FCA Board Meeting
February 2022




Higher Production Costs Facing Agriculture

Steven R. Koenig, ODAE
Brent R. Duey, OE

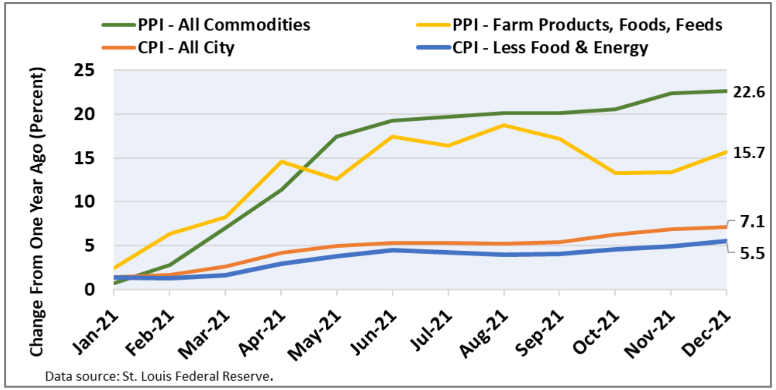
Agenda

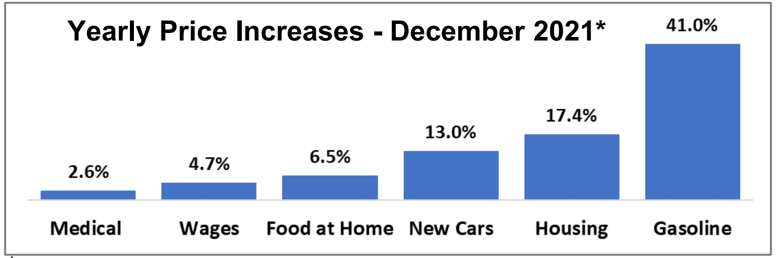
- Inflation environment for 2022
- Cost inflation in agriculture
- Impact on FCS borrowers and portfolios
- Examination & oversight

Price “inflation” dominates economic concerns

- Disrupted supply chains hinder ability to meet strong demand:
  - Government stimulus continues
  - Pandemic still impacting worldwide production
  - Distribution bottlenecks slow to resolve
  - Global energy supply not meeting demand
  - Tight labor markets

Broad Price Rise



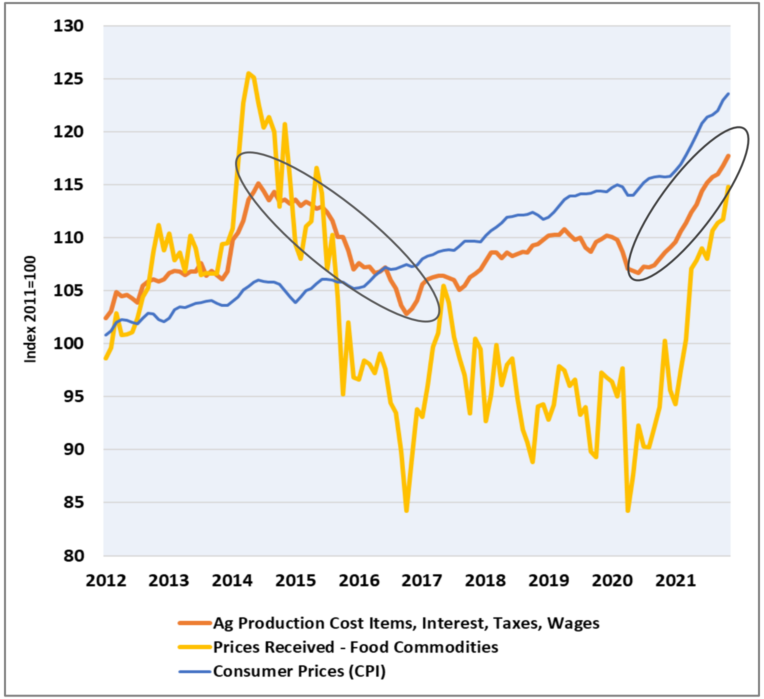


* CPI-U.S. Medical Care Services, BLS-Average Hourly Private Wages, CPI-At Home Food Prices, JD Powers-Average New Car Price, FHFA House Price Index, USIA-Regular All Formulations Gas.

Rising production costs in agriculture

- Prices paid for farm inputs increased 10% from mid-2020 to December 2021
- Prices received by farmers jumped 24% during the same period
- Prices paid by farmers are sticky, prices received by farmers are volatile

Indexes of Ag Prices and Production Prices Paid

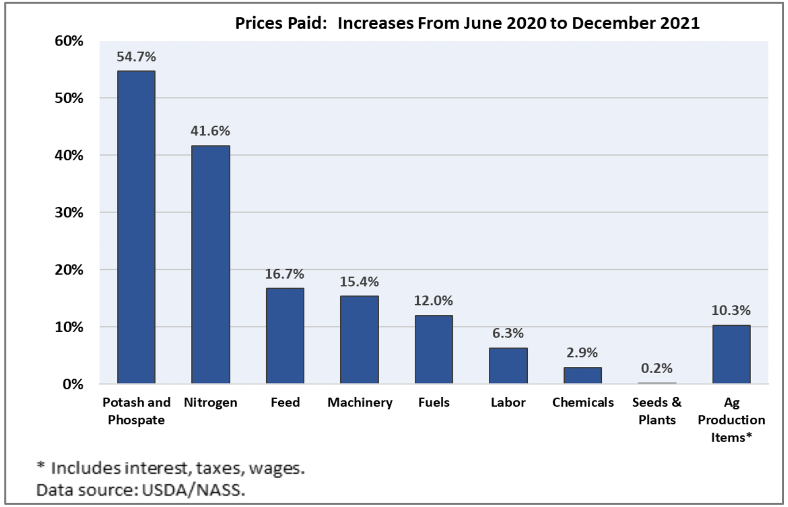


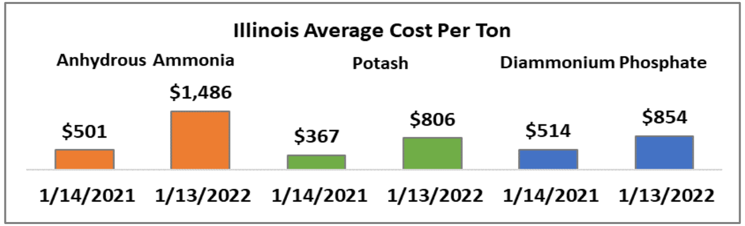
Data source: USDA/NASS.

Broad rise in farm input costs

- Historically high fertilizer costs are a big challenge for crop producers
- Certain chemicals and seeds are higher this year
- Higher labor, feed, and capital costs are challenges for livestock

Broad Rise in Farm Input Costs





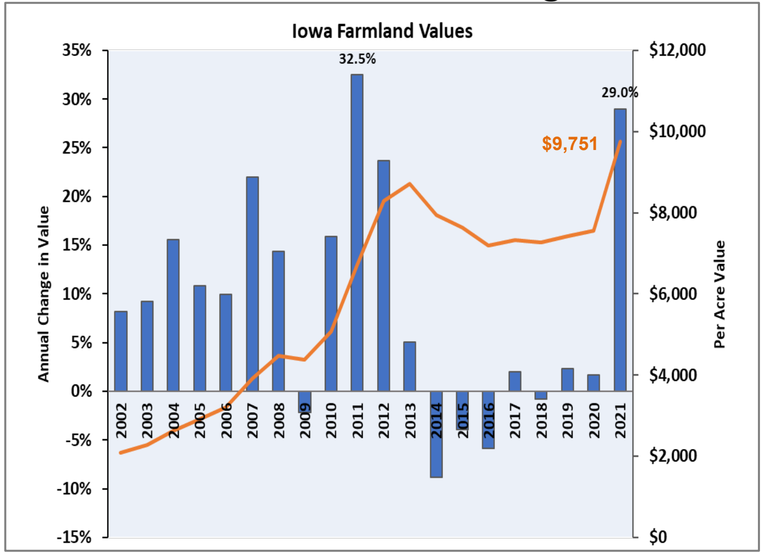
Data source: USDA/AMS.

Higher capital costs: farmland



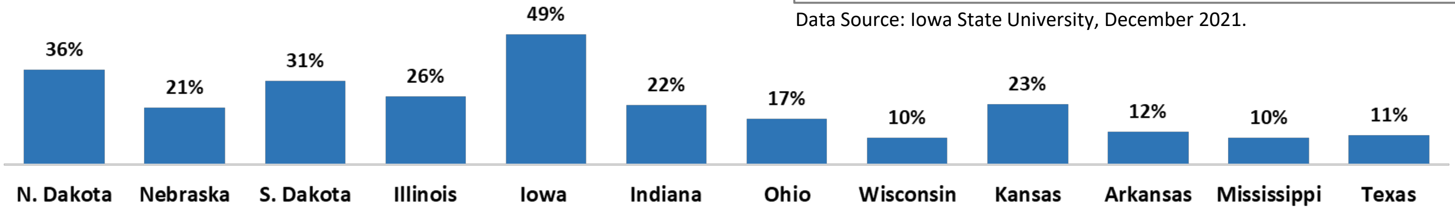

- Strong farm profits, particularly in cash grains, have translated into higher farm real estate values
- Higher rental rates in 2022
- Land rents are stickier than land prices

Land Prices Take Off Again



Data Source: Iowa State University, December 2021.

Average Sale Price Increase per Acre for High Quality Land, 2020 to 2022



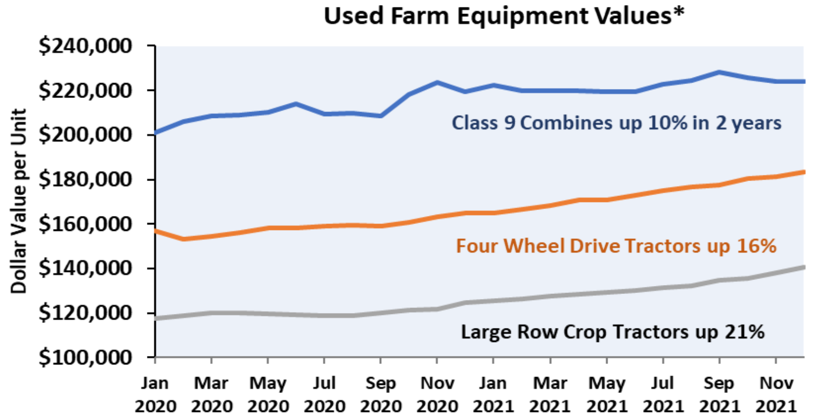
Source: Farmers National Company Agent Survey, January 2020 and 2022.

Higher capital costs: machinery and improvements

- New and used farm machinery values are higher on strong demand, lean inventories, and supply chain issues

- Higher material and labor costs are increasing building costs across the food system

Tractor and Combine Prices Rise



* = Trending sale prices for average equipment based on age, usage, and seasonality.
Source: Iron Solutions, Inc.

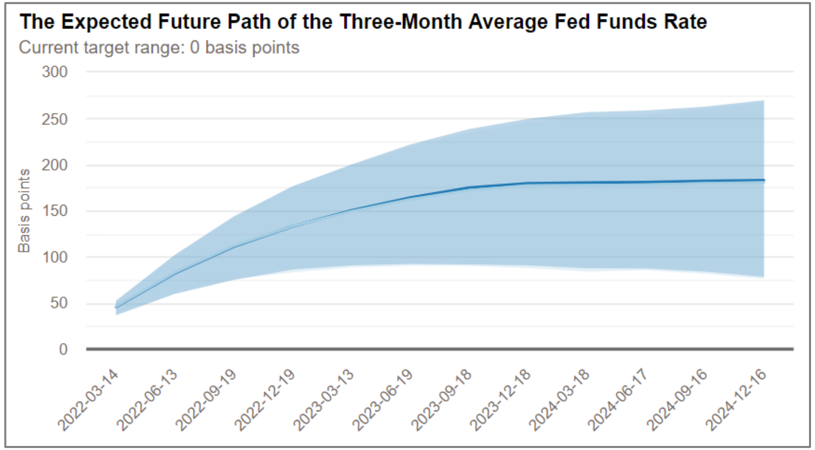
Annual New Equipment Sales	2020	2021	Yearly Change
	Units sold		
Self-Propelled Combines	5,030	6,272	24.7%
Four Wheel Drive Tractors	2,988	3,536	18.3%
100+ Horsepower Tractors	19,144	23,762	24.1%

Source: Association of Equipment Manufactures.

Higher capital costs: interest rates




- Rising borrowing costs are ahead for the $450 billion in total farm debt
- More System loan rates are now locked in for longer time periods but still about half of System loans carry floating rates



Loan Repricing Intervals for System Loans

	0 to 6 Months	6 Months to 1 Year	1 to 5 Years	Over 5 Years	Total	Total Gross Loans (millions)
	Share of total					
9/30/2021	46.9%	6.8%	26.3%	20.1%	100%	$325,784
12/31/2020	54.0%	8.3%	23.1%	14.5%	100%	$315,490
12/31/2019	51.9%	7.1%	24.3%	16.8%	100%	$286,964

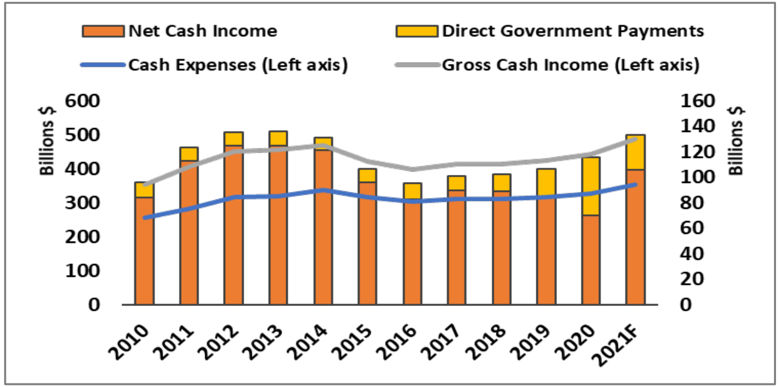
Sources: Atlanta Federal Reserve Bank (accessed 2/1/22) and FCS Funding Corporation Information Statements.

Farm finances are strong going into 2022

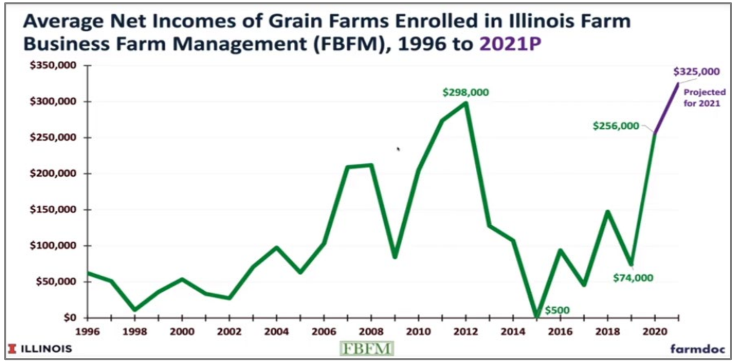



- Farmers, and the food industry in general, have the financial health to weather higher costs - at least initially
- Near-term outlook is encouraging
- Longer-term concern: Risk of a "Cost-Price Squeeze" for some parts of the ag industry

U.S Farm Income



Source: USDA/ERS, December 1, 2021.



Source: Univ. Illinois, December 3, 2021.

Lender outreach

- Surveyed System lenders to gain additional insight on how the current environment is impacting customers/portfolios
- Questions focused on:
  - Most significant cost pressures faced by customers
  - Estimated impact on borrowers and portfolio in 2022 and beyond
  - Growth and volume implications
  - Underwriting considerations

Lender responses: most significant cost pressures




- Inputs – particularly fertilizer, substantially higher
- Labor – cost and availability will encourage automation
- Land – prices and cash rents at/near record levels
- Infrastructure/Equipment – increasing construction costs for facilities and machinery in short supply
- Transportation – trucking availability and shipping rates
- Water – cost and availability

Lender responses: key takeaways




- Margins projected favorable in 2022, yet lower than 2021
- Input prices will likely cycle down based on supply/demand
- Higher fixed cost structure may be more permanent
- Borrowers can absorb expected increases in interest rates from the current low levels
- Pricing, risk management, and contract discipline necessary

FCS portfolio impact: credit quality




- Most institutions have included high-cost scenarios as part of existing stress-testing efforts
- Lenders do not expect significant adversity in 2022 as projected margins remain generally favorable, but lower than 2021
- Possible decline in credit quality is “down the road” as both borrowers and portfolios are starting from a position of strength
- Deterioration could occur sooner in Agribusiness portfolio versus producers as more sensitivity to interest rates, labor and supply chain issues
- FCS portfolios are diversified which provides some risk mitigation

FCS portfolio impact: growth/volume

- Operating loan usage is generally down from historical levels as profitability is more than offsetting higher costs
- Mortgage loan volume has increased as rising land values and higher sales activity have largely offset lower demand from capital improvement projects
- Moderate overall growth is expected for 2022

FCS underwriting considerations




- Front-end guidance and projections have been updated to account for the current environment
- No material underwriting adjustments were reported given:
  - Underwriting standards and practices are designed to be “through the cycle”
  - Near-term and long-term repayment analysis is typically completed
  - Higher costs but also higher revenues thus far – margins are projected to be narrower, yet remain favorable
- Lenders believe underwriting and risk rating systems are designed to account for various cyclical factors, including higher costs

FCA examination & oversight




- Fiscal 2022 National Oversight Plan includes risk topic of “Loan Underwriting in a Period of Significant Volatility”
- Examination work to evaluate:
  - Analyzing, underwriting and servicing of accounts in 2022, with a focus on the cash grains sector
  - Sources and quality of new loans/growth
  - Cost increases and related volatility
- Will continue to focus management discussions and monitoring activities on impacts of the current high-cost environment

Questions