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Best and Worst Lending Experiences

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One of my favorite parts of the Advanced Agricultural Lending School in Kansas is the pre-school assignment. The instructors ask the students about their best and worst experiences that they have been involved with during their lending careers. Capturing these institutional memories can be invaluable for the next set of lenders taking the helm. Let's take a look at some of my favorite examples.

Financially blind customer

This customer is like *A Nightmare on Elm Street* that never seems to end. The financially blind customer is one who spends money, both earned and borrowed, out of control. The lender often becomes frustrated because of the customer's lack of a sense of urgency. As a lender, the quandary is where do you draw the line before the relationship turns sour in a few years?

In this particular case, the solution was twofold. To control family living costs, develop a system of withdrawals and then the producer must live within the budgeted amount. The other suggested advice is to monitor credit cards, including those of spouses, children, and others, so that excess debt does not accumulate in these easy to access accounts.

When frivolous spending is causing farm losses, calculate the burn rate on working capital and core equity by dividing the total losses into total working capital and equity to provide a sense of urgency. Include spouses, business partners, and co-obligors in the discussion.

Customer goes elsewhere

One possible outcome of crucial conversations with a customer concerning their financial deterioration is that they will seek other sources of financing. Yes, this can be the worst experience, particularly if the customer has loyalty to you and your institution or you are the "new kid on the block" that has lost a high-profile account. In this case, stick to your numbers and limit the emotions. Also, be prepared for the customer to return if they are denied credit from other institutions.

Talk the talk, but do not walk the talk

Numerous lenders mentioned that their worst lending experiences were when the producers do not apply themselves to improve their financial situation and it continues to deteriorate. In this case, have the customer develop a one-page written recovery plan. Included in this plan are strategies, action items, and a monitoring timeline. Sometimes a projected to actual cash flow can be a device to motivate positive actions. If the customer is not committed to this plan, then you can expect excuses for why insufficient performance continues to persist.

Killed the golden goose

One lender commented that a couple’s financial troubles had deteriorated the wife’s family’s net worth and restructuring was only a temporary band-aid. Unfortunately, the wife’s family had exhausted their retirement funds trying to help the couple, but the problems were not solved. The major issues were excessive personal family living withdrawals, erroneous financial statements, a lack of management, and family dynamics that spilled over into other family members.

The bank of mom and dad, aunt and uncle, or grandma and grandpa need to have formality and structure. There must be full disclosure of the financial statements and any agreements that are made must be in writing with proper legal documentation. P.S. In this case, the lender’s children were even bullied at school by the children of both families involved.

Now, let's move to the positive side of the ledger.

Attitude

One lender recalled a case where there was a suggestion for the customer to enroll in a farm management class and a Dave Ramsey course. This engaged the customers to focus more on their business and personal financial position. Now, open conversations and meetings with the lender are a regular occurrence. Despite the recent economic times, earned net worth has increased $200,000 over the past three years for this particular customer.

Young farmers

Some lenders commented on the Farm Service Agency's Beginning Farmer and Rancher loan programs which provide favorable financing terms for young and beginning farmers. Other lenders noted that some organizations also provide educational programs for young and beginning producers. It was rewarding for these lenders to work side-by-side with young producers to build trust, loyalty, and their relationship, all while assisting them to achieve their goals.

An extra benefit was that the parents and other family members observing their successful lending relationship from afar transferred some of their business to the institution as well.

Lemons turned to lemonade

One lender commented that he utilized the burn rate on core equity as a tool to create a sense of urgency. The timely sale of farmland before land values declined resulted in saving part of the farm business and eliminating the farm’s debt. Now, this land is leased and the producer cares for the neighbor’s livestock on a profitable basis. This was a win-win for the lender, as well as the producer. The producer’s wife is now employed in a fulfilling position with the lending institution.

In later columns, we may revisit this topic. Sometimes stories confirm and verify that other lenders are having both positive and negative issues and experiences that come with the world of agricultural lending, particularly in a down cycle.

Domestic Economy

Storm clouds are on the horizon and are now exerting pressure on the leading economic indicators. While the U.S. and global economies are near or entering a manufacturing recession, the consumer is “holding down the economic fort.” Let’s take a look at the economic indicators which support this statement.

The Leading Economic Index (LEI) was down slightly in May and June, but recovered in July with the most recent release. Keep a close watch on this metric to determine if the recent declines were just a fluke or the beginning of a trend. Although the diffusion index has softened, it remains above 50 percent. The Purchasing Manager Index (PMI), another leading indicator, is moderating as well and is just above 50 at 51.2, which still illustrates an expanding economy.

Oil prices have decreased to the mid-50s range based on the West Texas Intermediate Crude Oil prices. Demand for oil has declined due to the slowdown of the world economy. Watch for oil prices strengthening as trade wars and political uncertainty occur in the U.S. and abroad.

The U-3 and U-6 unemployment figures are low at 3.7 percent and 7.0 percent, respectively. However, many large companies are laying off workers as there is a drive toward efficiency and being the low-cost provider is an attractive strategic objective. Housing starts are still stubborn in the growth range at approximately 1.2 million units annually, despite low interest rates. Slow wage growth, excessive debt, and regulatory factors have hindered additional growth.

Moving to factory utilization, the trade war has impacted supply chain management and these issues are coming “home to roost.” This is particularly relevant for international based businesses both on the supply and demand side of the economic equation.

Both the Producer Price Index (PPI) and the Consumer Price Index (CPI) indicate that inflation is very tame. This is important to the Federal Reserve, which utilizes these inflation metrics to gauge for future interest rate changes, particularly interest rate cuts.

Maintain a close watch on the stock market and its impact on U.S. and global spending and global economic health. The health of the stock market could be the foreteller of consumer sentiment, which is currently positive. However, if consumer sentiment starts to change dramatically, a major economic correction could occur very quickly.

Global Economy

A global manufacturing recession is now in place as a result of the trade wars and overall tariffs. The Purchasing Manager Index (PMI) is now below 50 in Germany and hovering around 50 in China. Uncertainty and an increase in the cost of doing business as a result of the tariffs are now impacting the outlook for global growth in many of the rich countries in the world.

The trade wars and tariffs between the U.S. and many nations are a downdraft to global economic activity. If any of the trade agreements materialize, expect them to be temporary. The status of these agreements will have a direct impact on the 2020 presidential and congressional elections.

The fallout from the trade wars could even impact the Canadian elections scheduled for October 2019. Prime Minister Trudeau is in a tight battle with a conservative candidate as a result of the economic slowdown in Canada, an increase in government spending and deficits, and increased regulation.

The question for the fall and winter speaking and writing circuits will be whether the trade wars, tariffs, and political discontent in Hong Kong will impact business and consumer confidence worldwide. Stay tuned!

Lender and Business Dashboard Economic Indicators (for the month of July)

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	112.2	✓		
LEI Diffusion Index	55%		✓	
Purchasing Manager Index - PMI	51.2	✓		
Housing Starts (millions)	1.191		✓	
Factory Capacity Utilization	77.5		✓	
Unemployment Rate	3.7%	✓		
Core Inflation	2.2%		✓	
Headline Inflation	1.8%	✓		
Oil Price ($/barrel)	$64.62		✓	
Yield Curve	-0.06			✓

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	<6%	6%-8%	>8%
Core Inflation	0%-2%	2%-4%	>4% or <0%
Headline Inflation[2]	0%-4%	4%-5%	>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