

Bert Ely's FARM CREDIT WATCH®

Shedding Light on the Farm Credit System, America's Least Known GSE

2010 Bert Ely

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CoBank acquiring U.S. AgBank to form \$85 billion behemoth

Finally, the shoe drops, with CoBank's December 16 announcement that it is acquiring U.S. AgBank, with the deal closing next October 1. This long-rumored deal will combine two of the five FCS banks, with the new CoBank the largest of the four remaining FCS banks. CoBank will now fund 30 FCS associations serving all or portions of 23 states in addition to lending nationally to agricultural and rural utility co-ops as well as financing government-guaranteed agricultural exports. What will be most interesting is to see how the other three FCS banks – Farm Credit Bank of Texas, AgFirst, and AgriBank – respond. Perhaps they will merge together, leaving the FCS with just two huge banks.

FCS takes huge loss on Kluge estate and winery loan

As last month's FCW reported, the foreclosure auction of the Kluge Estate Winery and Vineyard, near Charlottesville, Virginia, was held on December 8 at the behest of Farm Credit of the Virginias (FCV), the FCS association serving western Virginia and most of West Virginia. The Kluge estate consists of 907 acres, including 164 acres of vineyards, a farm shop and tasting room, six houses, office and production buildings, a huge barrel storage cave, and a 34,000 square-foot former carriage museum. This property secures a \$34.8 million loan FCV made to former billionaire Patricia Kluge in 2007.

Although more than 50 attended the auction, no one submitted a bid topping FCV's \$19 million opening bid. FCV regional lending manager Chip Saufley was quoted in a local paper as saying he was "disappointed" in the auction. A real-estate advisor said "he was surprised there wasn't more competition for the estate," citing "a pride of ownership" in owning land close to Thomas Jefferson's Monticello. However, pride of ownership has its limits, even in the winery business, especially when producing

wines of questionable value, as was demonstrated three days later when a separate auction was held for 25,000 cases of Kluge wine. Only 6,000 cases were sold, some for as little as \$2 per case, before FCV halted the sale. FCV now owns 19,000 cases of wine plus the equivalent of another 40,000 cases in barrels and vats. The eventual sale of that wine will produce barely a drop towards FCV's loss on this loan.

It will be most interesting to see how FCV accounts for this fiasco. Presumably, it will record at least a \$16 million charge-off on this loan (\$34.8 million minus \$19 million, FCV's opening bid), less whatever loss will be borne by other FCS associations who purchased participations in the Kluge loan. However, a \$19 million valuation may be too high given that no one bid even a slightly higher amount. Therefore, the loss on the loan could be much greater, perhaps in the \$20-\$25 million range, unless FCV can collect on personal guarantees from Kluge and her husband. Based on various news accounts, that is unlikely. The amount in FCV's Other Property Owned account at the end of this year will provide a clue; at September 30, it was \$4.27 million. Finally, it will cost money to maintain the winery properties and vineyards. Next year, the appropriate congressional committees should investigate the Kluge loan to find out why FCV made a loan so far removed from the original purpose for which the FCS was founded, lending to farmers and ranchers unable to get credit elsewhere.

Another FCS credit disaster?

The bankruptcy of Eastern Livestock Co., a major cattle brokerage located in New Albany, Indiana, may force a substantial write-off at Farm Credit West, a \$6 billion FCS association headquartered in Roseville, California. According to news reports, Eastern defaulted on approximately 500 contracts, totaling \$19.3 million, with Superior Livestock Auction, an online and satellite video cattle auction service wholly owned by Farm Credit West and operated as a "limited liability company," or LLC. As best can be determined from Farm Credit West's financial reports, Superior is one of two properties the association acquired in the fourth quarter of 2009 "as a result of loan collection activity in the beef cattle sector of [its] loan portfolio." The value attributed to those two properties, classified as Other Property Owned, was \$46.1 million. In light of the Eastern bankruptcy, it will be interesting to see how much Farm Credit West writes down its Other Property Owned in the fourth quarter of 2010.

Farm Credit West operates Superior as an LLC under a Farm Credit Administration (FCA) "bookletter," or policy statement issued on April 2, 2009. The letter states that "FCA will not object if [an FCS] institution, acting in good faith, forms or acquires an interest in one or more LLCs . . . for the limited purpose of carrying out the following

activities: 1) making credit bids at a foreclosure sale . . . of property collateralizing [FCS] institutions' loans that are in default; and 2) holding and managing acquired property to minimize losses, protect the property's value, and limit potential liability . . ." While the LLC structure may be appropriate for certain situations, the year or so that Farm Credit West has operated Superior as an LLC has been far more time than needed for an orderly sale of Superior. Now that Superior has been stuck with as much as a \$19 million loss from its dealings with Eastern, perhaps more bad news may yet flow from this fiasco. If nothing else, this caper should lead the FCA to reconsider, and narrow, the permissible uses of LLCs by FCS institutions.

Holiday Greetings And Best Wishes For The New Year

FCW wishes all of its readers as well as their families, friends, associates, and customers the very best for the Holiday Season and the New Year. 2011 promises to be another interesting year for banking, the FCS, and the FCA. Hopefully, the new Congress will probe who the FCS lends to, and why.

Report FCS lending abuses to: green-acres@ely-co.com

Bankers are continuing to send FCW reports of FCS lending abuses, such as FCS loans for rural estates, weekend getaways, and hunting preserves. Email reports of similar lending abuses in your market to: green-acres@ely-co.com. Please provide as much detail as possible about any loan which violates the spirit, if not the law, governing FCS lending.

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