

Rabobank Buyout of FCSAmerica

by Neil E. Harl*

The announcement in late July that Rabobank, the Dutch banking cooperative, had agreed to purchase Farm Credit Services of America (FCSAmerica) was greeted with surprise on most fronts. While mergers in finance, particularly among banks, have become commonplace, the proposed merger of a foreign lender with a unit of the Farm Credit System was a shock. In fact, the transaction would be precedent setting in that this is the first sale of a unit in the Farm Credit System. While regulatory approval and a favorable stockholder vote remain as obstacles to the buyout, the deal is likely to have an impact on the lending landscape in agriculture for some time to come.

The deal

The buyout, with a \$600 million cash purchase price, benefits the nearly 51,000 stockholders to the tune of an average of slightly less than \$12,000 each. The range of payout is expected to run from a few dollars to amounts well into six figures.

The announcement of the deal stated that the total purchase price would be “allocated among the FCSAmerica stockholders primarily on a patronage basis, based on each stockholder’s loans outstanding with FCSAmerica over a specified period.” The “specified period” has not been announced but is believed to be 1999-2004. A packet of materials explaining the deal is to be mailed in September to the stockholders.

Depending upon how it’s handled, there could be significant income tax consequences for the stockholders and the cooperative.

How will the stockholders vote? Apparently, each stockholder has one vote on the buyout. It’s not to be based on patronage. For approval, the acquisition requires a majority vote of those voting.

As of June 30, 2004, FCSAmerica had net assets of approximately \$1.3 billion. An important question: is \$600 million a reasonable premium for the deal?

The deal is subject to regulatory approval by the Farm Credit Administration. Thus far, there’s no indication of how FCA will vote on the proposed transaction.

What’s driving the deal?

The drivers behind the transaction appear to differ among the parties to the acquisition□

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- For members, the attraction is their share of the purchase price.
- For Rabobank, the big attraction is a lending beachhead in the heart of U.S. agriculture. Rabobank is already a huge player in agricultural lending but the proposed acquisition will boost the Dutch firm into the front ranks of agricultural lending in the United States.
- For FCSAmerica, the acquired lending units would be freed of Farm Credit System limits and constraints.

Who's Rabobank?

As we noted, Rabobank is a huge player in agricultural lending, almost world-wide, the 15th largest banking organization in the world, by one measure, headquartered in the Netherlands. The Dutch firm is owned by more than 325 local banks providing financial services and products to the Dutch retail and business markets.

Rabobank has 1.3 million members in the Dutch home market, 9,000,000 business and private customers and is a market leader in virtually every area of financial services.

Outside the Netherlands, the Rabobank group, as it is called, has 222 offices in 34 countries. The firm has a particularly large market share in Australia.

Rabobank has long been known as a leading lender to agri-business firms, including several that are globally prominent with a major presence in the United States.

This is another high-profile push by Rabobank into producer lending. In 2003, Rabobank acquired Cedar Falls, Iowa-based Ag Services of America, a crop input lender with an extensive delivery network. Also, in 2003, Rabobank International acquired an agricultural mortgage lender (St. Louis-based Lend Lease Agribusiness) with a nationwide distribution network.

How will this impact the Farm Credit System?

Clearly, Rabobank as buyer is not getting the FCS charter. As part of the deal, FCSAmerica must give up its status and membership in the U.S. Farm Credit System. The withdrawal of FCSAmerica from the Farm Credit System allows FCA to award charters to other Farm Credit System institutions for Iowa, Nebraska, South Dakota and Wyoming. A start-up phase is expected to take several years before a new charter holder is up and running with a meaningful competitive presence. Remember, the Farm Credit System has been building its system for 88 years.

As part of its withdrawal from the system, FCSAmerica must pay an "exit" fee of more than \$800 million. That payment will go into the Farm Credit System insurance fund. This is likely to lead to reduced insurance premiums for some period into the future for borrowers throughout the system.

What are the concerns?

The first and obvious concern is whether the stockholders of a unit of the Farm Credit System should be permitted to benefit from a sale of the cooperative. It's important to note that Congress has given the Farm Credit System a privileged position in agricultural lending. Among the benefits is a special status that allows the Farm Credit System to access funds from the money markets at a slightly higher cost than the U.S. Treasury can borrow in the same markets. Over the years, the cost of money has run from 20 to 80 basis points over treasuries. That's a very significant advantage and has contributed to the value of FCSAmerica.

The policy question: did Congress intend for the current stockholders in a Farm Credit System unit to vote to sell the assets and pocket the benefit? It seems questionable, at best, that such was the intent initially or during the extended period in the 1980s when the Farm Credit System was effectively rechartered with government assistance to failing components of the system.

An important question is the legal and tax status of the resulting "banks" or "bank offices" of Rabobank. It is widely known that Rabobank is a cooperative. Generally, cooperatives (other than credit unions) have not been allowed to engage in banking. The tax status, particularly, has important implications for competitiveness with other lenders.

If the buyout of FCSAmerica goes through, the message is unlikely to be lost on the remaining districts. Will they become targets from other large lenders looking to enhance their position in agricultural lending? That could well spell the end of the Farm Credit System. Only time will tell about this one.

Other proposals?

AgStar, which operates Farm Credit institutions in Minnesota and Wisconsin, had offered a counter-proposal to acquire FCSAmerica. That bid would have kept FCSAmerica within the Farm Credit System. That proposal was rejected by the FCSAmerica board. A second proposal by AgStar has been made since the buyout announcement.

The long view

An evaluation of moves of this nature and magnitude suggest that a very long view is appropriate. Here are some thoughts to ponder□

- Remember, the first unit of the Farm Credit System was the Federal Land Bank, created in 1916, to provide a dependable source of long-term credit for land purchases. Competition was already expected to be intense, even before this deal, in short- and intermediate-term agricultural lending. Will long-term land lending (25- to 30-year loans) fare as well?

If a new charter-holder moves into the states involved, the result could be a highly competitive environment once the charter-holder is up and running. Lender success will likely hinge on cost of money, efficiency in lending and marketing prowess.

- This proposed buy-out would be part of a dramatic increase in concentration in the input-supply side of agriculture, at the same time concentration has been increasing in the output side of the sector. In the past decade, consolidation in seed and chemicals, grain handling and shipping, farm equipment manufacturing and meat packing have helped to transform the agricultural sector.
- In recent months, some have voiced concern as to whether U.S. agriculture will remain competitive on a world-wide basis. This acquisition provides a fairly solid indication that the world's 15th largest bank views U.S. agriculture favorably enough to invest a significant amount of capital.
- At some point, Congress will be encouraged to get involved in re-examining the playing field, particularly if other FCS units make the same move.

Again, only time can tell. We're heading down an untraveled road.

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