

# LENDING IN THE AGRICULTURAL MARKETPLACE - 2024 AND BEYOND



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**Dr. David M. Kohl**

**Professor Emeritus, Agricultural and Applied Economics**

**Member of Academic Hall of Fame, College of Agriculture & Life Sciences**

**Virginia Tech, Blacksburg, VA**

**Email: [sullylab@vt.edu](mailto:sullylab@vt.edu)**

**January 12, 2024**

# Ag Views Watchlist

- Export markets
- Global economic slowdown
- Southern Hemisphere production
- Economic health of protein industry
- U.S. economy, value of the dollar



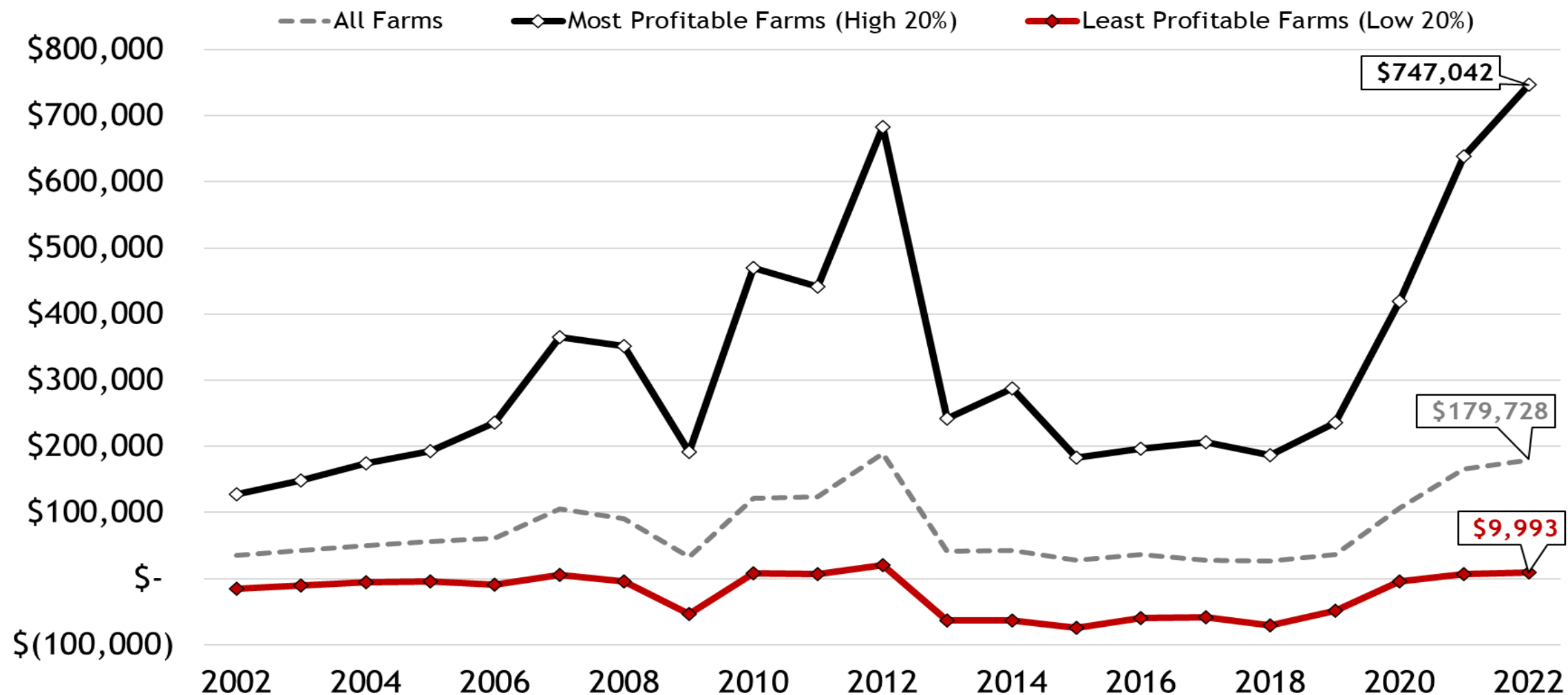
# Ag Views

- Higher expenses outlast higher incomes
- Thinner margin of error for financial & business decisions
- Price-cost volatility increases with resistance in interest rate declines
- Farm/ranch land or business IQ- the ultimate asset or liability
- Hard knocks: farmers, ranchers & lenders thrive



# Median Net Farm Income by Profit Group

Data: Minnesota, Sorted by Profitability Group

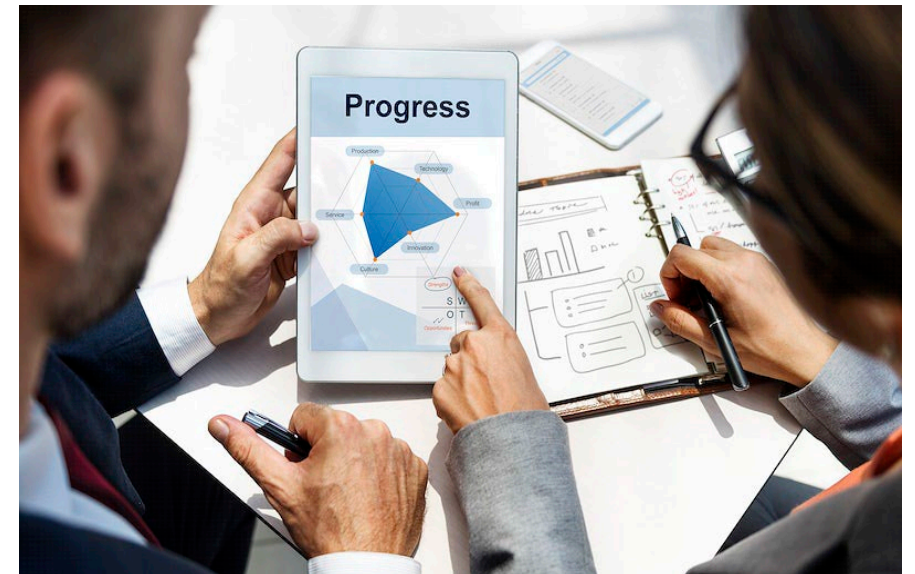


Center for Farm Financial Management  
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**FINBIN**

# Business Development Hat - Top 20-40%

- Selective growth & expansion
- Align with the next generation if in transition
- >50% working capital to expenses
- Selective cash rents & leases
- Focus on earns & turns





# Selective Refinancing: Average & Below Average

- Selective refinancing
- Working capital burn rate <1 year
- Debt to asset ratio <40%
- Plan for workout



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# Quote for the Quarter Century

“The opportunity for business and personal prosperity is not about the size, the enterprise or the next big thing. It is about being a ‘five-percenter,’ meaning being a little better in many components of production, operational efficiency, marketing, risk management, finance, human resources and in the focus on your values and goals.”



# China's Walk Around & Slow Growth

1

- 2<sup>nd</sup> largest economy globally
- Demographic issues
  - One child policy
  - 4-2-1 issue
  - 20% of 20-30 year olds unemployed
  - Government enforcement of technology
- Spending issue
  - Chinese citizens saved \$2.4 trillion during 3 year lock down
  - Uncertain future, not spending, prepaying mortgages
- Manufacturing/technology
  - Slow export markets- U.S. down 40% & Europe down 44%
  - Consumes 10-15% global oil & energy
  - Exports are down 14%



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# China's Walk Around & Slow Growth

2

- Debt issue
  - Household debt to GDP 110%
  - Housing devaluing by 25-50%
  - Government spending stimulus minimal
- China's growth rate as a result of deleveraging\*
  - 2000-2010 10.6%
  - 2010-2020 6.2%
  - 2020-2030 2-4% estimated
- A1 negative rating - downgrade of Moody's credit outlook
- U.S. agriculture's largest trading partner for cotton, soybeans, pork & milk



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\*Source: WSJ June 11, 2023

# Global Walk Around - India

- Surpassed China in population
  - Demographic divided
- Median Age: 29
- 5<sup>th</sup> largest economy globally
- 3<sup>rd</sup> largest economy by 2029
- India GDP per capita \$2,280
- Large exporters of: rice (Basmati & non-Basmati), sugar, onions, wheat



- Government limitations on exports
- Farm policy protectionism
- Only three-fourths of the population is literate
- Females in the workforce: 23%
- One-third live in cities
- >55% of population are farmers and live on small family farms

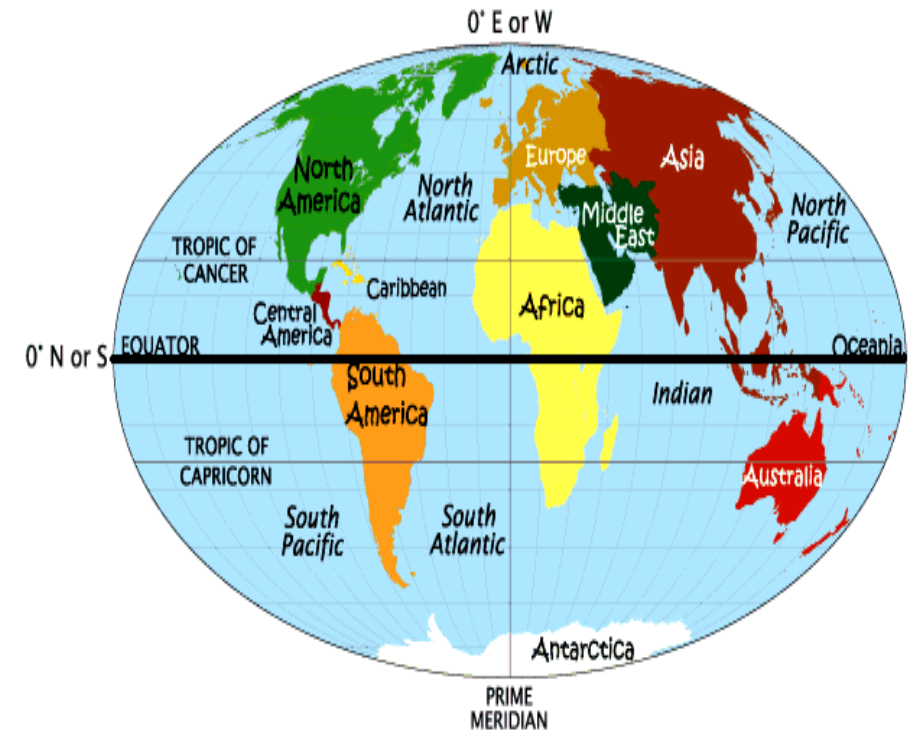
# Global Walk Around - Europe

- 20% of world economy
- European Union & Germany negative growth in Q3 of 2023
- Russia - China economic trap
- Immigration issues
- Increasing interest rates
- Tourism boom – U.S. stimulus money
- NATO & European unity – war in Europe
- Watchlist
  - Winter weather
  - Climate/social changes
  - Interest rates
  - Greenlash



# Global Walk Around - Southern Hemisphere

- Brazil's agricultural competitiveness & expansion
  - Soybeans
  - Corn
  - Protein industry
- Each year land equal to half the size of Illinois goes into production in Brazil
- Belt & Road Initiative
  - China 2013
- Alternative currency to U.S. dollar
  - New Development Bank (NDB)
  - Asian Infrastructure Investment Bank (AIIB)
- Oceania & Southeast Asia



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# Dollar vs New Currency

## NEW DEVELOPMENT BANK

- Multilateral bank established by BRICS
- Headquarters in Shanghai, China
- Reliance on U.S. currency 2/3
- Russia owns 20%- “new leader”
- New expensive debt
- Seeking membership from Saudi Arabia, Argentina, Honduras
- Russia invasion quadrupled borrowing cost

## ASIAN INFRASTRUCTURE INVESTMENT BANK

- Financed China’s Belt & Road Initiative
- Infrastructure for Tomorrow
- Designed to reduce dependence on dollar based funding
- Alternative to IMF
- Western countries are members



# Global Indebtedness

- \$305 Trillion Global Debt Q1 2023
  - \$45 Trillion increase since 2020
- \$100 Trillion Debt in Emerging Nations
  - 20% increase in the last three years
  - China, Mexico, Brazil, India & Turkey posted biggest increases
  - 250% of GDP in Emerging Nations
- 14% of companies in U.S. are “zombies”
  - “Zombie” companies are earning enough to pay expenses & service interest but not able to pay principal



**Source:** Data Compiled by IIF (Institute of International Finance- Washington, D.C.)

# Headwinds to the U.S. Economy

- Student debt payments
- Labor strikes
- Budget impasses
- Rapid acceleration of government debt: \$33 trillion
- Fiscal unsustainability
- Erosion of governance through election cycle
- Rapid rise in long term interest rates
- War in the Middle East
- Oil exceeding \$100/barrel



# Potential Tailwinds to the U.S. Economy

- Stock market
- Election year
- Inflation decline
- Decline of interest rates
- Employment strong



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# Steep Recession

- \$100/barrel oil
- Unemployment 5-6%
- Housing starts <1.0 million annually
- Interest rates in double digits
- Grey rhinos & black swans



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# Leading Economic Indicators Blinking Red

- LEI – Leading Economic Index
  - Down at least three tenths of one percent each month this year
  - Diffusion index < 50, 60% of the time
- PMI- Purchasing Manager Index
  - < 50 in 2023, a sign of a contracting economy
- Index of Consumer Sentiment (University of Michigan)
  - <75 since mid 2022
- Inverted yield curve
  - Inverted since May 2022
  - Predicted every recession since 1959
  - 19 to 24 month lag time
- Housing starts
  - Pressure from high median home prices & down payment requirements
  - 44% of household income



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# Factors for Interest Rate Decline

- Inflation
  - Headline 4.0%
  - Core 2.0%
- Unemployment
  - U-3: 4.5%
  - U-6: 7.5%
- Two quarters of negative GDP
- Yield curve – flat to positive



# R-star: The Natural Rate of Interest

- $R^*$  is the short term interest rate that would exist when inflation and unemployment are at levels that do not stimulate or restrain the economy.
  - 2.25% to 3.25% Fed funds rate
  - 5.25% to 6.25% Prime rate
  - Days of zero-bound interest rates (2008-2020) are in the rear view mirror.
  - Fiscal policy has an instantaneous impact with checks in the mail
  - Monetary policy (Fed action) has a lag effect of 8 to 18 months



# Farm & Ranch Values Watch List

- Demographics – baby boomer farms/millennial owners
- Narrowing of buyers
- Outside investors withdrawals
- Opportunity investments - CD's & money markets
- Green energy movement vs. “greenlash”
- Earned net worth gains vs. losses
- Appreciated net worth - gains vs. losses
- Water, mineral, & other value enhancements





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# Tools for 2024

# Business IQ: Management Factors

## Critical Questions for Crucial Conversations

<u>Farmer Checklist</u>	<u>Your Score</u>	<u>Green (3 points or 4*)</u>	<u>Yellow (2 points)</u>	<u>Red (1 point)</u>
1. Knows cost of production		Written	In head	No idea
2. Knows cost of production by enterprise		Written*	In head	No idea
3. Goals - business, family, & personal		Written*	In head	No idea
4. Record keeping system		Accrual adjusted	Schedule F (one & done)	No idea
5. Projected cash flow		Written*	In head	No idea
6. Financial sensitivity analysis		Written*	In head	No idea
7. Understand financial ratios, break evens		Written*	In head	No idea
8. Work with advisory team and lender		Yes*	Sometimes	Never
9. Marketing plan written and executed		Yes	Sometimes	Never
10. Risk management plan executed		Yes	Sometimes	Never
11. Modest lifestyle habits, family living budget		Yes*	Sometimes	Non existent
12. Written plan for improvement executed & strong people management		Yes*	Sometimes	Non existent
13. Transition plan/Business Owner plan		Yes	Working on plan	Non existent/controversy
14. Educational seminars/courses		Yes*	Sometimes	Never attend
15. Attitude		Proactive	Reactive	Indifferent

### \*Extra Points:

- **Progressive Business** may receive 4 points for #2,6,7,8,14  
- **Struggling Business Attempting Turnaround** may receive 4 points for #3,5,8,11,12  
(See pg. 2 for Progressive and Attempting Turnaround definitions)

<u>Score</u>	<u>Overall Analysis</u>
35-50	Strong management rating, strong potential for resiliency & agility
24-34	Moderate management rating, potential issues in resiliency & agility
<24	Weak management rating, potential major issues in resiliency & agility



# Business IQ Exercise

- After completing the Business IQ: Management Factors Scorecard, what are three areas/points in your business that you will continue and three areas/points for improvement?

Three areas/points to continue:

- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

Three areas/points to improve:

- \_\_\_\_\_
- \_\_\_\_\_
- \_\_\_\_\_

# Business IQ Scores & Successfully Navigating Adversity

Business IQ Score	Success Rate in Adversity	Stoplight Indicator
<25	Very low	Red
26-30	Low to moderate	Red
31-39	Average to above average	Yellow
40+	High to very high	Green

# Playing Defense vs. Risk

- Defensive Line = Cash Flow & Profits
- Linebackers = Working Capital
- Pre-Safeties = Equity
- Safety = Collateral



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# Bridge & Pier Concept

- Are you building a bridge or a pier?

The more you go down the pier, the deeper the water. This increases the need for a higher level of expertise, and there are fewer options.



# Banker & Borrower Engagement: Both Sides Add Value

Borrowers:	Bankers:
Provide up-to-date balance sheets	Monitor financials
Provide quality projected cash flow	Provide feedback on financials
Complete financial sensitivity testing on prices, costs and interest rates	Provide financial benchmarking
Articulate goals	Are part of the advisory team
Fill out a short and long term Business IQ	Fill out the Business IQ Assessment
Use financials & Business IQ for managing the business	Demonstrate the C's of banking



# Quotes & Perspectives from the ABA Ag Bankers Conference, Oklahoma City, OK - Dave's Top Ten 1

1. I like boring in marketing and risk management.
2. If you lose a community bank, then you kill a rural community.
3. Don't be without a chair.
4. Working capital/economic cycle
  1. Top half of producers burned approximately 50% of working capital
  2. Bottom half – burn rate was twice the burn rate on working capital
5. Stay in your lane.



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# Quotes & Perspectives from the ABA Ag Bankers Conference, Oklahoma City, OK - Dave's Top Ten 2

6. Top 20% under 80%, while bottom 20% above 85%.
7. Don't want to hear low prices, low costs. What are you going to change?
8. Hire to retire banking culture.
9. Greenlash and AI are just around the corner.
10. There is no culture without agriculture!



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# Banker Frank Philosophy: Wisdom for Banking and Life

- Can I trust you?
- Do you know what you are talking about?
- Do you care about me as a person?
- Success is often measured by dollar signs. Significance is making a difference in peoples lives.





# Q&A with Dr. Kohl

# Dr. David Kohl's Contact Information:

## Office:

(540) 961-2094

Alicia Morris

## Scheduling:

(540) 493-2724

Angela Meadows

## Email:

[sullylab@vt.edu](mailto:sullylab@vt.edu)

# Online Articles:



- Farm Progress Weekly Article:  
<https://www.farmprogress.com/author/david-kohl>
- Ag Trends & Insights Videos  
<https://agwestfc.com/education-and-resources/industry-and-economic-insights/economic-updates/agricultural-trends>
- Dave's GPS & Dashboard Indicators  
<https://www.farmermac.com/news-events/daves-gps/>