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Handicapping The Midterm Elections

“Gridlock” is the word that best describes the current state of American politics. Since January 2011, control of the federal government has been divided: Democrats in command of the White House and the Senate, Republicans in control of the House of Representatives. Sharp ideological divisions between the parties have thwarted legislative compromise on a wide variety of issues, from taxes and entitlements to health care and immigration reform. Many experts believe the 2014 Farm Bill will likely be the only major piece of legislation signed into law this year.

Against that backdrop, the upcoming midterm elections are among the most hotly contested in recent memory. Republicans believe they have a realistic shot at gaining both houses of Congress; Democrats are trying desperately to preserve their control of the Senate for President Obama’s final two years in office.

For perspective on the elections, *OUTLOOK* turned to Dr. Larry Sabato, founder and director of the University of Virginia Center for Politics. Sabato is widely quoted in the media as an expert on politics, and also directs the Center for Politics’ Crystal Ball website, a leader in accurately predicting elections since its inception. While Dr. Sabato believes that Republicans could well gain the majority in both houses of Congress, he believes gridlock will be a fact of life in Washington no matter what the election’s outcome is.

OUTLOOK: What’s your predicted outcome of the elections, and how will they impact President Obama’s final two years in office?

Larry Sabato: I think it’s very probable that Republicans will gain seats in both houses of Congress. We don’t know yet whether they’ll take over the Senate, but even if they simply gain seats in both houses, the President will have even more trouble securing legislation. We already have severe gridlock, so it will only get worse.

What that means for the President is that he’s going to rely more on his veto power. Incredibly, he’s only vetoed two bills during his time in office so far. That’s because Democrats have been in charge of one or both Houses

Historically, voters have exhibited some degree of rebellion by the sixth year of an eight-year presidency.

About this article



Dr. Larry J. Sabato is the founder and director of the University of Virginia Center for Politics. He is also the University Professor of Politics and has had visiting appointments at Oxford University and Cambridge University in Great Britain. A Rhodes Scholar, he received his doctorate from Oxford, and he is the author or editor of two dozen books on American politics. He has also won two Emmys for historical documentaries aired on PBS.

Sabato directs the Center for Politics' Crystal Ball website, a leader in accurately predicting elections since its inception. In 2004, the Crystal Ball notched a 99 percent accuracy rate in predicting all races for House, Senate, Governor and each state's Electoral College outcome. In 2006, the Pew Research Center and the Pew Charitable Trusts' Project for Excellence in Journalism recognized the Crystal Ball as the leader in the field of political predictors.

Sabato is also very active on social media. His Twitter feed (@LarrySabato) was named by *Time Magazine* as one of the 140 best Twitter feeds of 2014.

his entire time in office, and they tend to only send him bills that he will sign. In the current state, the Democratic Senate kills most of the bills from the Republican House.

He'll also do a lot more foreign travel, which is what Bush did and many Presidents do in their final two years. The President will also have the bully pulpit, he'll have administrative appointments to the extent he can get them through the Senate, and he'll have executive orders, which are controversial.

OUTLOOK: Historically, do midterm elections favor the President's party or the opposition?

LS: This could end up being a classic sixth-year, midterm election. I call it the "sixth-year itch" because, historically, voters have exhibited some degree of rebellion by the sixth year of an eight-year presidency. It's quite natural. The opposition party is furious about decisions that a President has made in his first six years. And parts of the President's own party have been alienated by inaction on some favorite topic, or a belief that the President could have done more to achieve X or Y or Z. So the sixth year tends to be a difficult year.

Still, sixth year elections don't have to be dramatic. You can have marginal losses by the President's party, but it's a very rare midterm election, especially in a sixth year, when the President's party gains seats. That's my 30,000-foot view and it's driven by history.

OUTLOOK: What are the key issues in this election? Will it be the economy, jobs, health care, immigration or foreign affairs?

LS: I would say all of the above. It's difficult to rank them right now because the election is still a few months away. As much as Americans don't want it, it's possible that we could be involved in conflict in one or more countries and that might take some precedence over other issues. If that doesn't happen – which we all hope – then the economy is always important. Obamacare is a massive controversy, especially to the Republican base. It's going to motivate lots of Republican voters, and so will immigration.

The refusal to tackle immigration reform is going to bite the Republicans sooner or later. I don't know if it will be this year; I tend to think it will be in

THE U.S. CONGRESS, SEPTEMBER 2014

	DEMOCRATS	REPUBLICANS	INDEPENDENTS	TOTAL
House	201*	234	0	435
Senate	53	45	2**	100

LEADERSHIP



Speaker of the House
John Boehner (R)



House Minority Leader
Nancy Pelosi (D)



Senate Majority Leader
Harry Reid (D)



Senate Minority Leader
Mitch McConnell (R)

*Includes two seats recently vacated due to resignations – Rep. Mel Watt of North Carolina and Rep. Robert Andrews of New Jersey.

**Both independent senators – Bernie Sanders of Vermont and Angus King of Maine – caucus with the Democratic Party.

the 2016 general election. My information comes from the Republican leadership in Congress. The leadership is united privately in desiring immigration reform compromise. They want to get it out of the way, but they know it's not possible now after the defeat of Eric Cantor. They hope to tackle it if they control both houses after November and send a bill that is appropriate from their perspective to the President. Whether he signs or vetoes it is another question.

Certainly, though, we're not going to have another government shutdown. Republicans are not insane – certainly the leadership isn't – and the last shutdown was an insane thing to do from a political perspective. You can justify

it from a policy perspective if you believe that the most serious question facing the country is the national debt and the deficit. But from a political point of view it was about as stupid as you get. That's what the leaders all said privately.

Leaders are very different from the grassroots. Some of the grassroots believe in being motivated completely by principle. That's admirable, except you can principle yourself to death electorally.

OUTLOOK: The U.S. economy seems to be strengthening, with 4.2 percent growth in the second quarter and an improving job market. How will that play into the election?

LS: I recently did a study on the effect of the economy on elections. Statistics show that when the economy is bad, it helps the out-of-power party a great deal. But when the economy is good, it seems to have minimal effect for the party in power. So, it's a "heads you lose, tails you lose" scenario for the Democrats. I think a strong economy can reduce your losses, but I don't think it's going to eliminate them. I think that's baked into the cake for 2014.

OUTLOOK: Former House Speaker Tip O'Neill famously said, "All politics is local." Do you think that's going to be true this year? Or, do you think larger national issues are going to define the election?

LS: It's fascinating to study the balance of national versus local issues. It's always wrong to say it's just one or the other. There's always a mixture – district-by-district and state-by-state – but increasingly we have had nationally focused elections.

We've had several wave elections in a row – 2006 and 2008 were wave elections for the Democrats, 2010 was a wave election for the Republicans. 2012 was less of a wave but it still had some characteristics of a pro-Democratic wave.

I tend to think that the national issues will predominate, but you can never ignore scandals that affect individual members of Congress. Indictments, gaffes, a major highway that is much disputed in a district – these things matter too.

OUTLOOK: What are the odds that the Republicans are going to maintain their current majority in the House? Do you think the Democrats have a realistic chance of gaining control there?

LS: The odds that the Republicans will retain the House are very high.

To most people, it doesn't look like the Democrats have a very high mountain to climb: They need to gain only 17 seats out of 435 to take control. The problem with that analysis is that the vast majority of districts are non-competitive. The races are over long before Election Day. We can already easily project 350 - 375 seats with a very high degree of confidence. By early fall, it will be 390 to 400 with only a dozen or fewer toss-ups by Election Day.

So, at this point, Republicans are more likely to gain additional seats. For them to lose 17 seats, there would have to be an earthquake or two between now and November, which I don't see happening. So, I would place a heavy bet on the Republicans to retain the House, and probably to add seats.

OUTLOOK: Democrats currently hold the Senate majority. Do you think they will maintain control there?

LS: Republicans are nearly certain to gain seats. Currently, there's a 10-seat gap – 55 for Democrats and 45 for Republicans. But Republicans need to take only six Democratic seats to take control. A tied Senate would still be Democratic because Vice President Biden would break the tie in the Democrats' favor.

I think that Republicans will gain because of the combination of seats that are up in this particular year. There are 36 races – we only elect about a third of the Senate every two years. The reason there are 36 instead of 33 or 34 is because we have a couple of special elections. But of the 36, 21 Democratic seats are coming up versus only 15 Republican seats. Literally, the Democrats have more to lose.

Also, the Republican-controlled states are, with only one exception, rock-ribbed Republican – Idaho, Wyoming, Nebraska, Kansas, Oklahoma,

Democrats have more seats that are vulnerable – both in terms of absolute number and political complexion.

Texas, all of the deep south states, plus Tennessee and Kentucky. The one exception is Maine. It's the only state in which a Republican Senator is coming up for reelection where Obama won the state in 2012. However, the Republican there – Susan Collins – is absolutely secure. That race is over; she will be reelected handily.

In the other states, to be blunt, the Republican incumbents or non-incumbent nominees would have to try to lose. They would have to make major gaffes, or be involved in significant scandals. I think Republicans have an excellent chance to win 14 or 15 of the 15 Senate seats they currently hold. The only ones that could be shaky for the Republicans are Georgia and Kentucky. In Georgia, there is a close battle for an open Republican seat, and in Kentucky Minority Leader Mitch McConnell, who would be Majority Leader if the Republicans take over the Senate, has a tough but winnable fight.

We lean to McConnell so far. He has a high unfavorability rating and people in Kentucky seem to be itching for a change, yet President Obama's popularity in Kentucky is only in the mid-thirties. That says to me that it will be very difficult for any Democratic nominee – including Alison Lundergan Grimes – to win in spite of McConnell's unpopularity. It could be close, but you have to give McConnell the edge as the final months begin.

OUTLOOK: Where, specifically, do you expect to see competitive races?

LS: The Democrats have more seats that are vulnerable – both in terms of absolute number, which is 21, and political complexion. The seats that I believe will automatically change from Democratic to Republican are West Virginia and South Dakota. Democratic incumbents Jay Rockefeller and Tim Johnson are retiring and the Republican nominees, Shelley Moore Capito in West Virginia and former Governor Mike Rounds in South Dakota, are heavy favorites.

I also think the Republicans are very likely to take Montana. There is an appointed Democratic incumbent there, but he had to withdraw from the November ballot due to a plagiarism scandal. Any substitute Democrat is likely to be defeated by the state's lone Congressman, Republican Steve Daines. He already represents the whole state and I think he's likely to win.

That analysis brings the Senate margin down to 52 – 48, and the Republicans have to find three more seats. I believe there is a specific order of probability.

Arkansas Senator Mark Pryor, a Democrat, is hard pressed by Republican Congressman Tom Cotton. Louisiana Senator Mary Landrieu will be hard pressed by the Republican selected in the open primary in November. Assuming no one gets a majority in the November primary, there will be a December runoff. Landrieu is likely to face GOP Congressman Bill Cassidy at that time.

Another battleground is North Carolina, where Senator Kay Hagan is in a very tight race with Republican State House Speaker Thom Tillis. Finally Alaska, where the Democratic incumbent Mark Begich won by just a few thousand votes six years ago running against Ted Stevens, who had been convicted of multiple felonies about a week before the election. That's why Begich won, but Alaska is still a Republican state. Those four Democrats are very vulnerable.

OUTLOOK: What other seats are competitive?

LS: I would mention in particular Iowa, where the Republicans have nominated Joni Ernst, a state Senator, who could be the first woman to represent Iowa in the Senate. Interestingly, she won on the basis of a TV ad touting her experience in castrating hogs.

She's facing Congressman Bruce Braley, who made some unfortunate comments about Senator Chuck Grassley and denigrated farmers. You don't do that in Iowa. It's a close race that could go either way. Colorado is another case that could be very close – Senator Mark Udall versus Congressman Cory Gardner. That is going to be one to watch all the way to November.

There are others that could possibly come into play, such as Michigan and New Hampshire where Scott Brown, formerly the senator from Massachusetts, has moved to run against incumbent Senator Jeanne Shaheen. Right now, though, the Democrats are ahead in both of those states.

There is another interesting dynamic. The Senate is divided into three classes and only one-third is up for reelection at any given time. It just so happens that this class is by far the most Republican group of states. Because there are so many small farm states that vote Republican, only half of the people are actually voting for Senator this year. In the other two classes, between two-thirds and three-quarters of the people vote for senator. This is the ideal year for Republicans to take over the Senate.

Gridlock is guaranteed unless there is a national emergency – a terrible natural disaster or a terrorist event. The system will be on hold until the next Presidential election, for the most part.

OUTLOOK: What do you expect to happen ideologically? Do you expect the status quo?

LS: I expect both the House and the Senate to become more conservative, because you're going to have additional Republicans in both houses. I don't think it'll be dramatically more conservative, because you're not going to have the kind of massive turnover that has defined some recent elections. You have so many incumbents running for reelection, and most of them are pretty secure. Therefore, you don't have the opportunity for a large turnover in political ideology. I would say modestly more conservative in both houses.

OUTLOOK: Looking at the final two years in President Obama's term, what are the implications of status quo – a Democratic Senate and a Republican House?

LS: I think you're simply talking about the degree of gridlock. Gridlock is guaranteed unless there is a national emergency – a terrible natural disaster or a terrorist event. Unless it's something of that sort, we're not going to see a very productive Congress that is passing bills that can be signed by the President. The system will be on hold until the next Presidential election, for the most part.

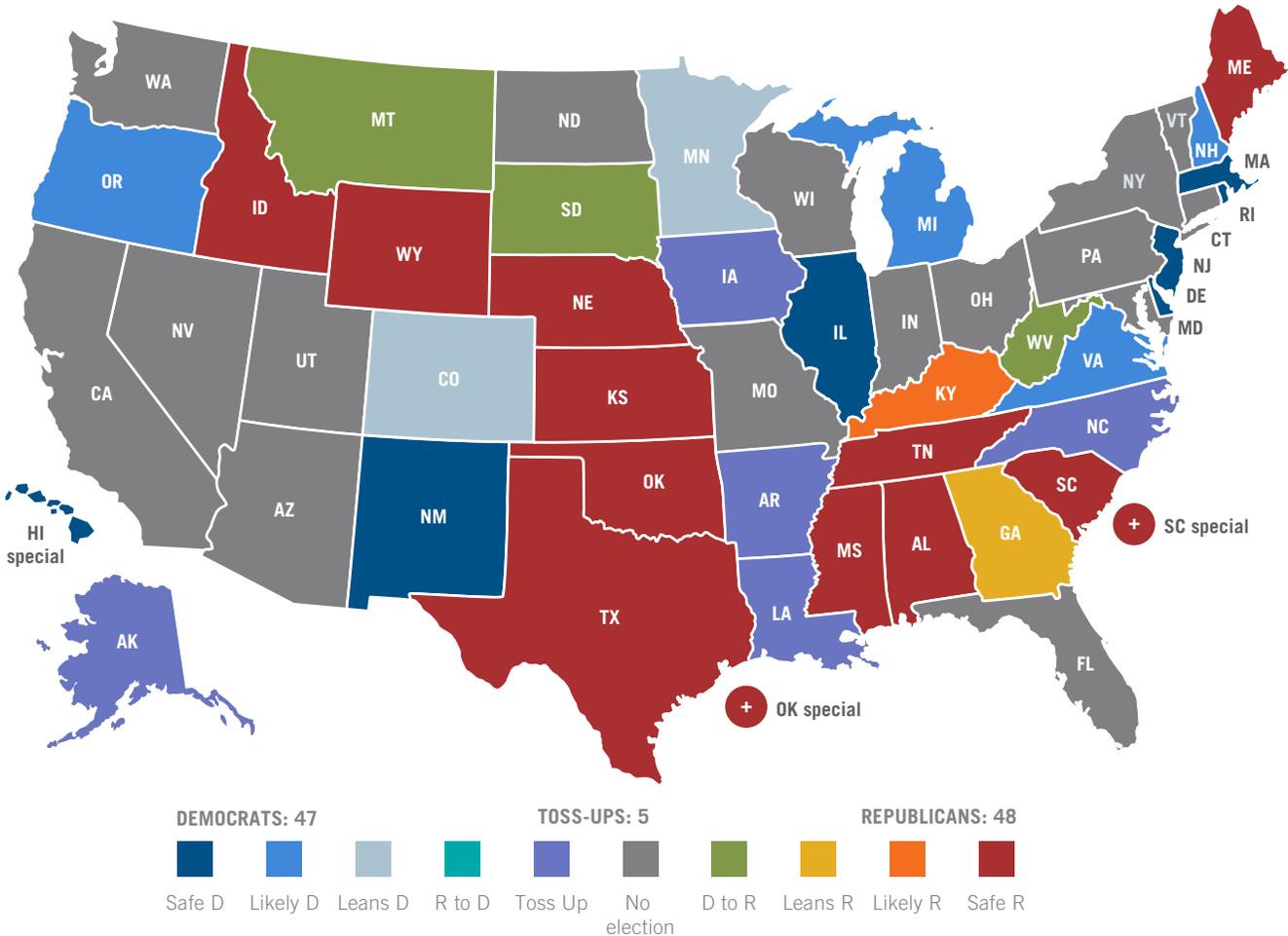
OUTLOOK: What if Republicans secure a majority in both houses of Congress?

LS: The Republican majority would be relatively small in both houses so it would certainly not be a veto-proof Congress. Republicans will not gain enough Democratic votes to override President Obama's vetoes in a vast majority of cases, maybe all the cases.

But it's also important to look beyond legislation. The most important implication is in the appointment area.

For instance, if a Supreme Court seat were to open up, we're going to have a historic battle. I think it's entirely possible the seat would stay vacant for a while or be filled only after a very nasty fight, because the President would have to find someone acceptable to at least a handful of Republicans – maybe a current or former Republican Senator who is more moderate. But keep in mind, many Republicans voted against Chuck Hagel for Secretary of Defense.

PROJECTED PARTY ALLEGIANCE BY STATE – U.S. SENATE RACES



Source: Sabato's Crystal Ball www.centerforpolitics.org/crystalball/

We've had situations where Supreme Court judgeships have stayed open for a period of time because the Senate wouldn't approve a series of Presidential choices. It would be a titanic struggle.

And there will be others – cabinet and ambassadorial positions that have to be confirmed. I think we will see loads of objections from Senators. Even in the lower courts with appellate and federal district court judges, I would expect a tremendous slowdown in judicial appointee confirmations from top to bottom.

A Republican majority in both houses will also increase the number of investigations. Both houses will have subpoena power, and the Republicans may choose to have joint investigating committees – special committees that will increase the power and prestige of those investigations. I think we can expect some of that.

Quite literally, Congress has approval from their families, friends and staffers. That's it.

OUTLOOK: How will President Obama's low approval rating play into the election?

LS: This is a critical factor. Right now, the President's approval rating stands at about 40 percent. If he's going to help his party hold onto the seats they have – I don't think gaining seats is a realistic possibility – he has to increase his job approval rating into at least the upper 40s.

Is it possible? Yes, but it would be difficult. Disasters, for example, tend to increase a President's popularity. We rally around the flag at these times, and that helps the President. But it will be difficult even if the economy continues to pick up steam. It will not necessarily add many points to the President's job approval.

We have to keep Presidential approval in perspective, though. Bush was in the 30s in 2006 and Clinton was highly unpopular in 1994. President Obama is not yet as low as either one of those was, so it's all relative.

OUTLOOK: Give us some insight into the current approval rating of Congress.

LS: Gallup recently placed the popularity of Congress at 7 percent. It's the lowest approval rating ever recorded since polls have been taken beginning in the 1930s. Quite literally, Congress has approval from their families, friends and staffers. That's it.

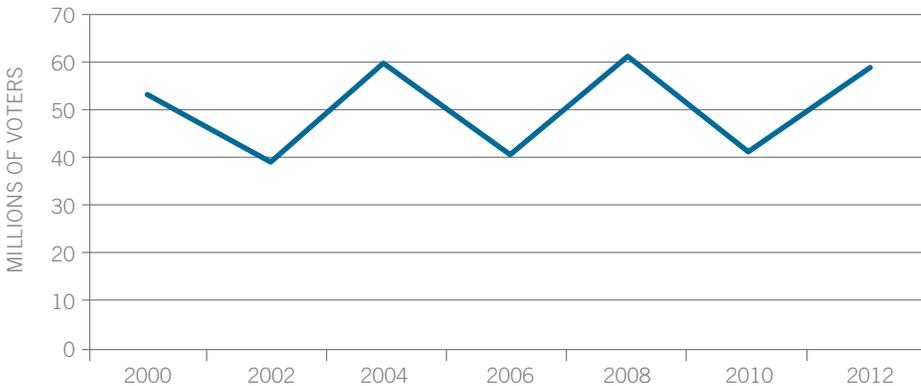
It begs the question of why they continue to win. The answer is that they have safe districts, which they designed for themselves. And, there's this old phenomenon that we call, loving your Congressman and hating Congress. People often say, "I wish they were all like my Senator John Doe, and Congresswoman Mary Smith." What they don't recognize is that they are all like John Doe and Mary Smith.

OUTLOOK: Does such low approval rating mean more challenges for incumbents? Will there be a strong "throw the bums out" sentiment in this election?

LS: Probably not, because the deck is stacked in the vast majority of districts. The post-World War II average for House incumbent defeats in the primaries is six. We've had only three so far in this primary season, all Republicans – former House Majority Leader Eric Cantor of Virginia, 91-year-old Congressman Ralph Hall of Texas, and freshman

VOTER TURNOUT

Election Years 2000–2012



Source: United States Elections Project

Congressman Kerry Bentivolio of Michigan. That’s it. We’re way below average. I see no indications of a widespread “throw the bums out” public movement.

The districts in this election are very one-party dominant. Very blue (Democratic) districts, very red (Republican) districts and a surprisingly low number of purple competitive districts. That explains a lot.

OUTLOOK: What do you expect to see in terms of voter turnout?

LS: Turnout will be below the Presidential level, as usual. We’ve essentially been getting about 60 percent of adults voting in Presidential elections. This election is going to be somewhere around 40. It may be 36, it may be 42, but essentially lop off 20 points for midterm elections.

There are reasons for the lower turnout. First, only 51 percent of Americans are even voting for Senator, and many of those races are completely uncompetitive. Then there are hundreds of House races that are uncompetitive and many governors’ races are uncompetitive, as well. You can see why turnout drops so drastically.

Lower turnout usually has a disproportionate negative effect on Democratic candidacies, because the first voters to flake off are young – who vote between 60 and 66 percent Democratic – and minority voters.

When you add all minorities together – African Americans, Hispanic Americans, Asian Americans – Democrats get about 80 percent of those votes on average. If the young and minorities are the two groups whose turnout declines most dramatically this year, then it’s obvious Democratic candidates will be struggling in some places.

OUTLOOK: What kind of surprises did you see in the primaries?

LS: Hardly any, which was actually a surprise to everyone. Not a single Senator has lost in a primary in 2014 – there is usually at least one – and so far only three House members have been defeated in a primary, with the post-World War II average being six. This doesn’t suggest a voter revolt, although more primary contests than usual have been reasonably close.

Certainly, Eric Cantor’s loss was a complete shock. I don’t know of a single professional analyst that predicted that. Nobody saw it coming. We expected it to be one of Cantor’s closer elections – maybe his closest since he was first elected by just a few hundred votes in 2000 – but no one thought he was going to lose. It was an anomaly.

In hindsight, though, Cantor had lost touch with his district. He almost never held town halls and when his district residents saw him, it was usually by Skype or on the national or international news. He forgot the basic lesson of Congress, which is that only the people in your district can continue or end your career.

The other surprise was the two close elections for Senate in Mississippi. I can't think of a comparable situation in the history of popular elections. Thad Cochran finished second and almost lost outright in the first primary – just a handful of votes kept both candidates beneath the magic 50% and put that election into runoff – and then Cochran came back and won in the second primary. It was extraordinary. It was also controversial because there's no question that African-American voters re-nominated Cochran. They're Democratic but they came into the Republican primary because they feared the other candidate.

OUTLOOK: Are there any historical trends that are worth noting? Is there anything that could be predictive of the general elections in 2016?

LS: The overwhelming lesson of history is that the White House party will lose seats in a midterm election. There are just a few exceptions in American history. We don't know how many they will lose, but we know the general direction of the election especially because it's a sixth year of an administration.

However, this will say next to nothing about 2016. Every election is different, and Presidential elections couldn't be more different than off-year midterm elections. I think one major question is, if Republicans do well are they going to make the same mistake they made in 2010? Will they over-interpret a low turnout "mandate" in a midterm election whose math intrinsically favors them? If the Republicans win Congress and then go too far rhetorically or legislatively, it will help the Democratic nominee for President in 2016.

OUTLOOK: How, specifically, will the 2016 presidential race impact President Obama? Will he be incented to be more or less moderate? How much will "legacy" affect his actions?

LS: I doubt the President moves in a more moderate direction, in part because the more Republican Congress has no particular incentive to work with him in the run-up to the 2016 Presidential election. My guess is that President Obama will try to operate as much as possible outside the orbit of Congress, because he is going to have even less backing on Capitol Hill for his final two years. Whatever he can accomplish, it will have to be mainly on his own—and some of his "legacy" actions (executive orders, military actions, etc.) may prove to be quite controversial. ■

Interest Rates and Economic Indicators

The interest rate and economic data on this page were updated as of 7/31/14. They are intended to provide rate or cost indications only and are for notional amounts in excess of \$5 million except for forward fixed rates.

KEY ECONOMIC INDICATORS

Gross Domestic Product (GDP) measures the change in total output of the U.S. economy. The Consumer Price Index (CPI) is a measure of consumer inflation. The federal funds rate is the rate charged by banks to one another on overnight funds. The target federal funds rate is set by the Federal Reserve as one of the tools of monetary policy. The interest rate on the 10-year U.S. Treasury Note is considered a reflection of the market's view of longer-term macroeconomic performance; the 2-year projection provides a view of more near-term economic performance.

ECONOMIC AND INTEREST RATE PROJECTIONS

Source: Insight Economics, LLC and Blue Chip Economic Indicators

US Treasury Securities

2014	GDP	CPI	Funds	2-year	10-year
Q3	3.20%	2.50%	0.10%	0.61%	2.89%
Q4	3.10%	1.90%	0.12%	0.79%	3.11%
2015	GDP	CPI	Funds	2-year	10-year
Q1	2.90%	2.00%	0.16%	0.98%	3.23%
Q2	2.90%	2.10%	0.29%	1.21%	3.39%
Q3	2.90%	2.20%	0.49%	1.38%	3.47%

PROJECTIONS OF FUTURE INTEREST RATES

The table below reflects current market expectations about interest rates at given points in the future. Implied forward rates are the most commonly used measure of the outlook for interest rates. The forward rates listed are derived from the current interest rate curve using a mathematical formula to project future interest rate levels.

IMPLIED FORWARD SWAP RATES

Years Forward	3-month LIBOR	1-year Swap	3-year Swap	5-year Swap	7-year Swap	10-year Swap
Today	0.24%	0.32%	1.11%	1.78%	2.21%	2.61%
0.25	0.26%	0.43%	1.31%	1.93%	2.33%	2.71%
0.50	0.32%	0.59%	1.50%	2.08%	2.45%	2.80%
0.75	0.47%	0.79%	1.69%	2.23%	2.57%	2.89%
1.00	0.67%	1.03%	1.89%	2.38%	2.69%	2.98%
1.50	1.13%	1.55%	2.25%	2.65%	2.90%	3.15%
2.00	1.68%	2.04%	2.56%	2.87%	3.06%	3.30%
2.50	2.08%	2.34%	2.77%	3.04%	3.20%	3.40%
3.00	2.47%	2.65%	2.98%	3.20%	3.35%	3.49%
4.00	2.83%	3.02%	3.23%	3.42%	3.53%	3.64%
5.00	3.13%	3.29%	3.46%	3.57%	3.67%	3.74%

HEDGING THE COST OF FUTURE LOANS

A forward fixed rate is a fixed loan rate on a specified balance that can be drawn on or before a predetermined future date. The table below lists the additional cost incurred today to fix a loan at a future date.

FORWARD FIXED RATES

Cost of Forward Funds

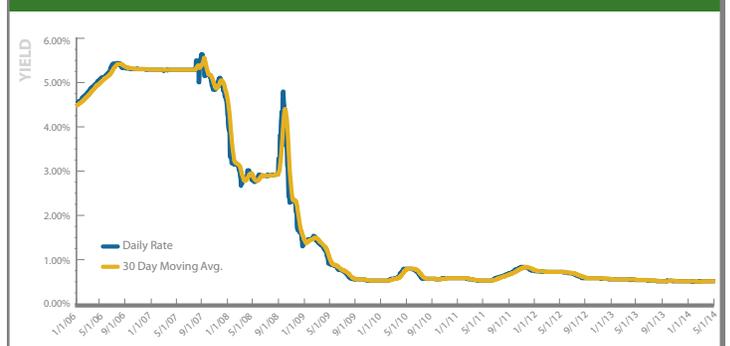
Forward Period (Days)	Average Life of Loan			
	2-yr	3-yr	5-yr	10-yr
30	9	9	8	6
90	22	23	19	13
180	42	43	35	25
365	95	89	70	48

Costs are stated in basis points per year.

SHORT-TERM INTEREST RATES

This graph depicts the recent history of the cost to fund floating rate loans. Three-month LIBOR is the most commonly used index for short-term financing.

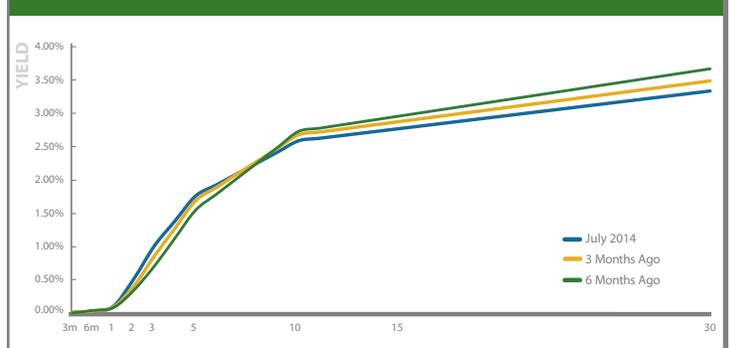
3-MONTH LIBOR



RELATION OF INTEREST RATE TO MATURITY

The yield curve is the relation between the cost of borrowing and the time to maturity of debt for a given borrower in a given currency. Typically, interest rates on long-term securities are higher than rates on short-term securities. Long-term securities generally require a risk premium for inflation uncertainty, for liquidity, and for potential default risk.

TREASURY YIELD CURVE





About CoBank

CoBank is a \$102 billion cooperative bank serving vital industries across rural America. The bank provides loans, leases, export financing and other financial services to agribusinesses and rural power, water and communications providers in all 50 states. The bank also provides wholesale loans and other financial services to affiliated Farm Credit associations serving farmers, ranchers and other rural borrowers in 23 states around the country.

CoBank is a member of the Farm Credit System, a nationwide network of banks and retail lending associations chartered to support the borrowing needs of U.S. agriculture and the nation's rural economy.

Headquartered outside Denver, Colorado, CoBank serves customers from regional banking centers across the U.S. and also maintains an international representative office in Singapore.

For more information about CoBank, visit the bank's web site at www.cobank.com.

Commentary in Outlook is for general information only and does not necessarily reflect the opinion of CoBank. The information was obtained from sources that CoBank believes to be reliable but is not intended to provide specific advice.

CoBank Reports Second Quarter Financial Results

Net Income Increased 10 Percent To \$232.9 Million

CoBank recently announced financial results for the second quarter of 2014.

Net income for the quarter increased 10 percent to \$232.9 million, from \$212.0 million in the same period last year. For the first six months of 2014, net income also increased 10 percent to \$464.2 million. The improvement in profitability resulted primarily from increased net interest income as well as a \$25 million loan loss reversal, compared to a \$20 million provision for loan losses in the first six months of last year. The reversal resulted from a lower level of reserves needed for specific loans as well as general improvement in the credit quality of the bank's loan portfolio.

Net interest income for the quarter rose 5 percent to \$311.4 million, compared to \$296.7 million in the same period last year. For the first six months of 2014, net interest income increased 4 percent to \$620.3 million. The increases were driven primarily by higher loan volume as well as improved earnings from the bank's balance sheet positioning.

Average loan volume for the quarter rose 7 percent to \$76.9 billion, compared to \$71.6 billion in the same quarter last year. For the first six months of 2014 average loan volume rose 6 percent to \$76.7 billion. The increases resulted from higher levels of borrowing in a number of customer segments, including food and agribusiness companies, affiliated Farm Credit associations and rural power providers.



Robert B. Engel

"We're very pleased with both the quarterly and year-to-date results of our business, including modest broad-based loan growth in many of the industries we serve," said Robert B. Engel, CoBank's chief executive officer. "While we continue to face a number of market challenges, CoBank remains well-positioned to meet the financial needs of its customers and fulfill its mission in rural America."

At quarter-end, 0.63 percent of the bank's loans were classified as adverse assets, compared to 0.71 percent at December 31, 2013. Nonaccrual loans improved to \$123.2 million, compared to \$147.8 million at December 31, 2013. The bank's allowance for credit losses totaled \$588.2 million at June 30, 2014, or 1.63 percent of non-guaranteed loans when loans to Farm Credit associations are excluded.



David P. Burlage

“We continue to benefit from the strong credit profile of our customer base,” said David P. Burlage, CoBank’s chief financial officer. “Overall credit quality measures have improved from what were already very solid levels at year-end, and that has made a meaningful contribution to the growth in profitability we’ve seen so far this year.”

CoBank’s capital levels remain well in excess of regulatory minimums. As of June 30, 2014, shareholders’ equity totaled \$7.0 billion, and the bank’s permanent capital ratio was 15.7 percent, compared with the 7.0 percent minimum established by the Farm Credit Administration (FCA), the bank’s independent regulator. At quarter-end, the bank held approximately \$24.1 billion in cash and investments and had 164 days of liquidity, which is in excess of FCA liquidity requirements.

Engel noted that the bank continues to experience intense competition, compressed margins and low interest rates that impact returns on invested capital. “It is essential that we continue to deliver exceptional value to our customers, manage the bank efficiently and steadily build our financial strength for the long term,” Engel said. “We’re grateful for the trust our customers place in us and look forward to making continued progress toward our business goals.” ■