CREDIT DECISIONS IN UNCOMFORTABLE ECONOMIC TIMES

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Views From the Road

- 40-40-20 Rule of land acquisitions in agriculture
- 2023-2025 move from farming the alphabet to profits through management mindset
- Accrual analysis:
  - Provides foresight of how quickly a customer is falling off a cliff
  - Tells you early how the top performing producers are positioning for growth
- Issues & problems in agricultural financials will come late 2023 & 2024 won’t be solved by default but a liquidity crunch.
Views From the Road

2020-2022
- Government payments
- Paper wealth gains
- Early cycle price/cost advantages

2024-2026
- Proactive management mindset
- Liquidity through refinancing
- Margin compression
Three Headed Fire Breathing Dragon - Burning/Growing Profits, Liquidity & Wealth

**Prices**
- Volatility
- Trade/consumer trends
- Geopolitical
- Flip the switch

**Inflated Costs**
- Just in time vs. just enough
- Cash rent negotiations
- Fertilizer & fuel
- Labor & other costs

**Interest Rates**
- How high, how long?
- Fixed rate resets

- Opportunities??
Factors Impacting Finzella

**Uncontrollables**
- Strong dollar inhibits exports
- Trade disruptions/geopolitics
- Weather beyond the farm/fields
- Energy policy, extreme volatility, fossil fuels, green movement
- Inconsistency in Central Bank’s monetary/government fiscal policy
- Other
Global Walk Around - China

- Real estate is 29% of economy
- COVID lockdown
- Oil & energy 15% of world capacity
- 55% of copper/refined copper production
- Weather is dry in growing regions, drying out rivers and causing transportation issues
- Technology disruptions, export markets slow
- President Xi’s third term
- Economic growth is slowest in decades
Global Walk Around - Europe

- Possible energy issues this winter
- Inflation nears double digits in some regions
- PMI <50
- Weather is dry in growing regions, drying out rivers and causing transportation issues
- NATO unity ????
- Leadership change/Brexit
- Technology challenges
Economic Inversion: Fiscal & Monetary Policy Conflict

- Stimulus 14%, $85 Trillion economy
- Tax cuts - Great Britain
- Inflation Reduction Act
- Student loan forgiveness
- European energy subsidies
- Central Bank’s accelerating rate increases
- Focused on lag indicators - unemployment
Federal Reserve Dilemma – Core & Headline Inflation- “Hard Habit to Break”

- Supply chains
- Weather
- Government stimulus savings
- Oil & energy
- Geographic wealth shifts
- Deglobalization

- Federal reserve- “the villains”
- Labor productivity lowest since 1948
  - -5.9% Q1
  - -4.1% Q2
  - 0.8% Q3
- Quiet quitting (U.S.)
- Lying flat (China)
  - 9-9-6
# Fed Funds Rate Hikes in 2022-2023

<table>
<thead>
<tr>
<th>Date</th>
<th>Rate Change in Basis Points</th>
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<tbody>
<tr>
<td>March 17, 2022</td>
<td>25 bps</td>
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<tr>
<td>May 5, 2022</td>
<td>50 bps</td>
</tr>
<tr>
<td>June 16, 2022</td>
<td>75 bps</td>
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<tr>
<td>July 27, 2022</td>
<td>75 bps</td>
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<tr>
<td>September 21, 2022</td>
<td>75 bps</td>
</tr>
<tr>
<td>November 2, 2022</td>
<td>75 bps</td>
</tr>
<tr>
<td>December 14, 2022</td>
<td>50 bps</td>
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<tr>
<td>2023</td>
<td>??</td>
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Implications of the Interest Rate Hikes for Farm & Ranch Businesses

- Very little impact on mortgage debt due to fixed rate structures; however, be careful of interest rate resets
- Increases in cost of production per acre, per head or unit creating margin compression
- Largest shock on operating monies on variable rates which drains financial liquidity such as working capital
- Production & intermediate operating loans will experience financial shocks first
- Businesses/households must get financially liquid fast, such as positive profits, cash flow, earnings/refinance
- Remember the refinance rule: one, two, three
Federal Reserve & World Central Banks’ Panic

- Wealth creates cycle 1990-2021
- Wealth destruction cycle 2022- ???
- Mama Bear & Papa Bear levels- “outlook”
  - Cryptocurrency- Papa Bear
  - Stock market- Mama Bear
  - Housing & real estate- Baby Bear
  - Farm real estate- ???
- Behavioral economics in full swing
2022 Farm Real Estate Value by State

Dollars per Acre and Percent Change from 2021

Sources: DTN Article link: Kansas Sees Highest Percentage Jump in Farmland Values (dtnpf.com)
Why Are Land Values in the 2020s Resilient?

- Baby boomer producers and landowners are in later stages of ownership with equity
- Interest rates have been stable
- Government payments to agricultural sector have been generous
- Rural renaissance
- Outside investors
  - Solar/wind green payments
  - Water & mineral resources
  - Development for housing industry is strong
  - Diversification of investments
- Demographics: Rule of 78
Eight Habits of Parents/Grandparents
Rule of 78: Quality of Life

PHYSICAL
- Drink water
- Exercise regularly
- Healthy diet
- Sleep

MENTAL
- Support network
- Life purpose
- Mental activities: read, meditate
- Faith & spiritual
Post Super Cycle/Post Pandemic Strategies
2013-2018 Strategies Applicable to the 2023-2026 Era

- Fine tune risk management plan
  - Cost of production
  - Cost of product/enterprise

- Develop input & output marketing plan
  - Just in time vs. just enough
  - Crop & other insurances
  - Options, hedging

- Prepare cash budget/cash flow
  - Financial sensitivity 10-10-4
  - Monitor budgets to actuals
Post Super Cycle/Post Pandemic Strategies 2
2013-2018 Strategies Applicable to the 2023-2026 Era

- Working capital strategy
  - >25% expenses
  - <10% Expenses
  - Quickness to cash

- Family living budgets
  - Inflation 5-10%
  - Budget buster
  - Number of families living out of budget
Borrower/Lender Playbook to Build Resiliency & Agility - Financial Ratios

- Working capital/expenses
  - >25% moderate agility/resiliency
  - <10% low agility/resiliency

- Term debt coverage ratio:
  - 175% moderate agility/resiliency
  - 125% breakeven, low agility/resiliency

- Term debt/EBITDA
  - < 3:1 moderate agility/resiliency
  - 3:1 to 6:1 some resiliency, little agility
  - >6:1 low agility/resiliency
Factors Lenders Look For Beyond the Numbers

1. Agriculture is still a family business
   - Relationship problems
     - Mom/Dad
     - Cousins managing cousins
   - Business culture destroying or building new talent

2. Business owners will not tell you about their problems. If they do, what’s the solution?

3. Excess spending, killer toys

4. Management of workers

5. Succession of estate, transition planning
   - Estate- hand over the assets
   - Transition- hand over the management
Factors Lenders Look For Beyond the Numbers

6. Confidence in risk management
   - Not good at it, then utilize an advisor
   - Leave money on the table

7. Imposter syndrome
   - Confidence to run the business
   - Client, investor confidence

8. Integrity, honesty usually financials uncover early

9. Likes & dislikes or improvements with relationship with lenders
Economic Cycles- Resiliency/Agility
The Future Links to the Past

- If it grows too fast, it is a weed.
- The 5% Rule of success.
- The biggest mistakes are made at the top of the cycle.
- The most important “C” of credit is cranium.
- If swimming in cash, keep swimming.
- Manage the controllables, manage around the uncontrollables.
- No traffic jams in the extra mile.
- Change occurs bottom up, not top down.
- More high tech causes people to seek more high touch.
- Net worth in financials & quality of life is equal to your network of people.
- Success is measured by dollar signs; significance is giving back to others in life.
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Online Articles:

- Road Warrior of Agriculture
  [https://www.farmprogress.com/road-warrior](https://www.farmprogress.com/road-warrior)

- Ag Globe Trotter

- Dave’s GPS & Dashboard Indicators