

Background Information

Discussion of S&P Rating Class

Long-Term Issue Credit Ratings

Issue credit ratings are based, in varying degrees, on the following considerations:

- Likelihood of payment—capacity and willingness of the obligor to meet its financial commitment on an obligation in accordance with the terms of the obligation;
- Nature of and provisions of the obligation;
- Protection afforded by, and relative position of, the obligation in the event of bankruptcy, reorganization, or other arrangement under the laws of bankruptcy and other laws affecting creditors' rights.

Issue ratings are an assessment of default risk, but may incorporate an assessment of relative seniority or ultimate recovery in the event of default. Junior obligations are typically rated lower than senior obligations, to reflect the lower priority in bankruptcy, as noted above. (Such differentiation may apply when an entity has both senior and subordinated obligations, secured and unsecured obligations, or operating company and holding company obligations.)

AAA

An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong.

AA

An obligation rated 'AA' differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong.

A

An obligation rated 'A' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.

BBB

An obligation rated 'BBB' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

BB, B, CCC, CC, and C

Obligations rated 'BB', 'B', 'CCC', 'CC', and 'C' are regarded as having significant speculative characteristics. 'BB' indicates the least degree of speculation and 'C' the highest. While such obligations will likely have some quality and protective characteristics, these may be outweighed by large uncertainties or major exposures to adverse conditions.

BB

An obligation rated 'BB' is less vulnerable to nonpayment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial, or economic conditions which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

B

An obligation rated 'B' is more vulnerable to nonpayment than obligations rated 'BB', but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse

business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation.

CCC

An obligation rated 'CCC' is currently vulnerable to nonpayment, and is dependent upon favorable business, financial, and economic conditions for the obligor to meet its financial commitment on the obligation. In the event of adverse business, financial, or economic conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation.

CC

An obligation rated 'CC' is currently highly vulnerable to nonpayment.

C

A 'C' rating is assigned to obligations that are currently highly vulnerable to nonpayment, obligations that have payment arrearages allowed by the terms of the documents, or obligations of an issuer that is the subject of a bankruptcy petition or similar action which have not experienced a payment default. Among others, the 'C' rating may be assigned to subordinated debt, preferred stock or other obligations on which cash payments have been suspended in accordance with the instrument's terms.

D

An obligation rated 'D' is in payment default. The 'D' rating category is used when payments on an obligation are not made on the date due even if the applicable grace period has not expired, unless Standard & Poor's believes that such payments will be made during such grace period. The 'D' rating also will be used upon the filing of a bankruptcy petition or the taking of a similar action if payments on an obligation are jeopardized.

Plus (+) or minus (-)

The ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

NR

This indicates that no rating has been requested, that there is insufficient information on which to base a rating, or that Standard & Poor's does not rate a particular obligation as a matter of policy.

<http://www2.standardandpoors.com/portal/site/sp/en/us/page.article/2,1,3,0,1204838038012.html#ID217>

Bond Spreads as of 2006

Rating	1 yr	2 yr	3 yr	5 yr	7 yr	10 yr	30 yr
Aaa/AAA	14	16	27	40	56	68	90
Aa1/AA+	22	30	31	48	64	77	99
Aa2/AA	24	37	39	54	67	80	103
Aa3/AA-	25	39	40	58	71	81	109
A1/A+	43	48	52	65	79	93	117
A2/A	46	51	54	67	81	95	121
A3/A-	50	54	57	72	84	98	124
Baa1/BBB+	62	72	80	92	121	141	170
Baa2/BBB	65	80	88	97	128	151	177
Baa3/BBB-	72	85	90	102	134	159	183
Ba1/BB+	185	195	205	215	235	255	275
Ba2/BB	195	205	215	225	245	265	285
Ba3/BB-	205	215	225	235	255	275	295
B1/B+	265	275	285	315	355	395	445
B2/B	275	285	295	325	365	405	455
B3/B-	285	295	305	335	375	415	465
Caa/CCC+	450	460	470	495	505	515	545

[http://www.bondsonline.com/Todays Market/Corporate Bond Spreads.php](http://www.bondsonline.com/Todays_Market/Corporate_Bond_Spreads.php)

Discussion of Risk Rating Classes from Mark Winger's Master of Agribusiness Thesis.

Utilizing the Basel Accord, Farm Credit categorizes borrowers into the following risk ratings.

1 – Borrowers of the Highest Quality: National and multi-national companies with diverse business assets and sources of income and virtually no lending risk. Often these firms have a significant share of a major, stable industry. Leverage is extremely low relative to the industry. These firms have continuing substantial excess cash flow and interest coverage. Interest payments are protected by a large and exceptionally stable margin. These borrowers' access to national debt markets is virtually assured at all times. Depth of management is apparent in the company organizational structure. These loans are of unquestionable strength. Firms in this category are almost exclusively national credits with public debt ratings of AAA and AA (S&P) or Aaa and Aa (Moody's). Typical farm production loans or local/regional agribusiness credits would not be expected in this class.

2 – Borrowers of Superior Quality: National and multi-national companies with diverse business assets and sources of income and little foreseeable lending risk. Leverage is extremely low relative to the industry. A continuing substantial excess cash flow and interest coverage exists. Interest payments are protected by a large or a very stable margin. These assets are rated lower than the highest quality assets (1s) because the margin of protection may not be as large. These firms have substantial unused debt capacity. These borrowers have access to national markets at virtually all times. Management is highly regarded and has demonstrated industry experience and business expertise. These loans are of undeniable strength. Almost exclusively national credits with public debt ratings of AA and A (S&P) or Aa and A (Moody's). Typical farm production loans or local/regional agribusiness credits would not be expected in this class.

3 – Borrowers of Exceptional Quality: Largely national companies with varied business assets, and sources of income and very limited lending risk. Leverage is extremely low relative to industry. These firms have substantial excess cash flow and interest coverage. Interest payments are protected by a large or stable margin and there is considerable unused debt capacity. These borrowers have ready access to national debt markets. Management is highly regarded and has demonstrated industry experience and business expertise. These loans are of exceptional strength. Rated companies in this category would include those typically in the A range or equivalent. Typical farm production loans or local/regional agribusiness credits would not be expected in this class.

4 – Borrowers of Excellent Quality: Leverage is very low relative to industry standards with very strong liquidity. These firms have a long history of quality earnings with strong interest coverage, cash flow, and debt capacity. Where size allows, the borrower has ready access to national or regional debt markets. Alternative financing is available at all times. Management is highly regarded and has demonstrated industry experience and expertise. These are very strong assets. Rated companies in this category would include

those typically rated BBB+ or BBB (S&P) or Baa1 or Baa2 (Moody's). The highest quality agricultural production loans and local agribusiness accounts would be included in this classification. Loans with Farmer Mac standby purchase commitment would be included.

5- Borrowers of Strong Quality: Leverage is low relative to industry standards with strong liquidity. Consistently generates excess cash flow and interest coverage. Operations are consistently profitable in recent years with significant debt capacity. Borrower has very good access to other financial institutions. Management is sound and has demonstrated industry experience and expertise. These are sound assets in every aspect. Rated companies in this category would include those typically rated BBB or BBB- (S&P) or Baa2 or Baa3 (Moody's).

6 – Borrowers of Good Quality: Leverage is favorable to peers in the industry and typically would have good liquidity. Most key financial measures are at or above the median for peers in the industry. These assets generate excess cash flow and above average levels of profitability. Any unfavorable trends or interim losses are seasonal or cyclical in nature and do not affect overall operations. The firm is readily able to refinance debt with other institutions at similar rates and terms. Management is sound and has demonstrated industry experience and expertise. Assets are of above average quality. Rated companies in this category would include those typically in the BB+ (S&P) or Ba1 (Moody's) range.

7 – Borrowers of Average Quality: Acceptable borrowers based on peers in the industry. Adequate earnings, cash flow, and debt service exist. Trends are positive but may not be consistently stable. Operations typically are profitable, but losses may periodically occur due to a difficult economic environment. Borrowers have sufficient strength and financial flexibility to offset these events. These operations are somewhat vulnerable to prolonged adverse industry conditions. These borrowers are readily able to refinance debt with other financial institutions on similar terms. Management and owners have unquestioned character. Rated companies typically include those in the BB+ and BB (S&P) or Ba1 and Ba2 (Moody's) range.

8 – Borrowers of Adequate Quality: Slightly higher leverage based on peers in the industry. These borrowers exhibit adequate, but inconsistent earnings, cash flow, and debt service. Trends are erratic. Operations are typically profitable, but losses may periodically occur due to a difficult economic environment. Borrowers have sufficient strength and financial flexibility to offset most adversity; however, these operations are vulnerable to adverse industry conditions. Borrowers are able to refinance debt with other institutions. Management concerns may be noted. These assets are desirable but have some weaker characteristics. Rated companies might include those in the BB and BB- (S&P) or Ba1 and Ba2 (Moody's) range.

9 – Borrowers of Minimally Acceptable Quality: More leveraged than peers in the industry and/or liquidity is weak or unstable. Earnings may be marginal, but cash flow, and debt service are sufficient but may be deteriorating, exhibiting signs of strain, are

inconsistent or reliant on projections. These firms are prone to deterioration in a difficult economy. These borrowers have limited access to alternative lenders and a heavy reliance on debt financing. Borrowers may have difficulty in obtaining similar rates and terms. The performance record and lender relationship are usually satisfactory. Management is either unproven or less than average. Assets are acceptable but have conditions that could bring deterioration more quickly than other acceptable loans. Loans with deteriorating trends but still with cash flow coverage would be included in this category. The firm may have temporary setbacks in profitability. Rated companies are typically in the BB- and B+ (S&P) or Ba3 and B1 (Moody's) range. Loans guaranteed by federal agencies such as the USDA Farm Service Agency would be included in this classification.

Categories 10 through 14 are used to classify criticized and adversely classified assets and the discussion of those is beyond the scope of this research. Categories 1 through 3 are typically used for borrowers that are publicly rated and thus will only be used by the largest institutions and would not be applicable to production agriculture firms.