S&P Global Ratings

Research

American AgCredit ACA

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American AgCredit ACA

SACP: bbb+ → **Support: 0** → **Additional factors: 0**

Anchor	bbb+	
Business position	Moderate	-1
Capital and earnings	Strong	+1
Risk position	Adequate	0
Funding	Adequate	0
Liquidity	Adequate	
CRA adjustment		0

ALAC support	0
GRE support	0
Group support	0
Sovereign support	0

Issuer credit rating
BBB+/Stable/--

ALAC--Additional loss-absorbing capacity. CRA--Comparable ratings analysis. GRE--Government-related entity. ICR--Issuer credit rating. SACP--Stand-alone credit profile.

Credit Highlights

Issuer Credit Rating
BBB+/Stable/--

Key strengths	Key risks
Record of low loan losses and solid profitability	Exposure to cyclical commodity prices and unpredictable agricultural conditions
Access to favorably priced funding through CoBank	Limited business diversification
Strong risk-adjusted capital ratio	Higher-than-peers growth, which could indicate greater risk appetite

Our rating on American AgCredit (AAC) balances the company's solid credit history, good earnings, strong capital ratios, and substantial funding and borrowing capacity against its concentration in the cyclical agricultural sector and high growth rates compared with peers. AAC's performance has been solid over the past several years, despite the volatile agricultural markets during this period. We expect AAC to continue generating good earnings, with strong asset quality, and maintain healthy capital ratios over at least the next two years.

Although robust loan growth has weighed on capital ratios, they remain strong, buttressed by the 2021 issuance of preferred stock and subordinated debt. We expect AAC's S&P Global Ratings risk-adjusted capital (RAC) ratio to decline moderately in the next two years, but remain within the 10%-15% range we consider strong. Earnings have remained strong and above peers, reflecting strong loan growth, low provisions, improving efficiency ratios, and the low-cost funding it enjoys as a member of the Farm Credit System (FCS).

AAC's asset quality is consistently healthy, with modest nonperforming loans and low loan losses. However, we believe the loan portfolio, which consists entirely of agricultural related loans as mandated in AAC's charter, remains vulnerable to shifts in market conditions.

AAC, as an association within the FCS, benefits from access to readily available, low-cost funding. We expect it to maintain access to sufficient funding though its general funding agreement with CoBank, a funding bank within the FCS. However, we view on-balance-sheet liquidity as low.

Outlook

The stable outlook indicates our expectation that over at least the next two years, AAC will continue to report good earnings, maintain a RAC ratio between 10%-15%, and have uninterrupted access to funding and liquidity from CoBank. In addition, we expect asset quality measures will remain solid and AAC will maintain its conservative underwriting even while generating above-peer loan growth.

Downside scenario

We could lower our ratings on AAC if its RAC ratio were to fall below and remain lower than 10%, if credit quality metrics weakened substantially, or if we perceived that the association's high growth targets were leading it to loosen its underwriting standards.

Upside scenario

Conversely, we could raise our ratings on AAC if its capital ratios grew and we believed its RAC ratio would remain above 15% on a sustainable basis, if the pace of balance sheet growth moderated, and if loan and revenue diversification improved. We would also look favorably on an increase in the association's proportion of on-balance-sheet liquidity.

Anchor: Adjusted Based On AAC's Regulated Status, Low Competitive Risk, And Favorable Funding

Our starting point--or anchor--for our rating on AAC is 'bb+', in line with that for other U.S. companies that we rate under our nonbank financial institutions criteria. Because of AAC's public policy role, access to government-related entity (GRE) funding, and regulated status, we raise its anchor to 'bbb+', three notches above our anchor for other finance companies and equal to that of U.S. banks. This is to account for the Farm Credit Administration's regulatory oversight, the company's favorable funding through its position in the FCS, and its strong competitive position.

Business Position: Solid Market Position Limited By Concentration Risk

AAC's solid market position as an agricultural lender in seven states and its role as an association operating within the FCS support its business position. With $17.9 billion in assets as of Sept. 30, 2022, AAC is the fourth-largest association in the FCS and the largest in the CoBank district. However, its concentration in agricultural loans--with large exposures to vineyards and wineries, field crops, tree fruits and nuts, dairy, and other agricultural commodities--somewhat offsets these strengths.

In addition, AAC's loan growth in recent years, spurred in part by its shift to an increasingly digital lending platform, has been high, averaging 13% annually over the past five years. We view the deepening of the association's market share within its designated territory because of this growth favorably. However, we also see such outsize growth as a sign of increased risk appetite. That said, AAC management has extensive experience in the agricultural lending industry and has managed risk adequately in recent years, illustrated by its record of strong asset quality, supported by conservative underwriting.

In 2022, AAC announced it plans to merge with Farm Credit of New Mexico (FCNM), a $2.1 billion asset association operating across New Mexico. In our view, the merger, expected to close in July 2023, will modestly increase AAC's geographic reach, loan diversification, and capital ratios, while not significantly changing AAC's financial profile or asset quality performance.

Both American AgCredit FLCA and American AgCredit PCA are wholly owned subsidiaries of American AgCredit ACA. As of Sept. 30, 2022, American AgCredit FLCA and American AgCredit PCA collectively held nearly all the group's assets and generated all its net income. American AgCredit FLCA provides long-term real estate mortgage loans, and American AgCredit PCA provides short-term and intermediate-term loans to agricultural borrowers.

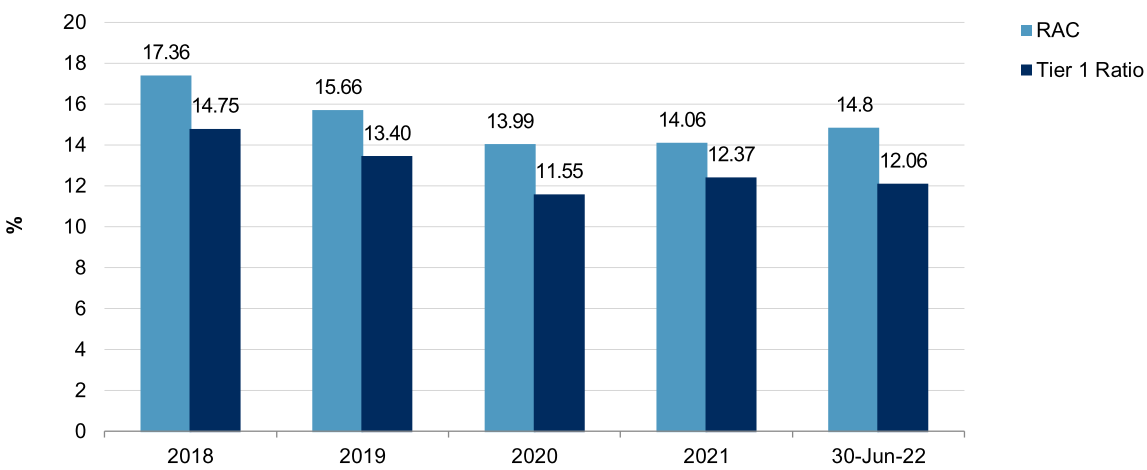
Capital And Earnings: Strong Risk-Based Capital

Our assessment of AAC's capital and earnings incorporates the company's high regulatory capital ratios, combined with low credit loss provisions and satisfactory retention of earnings after patronage payments. However, outsize loan growth has pressured capital ratios, with the association's common equity Tier 1 ratio falling to 10.50% on Sept. 30, 2022, from 15.37% at year-end 2017, while its total capital ratio decreased to 13.27% from 15.57% over the same period. $300 million of preferred stock supplements AAC's capital base.

We calculated a RAC ratio of 14.8% as of June 30, 2022, which is within the 10%-15% range we consider strong. We believe continued above-average loan growth could weigh on capital ratios further, and AAC's RAC ratio will decline to close to the middle of this range within the next two years.

Chart 1

S&P Global Ratings Risk-Adjusted Capital Versus Tier 1 Ratio



The company pays a patronage, or refund, to its members of approximately 50%-60% of earnings annually. We expect the company to pay a similar percentage going forward.

We expect AAC to continue to generate healthy profitability and stable earnings measures over the next several years. We expect AAC to generate increased net interest income propelled by the addition of FCNM and continued, though moderating, loan growth, continued low provisions given low net charge-offs (NCOs), and stable efficiency measures.

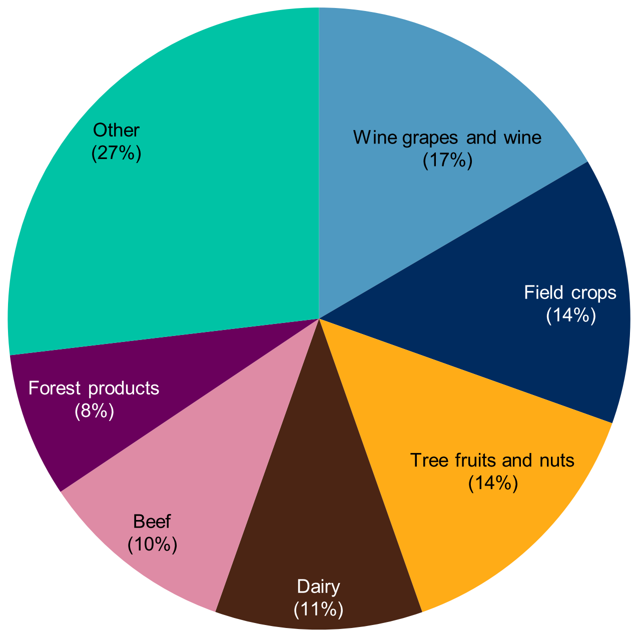
Risk Position: Good Asset Quality Measures

AAC's loan portfolio is somewhat more diversified by product and geography than many other associations. The portfolio includes several different products and commodity types. Similarly, AAC is geographically diverse, with the largest exposures to California (51%), Kansas (11%), and Colorado (10%), and the remainder of the portfolio spread across the U.S. and Guam.

The association engages in loan participations with other Farm Credit institutions to manage risk and improve portfolio diversification. About $3.9 billion of the loan portfolio was purchased and about $6.2 billion of total commitments sold as of Sept. 30, 2022.

Chart 2

Loan Composition As Of Sept. 30, 2022



Source: S&P Global Ratings.

AAC's loan credit quality is strong, with NCOs averaging less than two basis point (bps) annually in the past five years. AAC's nonperforming assets (NPAs) (including troubled debt restructurings) grew to a still moderate 0.71% of loans and other real estate as of Sept. 30, 2022, illustrating industry-wide pressures. We believe AAC's underwriting, and concentration limits, are conservative, as this record indicates. Although the association's allowance for loan losses, measuring 0.25% of loans as of Sept. 30, 2022, is low on an absolute basis, we believe it is appropriate relative to the low NPAs and NCOs.

Funding And Liquidity: Concentrated Funding Source, Offset By Stable Access To Low-Cost Funding

Unlike most other FCS associations, AAC manages its funding through a block funding arrangement with CoBank (most associations match-fund through their funding banks). AAC determines its funding strategy and product offerings, and CoBank executes debt issuance through the Funding Corp. on its behalf. Because AAC does not match-fund through CoBank, it manages its own interest rate risk. Board policies limit sensitivity to a 200 bps shift in interest rates to 10% of net interest income. We believe that management remained within these guidelines as of Dec. 31, 2022.

As a part of its arrangement, AAC maintains liquidity coverage consistent with CoBank's requirements for 15, 30, 90, and 120 days of liquidity. CoBank allocates $4.6 billion of its investment portfolio to AAC for liquidity measurement purposes. In addition, AAC had access to the additional liquidity available through its direct note with CoBank. However, AAC held only a modest $28 million of cash on the balance sheet as of Sept. 30, 2022.

We view favorably AAC's long-term general funding agreement with CoBank, one of the four banks making up the government-sponsored FCS, which lends to associations like AAC. The three-year running agreement provides a low-cost, stable, and primary funding source for AAC. The direct note with CoBank provides it with enough funding for its lending activity, up to a maximum borrowing base, which is redetermined every 15-18 months, though it can be renegotiated as needed. Although AAC is largely dependent on this primary source of funding, we see little risk that it would lose access to funding from CoBank, based on its long historical funding relationship with the bank since the founding of the FCS.

Moreover, the association's issuance of preferred stock and subordinated debt in June 2021 demonstrate its ability to tap additional funding sources if needed. We think AAC could likely obtain additional liquidity, if necessary, by issuing additional debt or preferred stock, or through whole loan or participation sales.

Support

While the rating incorporates the ongoing funding benefits the association receives as a member of a GRE, we believe there is a low likelihood that the U.S. federal government would provide extraordinary support directly to AAC in the event of financial distress. Our assessment is that AAC's individual role is of limited importance to the federal government. In addition, we view AAC as having a limited link to the government. Its members privately own AAC, and the government has no history of providing extraordinary government support directly to associations like it. Therefore, the issuer credit rating does not incorporate any uplift for extraordinary government support.

Environmental, Social, And Governance

Social factors are a positive consideration in our credit rating analysis of AAC. As an association in the FCS, AAC benefits from low-cost funding, which helps it support rural communities and agriculture. Moreover, its cooperative structure prioritizes access and benefits for its member-owners and leads it to maintain strong risk-adjusted capital with less focus on short-term profitability.

Group Structure, Rated Subsidiaries, And Hybrids

We view American AgCredit FLCA and American AgCredit ACA as core subsidiaries to the parent, American AgCredit ACA. We expect AAC to support both entities under all foreseeable circumstances, if needed. We rate AAC's hybrid securities, including its subordinated debt and preferred stock, relative to its group stand-alone credit profile (SACP) because these instruments could face nonpayment risk before more senior instruments. As such, we rate the subordinated debt issued by the core subsidiaries 'BBB' (one notch below the group SACP for contractual subordination) and AAC's preferred stock 'BB+'(three notches below the group SACP for risk of deferral and coupon nonpayment).

Key Figures

Table 1

American AgCredit, ACA Key Figures

		--Year-ended Dec. 31--			
(Mil. $)	2022*	2021	2020	2019	2018
Adjusted assets	17,909.4	16,968.4	15,094.1	12,663.4	10,914.0
Customer loans (gross)	16,938.6	15,934.7	14,170.9	11,844.8	10,214.8
Adjusted common equity	2,642.9	2,382.6	2,214.1	2,113.9	2,002.4
Operating revenues	470.9	592.8	485.6	396.8	345.8
Noninterest expenses	191.3	235.0	228.8	190.7	173.9
Core earnings	261.9	343.1	247.3	200.7	169.4

*Data as of Sept. 30.

Table 2

American AgCredit, ACA Business Position

		--Year-ended Dec. 31--			
(%)	2022*	2021	2020	2019	2018
Return on average common equity	14.0	15.1	11.5	9.8	8.7

Table 3

American AgCredit, ACA Capital And Earnings

		--Year-ended Dec. 31--			
(%)	2022*	2021	2020	2019	2018
Tier 1 capital ratio	12.0	12.4	11.6	13.4	14.8
S&P Global Ratings' RAC ratio before diversification	N/A	14.1	14.0	15.7	17.4
S&P Global Ratings' RAC ratio after diversification	N/A	10.1	10.0	11.1	10.8
Adjusted common equity/total adjusted capital	89.8	88.8	92.7	94.3	94.1
Net interest income/operating revenues	78.3	75.2	76.0	77.5	77.5
Fee income/operating revenues	2.3	4.3	4.5	3.5	5.2
Market-sensitive income/operating revenues	0.1	0.1	(0.7)	N/A	0.1
Cost to income ratio	40.6	39.6	47.1	48.1	50.3
Preprovision operating income/average assets	2.1	2.2	1.9	1.7	1.6
Core earnings/average managed assets	2.0	2.1	1.8	1.7	1.6

*Data as of Sept. 30. N/A--Not applicable.

Table 4

American AgCredit, ACA Risk Position

		--Year-ended Dec. 31--			
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Growth in customer loans	8.40	12.45	19.64	15.96	9.75
Total diversification adjustment/S&P Global Ratings' RWA before diversification	N/A	38.63	39.81	40.86	60.65
Total managed assets/adjusted common equity (x)	6.78	7.12	6.82	5.99	5.45
New loan loss provisions/average customer loans	0.05	0.05	0.07	0.05	0.03
Net charge-offs/average customer loans	0.01	0.02	0.01	0.01	0.00
Gross nonperforming assets/customer loans + other real estate owned	0.71	0.51	0.47	0.51	0.49
Loan loss reserves/gross nonperforming assets	35.65	46.40	49.51	42.71	42.89

*Data as of Sept. 30. N/A--Not applicable.

Table 5

American AgCredit, ACA Funding And Liquidity

		--Year-ended Dec. 31--			
(%)	**2022***	**2021**	**2020**	**2019**	**2018**
Long-term funding ratio	55.8	55.5	61.9	54.9	52.8
Stable funding ratio	53.5	53.0	59.4	52.9	50.8
Short-term wholesale funding/funding base	53.1	53.1	45.5	55.1	58.9
Broad liquid assets/total assets	0.2	0.0	0.4	0.5	0.4
Short-term wholesale funding/total wholesale funding	52.1	52.0	44.9	54.4	58.1

*Data as of Sept. 30.

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Dec. 9, 2021
- Criteria | Financial Institutions | General: Financial Institutions Rating Methodology, Dec. 9, 2021
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Federal Farm Credit Banks, Oct. 6, 2022

- CoBank ACB, Oct. 18, 2022

Ratings Detail (As Of February 15, 2023)*	
American AgCredit, ACA	
Issuer Credit Rating	BBB+/Stable/--
Preferred Stock	BB+
Issuer Credit Ratings History	
19-May-2021	BBB+/Stable/--
Sovereign Rating	
United States	AA+/Stable/A-1+
Related Entities	
American AgCredit FLCA	
Issuer Credit Rating	BBB+/Stable/--
Subordinated	BBB
American AgCredit, PCA	
Issuer Credit Rating	BBB+/Stable/--
Subordinated	BBB

*Unless otherwise noted, all ratings in this report are global scale ratings. S&P Global Ratings' credit ratings on the global scale are comparable across countries. S&P Global Ratings' credit ratings on a national scale are relative to obligors or obligations within that specific country. Issue and debt ratings could include debt guaranteed by another entity, and rated debt that an entity guarantees.