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On Ground Intelligence

By: Dr. David M. Kohl

The summer has flown by while lecturing at seven agricultural banking and lending schools along with many board planning sessions. The following are some observations and perspectives gained through my interaction with participants and leaders.

Lax Lending Practices

Despite all of the discussion concerning more regulatory supervision on agricultural loans, the opposite was observed at one of the agricultural banking schools. Case in point was a student's reaction to my lecture on financial ratio analysis. While the student found the points valid, he elaborated that his bank president told him that if the net worth on the balance sheet was positive, make the loan. Another student chimed in that his institution based loans on character. "If they can find a way to pay it back, make the customer the loan." In the discussion concerning collateral, land was compared to certificates of deposit. One student piped up and stated that "If you have got the dirt, you cannot get hurt."

While the preceding perspectives were not shared by the majority of the class, one can surmise that increasing land values, particularly in the Midwest, are resulting in lax lending practices at some institutions. Profits and cash flow backed by working capital reserves are critical in times of volatility, along with a sound management plan that is executed. Granted, equity and collateral are fallback positions; however, they should not be the lead variable in the credit analysis.

Analysis Feedback

One of our producer panelists was upset that her lender did not take time to analyze or provide feedback on data and trend analysis which she has been doing for a 15-year period. She was shopping for another lender. In this cycle of the economy, now more than ever the better quality borrowers are expecting feedback and critique of their operations and financial performance. This is another way lenders can differentiate themselves from competition and conduct a better assessment of overall risk, while providing value-added services to borrowers.

Ag Real Estate Values

Wherever I go, everyone asks for my take on agricultural real estate values. The agricultural economy, particularly the grain sector and the Upper Midwest, is still performing well. Land values continue to increase in areas of high quality soils and access to water, with growth-minded producers and aggressive investors who are positioning themselves to take advantage of biotechnology (*Refer to the Farm & Ranch Land/Real Estate Clock*). Volatility is still with us. A case in point is that wheat recently increased $2.51 per bushel in 27 days.

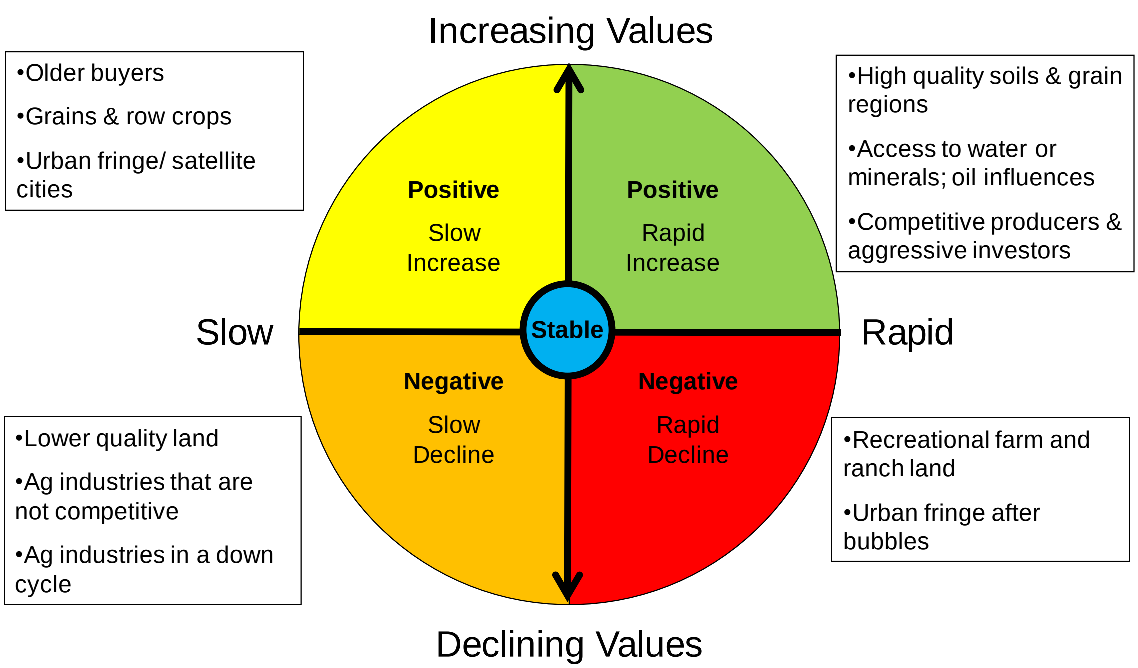
Areas where older buyers are investing, regions with a combination of grain and row crops, as well as real estate on the urban fringe or in satellite cities, are still seeing slow increase in land values.

Lower quality land and areas where the ag industries are not as competitive are seeing a slow decline in land values or "no sales" at auctions. East and West Coast agriculture and those involved in livestock are still in a struggling part of the economic cycle. Recently, the hog and dairy industries have shown some improvement and land values in predominantly hog and dairy regions with specialized facilities are for the most part stagnant, to declining.

Recreational farm and ranch land as well as properties on the urban fringe of cities that experienced a huge run-up of real estate values are still decreasing in value in many regions of the country.

The keys to agriculture in the Upper Midwest are ethanol growth and the growth of economies of the BRIC nations of Brazil, Russia, India, and China. A shock to either could take the glow off profit expectations, resulting in a downturn in Midwest agriculture.

Farm & Ranch Land/Real Estate Clock



Double Dip?

While The Conference Board Leading Economic Index® and Purchasing Manager Index are positive and showing growth because of stimulus in the U.S. and abroad, the U.S. economy is one shock event away from a possible double dip recession. The yield curve is flattening and oil prices are critical to the success of the livestock industry and rural areas. The specter of deflation or a Japanese style economy has a higher probability given the soaring federal, state, and local debt loads and business' uncertainty concerning taxes and regulation. Core and headline inflation are very low. Housing starts at 546,000 annually, unemployment reported at 9.5% (16.5% real unemployment), and factory utilization at 74% suggest the possibility of the general rebalancing of the U.S. and global economies for the next decade. Businesses and households are deleveraging, stockpiling cash, and increasing savings rates which will be reflected in consumer confidence in the service economy.

Indicator	Green	Yellow	Red
The Conference Board Leading Economic Index® - LEI	✓		
LEI Diffusion		✓	
Purchasing Manager Index - PMI	✓		
Housing Starts (millions)			✓
Factory Capacity Utilization		✓	
Unemployment Rate			✓
Core Inflation	✓		
Headline Inflation	✓		
Oil Price ($/barrel)		✓	
Yield Curve		✓	

Lender and Business Dashboard Economic Indicator Benchmarks

Indicator	Green	Yellow	Red
The Conference Board Leading Economic Index® - LEI	Increasing	Flat to Decline	Decline 0.3% for 3 consecutive months AND >1% over the period
LEI Diffusion[1]	>60%	40%-60%	<40%
Purchasing Manager Index - PMI	>50	41.7-50	<41.7
Housing Starts (millions)	>1.5	1.0-1.5	<1.0
Factory Capacity Utilization	>80%	70%-80%	<70%
Unemployment Rate	5%-6%	6%-8%	>8% or <5%
Core Inflation	0%-2%	3%-4%	>4% or <0%
Headline Inflation[2]	0%-3%	3%-4.9%	>5% or <0%
Oil Price[3] ($/barrel)	<$50	$50-$100	>$100
Yield Curve[4]	Steep	Flattening	Inverted

[1]Ten indicators make up the LEI - measures % that are increasing; [2]Includes food & energy; [3]Consumer's perspective; [4]3-Month Treasury Bill rate to 10-Year Bond rate