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

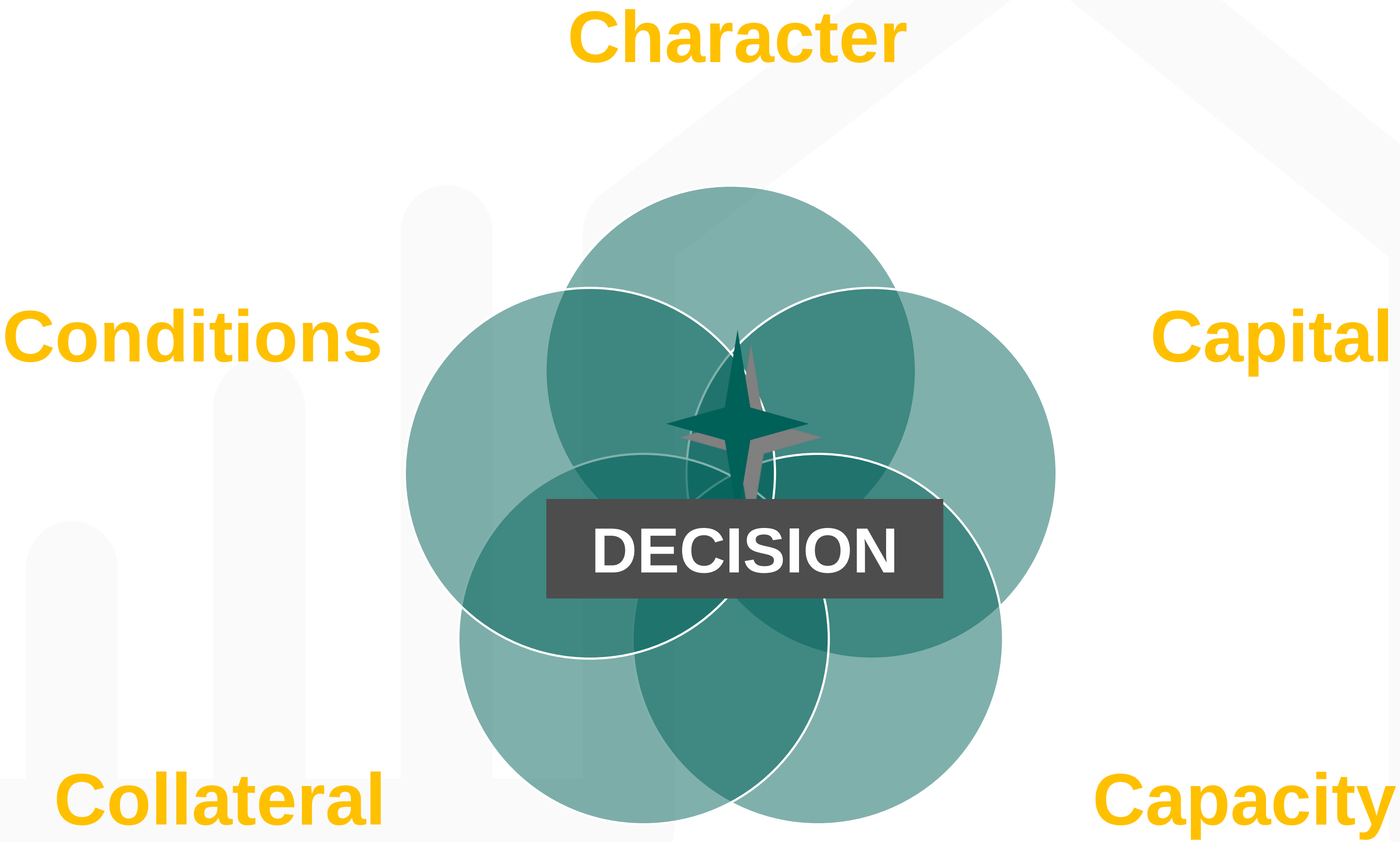
FOOD, LAND AND WATER CONFERENCE

OCTOBER 16, 2017

ELKHART LAKE, WI

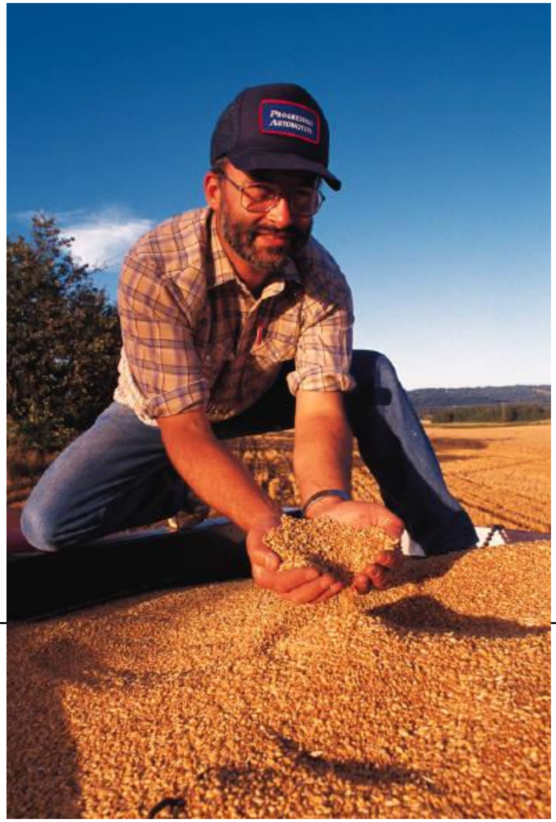
Paul Dietmann, Sr Lending Officer

608-370-6956 or paul.dietmann@compeer.com


Character
Conditions
Capital
DECISION
Collateral
Capacity

THE FIRST C: CHARACTER (and credit history)

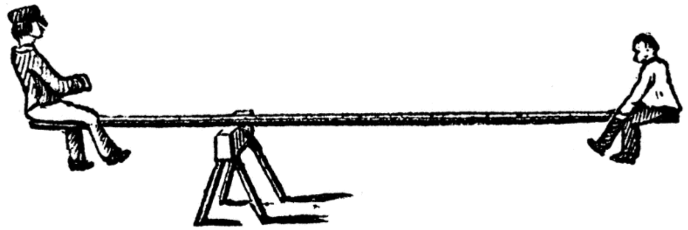
- Experience managing the farm business
- Education and training
- Attitude and skills
- Past work experience
- Credit reports
- FICO scores



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

COMPEER FINANCIAL

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!