been and will continue to be providing competitive rates and distributing profit through patronage.



MidAtlantic

Farm Credit

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Suggestions? Ideas for articles?

Give us a call!

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800.477.9947

Events

June 19

No-Till Field Day—9:30 am-2:00 pm

Pequea Planter

561 White Horse Rd (Route 897), Gap

June 24

No-Till Field Day—9:30 am-2:00 pm

John Stoltzfus Farm

214 Peach Bottom Rd, Peach Bottom

July 12

SAFE Kids—Farm Family Safety Day

Gordonville Fire Hall

To register contact: Courtney Barry

Lancaster General Hospital

717.544.3282