HOW DO AG LENDERS & FARMERS MAKE BUSINESS DECISIONS? WHERE DOES GOOD STEWARDSHIP FIGURE IN?

FOOD, LAND AND WATER CONFERENCE
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THE FIRST C: CHARACTER (and credit history)

- Experience managing the farm business
- Education and training
- Attitude and skills
- Past work experience
- Credit reports
- FICO scores
THE SECOND C: CAPITAL

The farmer’s investment in the business

- Down payment available
- Overall leverage & owner’s equity
- Working capital position
- Interest rate sensitivity
- Whose investment at risk
- Weaknesses can be mitigated by strengths
THE THIRD C: CAPACITY

• How will debt be repaid?
  ▪ Cash flow from the farm
  ▪ Cash flow from other sources

• Need month-by-month cash flow projection

• Detailed assumptions

• If you’re already in business, cash flow should be based upon actual history as documented in federal tax returns
THE FOURTH C: COLLATERAL to secure the loan

- Loan-to-Value (LTV) ratio
- Quality of the collateral
- Generally based on appraisals
- Is the loan term matched by security life?
- In the worst case: Collateral is used to pay off the loan

**Common limits:**
- Short-term 40-75% LTV
- Intermediate 70%
- Long-term 65-75%
THE FIFTH C: CONDITIONS of loan approval

- Is an appraisal needed?
- What kinds of insurance are required?
- Is title insurance or evidence of lien required?
- Loan guarantees?
- Who is signing?
- Need additional documentation?
- Other agreements?

Life Insurance
Hazard Insurance
Minimum collateral requirements
Minimum financial requirements
Yearly documentation
SOME FEATURES OF THIS METHODOLOGY

• Allows a common set of financial standards, which have been used by most lenders since Farm Crisis of the 1980s
• Capital, capacity, and collateral are all based on numbers
• Character and conditions are somewhat subjective
• We can “force” some things to happen as conditions of loan approval; we can only encourage other things to happen
• Much of our thinking focuses on annual cash flow
CHALLENGE: HOW DO WE ENCOURAGE GOOD STEWARDSHIP PRACTICES THAT MAY CAUSE CASH FLOW TO BE WORSE IN THE SHORT TERM?

• Managed grazing
• Cover cropping
• Transition to organic production
• Timber stand improvement
• Other land conservation practices
WHAT CAN BE DONE FROM THE LENDING SIDE

• Help farmers analyze long-term investments from a profitability perspective (calculate the Internal Rate of Return)
• Encourage farmers to work with NRCS, county LCDs, and others on good stewardship practices
• Include cost-sharing dollars in farm cash flow projections
• Be open to providing short-term credit while farmers are waiting for cost-share reimbursement
• Think more broadly about “risk management” than just crop insurance
• Model good stewardship on our own land
THANK YOU!