

Credit Market Overview for the U.S. Water Industry

California Water Association
June 17, 2009 Sacramento CA





- **A leading financial services company serving agribusinesses and rural utilities throughout the United States**
- **Member of the Farm Credit System, a Government Sponsored Enterprise with \$214 billion of assets at December 31, 2008**
- **Over \$61 billion in assets at December 31, 2008; AA-rated by both S&P and Fitch**
- **Cooperatively owned, headquartered in Denver, CO; regional offices and banking centers throughout the country**



Loan & Lease Portfolio ⁽¹⁾



Total \$44.6 billion

Global Financial Services
\$7.91 billion

Agribusiness
\$10.59 billion

Communications, Energy & Water
\$11.03 billion

Strategic Relationships
\$15.03 billion

(1) As of December 31, 2008



What Went Wrong?

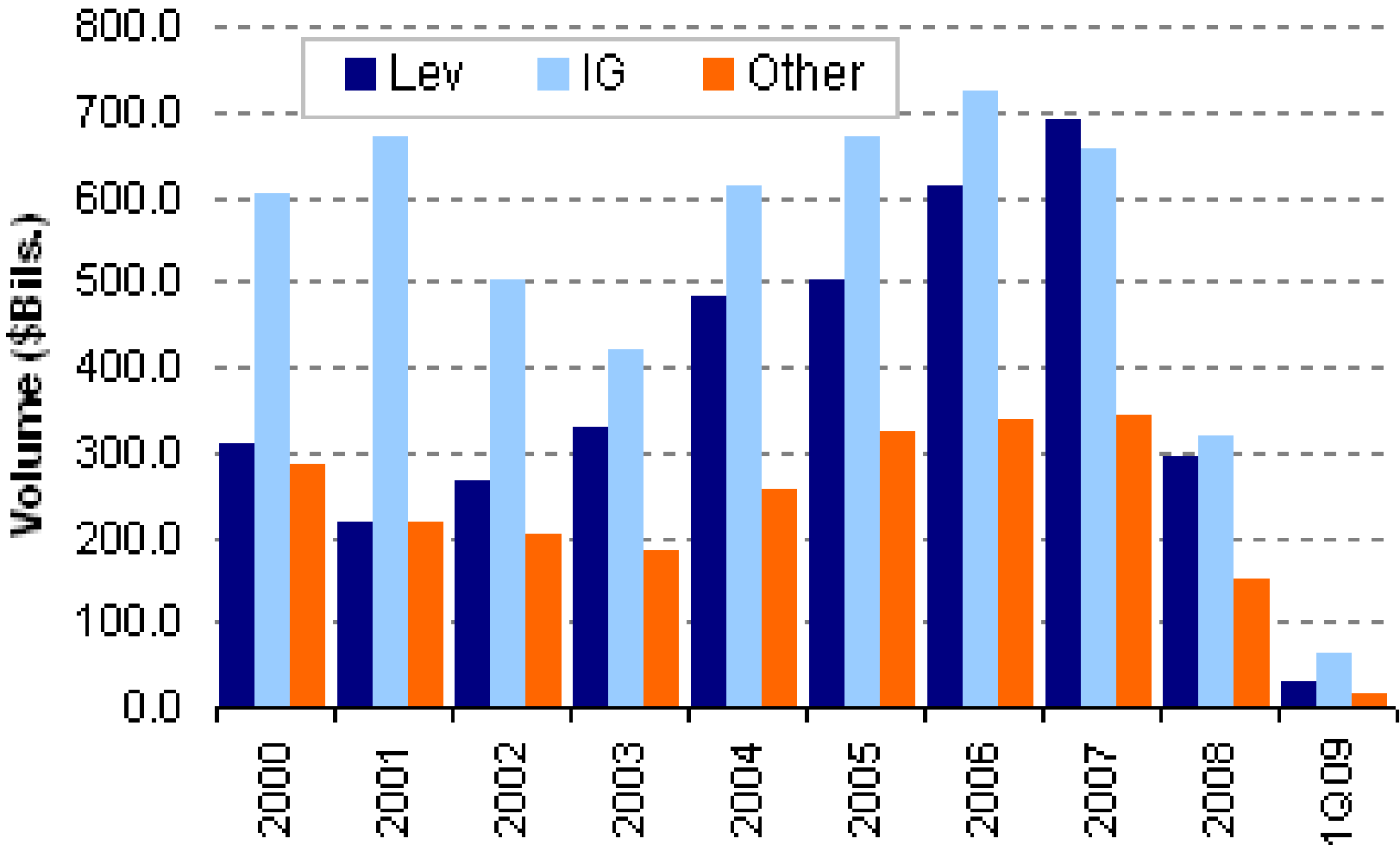


- **Subprime Meltdown**
- **Shock in Housing Markets**
- **Securitization Market Tanks**
- **Huge Asset Write-Downs on Bank Balance Sheets**
- **Capital Constraints**
- **Liquidity Concerns**
- **Company Failures: Bear Stearns, Lehman Brothers, Washington Mutual, AIG, Chrysler, GM**
- **Increasing unemployment leads to downward spiral of reduced spending, increased foreclosures and consumer defaults**

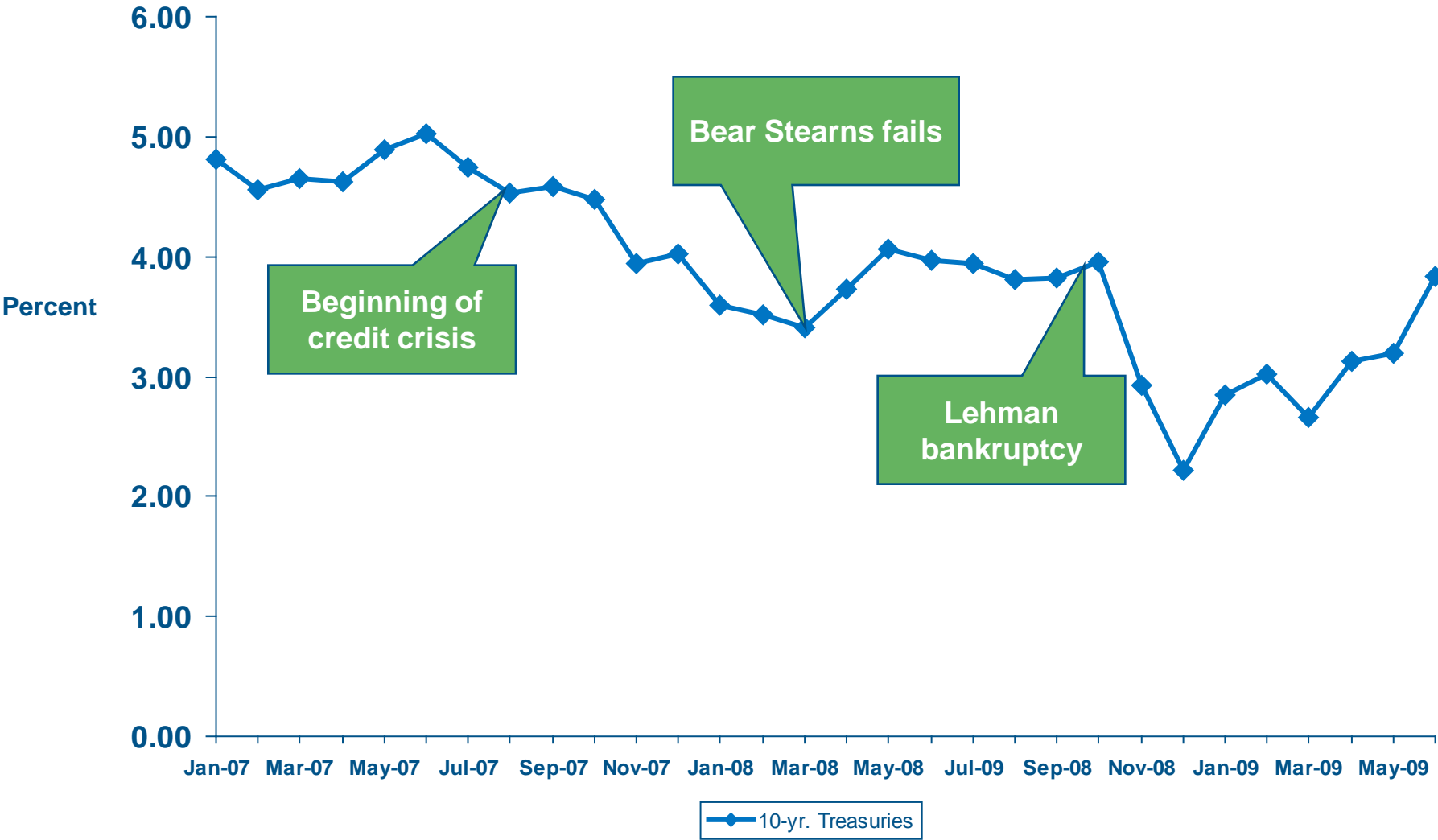


- **The Fed and Treasury Backstop Financial System and Select Industries**
- **Massive Drop in Bank Debt Issuance Since Mid-2007, Intensified After September 2008**
- **Insurance Companies Left the Market in 4Q08**
- **Flight to Quality**
- **Strained Relationships**
- **Lower Leverage**
- **Tighter Covenants**
- **Shorter Tenors**
- **Higher Pricing**

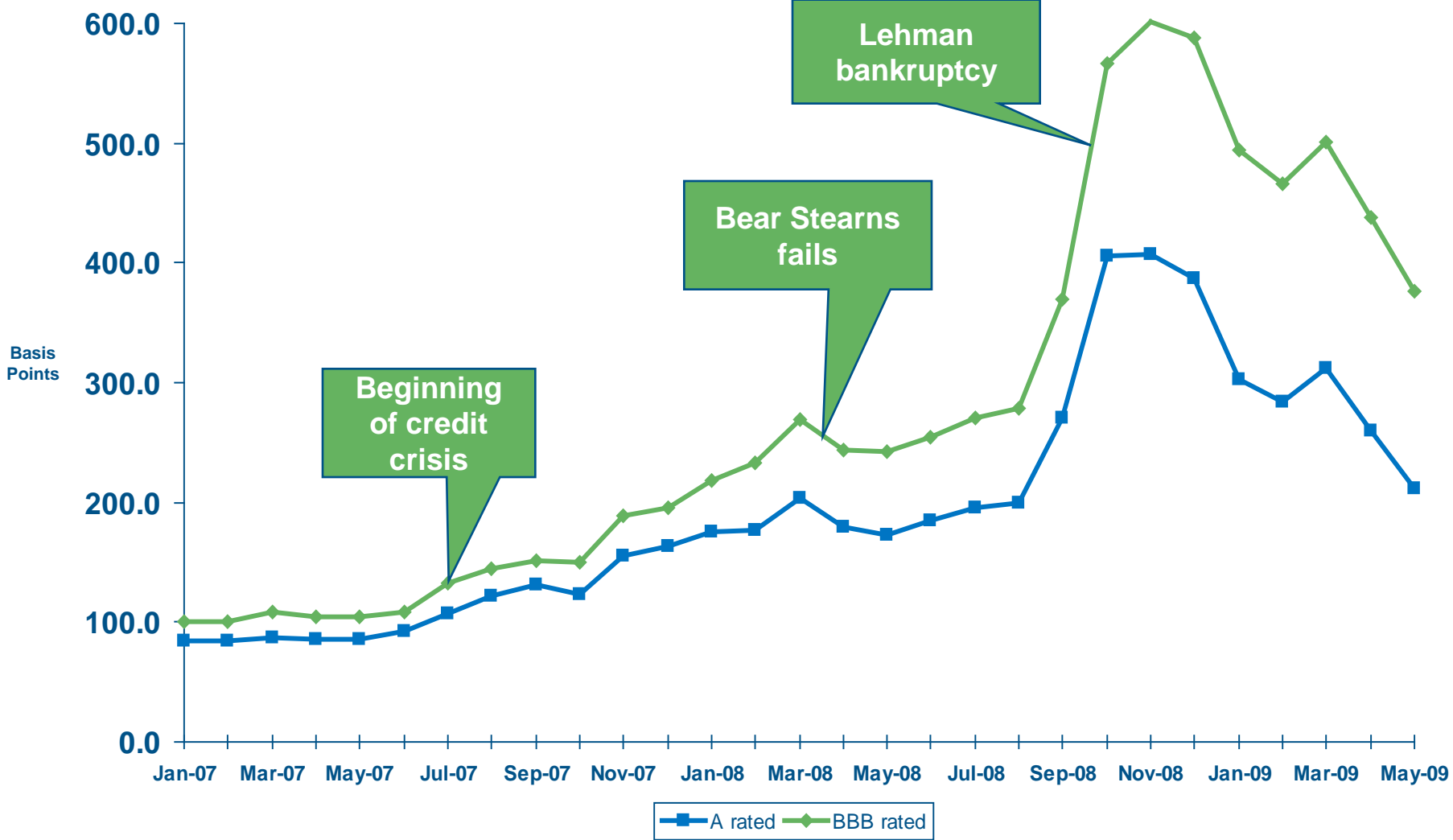
Syndicated Bank Loan Volume



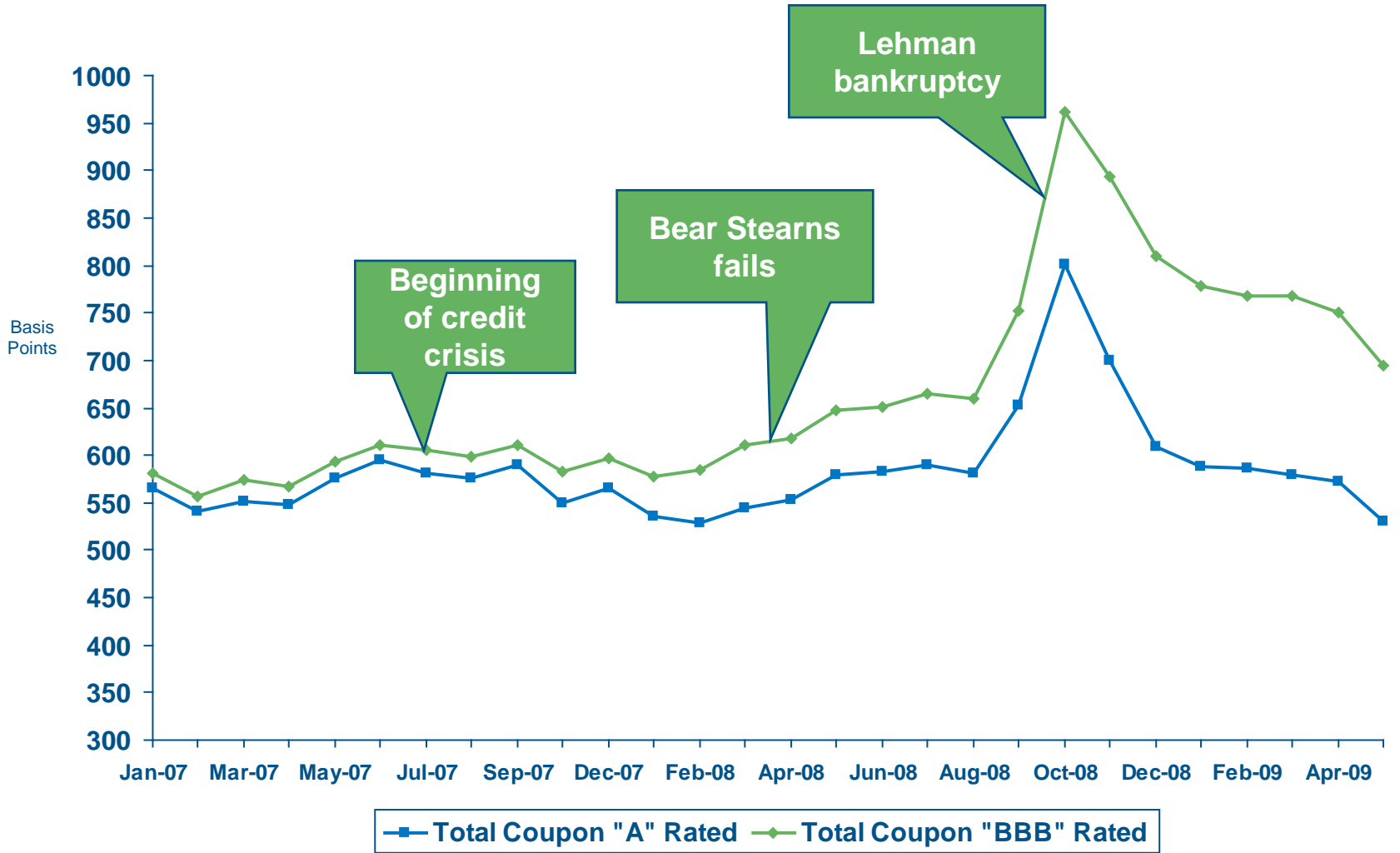
Credit Market Trends: 10-yr U.S. Treasury



Credit Market Trends: U.S. Utility Corporate Index – Credit Margins



Credit Market Trends: Total Coupon (10-year U.S. Treasury plus U.S. Utility Corporate Credit Spreads)





➤ NAIC-1 (Higher Investment Grade)

- Average credit spread 2Q08: 219
- Average credit spread 4Q08: 475
- Average credit spread 1Q09: 389

➤ Large Water Company Issuances

- Cal Water 5/09 \$100MM 10yr credit spread was 2.5x 8/06 \$20MM 25yr
- Golden State 3/09 \$40MM 10yr credit spread was 2.9x 10/05 \$40MM 23yr
- American Water 5/09 \$50MM 10yr credit spread was 3.6x 3/07 \$100MM 12yr
- Credit spreads are now 300-400 bps vs. 110-140 bps
- Coupons are now 590-725 bps (10-yr bullets) vs. 560-610 bps



- **Restored Financial System Stability**
 - **Reduced counterparty risk**
- **Increased Risk Taking**
- **Global De-Leveraging Still to Run its Course**
 - **Governments, banks, investment funds, and consumers**
 - **Debt financed assets of uncertain value**
- **Loan Securitization Market Closed**
- **Government Largely Supporting ABS markets**
- **Uncertain Regulatory Regimen**
- **Deflation Fears Replaced with Inflationary Outlook**
- **UST Interest Rates on the Rise with Steepening Yield Curve**



- **Banks Still Constrained but Largely Improving**
 - Income up
 - Portfolio concerns remain: consumer loan and corporate defaults
- **Focus on Existing Relationships**
- **Higher Credit Standards**
- **ROE Targets**
 - Credit spreads not expected to narrow much
- **Challenging Loan Syndication Market**
 - Little underwriting risk
 - Club Deals/Best Efforts
- **Yield Certainty**



- **Highly Active in Private Placement Market**
 - **Generally have higher liquidity**
- **Spreads Have Narrowed Off of Highs and May Continue Down**
- **Absolute Yield vs. Spread**
 - **Minimum coupons for certain terms**
- **Focused on Quality Industries and Companies**
- **Open to Syndicated Bank Transactions**



- **Historically Lower Risk Profile Still Attractive to Current Industry Lenders**
- **Capital Allocation Issues Remain**
- **Covenants Largely Unchanged**
- **Tenors Mixed for Term Debt but Revolvers are Shortening**
 - **Most Bullet Debt is 10 years**
 - **American Water Closed a 30-year tranche in May**
- **All-in Cost of Debt will Remain Higher**
 - **Banks will require increased spreads, higher fees and some ancillary business**
 - **Could narrow among insurance companies as UST yields increase**
- **Debt Highly Dependent on Equity**
 - **Refinance Risk**