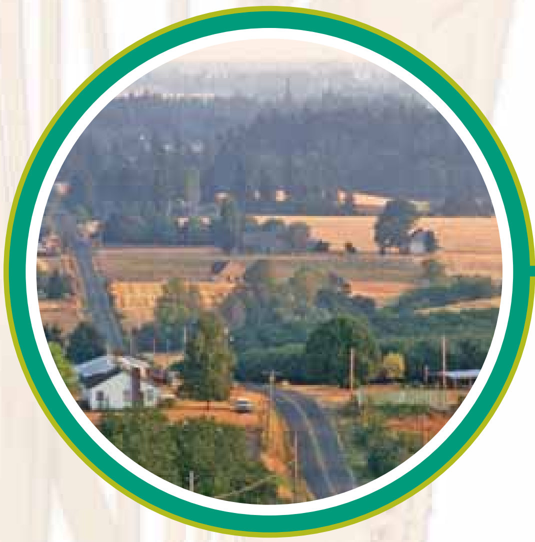

21st Century Rural America:
New Horizons for U.S. Agriculture

About This Report

This report about the emerging financial and economic needs of agriculture and rural America is part of a forward-looking research and assessment initiative undertaken by the U.S. Farm Credit System.

The initiative, called HORIZONS, actively engaged leading independent experts, farmer-directors, Farm Credit managers and lending officers in an extensive national research and analysis project. HORIZONS identified and characterized the most dynamic elements of the rural and agricultural landscape — and found it to be dramatically different from what it was even a few years ago.

This report highlights the many factors that have driven change and the resulting effects and business trends. It also identifies eight key findings about the future of agriculture and rural America. The findings demonstrate the need for policy solutions that will help farmers, rural businesses and rural communities succeed in the emerging marketplace. At the back of this report, you'll find inserts that profile farmers, ranchers, rural entrepreneurs and business owners. These individuals have volunteered to share their unique stories about their business challenges and financial needs. They are among the millions of people who live and work in Rural America and the reason for the HORIZONS initiative.

Since its inception, the mission of the Farm Credit System has been to help maintain the quality of life in rural America and on the farm by ensuring that farmers, ranchers, and rural businesses have access to sound, dependable financing for a variety of needs. The goal of this report is to stimulate awareness of the ways in which these needs have changed, and to explore solutions to maintain a vibrant agricultural sector and build a strong economic future for rural America.

For more information: Visit the HORIZONS Web site at www.fchorizons.com or call The Farm Credit Council at (800) 525-2345.

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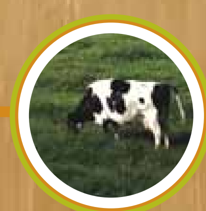


From cotton and rice fields in the South to wheat, corn and soybean fields in the Plains states, and from fruit and nut orchards on the West Coast to the dairies and greenhouses of New England, farms and related businesses have become more diverse in size, revenue, ownership structure and marketing strategies.

Whether large or small, 99 percent of all American farms are owned by individuals, family partnerships and family corporations.

When I started farming with my father in the 1960s, the world was very different from the one my sons entered when they joined the family business. Back then, our small poultry and grain operation was all we focused on, but today things are more complex and we rely on other related businesses to stay in agriculture.

— Wayne Lambertson, Maryland farmer and HORIZONS Project Co-Chairman

Executive Summary

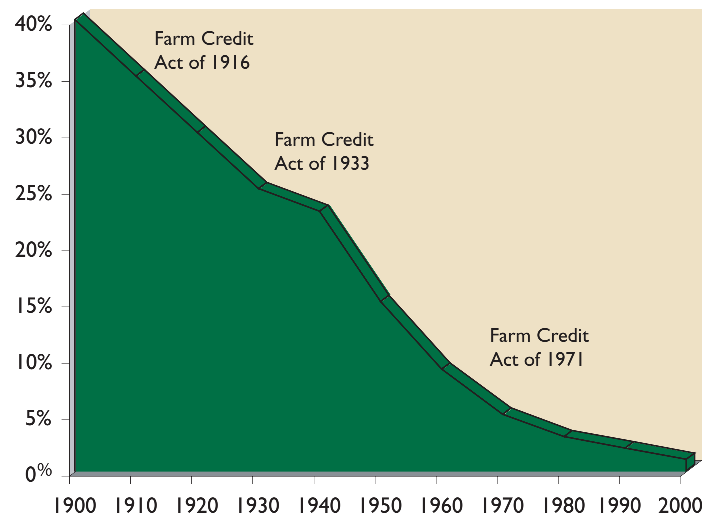
For generations, American farmers and ranchers set the global standard for making use of technology and research, adjusting to market conditions, and improving productivity so that our nation produces the safest and most abundant food and fiber possible. U.S. farmers, ranchers and rural entrepreneurs serve not only the mass market with affordably priced food, but also deliver the best food and drink to the most discriminating consumers here and around the world.

They provide raw materials for the clothes we wear, the homes we build and the alternative fuels we use. They are stewards of the rural landscape and they create millions of jobs in supply, processing, export, transportation and retailing. Many factors contribute to the success of U.S. agriculture — leading-edge science and education, farmer-owned financial institutions, advanced marketing and transportation networks, and critically important rural infrastructure.

From high-tech, low-cost commodity producers to small-scale, high-value niche operators, agriculture's entrepreneurs continue to have a positive impact on the economy of rural America. Technology, economics and the rising aspirations of people around the world have altered forever the structure of farming, ranching and rural America. The result: A more complex, more diverse, and more consumer-driven agricultural and rural environment, rich in both challenges and opportunities.

The policies and institutions that served yesterday's agriculture also are transforming, but must adapt even more quickly to meet the challenges that face the dynamic farm, ranch and rural entrepreneurs of today and tomorrow.

Percentage of U.S. Population on Farms, 1900-2000



Source: Farm Credit HORIZONS Project and USDA

Commercial farm and ranch sizes are growing, while smaller-scale farms, including specialty and beginning operations, continue to make up the largest number of farms. These trends place new demands on production and marketing systems that must rely on debt and equity capital to grow and profit. These changing demands challenge our existing rural infrastructure — transportation networks, schools, housing, health care facilities, energy, water and communications systems — that were created to serve rural America in an earlier time.

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To capitalize on a rapidly changing new environment, agriculture and rural America need ongoing access to a wide range of reliable, flexible and competitively priced financial services that meet a new set of needs.

For more than a year, the customer-owned U.S. Farm Credit System, the oldest and single largest lender to U.S. agriculture, analyzed the dynamic needs of farmers, ranchers and rural America. It consulted widely with customers, farm organization leaders, university specialists and rural community leaders to draw a composite of rural America's need for financial services and the System's ability to fulfill its Congressionally mandated mission.

This comprehensive, nationwide research study, called the HORIZONS Project, identified eight key findings about the future of agriculture and rural America. The findings demonstrate the need for policy solutions that will help farmers, rural businesses and rural communities succeed in the emerging marketplace. The project also identified how incremental changes to the Farm Credit System can free up additional capital that can be used to expand the contribution of U.S. agriculture to rural prosperity while maintaining the System's focus as provided for in the preamble to the Farm Credit Act of 1971:

> ". . . making credit available to farmers and ranchers and their cooperatives, for rural residences, and to associations and other entities upon which farming operations are dependent, to provide for an adequate and flexible flow of money into rural areas . . ."

Significant research findings from the HORIZONS Project

Sponsored by the 90-year-old, $135 billion U.S. Farm Credit System, the HORIZONS Project used a broad mix of tools to identify and document the evolving financial needs and business trends of farmers, rural businesses and rural communities. These assessment tools included: surveys of the nation's Farm Credit associations and banks; extensive outside expert papers on agriculture, the food industry and value chains, as well as agricultural and rural finance, listed at the back of this report; secondary studies completed by various government agencies and trade associations; and local, regional and national meetings with various financial, farm and rural groups who have a vested interest in the future success of U.S. agriculture and rural America.

Eight key findings

1. American farmers are not a homogeneous group.

There is tremendous diversity in farm size, annual revenue, ownership structure and marketing approaches. To a lesser extent, we see an emerging diversity in the age, ethnicity and gender of owners and operators. An overwhelming majority of small-scale farms dominate the rural landscape and a relatively small number of large-scale farms dominate the food and fiber production system.

2. A small number of *farming-only* businesses remain in today's agriculture.

The overwhelming majority of all

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Percentage of Workforce Employed in Agriculture

Source: Compiled by Economic Research Service, USDA. Share of workforce employed in agriculture, for 1900-1970, Historical Statistics of the United States; for 2000, calculated using data from Census of Population.

1900

41%

1930

22%

continued from page 4

farmers, but especially small operators, rely on off-farm employment to stay in agriculture. Even large operators diversify their income as a risk management strategy through agriculturally related and non-farm investments.

3. The business models and farmer ownership structures of the businesses on which farmers rely continue to evolve and adapt.

Farmers depend on a wide range of businesses for products, services, marketing and processing directly and indirectly related to their farming operations. These businesses may or may not be owned by farmers, and they may or may not be located in a rural community, but all are essential to the economic viability and quality of life for farmers.

4. While the number of farmers, agriculturally-related jobs and industries, and agriculturally-dependent communities has declined, the future of U.S. agriculture remains bright.

The competitive pressures of globalization and technology advances have resulted in more consolidated and more efficient systems for producing food and non-food products. And yet, in some areas, new small and niche agricultural enterprises have injected local communities with a new vitality. Other advances have resulted in agriculture becoming an increasing source of energy production, feedstock for industry and medicine and other value-added products.

5. Some rural areas retain few ties to agriculture. Conversely, more agriculture and related businesses are located in suburban areas and near metropolitan centers.

It is becoming increasingly difficult to define a "rural" community solely by population or traditional qualities. Rural communities continue to grow if they are located near growing urban areas or regional economic centers, blessed with scenic resources, or designated as attractive retirement destinations. Communities without these attributes often struggle to survive.

6. Regional collaboration, public-private partnerships and coalitions of investors are key to the future of many rural communities.

To create new jobs, attract new business and foster an environment for future economic development, agriculture and rural America must find new ways to reinvest farm real estate equity and to form partnerships among financial institutions, all levels of government, universities, rural economic development agencies and local farm and community leaders.

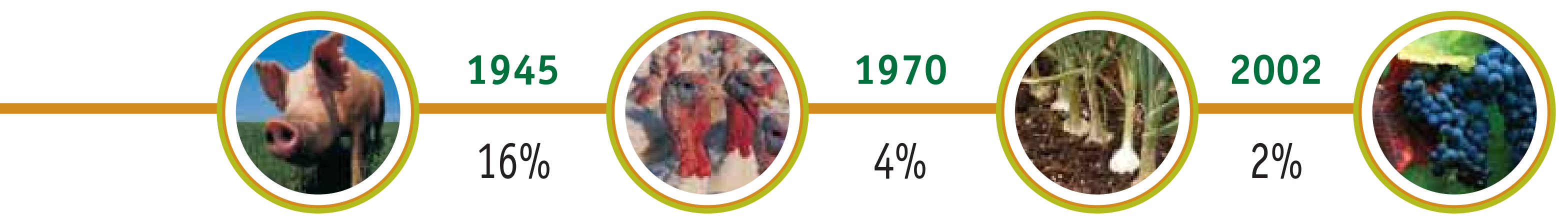
7. Entrepreneurs remain the lifeblood of American agriculture.

Historically, the ingenuity, adaptability and hard work of rural entrepreneurs — American farmers and ranchers — have driven the enhanced productivity and success of U.S. agriculture. As skilled, experienced and innovative business owners, today's rural entrepreneurs, farmers and ranchers continue to need access to capital, essential infrastructure, and business support services.

8. Ongoing access to debt and equity capital is paramount to the future prosperity of U.S. agriculture and rural America.

The specialized financial needs of U.S. agriculture and rural America remain as great as ever. The diverse farms, rural businesses and rural communities of the 21st Century need access to dependable, flexible and competitive financial products and services to compete and thrive in this global and rapidly changing environment.

All Americans depend upon and benefit from the success of U.S. agriculture and the prosperity of rural America. The HORIZONS findings demonstrate the importance of ongoing industry cooperation, community collaboration, financial support and investment, dependable infrastructure and updated public policy in ensuring continued success and a bright future for rural America. ●



Numerous forces are blurring the identification of "farming" and the role of farmers in the overall food and fiber system. Called industrialization, supply chains, contractualization of agriculture, integration, or otherwise, the results are diminishing distinctions between farming and non-farming in the food system and increasing diversity in the structure of traditional farming.

— Peter J. Barry, Center for Farm and Rural Business, University of Illinois

Forces Shaping a New American Farm

Technology has fueled much of U.S. agriculture's success. According to USDA, farm productivity growth averaged 1.8 percent annually from 1948 to 2002, exceeding the 1.2 percent growth in productivity levels of non-farm business in the U.S. To assure ongoing success, today's rural entrepreneurs, farmers and ranchers continue to need access to essential infrastructure, business support services and flexible financial products and services.

From science laboratories to national capitals, several forces converged at the end of the 20th century to drive fundamental changes in agriculture. Experts generally agree that the principal change agents include technology, globalization, government policies and the rising influence and shifting demands of the consumer. These and perhaps other dynamics not yet understood continue to shape the way we produce, market and use the products of the land.

Biotechnology has improved crop yields, reduced the need for labor, energy and chemicals and promises new markets for agriculture including pharmaceuticals and industrial products. Ethanol and biodiesel technology fulfill a need for cleaner, alternative fuel sources and, at the same time, create new markets for farmers. Technology improvements have contributed to the trend towards fewer, but more efficient, processing plants in almost every industry from dairy to fruit to grain.

Technology continues to transform this generation's agricultural business just as the tractor and hybrid seed transformed its grandparents'. Farmers today carry on a legacy of innovation. The Internet represents just one example. More and more, agricultural producers use the Internet for marketing information, to obtain farm inputs and to seek other services.

Beyond global competition and technological advances, the ingenuity, adaptability and hard work of American farmers and ranchers have driven agriculture's enhanced productivity and success.

The internationalization of the agricultural economy has been marked by hungry export markets and intensifying competition. Export earnings account for 20 to 30 percent of U.S. gross farm income. U.S. farm exports exceeded $61 billion in 2004, a new record over the one last set in 1996. While agricultural exports still outpace imports, imports are on the rise due to global competition and

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expanded trade under negotiated trade agreements.

More than 95 percent of the world's consumers live outside the U.S., many in countries with rising incomes. U.S. exports of higher-value products such as meat and dairy products and processed foods have increased by 25 percent since 1998. By comparison, exports of bulk commodities such as corn, soybeans and wheat rose modestly in value and stayed flat or declined in volume.

Regulatory and environmental policies and federal support for agriculture influence, to a significant degree, the profitability and the structure of farming and ranching. Increasingly, environmental regulation affects farm costs, size and location.

As Michael Boehlje and Allan Gray of the Center for Food and Agricultural Business at Purdue University point out, "One would not expect the elimination of U.S. farm programs, but should not be surprised that government expenditures would be reduced, that the payments might be more targeted to environmental and other public concerns, and that more restrictions might be placed on the size of payments that individual producers might be able to receive." In fact, these changes have been occurring incrementally for years.

At the same time, policies of other countries affect the terms of competition in export markets as well as imports to the U.S., and the terms of trade in feed and foodstuffs. Negotiation of new multilateral, regional and bilateral trade agreements will affect U.S. agricultural profitability on an ongoing basis.

As farm policy continues to evolve and reshape U.S. agriculture and the food system, the influence of the consumer has become paramount. Health and dietary concerns have made some consumers more sensitive and selective about food choices, generating a plethora of organic, low-fat, cholesterol-free, calcium-fortified, low-carbohydrate, high-protein, sugar-free food and beverage products. At the same time, advice to increase fiber in the diet has propelled demand for fresh fruits and vegetables.

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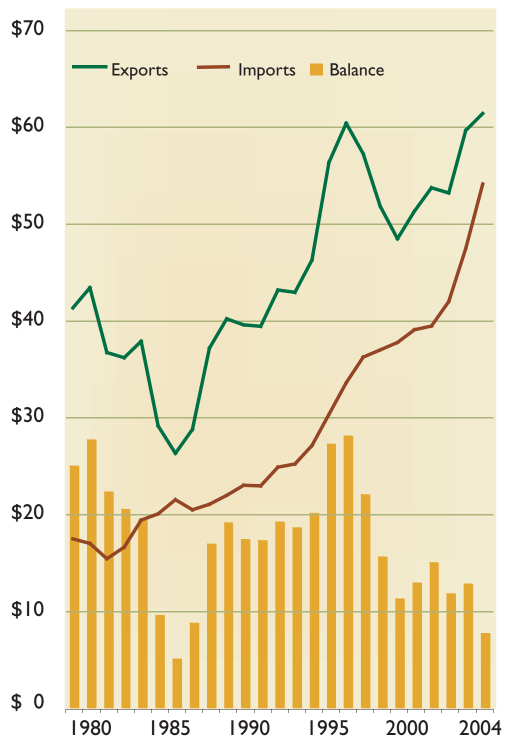
U.S. Agricultural Trade 1980 - 2004

Dollars in Billions



Source: USDA Economic Research Service

In recent decades, American agriculture has become much more demand-driven. Health and dietary concerns make consumers more selective, generating a plethora of organic, low-fat, cholesterol-free, calcium-fortified, low-carbohydrate, high protein, sugar-free food and beverage products. At the same time, advice to increase fiber propels demand for fresh fruits and vegetables.

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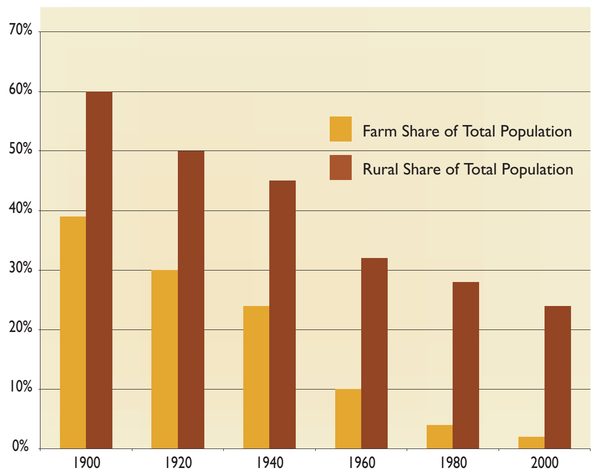
Consumer preferences and demands are also influencing environmental policy. Expanded conservation programs help producers reduce agriculture's impact on water and air quality and encourage wildlife and landscape protection.

In recent decades, American agriculture has become much more demand-driven. As a result, the American consumer can find 35,000 products in the average U.S. supermarket today. According to the Grocery Manufacturers of America, approximately 1,200 new food and consumer products are introduced annually in the U.S. Americans now spend nearly half of their food dollars on meals and snacks away from home. And American households are, on average, richer, older, smaller, more ethnically diverse and more likely to contain either singles or adults without children at home, according to USDA analysts.

Responding to changing consumer preferences has led to new relationships among producers, processors and retailers. Contracting and vertical integration for supply and quality and for special-use, high-value commodities have changed the structure of agricultural markets, further increasing the specialization and scale, particularly of livestock and specialty crop operations. To paraphrase Peter Barry of the University of Illinois, when agriculture simply produces commodities, the financial returns can't compete with those gained from other capital investments. That's why today's farmers seek new ways to add value to and earn more from their products.

U.S. Farm and Rural Populations



Source: Share calculated by USDA Economic Research Service, using data from Census of Agriculture, Census of Population, and Census of the U.S.

Consumers' changing tastes at home and abroad, along with more demanding retailers and processors, have consolidated distribution systems and integrated supply chains. A handful of large food retailers will continue to control the food distribution system worldwide. Altogether, the impact of rising consumer expectations, improved technology, globalization and farm policy and more demanding processors and retailers places unprecedented pressure on today's farmers. At the same time, these forces create unequalled opportunities for those positioned to compete and deliver value to consumers at home and to far away markets. ●

The structure of farming continues to move toward fewer, larger operations producing the bulk of farm commodities, complemented by a growing number of smaller farms earning most of their income from off-farm sources, all increasingly affected by global events.

— The 20th Century Transformation of U.S. Agriculture and Farm Policy, USDA, Economic Research Service, June 2005

Fewer Farmers with Greater Impact

A portrait of today's American farmer proves difficult to paint. First, farmers are not a homogeneous group. There is tremendous diversity in farm size, annual revenue, ownership structure and marketing approaches. A second characteristic adds to the difficulty in capturing one snapshot of the American farmer. Few "farming-only" businesses remain in today's agriculture. The great majority of all farmers, especially small operators, rely on off-farm employment to stay in agriculture. Even large operators diversify their income as a risk management strategy through agriculturally related and non-farm investments.

How did we arrive at this complex mix of producers? Less than a century ago, nearly half the American work force lived on the farm, producing food and fiber mostly for local markets. Today, less than 2 percent of workers live on the farm, yet they meet the needs of consumers next door, across the nation and around the world.

More than six million farm families worked the land in 1916, on an average farm of about 150 acres. Today's 2.1 million farm operations average about 440 acres. American agriculture sold $240 billion in crops and livestock last year, exporting more than a fourth of it.

Today's farms, ranches and agricultural enterprises are more diverse, more specialized and more concentrated in ownership, and increasingly operate in suburban areas or near metropolitan centers. Still, a small number of large businesses generate the largest share of agricultural products. Another, much larger group of small-scale operations mostly supply local markets and rely heavily on non-farm income. Both large and small operators, each in their own way, drive the agricultural economy.

Of the 2.1 million farms tallied in the 2002 Census of Agriculture, about 7 percent reported cash receipts of more than $250,000 and were responsible for 76 percent of all agricultural sales. The historical data show that fewer farms are becoming increasingly important as the source of the bulk of our nation's food. Today, the 30,000 commercial farm operations — those that sell more than $1 million in farm products annually — account for about half of all farm output.

While farming operations are as diverse as the food we consume, commercial producers tend to fall into three primary categories. One produces and sells bulk commodities, generally on large-scale operations. Another group of farms of varying size supplies targeted niche markets or those with specific output characteristics. A third category produces specifically for vertically integrated value chains, where farmers grow the product and participate in at least part of its further processing, marketing and retailing — a rapidly growing

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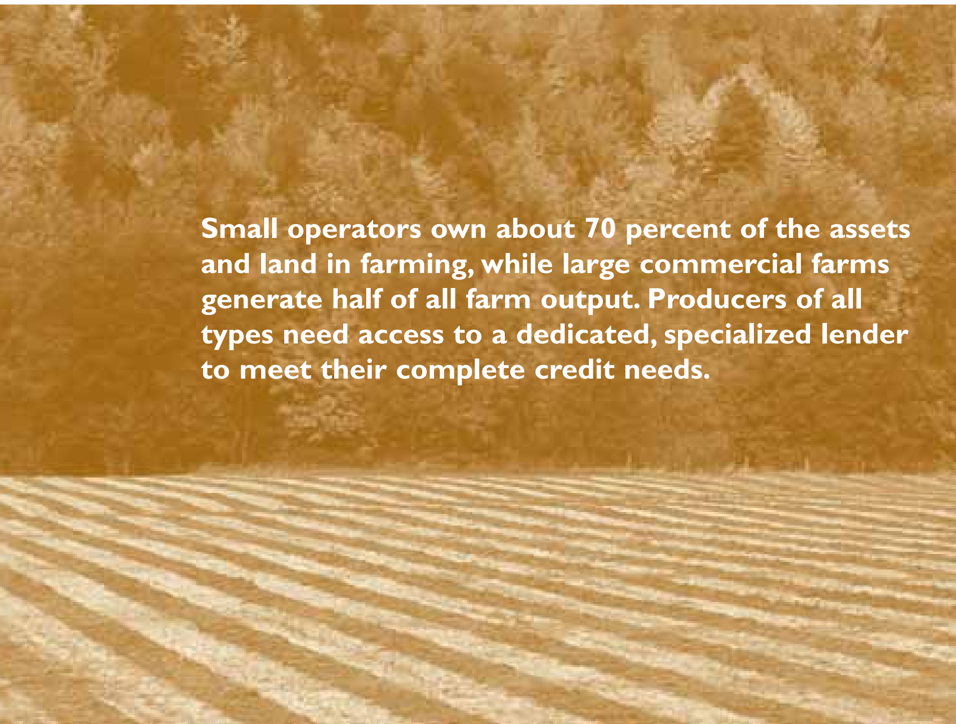
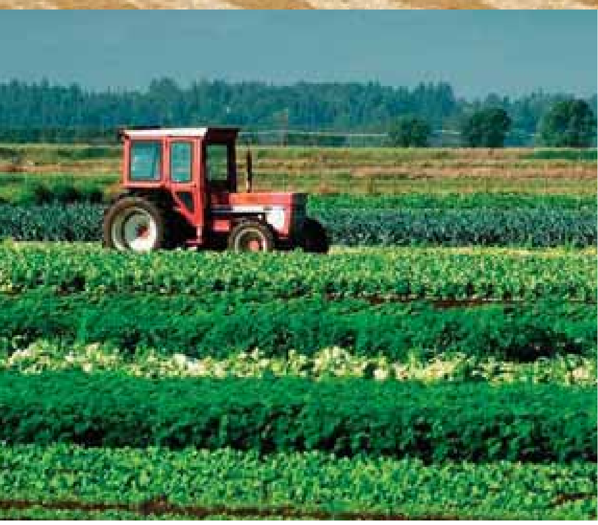
Percentage of Farmers with Off-Farm Work or Income

Source: Compiled by Economic Research Service, USDA, using data from Census of Agriculture and Census of the United States.



Small operators own about 70 percent of the assets and land in farming, while large commercial farms generate half of all farm output. Producers of all types need access to a dedicated, specialized lender to meet their complete credit needs.



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segment that differs greatly by commodity and by region.

Many producers who have integrated into the supply chain find ways to not only increase the return on their crops, but also to reduce unit costs through economies of scale, often by expanding. Some farms and ranches operate not only in several counties, but also in different states or countries. Today, an Iowa soybean grower may invest in Brazil or a California vegetable grower may operate in Mexico as well.

Small farms rely more on off-farm income

Nearly two million farms — many of them young farm families, beginning farmers, retired people or those who prefer smaller operations — sell less than $250,000 annually. Almost 1.3 million of these farms generate sales of less than $10,000 annually. About 90 percent of the household income of the two million farms comes from off-farm sources. Small farms own about 70 percent of the assets and land involved in farming.

Demographic characteristics of farm families also have changed. Of farmers who reported being on their current farms four or fewer years, 24 percent were age 35 or younger, while 24 percent were 55 or older. Such data from the 2002 Census of Agriculture suggests that a significant number of "beginning farmers" may be seeking a second career and a rural lifestyle.

Another 2002 Census of Agriculture demographic shows 144,000 farms where the primary operator was 35 years old or younger. In addition, 684,000 farms reported having a junior partner that was 35 years old or younger. These producers bring innovation that will prove critical to agriculture's success.

In the past, and even today, people who grew up on farms traditionally were the next generation of farmers — agriculture grew virtually all its own replacements. Increasingly today, people who did not grow up on farms enter agriculture. Country lifestyle amenities and entrepreneurial small business opportunities attract new entrants across all farm sizes.

According to George Acquaah and Clark Williams of the Department of Agriculture and Natural Resources at Oklahoma's Langston University, minorities together own less than 5 percent of all U.S. farms and less than 2 percent are owned by Hispanics and African-Americans. Most farms owned by minorities are small farms. The new generation of farmers may include second-generation Latinos in the rural West and Southeast, first generation Asian Americans in California and New England and previously

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urban African-Americans returning from the North to the rural South.

Acquaah goes on to say that the number of women operators is also on the rise in this new generation of farmers. Currently, women operate 238,000 farms. Approximately 31 percent operate farms with less than $1,000 in total sales and 9 percent with over $50,000 in sales.

Outlook bright — for large and small farms

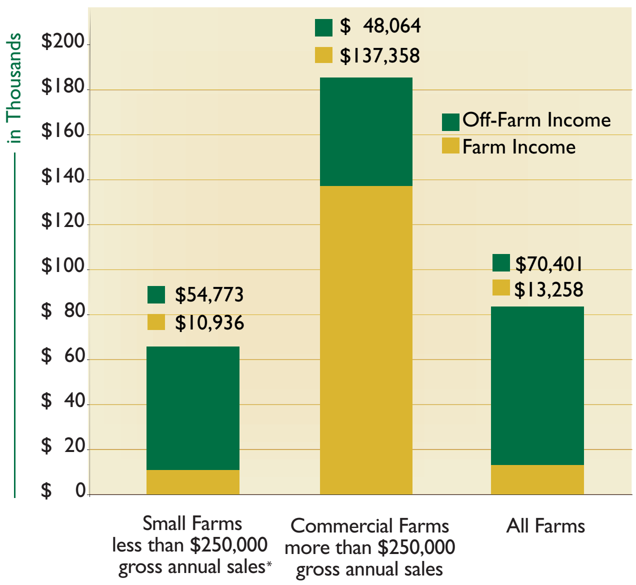
Continued growth is likely for the largest commercial farms — those with annual sales of $5 million or more — as well as for smaller specialty growers. Mid-size, traditional farms and ranches producing between $250,000 and $1 million face the greatest challenges. Such farms likely will continue to decline in number — either expanding into the larger category, diversifying into non-farm enterprises to survive, or ceasing production, mostly through retirement.

Large producers will continue their trend toward getting bigger as they invest more dollars into adding value to their products as well as diversifying their products and their geographic holdings to spread risk.

Experts anticipate the largest numerical growth among smaller-scale operations, especially those in the category with annual production of less than $50,000. In addition, the number of land-owner-investors will continue to increase in size and importance.

In summary, the future points to farmers producing a more diversified and larger quantity of food and non-food products than ever before in our country's history. Large farms will continue to dominate food production while small farmers will dominate the landscape. All farmers, large and small, are increasingly more diverse, more specialized, more dependent on technology and more reliant on multiple sources of income. This multi-dimensional, highly complex restructuring of agriculture presents new challenges and different opportunities to institutions serving agriculture and rural America.

Average Income of Farm Households for 2005



*Excluding rural residence farms *Source: USDA Forecast*

That includes financial institutions. Today's more diverse farmers and related businesses require new financial services, more equity and greater flexibility from their lenders if they are to effectively manage their businesses. They also need new sources of investment funds. Producers and rural entrepreneurs of all types need access to dedicated, specialized lenders to meet their complete credit and financial services needs.

Less than 10 percent of all farms remain "farming-only" businesses today. The overwhelming majority of all farmers, especially small operations, rely on off-farm employment to stay in agriculture. Large operators also diversify their income to manage risk.

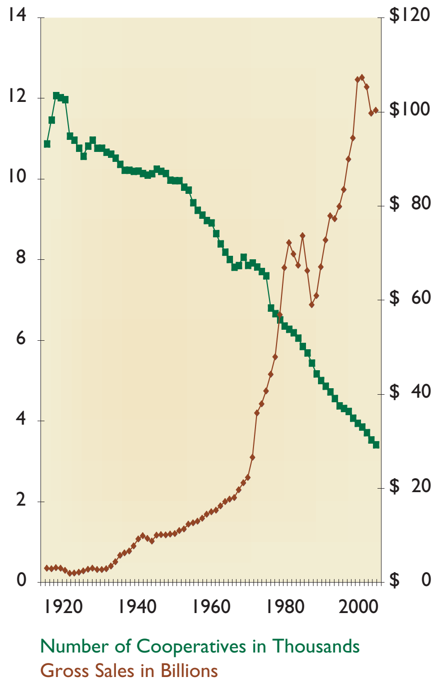
An increasing number of the most astute farmers and ranchers are diversifying into other business investments in order to spread risk, generate additional income and capitalize on their entrepreneurial talents. Many of these ventures are or will be non-agriculturally related.

— Danny Klinefelter and John Penson,
Department of Agricultural Economics, Texas A&M University

Evolving Role of Farm Businesses

The business models and ownership structures of the businesses on which farmers rely continue to evolve and adapt. Farmers depend on a wide range of businesses for products, services, marketing and processing directly and indirectly related to their farming operations. These businesses may or may not be owned by farmers, and they may or may not be located in a rural community, but all are essential to the economic viability and quality of life for farmers.

U.S. Ag Co-ops
Number of Co-ops vs Gross Sales
1920 - 2000



Source: USDA Rural Cooperatives

The economic role and importance of agricultural and rural businesses dramatically shifted in the last few decades. For many communities, the local farmer-owned cooperative, whether it was a grain elevator, cotton gin, dairy processor, or fruit packer, was the biggest business in town and the largest employer. And, as a rural resident, you either worked on the farm, or you worked in town. It was an era marked by fewer choices, less competition, and simpler times. As a farmer, you defined your world by your local community, county and, maybe, your state.

Today, global competition touches every community in rural America and every farmer in one way or another. Farmers only own or control some of the businesses they depend on to market and process their products. Furthermore, many of the businesses farmers rely on for agriculturally related services often have only some or no farmer ownership. In some cases, businesses on which farmers depend have moved away from the rural community to a larger city or regional center to serve a broader customer base. Still, farmers and their families rely on non-farm businesses and jobs in town.

In particular, the farm supply and service sector has evolved into larger, integrated businesses on which producers rely for inputs — feed, seed, fertilizer, and equipment — and services. The consolidation of these businesses limits farmers' choices and requires some farmers to travel longer distances to obtain services.

Traditional farmer cooperatives have not been immune to these competitive forces. They have increased their members' earnings and spread risk through geographical diversity — serving members in Mexico and Canada as well as the U.S. More cooperatives have shifted from producing high-volume, low-value commodities

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Today, fewer farmer-owned cooperatives make a greater impact on the U.S. economy. Together, ag co-ops generate almost $100 billion in annual revenue. At the same time, a new breed of farmer-owned businesses is emerging. A number of states recently adopted laws to accommodate the changing structural and equity needs of these new enterprises. These businesses may or may not be owned by farmers, and they may or may not be located in a rural community, but all are essential to the economic viability of rural America.

All businesses on which farmers depend need ongoing access to reliable, flexible financial products and services to compete in today's rapidly changing business environment.

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to focusing on more profitable value-added processing and branded products where they can gain a larger share of the consumer's dollar. Across every industry, co-ops have consolidated and merged, seeking efficiencies as well as growing and expanding to stay competitive. Nationally, mergers and acquisition in food manufacturing average about 200 a year.

Even though the number of agricultural cooperatives has steadily declined, just as the number of farmers has decreased, cooperative market impact remains significant. Today's 3,000 agricultural cooperatives contribute almost $100 billion in revenue to the U.S economy.

The need for alternatives

While traditional cooperatives continue to represent a formidable force in the agricultural economy, competitive pressures have created the need for alternative farmer-owned companies that serve the new requirements of the rural entrepreneur and create market advantages for rural businesses. The need for equity capital and financing for growth, expansion, research, product development and marketing drives much of the change in corporate structure. One common principle fuels the change — the need to provide farmers with what it takes to compete in today's rapidly changing marketplace.

"New generation" co-ops, which require a higher up-front equity investment than traditional co-ops in return for a greater share in rewards, continue to crop up across the U.S. to convert corn into ethanol and grain into meat or eggs, for example.

Beyond the need for added farmer investment, farmers have moved to hybrid cooperatives and other new structures to seek flexibility in legal, governance and capital structures as well as tax advantages. High-profile examples of cooperatives converting to new structures include a soybean processor in South Dakota, an egg co-op in Minnesota and a beef co-op in Missouri, all of which converted to limited liability companies (LLCs) in the past few years.

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The number of farmers in the U.S. fell from 6 million to 2 million in the last 90 years. The number of agriculturally related jobs and industries, and agriculturally dependent communities declined as well. Still, the future of U.S. agriculture remains bright.

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Recently, more states authorized the creation of LLCs and other structures that allow farms and businesses to combine the liability protection of a corporation with the simplicity and tax benefits of a partnership. Often, the optimum business model for such ventures is a combination of farm and non-farm investment. Interest in multi-owner businesses held by both farmers and non-farmers continues to grow. Together, they can better manage risk, attract non-farm capital and offer ownership incentives to attract skilled managers.

In addition to ownership and investment opportunities, the 21st Century farm family needs profitable rural businesses for employment and services. Today, nearly all farm families have one or more members working in town or a nearby city because of the need for employer benefits such as health insurance, retirement benefits, or reliable year-round income. Off-farm employment may or may not be related to agriculture. USDA statistics confirm that off-farm employment is critical for small-sized farms to stay in agriculture.

Because much of agriculture involves short, but intensive, production tasks at times during the growing season, slow or off-season intervals allow farmers and their spouses to employ their talents in off-farm work or develop their own businesses, on or off the farm. For instance, many farms, both large and small, sell directly to consumers or retailers. Some own or share in processing ventures that add value to what they grow — traditional and "new generation" cooperatives that export grain, refine ethanol, gin cotton or make wine, pasta, cheese or breads. Many farmers own or work for other small businesses — from farm machinery repair shops and accounting services to local bakeries or Internet-based businesses.

Greater opportunities lie ahead

Tomorrow's farmer and rancher typically will bring more education, more business management experience,

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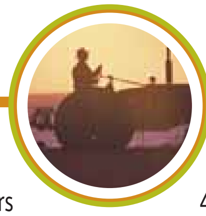
Mechanization of Agriculture

Source: Compiled by Economic Research Service, USDA, using data from Census of Agriculture and Census of the United States.

1900
21.6 million work animals

1930
18.7 million work animals
920,000 tractors

1945
11.6 million work animals
2.4 million tractors



1960
3 million work animals
4.7 million tractors

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and a broader understanding of business risk to the task. Farmers will demand more from those who provide services and expect more in return for their investment.

Many agricultural college graduates express a desire to return to the farm after a few years in a farm-related or even unrelated business. The entrance of retiring baby boomers into the farm sector likely will further alter farm structure and demographics. The continued influx of producers and rural entrepreneurs with diverse backgrounds, new technologies, greater accumulated capital and ties to the non-farm economy make for a positive outlook for agriculture and rural communities.

"The experiences they obtain off the farm will supplement the decades of experience of actual farming that the older generation has gained," says Joseph F. Guenthner, a professor of agricultural economics at the University of Idaho. "Growing up in the information age, the new farmers understand how Bill Gates used intellectual property rights to become the world's wealthiest person. They understand that they, or a group of them, can own proprietary varieties and sell branded products rather than commodities."

The new generation of farmers and farm-related business managers will bring new ideas, new technology and a new educational background to the industry. More than any previous generation, they will face fierce global competition and a rapidly changing business environment. As a result, they will be motivated to access more efficient products and services for their businesses, and to further process their products to gain added profits. At the same time, they will be challenged to unlock the potential of current agricultural assets to reinvest in important off-farm businesses. The financial services providers of the

future must adapt and change with these customers to deliver ongoing access to reliable, flexible financial products and services. ●

In some areas, new small and niche agricultural enterprises inject local communities with a new vitality. Across the country, farmers and ranchers are inviting visitors into their homes in response to a growing interest in agritourism. These activities range from winery tours and pick-your-own operations to dude ranches and hunting excursions. In addition, agriculture provides the raw materials for an increasing variety of new value-added products for industries ranging from medicine to energy, including ethanol.

The rural economy has been through tremendous change. It will undergo even greater change in the future. The old rural economy is fueled by commodities, agricultural, industrial, mineral, timber. Globalization creates a new imperative. The most successful regions will grow entrepreneurs — lots of them.

— Mark Drabenstott, Federal Reserve Bank of Kansas City

Rural Entrepreneurs and New Ways to Invest in the Future

Entrepreneurs remain the lifeblood of American agriculture and rural America. Historically, the ingenuity, adaptability and hard work of rural entrepreneurs — American farmers and ranchers — have driven the enhanced productivity and success of U.S. agriculture. These entrepreneurial skills also can be seen in the influx of new regional alliances, public-private partnerships and coalitions of investors that are energizing a number of rural communities. No matter how skilled, experienced and innovative today's farmers and rural business owners have proven to be, they continue to need access to capital, essential infrastructure, and business support services.

Agriculture and rural America will need to work with others to create new jobs, attract new business and foster an environment for future economic development.

Farmers are among 59 million people in rural America — 21 percent of the total U.S. population who live on 80 percent of the land.

Small towns and rural America have changed along with agriculture. The differences between the farm business and other lines of business have narrowed. Due to increased competition, new technology and more sophisticated consumer demands, farming today demands many of the same business skills that other businesses require.

Areas that are blessed with scenic and recreational resources — in many cases, near population centers — prosper as people can earn a living and enjoy country life. Migration from cities and suburbs to rural America is creating new social capital and bringing innovative leadership. Intellectual pursuits are replacing manual labor as the engine of growth.

Yet there's also another rural America. Not everyone has shared in prosperity. Some rural areas are better off than many population centers while others lack basic modern amenities. Since 1970, seven in ten rural counties have gained population but slightly more than two in ten have been losing population rapidly.

Like farms, rural areas have become more diverse. Once, nearly every rural county depended mostly on agriculture, forestry and mining. Half a century ago, many rural areas depended on manufacturing, but factory jobs have declined along with dependence on agriculture and mining.

Some rural areas retain few of their former ties to agriculture. Only about one in five rural counties depends heavily on agricultural income and jobs. And only two percent of total income in rural counties comes from agricultural production. Overall, farm and farm-related employment accounts for 14 percent of total U.S. employment.

Looking beyond the statistics, recent evidence suggests that the success of agriculture depends on a vibrant rural America, and vice versa. Considering the growing number of small farmers in this country, the ability to remain on the farm often depends on the availability of jobs nearby. In a growing

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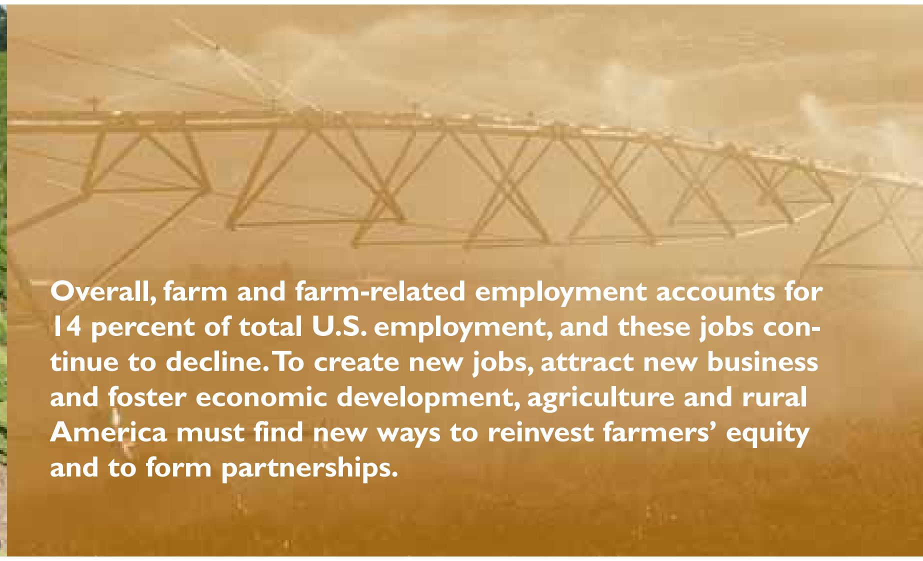

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number of cases, it's producers themselves who build new processing businesses that create jobs and revitalize their communities.

The trend toward producers and others building processing facilities in rural areas represents a bright spot in an American landscape where many manufacturing facilities are disappearing. Yet even in rural areas, new plants face an uphill battle, according to Dr. Lloyd C. Irland of the Irland Group and Yale University: "America's rural areas are experiencing a wrenching crisis across the entire manufacturing sector. From the 50s through the 80s, small plants relocated to rural areas for lower wages, cleaner air, small town lifestyles, and at times to escape escalating big city woes. These plants were a significant aid in helping rural areas to adjust to declining labor requirements in agriculture and food processing, as well as falling employment in traditional mainstays such as the railroads. These industries are often just the ones most vulnerable to offshore competition and to more intense mechanization."

Partnerships key to prosperity

Those who *have* built successful rural enterprises have proven that you not only provide good-paying jobs in the context of the region, but also benefit farmers, ranchers and the entire community by providing better services and essential infrastructure as well as an added incentive for further economic development. The leaders of rural electric cooperatives, family-owned and cooperative telecommunications companies as well as rural water systems often play an integral role in bringing new business opportunities to rural communities.

The future of many rural communities may depend on developing regional coalitions of investors or finding new ways to assist farmers who want to free-up their equity for off-farm investments. More and more, communities that succeed in creating new jobs, attracting new business, and fostering an environment for economic development collaborate and partner with financial institutions, universities, government agencies, rural community leaders and farm groups.

Together, they capitalize on resources and find new ways to invest in the future of the community. These may be strategic, partnership, equity or community investments, ranging from forming state-chartered LLCs to providing financially related services to acquiring an ownership interest in a rural business or investing in bonds that fund rural infrastructure. In addition to sourcing capital and appropriately managing the risk involved, the essence of success for many lies with entrepreneurial support such as business consulting.

Regional collaboration, public-private partnerships and coalitions of investors are key to the future of many rural communities. Rural America and agriculture need investors and financial/business partners to meet the growing requirements of rural entrepreneurs and to fuel economic growth.

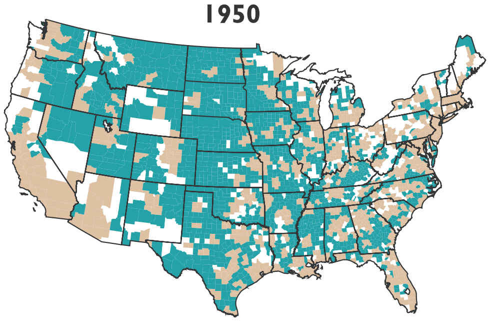
Still, challenges remain for communities losing population and lacking

continues on page 18

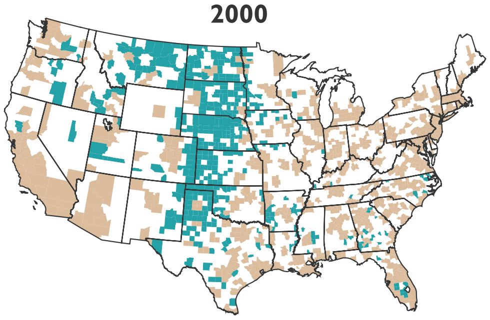
It is increasingly difficult to define a "rural" community solely by population or traditional qualities, yet financing sources often remain limited by these definitions. Some rural areas retain little tie to agriculture today and more agriculture and related businesses are located in suburban areas and near metropolitan centers. Rural residents and producers living in diverse communities throughout the nation need access to full-service residential mortgage products and the ability to leverage equity for other family needs and obligations.

Farming-Dependent Counties

1950



2000



Nonmetro farming-dependent
Other nonmetro
Metro

Source: USDA

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opportunities for rural entrepreneurs and young families. Data from USDA and the Federal Deposit Insurance Corporation (FDIC) identify those counties with the most persistent population loss and those that depend most on production agriculture. In many cases, they are the same areas.

The major areas losing rural population include the Great Plains, the Corn Belt, the southern Mississippi delta and the eastern Appalachian Mountains. The most serious population drain is in the rural Great Plains, where only 11 percent of counties qualify as metropolitan. The Great Plains account for 304 of the nation's 662 depopulating rural counties. In this region, 72 percent of rural counties have lost population since 1970 and population loss accelerated during the 1990s.

USDA considers 403 of the nation's 2,052 rural counties to be "farming-dependent," where either 15 percent or more of average annual labor and proprietors' earnings derived from farming or 15 percent or more of employed residents worked in farm occupations in 2000. These farm counties tend to be clustered in the Great Plains states from Montana and North Dakota through Texas.

"Communities experiencing financial stress may be caught in a downward spiral as their sagging economies are met with less access to the very capital they need to shore up existing businesses," observes Dr. Gary A. Goreham of North Dakota State University. Social and human capital often dictates access to financial capital, Goreham notes. The number of organizations, the people involved in them, their commitment and participation, and the quality and quantity of the resources they contribute to the organizations defines social capital. "Research has borne out that a cyclical, symbiotic relationship exists among the various forms of capital. By building human and social capital, financial capital is increased," Goreham concludes.

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Progress of Rural Infrastructure

Source: USDA

1930

13% of all farms have electricity

1940

25% have phones
33% have electricity

continued from page 18

Importance of rural housing

As the population size and character of rural communities changed over the years, the need for, cost of and available financing for rural housing has varied from town to town and county to county. Housing is rated deficient in 302 rural counties, educational levels rank below average in 499, unemployment above average in 396 and poverty has persisted for more than 40 years in 340.

On the other hand, 227 rural counties are seeing population growth as a result of retirement and 334 earn significant income from recreation-related business.

Rural home financing often does not fit the cookie cutter approach of lenders who originate qualifying loans to be sold to government-sponsored enterprises such as Fannie Mae and Freddie Mac. Additional acreage, farm outbuildings, woodlands, proximity to farms and lack of sales data for comparable properties often makes these properties "non-conforming" to other lenders. Also, they may be undesirable to lenders who do not want to bear the risk of carrying long-term loans on their balance sheets.

On the other hand, rural homeowners are not unlike others in suburban and urban areas in that they rely on their accumulated real estate equity for other family purposes such as college education expenses, retirement, uninsured health care expenses, major consumer goods purchases, home improvements or to start a new business.

Research conducted by the Housing Assistance Council, headquartered in Washington, D.C., consistently shows that the lower the population of a community, the less access residents have to competing lenders. According to the HAC, "Quality credit and affordable mortgage sources are more difficult to find in many rural areas than in cities or suburbs. The smaller size and remoteness of many rural communities tend to raise lender costs. Lenders in rural areas generally have fewer competitors than urban markets, resulting in increased mortgage costs. It has been estimated that $300 million annually is paid in additional interest rates due to these rural price increases in mortgage products."

For some rural residential markets, experts predict continued growth and rising housing and land costs. Rural home mortgage borrowers need access to a stable source of credit and a full range of residential mortgage products that may not be available as interest rates rise and national or regional lenders abandon rural markets. In the U.S. economy, home ownership is fundamental to improved quality of life and financial mobility. For low-income families and minorities who live in rural America, access to financing that enables home ownership is a critical need.

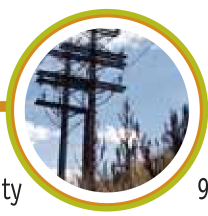
The most-favored rural areas — those with natural beauty, often close to metropolitan areas — will continue to grow. More remote areas that lack these amenities will continue to lose population unless they can improve economic conditions. That will require new entrepreneurs, creating new business ventures and new jobs. And that will require new ideas and new investment.

"Small rural communities don't all suffer from the same problems," says the non-profit Center for Rural Affairs in Walthill, Nebraska. "No model can fix the woes of all small rural communities. It may come down to leadership or it may be as simple as a housing issue. We, as community development providers, must recognize that only the community can address their problems. The best we can do is to provide the resources for them to get the job done."

One of the most critical resources is capital. First, farmers and rural entrepreneurs need investors and financial/business partners to fund and support economic growth in rural communities. Secondly, rural residents and producers living in diverse communities throughout the nation need access to full service residential mortgage products and the ability to leverage real estate equity for other family needs and obligations. Financial institutions serving these customers must have the capacity and flexibility to respond to changing needs. ●

1954

49% have phones
93% have electricity



1968

83% have phones
98% have electricity

1978

90% have phones
99% have electricity

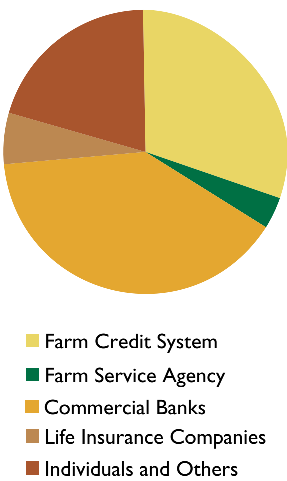
The farm business environment is more competitive and more international in scope than ever before. Managers must not only be highly skilled and knowledgeable of production techniques, but have to confront many complex financial decisions.

— Economic Research Service, USDA, April 2005

Specialized Financial Needs in Rural America

Ongoing access to debt and equity capital is paramount to the future prosperity of U.S. agriculture and rural America. The diversity and continued change in rural America brings with it the need for financial products and services — including some not now widely available in rural areas. The farms, rural businesses and rural communities of the 21st Century need access to dependable, flexible and competitive financial products and services to compete and thrive in this global and rapidly changing environment.

U.S. Farm Debt 2003
$198 Billion



Source: USDA Economic Research Service

In a report requested by Congress in the 1996 farm bill, USDA's Economic Research Service concluded that "rural financial markets work reasonably well" but that the range of financial institutions often narrows compared to urban and suburban areas. The small size of rural communities and the small size of rural borrowers, it notes, limit the number of lenders so that "competition for rural loans is often not as keen as it is for urban loans." USDA added that "small municipalities interested in investing in rural development projects and rural entrepreneurs interested in starting new non-farm businesses may be less well served."

Many of the financial service providers that serve rural areas, keeping pace with their customers, are in the midst of significant restructuring. Current trends affecting financial institutions and their customers raise questions about the cost and availability of capital for rural America.

Traditionally, farm lending has been the principal financial service provided in rural America. Farm business debt is expected to surpass $213 billion by the end of 2005. Most agricultural credit is provided by four major groups of institutional lenders —commercial banks, the customer-owned Farm Credit System, USDA's Farm Service Agency and life insurance companies. Increasingly, merchants and farm implement dealers provide credit for purchases and operations. In recent years, Congress has responded to the requests of commercial banks

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that desired greater access to funding sources to assist them in serving agriculture by authorizing Farmer Mac (the Federal Agricultural Mortgage Corporation) and by expanding the role of the Federal Home Loan Bank System to provide advances for some agriculture needs.

Deregulation of commercial banks' interest rates, territorial limitations and permissible activities in the early 1980s not only gave agricultural commercial banks more flexibility but also made them attractive for takeover by larger banks. According to an FDIC Report, in the ten years from December 31, 1992 to December 31, 2002, the number of agricultural banks fell from 3,022 to 1,826, a 40 percent decline. As of the third quarter of 2005, the number of agricultural banks continued to decline to 1,732, and the number will likely decrease further.

Consolidation may improve commercial banks' service to agriculture in some regions but effectively eliminate it in other areas, especially those beyond the agricultural heartland — the banks that serve farmers and ranchers tend to be concentrated in pockets in a few central states. When larger banks that have more profitable, less risky operations elsewhere absorb local banks, the competition to serve agricultural borrowers — especially smaller farmers — may erode.

Many farm supply and marketing entities located in rural areas, because of their targeted focus on the agricultural community, find it difficult to attract a bank that understands their marketplace and the business challenges they face. Their challenges stand out more acutely in areas where commercial banks are not actively engaged in agricultural lending.

FDIC counted more than 1,400 banks in counties with declining populations in 2004. It said many of these banks would face challenges on both sides of the balance sheet — with funding increasingly difficult and the demand for loans waning. "Rural depopulation therefore has significant implications for the U.S. banking industry, especially with regard to the long-term health of rural community banks," said FDIC's report.

The evolution of agriculture from a relatively homogeneous sector to one that is characterized by diversity has had a direct effect on agricultural lenders. While farm loans share some characteristics, the financial service needs of large commercial farms are different and often more complex than those of smaller-scale farmers.

In some areas, some small-scale farms do not have access to several competitive lenders or to the offices of full-service financial institutions that proliferate in cities and suburbs to meet all of their needs.

Larger agricultural firms may follow business practices that resemble those of non-farm corporate business, making it easier for them to take advantage of the services of money

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Declining Number of Agricultural Banks

Source: FDIC. U.S. banks with 25 percent or more of portfolio in ag; excludes Farm Credit

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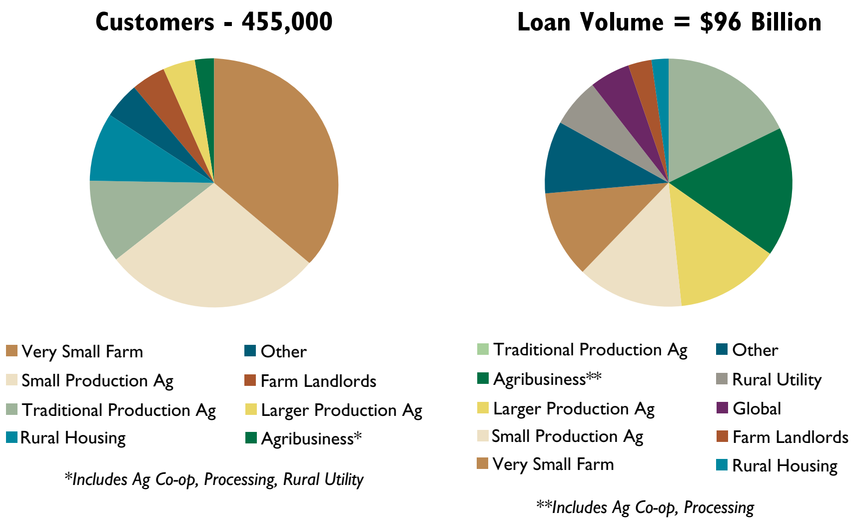
center financial institutions. They do, however, place a premium on knowledgeable, service-oriented lenders who understand agriculture.

Research at Texas A&M University identified the emergence of new competitors for traditional agricultural lenders in serving larger, specialized farmers. These are the major food processors and retailers who coordinate integrated supply chains that move an increasing share of agricultural commodities. Once they have consolidated their supplier base, some economists believe they may begin to seek ways to help their growers reduce borrowing costs and tie growers more closely to them.

Beyond the need for adequate financing for today's farmers, the nation needs adequate financing for the businesses that serve them and that process their products. Eddy LaDue and Brent Gloy of Cornell University emphasize the needs of this sector:

Meeting the needs of the wide range of producers and related businesses that supply our food and fiber requires far different strategies and more flexible financial solutions than were necessary in a time of a more homogeneous agriculture. Today that includes everything from commercial fishing to greenhouse operations.

Farm Credit System - December 31, 2004



Source: Farm Credit HORIZONS Project

"Strong businesses are required for a strong agriculture. By ensuring adequate funding for agribusinesses, the health of the entire agricultural community is improved. This would allow agriculture to make its maximum contribution to the development of rural areas. Although agribusinesses are only a part of the total rural development picture, they do comprise a major part of the economy of many rural communities. However, the basic question remains as to whether debt capital is a limiting factor for agribusinesses in rural communities."

The most widely recognized gap in rural financial markets lies in the equity market. Venture capital has been invested largely in a few metropolitan centers with the promise of higher returns from information technology and biotechnology. Successful rural businesses need a balance between equity and debt financing. Limits on the amount of available equity will constrain access to debt. Phil Kenkel of Oklahoma State University's Department of Agricultural Economics, expands on this point. "The typical agricultural value-added project does not have the size or growth potential to interest venture capital providers."

No matter what their size, almost 99 percent of all American farms are owned by individuals, family partnerships and family corporations, according to the U.S. Census of Agriculture. Farmers of all sizes, and ag-related businesses, face ongoing economic cycles resulting from weather and other volatile factors. This makes it even more important that they have access to a reliable financial partner dedicated to their industry.

Experts agree that no other financial system has the long-term commitment, singular mission focus, financial capacity, expertise and network of customer-owned associations and banks to better serve agriculture and rural America than the Farm Credit System. With its 90-year track record and approximately $20 billion in farmer-owned capital, the Farm Credit System represents one of the most successful, financially sound farmer-owned cooperatives in the U.S, and possesses the expertise and

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Farm Credit System Lending to Young, Beginning, and Small Farmers and Ranchers During the Year Ending December 31, 2004

All Farm Credit Institutions

	Number of Loans	Loan Volume (Millions)	Average Loan Size (Actual)
Young:			
Loans Made	39,670	$4,415	$111,310
Beginning:			
Loans Made	49,636	$6,758	$136,161
Small:			
Loans Made	148,086	$9,840	$66,450

Note: It is not meaningful to add two or three YBS categories together since the categories are not mutually exclusive.

Source: Farm Credit Administration

continued from page 22

delivery system to lead and collaborate with other partners in investing in the future growth of rural America.

At the end of 2004, Farm Credit's 455,000 customer-owners collectively reported nearly $96 billion in outstanding loans. A survey of Farm Credit System associations conducted as part of the HORIZONS Project found that the majority of its borrowers are small- and mid-size farms, while the concentration of borrowing volume rests with mid-sized and larger farmers. Nearly two in five Farm Credit borrowers sell less than $50,000 a year, yet 5 percent produce $1 million or more. Approximately 60 percent of the number of the System's loans made in 2004 went to small farmers with less than $250,000 in annual sales. Measured separately, about 20 percent of System's loans made in 2004 benefitted beginning producers, those with ten or less years in farming, or ranching. Approximately 16 percent of the new loans made in 2004 benefitted young producers 35 years old and younger.

This report has discussed several facets of businesses in rural America, from the high-tech, capital-intensive industrial-scale operation through today's two-income family farm to the rural entrepreneur who may have investment income or a city job.

Like these businesses, Farm Credit must evolve. As stated by Dr. David M. Kohl, professor emeritus of agricultural and applied economics at Virginia Tech, "The emerging agricultural base that is earnings-oriented and entrepreneurial makes [Farm Credit] institutions vulnerable because of government and regulatory restrictions that are too slow to be proactive."

Agriculture remains strategically important to the U.S economy and the economic health of rural America affects our national well-being. Fully serving the financial needs of both will continue to require the resources of the Farm Credit System, commercial banks and other financial service providers working together.

To the 21 percent of the U.S. population in rural America, access to capital drives economic growth and opportunity. While rural America has changed, the need for capital and financial services remains as great as with previous generations.

Rural America is a dynamic place and will require additional financing as it adapts to its changing environment. Traditional agricultural financing needs can be expected to increase as output expands and as technology changes. Farmer families with substantial off-farm income will also require additional financing as will rural residents who may, or may not, have a direct connection to traditional agriculture.

–Dr. Emery N. Castle, Retired, Oregon State University

Conclusion: Collaboration Essential for the Future

This report is part of a forward-looking research and trends analysis project called HORIZONS. The objective of this project, which was created by the customer-owned Farm Credit System, is to identify the financial and economic needs that are emerging in rural America and agriculture, and disseminate this information to individuals and organizations having an interest in a vibrant future for rural America and agriculture. Through original research and data collection, HORIZONS identified and documented business trends across the entire national spectrum of agriculture, agriculturally related enterprises, rural businesses as well as the community and financial services infrastructure that supports them.

HORIZONS offers a number of valuable insights and observations, some of which amplify and sharpen the evolving picture of rural America and agriculture and others that identify and explore new challenges and opportunities. But at its core, the HORIZONS research and assessment initiative identified four essential financial needs related to future success.

FOUR ESSENTIAL FINANCIAL NEEDS

1. Producers and rural entrepreneurs of all types require access to a dedicated, specialized lender to meet their complete credit needs.

2. A broad range of processing, marketing and other agriculturally related businesses on which farmers depend require ongoing access to reliable, flexible financial products and services to compete in a rapidly changing business environment.

3. Rural America and agriculture need investors and financial/business partners to meet the growing requirements of rural entrepreneurs and to fuel economic growth in rural communities.

4. Rural residents and producers living in increasingly diverse communities throughout the nation require access to full service residential mortgage products and the ability to leverage real estate equity for other family needs and obligations.

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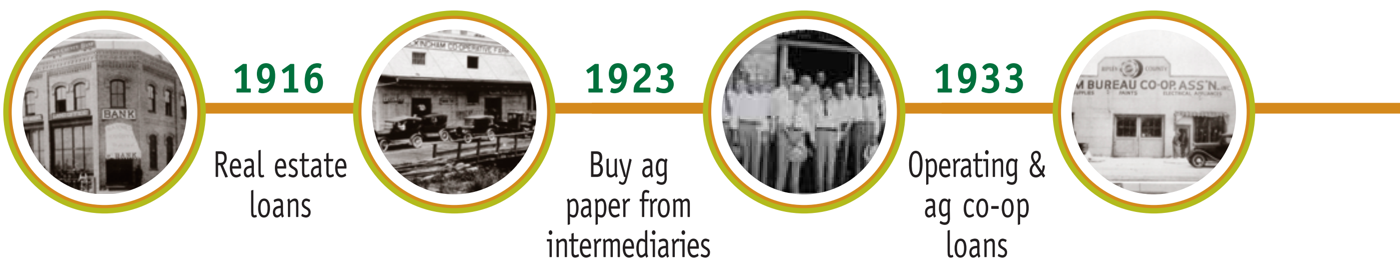
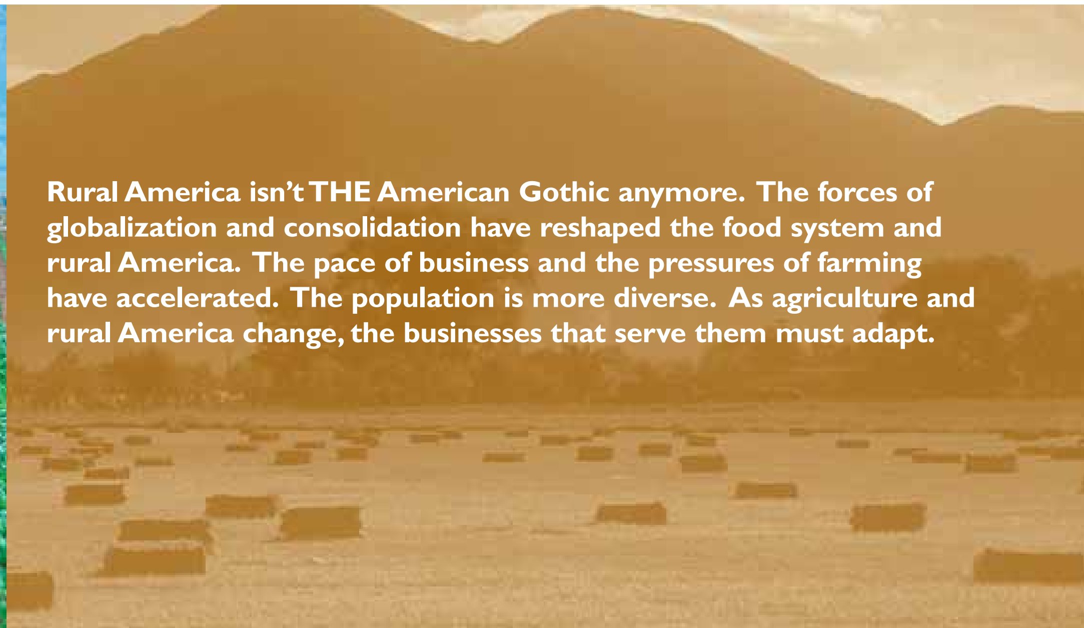
Farm Credit Serving Rural America

Dates U.S. Congress authorizes Farm Credit banks and associations to fill specific credit needs





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At the back of this report, you'll find inserts that profile farmers, ranchers, rural entrepreneurs and business owners. These individuals have volunteered to share their unique stories about their business challenges and financial needs. They are among the millions of people who live and work in rural America and the reason for the HORIZONS initiative.

Rural America isn't THE American Gothic anymore. The forces of globalization and consolidation have reshaped the food system and rural America. The pace of business and the pressures of farming have accelerated. The population is more diverse.

But even as the number of farmers, ag-related jobs and industries, and ag-dependent communities has declined, new advances in mechanization and biotechnology, and the emergence of new global markets for U.S. products, offer much promise. Rural America offers a significant advantage for business development and growth.

A bright future for agriculture and rural America depends to a great degree on the continued ability of farmers, ranchers, and rural business and civic leaders to adapt and change in a dynamic environment.

But others also can adapt — and respond

Because rural communities and the agricultural sector must have reliable access to capital, financial services and the expertise necessary to sustain a strong economic future, investors should

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1971

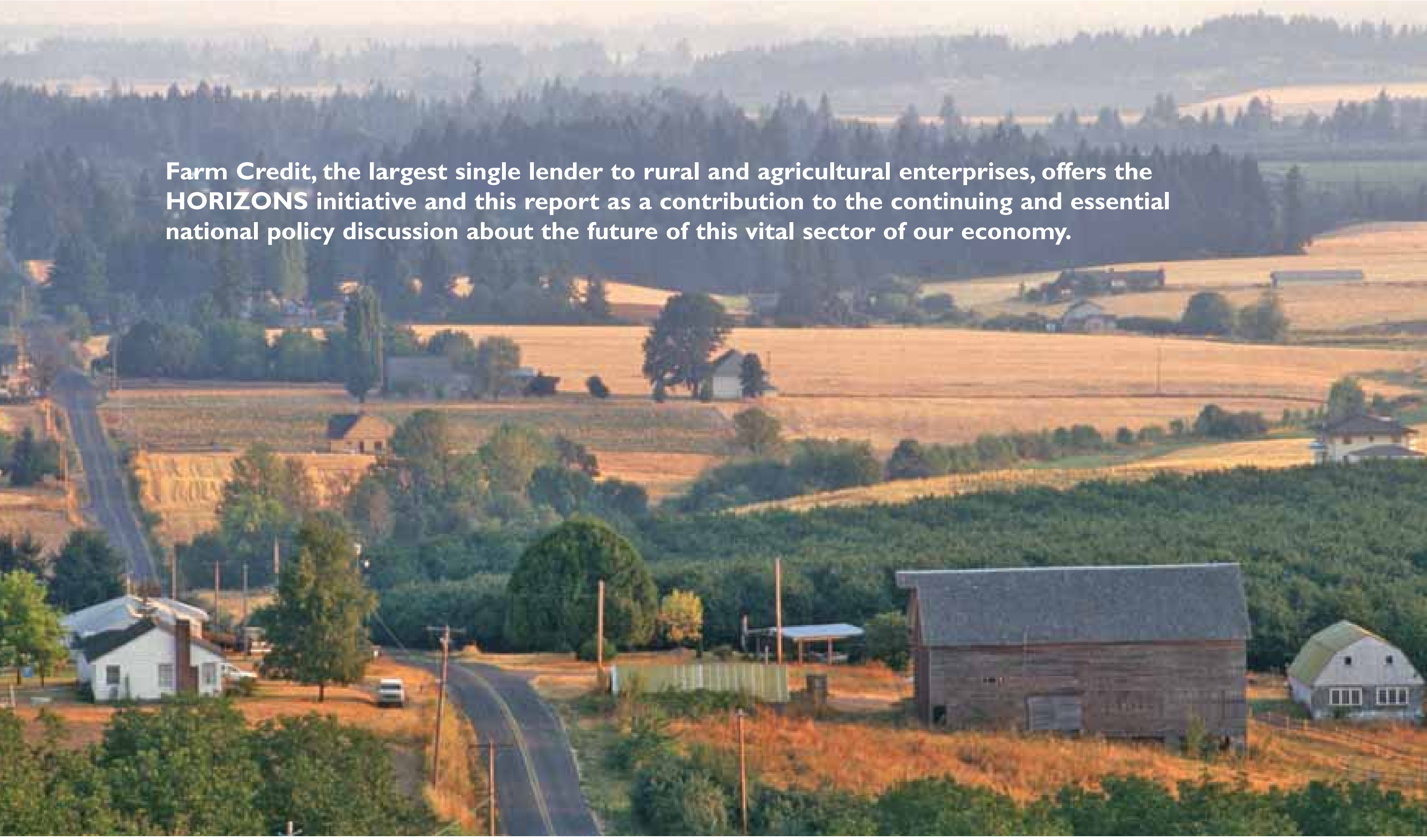
Rural homes, electric & telephone co-ops, financial services

1980

Agricultural exports

1990

Water & waste disposal systems



Farm Credit, the largest single lender to rural and agricultural enterprises, offers the HORIZONS initiative and this report as a contribution to the continuing and essential national policy discussion about the future of this vital sector of our economy.

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understand and appreciate the promise of the emerging rural marketplace.

Lenders and financial services providers must have the capacity, knowledge and flexibility to anticipate and respond to a wide range of opportunities to foster economic development and support growth in agriculture, related businesses and rural infrastructure.

Rural civic and business leaders, and groups and individuals with an interest in agriculture and agriculture policy issues, can contribute by working together and lending their expertise and resources to help raise awareness of evolving rural challenges and opportunities.

And policymakers can help address the new realities confronting agriculture and rural America by implementing workable policy solutions.

Over the past 90 years, the customer-owned Farm Credit System has dedicated its financial strength, resources and expertise to the singular mission focus of maintaining the quality of life in rural America and on the farm and ranch.

Farm Credit, the largest single lender to rural and agricultural enterprises, offers the HORIZONS initiative and this report as a contribution to the continuing and essential national policy discussion about the future of this vital sector of our economy. We will continue to invest our time, and our resources, in the search for viable policy and marketplace solutions to foster rural and agricultural growth and prosperity for another 90 years and beyond.

Research Methodology

The HORIZONS Project invited 19 experts, mostly from the U.S. Land Grant University System, to submit papers on a variety of customer, financial and marketplace issues affecting U.S. agriculture and rural America. In addition, the HORIZONS Project consulted more than 125 third-party articles, reports, Web sites, statistical summaries and books that were relevant to the HORIZONS initiative. Sources included several U.S. Department of Agriculture agencies, Land Grant Universities, rural development groups, other farm organizations, farm publications and the wealth of information available on the Internet.

The project asked each Farm Credit System institution with direct-lending authorities to complete a 19-page, self-assessment or survey based on common customer segmentation guidelines. This included questions about customer business trends and financial needs as well as a detailed breakdown of customer numbers and loan volume outstanding as of December 31, 2004. In all, 79 Farm Credit associations and five System banks completed the surveys and submitted them on January 31, 2005.

The information from external and internal sources was compiled and provided to seven HORIZONS Marketplace Task Forces and the HORIZONS Steering Committee, comprised of farmer-directors and management from across the nation. The seven task forces, made up of more than 100 System employees and managers, conducted an extensive analysis of the research and developed findings.

The HORIZONS findings were shared and discussed with some 750 local farmer-directors and Farm Credit managers at national and regional meetings across the country. Subsequently, the HORIZONS Steering Committee prepared this report to disseminate to all who have a vested interest in the continued success and future of U.S. agriculture and rural America.

External Expert Papers

Complete copies of the papers are available on www.fchorizons.com.

George Acquaah
and Clark Williams,
Langston University
Diversity in the American Farming Community and Opportunities for the Farm Credit System

Dr. Michael Boehlje and
Dr. Allan Gray, Purdue University
Agricultural Lending Challenges in the 21st Century: The Challenges and Opportunities

Dr. David Freshwater,
University of Kentucky
External Constraints and Opportunities for The Farm Credit System

Dr. Emery N. Castle, Retired,
Oregon State University
Financial Strategies for Rural America, 2005-2016

Dr. Gary A. Goreham,
North Dakota State University
Farm Credit Services and Social Capital in Rural Communities

Dr. Phil Kenkel,
Oklahoma State University
Evolving Credit Needs of Cooperative and Producer-Owned Businesses

Dr. Danny Klinefelter and Dr. John Penson, Texas A&M University
Serving the Changing Financial Needs of American Farmers and Ranchers, 2005-2016

Dr. Peter J. Barry,
University of Illinois
Meeting the Needs of a Diverse Agriculture: The Farm Credit System's Public Mission

Dr. Lloyd C. Irland,
The Irland Group and Yale University
Challenges Facing the US Solid Wood and Timberland Sector: A Lending Institution's Perspective

Dr. David M. Kohl,
Virginia Tech
From the Outside Looking In: Through Your Competitor's Eyes

Dr. Eddy LaDue and
Dr. Brent Gloy, Cornell University
The Changing Marketplace and Its Implications for the Future of The Farm Credit System

Joseph Guenthner,
University of Idaho
Gaining Market Power through Grower Consolidation, Intellectual Property Rights and Human Capital

Mark Drabenstott,
Federal Reserve Bank of Kansas City
Top Ten Ways to Reinvest Rural Regions

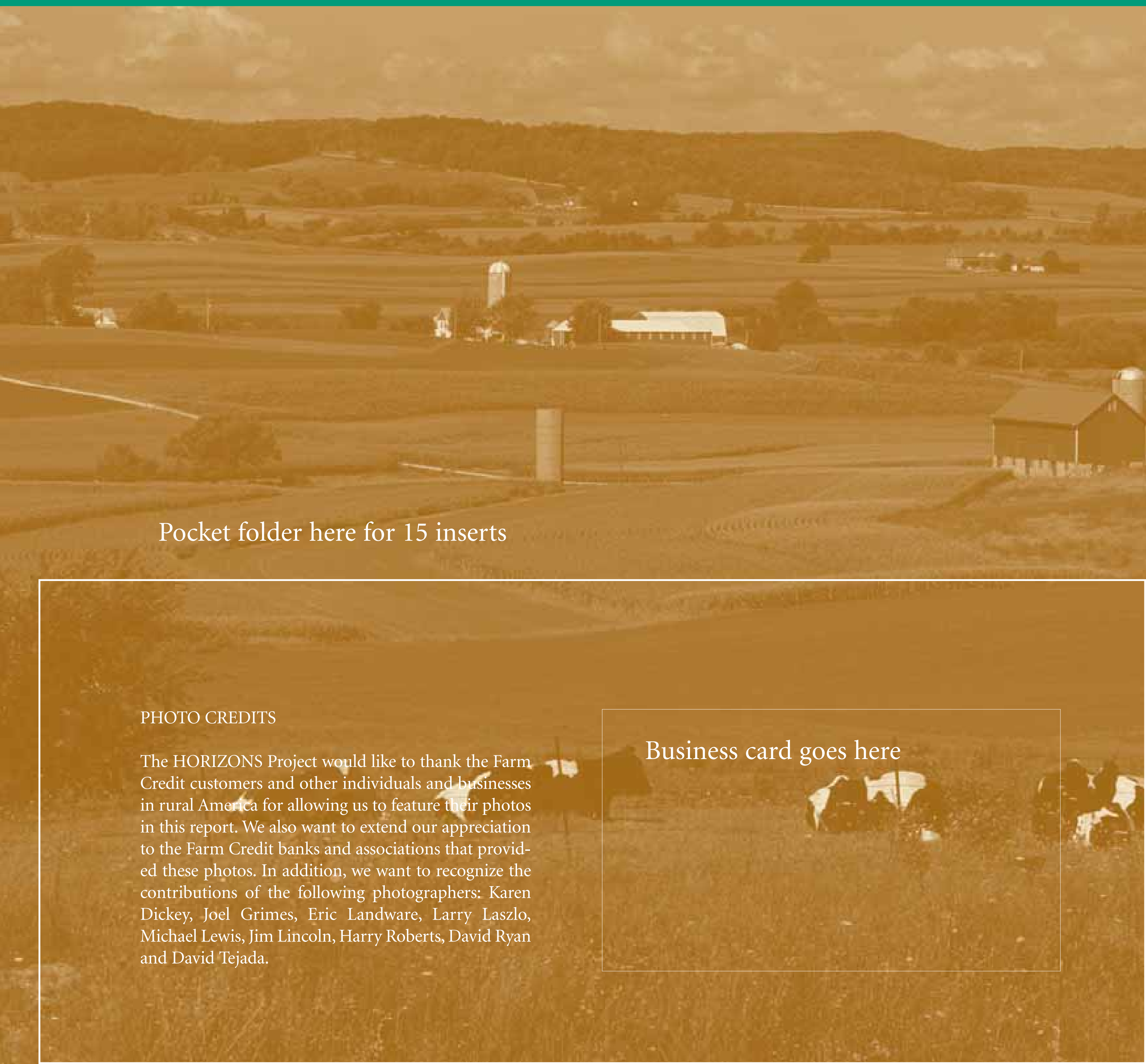

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PHOTO CREDITS

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THE FARM CREDIT COUNCIL, INC.
50 F Street, N.W., Suite 900
Washington, DC 20001-1530

(800) 525-2345

www. fccouncil.com
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