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02/28/17

<u>Courageous Agricultural Lending</u>

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The economic reset continues to ripple through the agriculture industry and rural America. The duration is uncertain as the economics appear to be trolling along the bottom. To compound matters, uncertainty in NAFTA, international relations and currency trades only elevate the level of risk for agriculture. A few years ago, a well-respected CEO of an agricultural lending institution said that strong lenders and lending institutions must follow the three C's of credit: Be conservative in the good times, be courageous in the tough times and be consistent all the time. Well, given the current economic dynamic, now is a good time to examine what it means to be courageous.

<u>Teacher, Coach, Facilitator</u>

There are three characteristics required to be a courageous agricultural lender. First, many agricultural lenders may have the opportunity to be a teacher. It is quite likely that lenders will be called upon to explain difficult financial situations, outline options, alternatives, as well as possible outcomes. Courageous lenders must adapt to the customer's comfort level with complex financial metrics and overall grasp of business financials.

Next, the role of a courageous agricultural lender will mirror coaching, at least in some ways. Yes, this includes encouragement and positive motivation. An understanding of the customer's goals is critical. Lenders must also get to know the family, partners and other business relationships that could impact the bottom line. However, and perhaps most importantly, courageous agricultural lenders may need to show some "tough love" both in their assessment of the business and counsel to the customer. In other words, a good coach is firm with the team and players when warranted.

Finally, a strong agricultural lender serves as a good facilitator for the customer. Often, lenders must examine options and alternatives in order to customize the best possible outcome for a customer. Courageous lenders do not think in terms of a "cookie-cutter" approach. In fact, there may be situations where a lender utilizes a competitor's offer to achieve the best solution for an individual customer's needs.

Denial

The most difficult aspect of the job of a courageous agricultural lender is denying the request of a customer. Nevertheless, even when denying an account, the job of a courageous lender is not done. Perhaps there is an alternative solution with another institution which the lender could offer. At the very least, a courageous lender will outline suggestions for improvement or feedback on the customer's current plan. One never knows, the customer could make adjustments and become eligible for future credit.

Candid Communication

A strong agricultural lender must be candid and transparent with the customer. In today's economic environment, lenders often conduct burn rates on working capital. With no change in business strategy, this shows the customer how long it would take to burn through core equity, which is often in land. Sometimes this type of candid approach will upset the customer, but keep in mind that land and other accumulated wealth is commonly the retirement program for producers, which makes its preservation very personal. However, if a producer is on the road to financial ruin, a courageous lender speaks up. It can be a delicate and difficult situation, but some lenders have stories of irate producers that returned years later with a message of thanks. Candid communication from a courageous lender may just change the direction of a course otherwise headed for destruction.

Teamwork

The courageous lender and institution work well as a team. For example, the relationship officer works well with the back office analyst and those in charge of the processing paperwork are prompt and accurate. An attribute of the courageous institution is the commitment of the board and management teams to the industry through the economic cycles. The recent commodity super cycle attracted new lenders, producers and investors. On the lending side, the exit of many of these newly attracted lenders has created somewhat of a void, especially as the industry needs courageous lenders. In a courageous institution the Board of Directors should be reflective of the customer base. Around the country, many Board Directors continue to show their commitment to the industry by incorporating more women, minorities and younger members to match the changing demographics of agriculture.

Lifelong Learning

The courageous agricultural lender and institution are committed to lifelong learning. They are careful not to cut training and education during tough times. A strong institution is committed to training the new generation as well as the more experienced and seasoned staff.

A courageous agricultural lender is invested in education for his or her customers. Many institutions host educational programs for young and beginning farmers and ranchers. These opportunities develop the skills base needed to be successful in challenging economic environments. Education benefits the entire industry so it makes sense for a courageous lender to work with other alliances and even competitors to strengthen educational opportunities in quality, location or frequency.

Quiet

Finally, courageous lenders are intent listeners. They are astute at assessing communication styles and dynamics, and are respected and networked in the community. They are not overly dependent on technology, yet keep up on its progress and capabilities in the industry. In short, a courageous lender understands the value of human connection, which many times requires saying nothing.

At the end of the day, one factor that becomes the real difference-maker is perspective. Courageous lenders and institutions, and those that operate by the 3 C’s of credit see the cup half-full instead of half-empty. They exhibit strong character and always take the high road. Whether it is education, tough love, listening or coaching, today’s economic times call for courageous agricultural lenders and institutions.

Management Tip:

While we focused on the courageous agricultural lender and institution, tough times also require courageous customers as well. Do they exhibit a courageous type of business mentality? Remember that success in any economic cycle requires working side-by-side.

Global Economics

Global economics and international trade have now become the biggest macroeconomic risks for many commodities in American agriculture. Discussions concerning the NAFTA agreements, border tax and currency disputes can bring agriculture unwanted risk in the already difficult economic environment of suppressed prices and global surplus for most commodities.

Canada, China, Mexico, and the European Union represent major trading partners for the U.S. Continued agriculture exports are critical to cotton, tree fruit, vegetables, wheat, corn and dairy. For example, $2 billion of trade in corn with Mexico is a topic of discussion for Mexico. As alternate suppliers of commodities, Brazil and Argentina are now at the negotiating table, even with higher prices. This type of break with our trade partners could lead to long-term disputes in the marketplace.

In the dairy industry, one in seven days of milk production is exported with 39 percent going to Mexico and other large amounts heading to China. The media diligently plays out the roller coaster of negotiations, which will impact planning decisions and eventual cash flows of the agricultural lender's customer base. One aspect to monitor is whether this will carry over into land prices and balance sheet adjustments.

The European region is now starting to see inflation with slow growth in many countries. However, the Dutch elections in March and April, followed by late spring elections in France, and then fall elections in Germany could dictate the long-term future of Europe.

In the European Union and throughout many areas of the world, the movement toward nationalism or inward-directed economies is accelerating. Immigration will be among the major issues of the various elections in Europe and will undoubtedly impact the direction of the European Union as well as the Euro currency.

Another global situation to monitor is the posturing of the Chinese leader, Xi Jinping. At the recent economic forum at Davos, he was positioning China as a champion of globalism and his leadership as steady and calm in contrast to the uncertainty in many other areas of the world. Specifically, watch for the buildup of the Chinese Navy and possible issues in the South China Sea where the trade flow of agricultural goods is prominent. China, Europe, Japan, Brazil and others continue to add economic stimulus which directly impacts their currency to the U.S. dollar, and continues to keep the dollar strong.

Domestic Economics

The new administration is in full swing touting pro-growth and pro-business policies. Through tax reductions, infrastructure spending and other initiatives, the new administration has stated a goal of a 3 percent overall increase in GDP. At this time, the equity markets are exuberant with what appears to be froth.

Examination of the dashboard of indicators finds that the Leading Economic Index (LEI) as well as the Diffusion Index are still positive, but not robust. The PMI or Purchasing Manager Index is strong, locking in well above the 50 metric for growth.

Oil prices have maintained balance in the low to mid $50 per barrel range. After increasing earlier this year, gasoline prices have flattened out, which bodes well for both consumer spending and farm inputs.

Continue to monitor copper prices. With infrastructure spending in the U.S., this metric could be the foreteller of inflation and interest rate increases.

Housing starts have had difficulty reaching 1.5 million starts. At this level, the industry would be considered strong, but housing starts are not quite there. A watch on factory capacity utilization finds this metric in the flat state as well, particularly with those who export, given the strong dollar.

In 2017, three interest rate increases by the Federal Reserve will be predicated on unemployment remaining under 5 percent, inflation in the 2.5 percent range or above, and economic growth (GDP) moving toward 3 percent. Of course, consumer sentiment above 90 may move the needle forward on interest rates as it is indicative of consumer spending, which is 70 percent of the economy.

The stock market has accumulated nearly $3 trillion of additional paper wealth to investors over the recent months. This in turn has spurred consumer and investment spending. The key will be whether the markets will sustain throughout 2017.

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

Indicator	Current	Green	Yellow	Red
Leading Economic Index - LEI	125.5	✓		
LEI Diffusion Index	85%	✓		
Purchasing Manager Index - PMI	56.0	✓		
Housing Starts (millions)	1.246		✓	
Factory Capacity Utilization	75.3		✓	
Unemployment Rate	4.8%	✓		
Core Inflation	2.3%		✓	
Headline Inflation	2.5%	✓		
Oil Price ($/barrel)	$52.78		✓	
Yield Curve	1.93	✓		

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%**	**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