FARMER MAC

DR. KOHL'S GPS

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TOP QUESTIONS FROM THE SPEAKING CIRCUIT

My recent engagements across 21 states and with Canadian and Mexican neighbors have surfaced several recurring questions about agricultural lending in today's economic environment.

BRIDGE OR PIER?

When borrowers seek refinancing for operating funds on term loans amid low prices, inflated input costs, and doubled interest rates, how can lenders tell if they're building a bridge to recovery or extending a pier that leads to drowning in debt?

Consider these factors:

- Investigate whether cash flow problems are temporary or recurring.
- Assess if management practices like marketing and risk management were proactively used.
- Evaluate their responsiveness and willingness to follow through on monitored plans.
- Review their history of being coachable and working with advisory teams.
- Determine if they seek quick fixes or are open to business transformation.

A term debt to EBITDA (earnings before interest, taxes, depreciation, and amortization) ratio exceeding 6:1 after refinancing often signals that the end of the pier is near.

THE TOUGH CUSTOMER

In challenging economic times, some customers become angry and adopt an "it's not my fault" mindset. How do lenders discern which customers to support and which to gracefully demarket?

In challenging economic times, some customers become angry and adopt an "it's not my fault" mindset. Leading agricultural lenders often must make the difficult decision to demarket a customer when faced with critical, non-financial red flags like inflated egos, character issues, or resistance to management planning.

The Business IQ Assessment,* as covered in previous articles, can objectively assess financial and business practices to identify underlying issues, placing responsibility in the customer's court. The customer and lender can both fill it out and then compare results to stimulate discussion of pertinent issues. Requiring operational plans behind cash flow projections is essential. If a customer resists developing projected cash flows, production costs, or breakeven budgets, their problems will likely worsen, increasing risk to the financial institution.

Remember the 90-10-50 rule: 90% of customers perform well, but ag lenders will spend 50% of their time and resources on the problematic, and 10% on the high maintenance.

BRIDGING THE CREDIT ANALYSIS GAP

For a credit analyst who does not speak or interact with the borrowers, what are some tips on communicating potential problems to the loan officer or back to the customer?

As lending institutions separate the roles of loan officers (who find deals) from analysts (who focus on financials), effective communication between these roles becomes crucial for identifying and addressing potential problems. The Business IQ results can help analysts assess the management mindset behind the numbers. In some cases, analysts may want to visit the businesses and the individuals involved. This often can provide perspective on the existing conditions and the potential to resolve an issue from a team standpoint.

OPENING EYES TO FINANCIAL REALITY

How do lenders work with a borrower going through hard financial times when they are unaware of their financial troubles?

For borrowers unaware of their financial troubles, let the numbers speak. Some customers with strong balance sheets (often based on inflated land values) use this as leverage for restructuring while ignoring losses or negative cash flow.

Calculate and share the "burn rate" on working capital or core equity to emphasize the urgency of the financial situation. For example, if a borrower has annual accrual-adjusted losses of $500,000 after a refinance providing $1 million in working capital, the burn rate of working capital is two years if no improvements occur. A similar analysis can be done regarding burn rate on core equity. If core equity after assets are adjusted for advance rates is $2 million, the burn rate in the previous scenario would be 4 years to deplete the core land equity at $500,000 per year. Adjustments can be made in the calculation to account for a decline of asset values of 20% to 30%, which would accelerate the burn rate.

A straightforward analysis on one page like this can help the borrower see the sense of urgency and can facilitate crucial conversations with spouses or stakeholders. Benchmarking against other businesses through a 3-to-5-year trend analysis can also expose weaknesses in coverage ratios, working capital, and debt-to-asset positions.

WHEN COVENANTS ARE BROKEN

If there are loan covenants, what actions can be taken if a customer does not follow through on the requirements, but has significant net worth in hard assets such as land?

If a customer with significant net worth in hard assets fails to follow through on agreed-upon parts of the servicing plan or loan covenant requirements, lenders should first determine if this is a pattern or one-time situation.

Be firm but fair. A covenant is only effective if it's enforced—but consider whether it was designed to accommodate market volatility. Examine what triggered the covenant breach: was it poor execution of marketing or risk management plans? Recently, the lack of execution of marketing and risk management plans with grain in the bin quickly altered working capital positions and subsequent coverage ratios on the cash flow.

When a business trips coverage or working capital covenants despite ample net worth, the institution's lending philosophy becomes critical. If it's a collateral lender, it might apply acceptable net worth covenants. If not, it might be time to consider proactively demarketing the customer.

Remember that servicing plans and covenants exist to protect the institution while benefiting customers—they should create win-win situations during adversity.

LENDER AND BUSINESS DASHBOARD ECONOMIC INDICATOR ASSESSMENT

May 16, 2025

GLOBAL ECONOMY: U.S. ECONOMY AND GLOBAL INTERCONNECTIONS

The ongoing tariff changes have created uncertainty, even for the most resilient businesspeople and the general public. After decades of globalization following World War II, it seems we are now shifting toward deglobalization. While some changes are needed to create a fairer playing field, the sudden and extreme adjustments in trade agreements driven by geopolitical agendas have led to delays or cancellations of investment and consumption decisions.

LONG-TERM DAMAGE - ANALOGOUS TO THE BACKWASH OF A TSUNAMI

Regardless of future positioning, long-term damage has likely been done to the United States' global standing. This is critical for agriculture and lenders, as 1 in 5 dollars of U.S. net farm income comes from agricultural exports. Ag lenders should consider conducting a risk profile analysis of customers and the industries that are prone to changes in export and import trade policy in this rapidly changing environment. Layer this on the businesses, industries, and communities that are in the crosshairs of a sudden trade action. United States agriculture is still very reliant on non-farm income for cash flow, particularly on smaller and midsize farms.

Long-term trading relationships with Mexico, Canada, China, Japan and the euro sector have been compromised. This is resulting in these areas of the globe forming new trading alliances with trading commodity tentacles in the global South—the rising star of 21st century agriculture.

Since the turn of the 21st century, the U.S. has rapidly urbanized, with the urban population increasing from 73% to 84%. During the pandemic, agriculture was the shining star. However, that glow is quickly fading among the non-farm public. Negative sentiment due to election results, along with government subsidies and possible future payments to agriculture, are not being well received by the large, powerful non-farm sector. This may be impactful to the outcomes of midterm elections and detrimental to negotiations of the future Farm Bill, as well as potential supplemental subsidies to the agriculture industry.

The impact of tariffs on future money costs is uncertain. Tariffs tend to be inflationary and may limit the Federal Reserve's ability to lower interest rates. About $9 trillion in federal debt is due to be refinanced this year, but at what cost as global investors pull back from the once-safe haven of U.S. government-backed securities? This could ripple through business, household, and personal finances.

In the near term, I recommend ag lenders observe the outcome of the Canadian elections and their post-election strategies. Will Europe continue to increase the use of debt to invest in the military and industries? China will likely play the long game and strengthen its strategic alliances with the BRICS nations (Brazil, Russia, India, China, and South Africa). This will be important to the American agricultural industry, as these nations serve the Asian sector, which is a large importer of cotton, soybeans, dairy, pork, and poultry.

Trade with Mexico, particularly corn and some of the commodities previously mentioned, will create economic volatility, requiring a strong management mindset with emphasis on marketing, risk management, and cash flow, which will likely be critical.

DOMESTIC ECONOMY: INDICATORS

The lead and lag indicators have considerable noise in them as a result of abrupt changes in U.S. and global strategies and actions, making it difficult to discern trends.

- The LEI (Leading Economic Index) and its diffusion index would suggest a slowing economy ahead, but a possible recession if policy changes are not made.

- The PMI (Purchasing Managers Index) is currently in the high 40s, indicating a contracting economy, but not yet reaching recessionary levels which are generally in the low 40s.

- Gold prices have accelerated, which suggests a possible economic downturn.

- Crude oil, on the other hand, is under $60 per barrel, which is a positive metric, particularly for the summer travel season.

- Factory utilization is still in the caution zone as trade policy is very nebulous.

- Unemployment rate, a lag indicator, will need to be closely observed. The rate, as measured by U-3 and U-6, is creeping up.
  - Diving into a specific demographic, such as the high-income technology and service sectors, finds these individuals are losing jobs or not being replaced.
  - On my recent visits to many college campuses and lecturing across the U.S., I find the job market has dried up, and those switching jobs have come to a screeching halt.
  - Wage hikes have also leveled out in many sectors.
- The housing market has slowed significantly in many areas, even during the typically busy spring season.
  - Will continued foreign investment in mortgage-backed securities and undisciplined fiscal policy drive up long-term borrowing costs?
  - Rising insurance and property taxes have added a significant financial burden to both existing homeowners and recent buyers.
- Headline inflation, including food and energy, should experience some relief as oil prices are lower.
  - Food prices are still impacting the level of inflation.
  - Core inflation is still high and remains stubborn because of housing and medical costs.
- The key metric to watch this spring and summer will be consumer sentiment, which is currently in the 'red zone' below 75. Recently, it dropped to 50.4, the second-lowest level ever recorded.
  - With consumption and services making up 70 percent of the U.S. economy, the persistently weak metrics across all demographics and income levels point to serious concerns for the nation's economic outlook.

In conclusion, the U.S. economy faces significant uncertainty as trade policies, shifting global alliances, and domestic challenges intersect. The long-term effects of tariffs, geopolitical tensions, and an evolving economic landscape are already impacting key sectors like agriculture, finance, and housing. While some indicators point to a slowing economy, the full impact remains unclear, especially as consumer confidence and international trade relations continue to fluctuate. Vigilant risk management and strategic planning will be crucial for businesses and industries to navigate this turbulent environment.

*Click the link to find Dr. Kohl's Business IQ survey, hosted by the Center for Farm Financial Management at the University of Minnesota. The survey takes about 10 minutes and helps you identify your strengths and weaknesses in managing uncertainty and set your agribusiness up for success. After completing it, you'll receive your Business IQ score. All responses are completely anonymous.

LENDER AND BUSINESS DASHBOARD ECONOMIC INDICATORS

For the month of March

Indicator	Current	Green	Yellow	Red
Leading Economic Index – LEI	100.5		●	
LEI Diffusion Index	50		●	
Purchasing Manager Index – PMI	49.0			
Housing Starts (millions)	1.324		●	
Factory Capacity Utilization	77.8%		●	
Unemployment Rate	4.2%	●		
Core Inflation	2.8%		●	
Headline Inflation	2.4%	●		
Oil Price ($/barrel)	$75.96		●	
Yield Curve	(0.08)			●

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 and energy.
[3] Consumer's perspective.
[4] Three-Month Treasury Bill rate to 10-Year Bond rate.