The Downturn in Agriculture: Implications for the Midwest and the Future of Farming

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Bank Iowa®

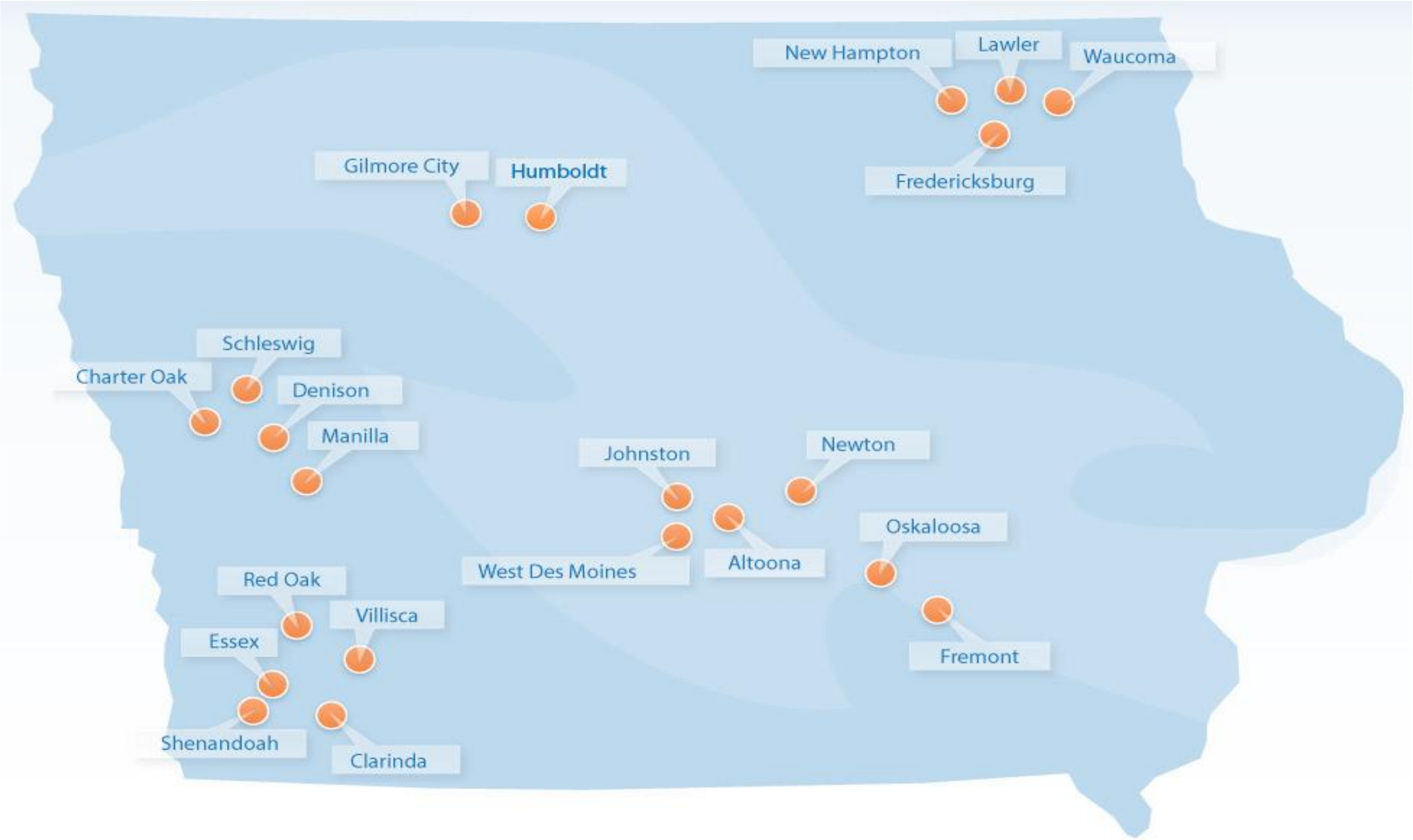
About Me

- Started as an Ag Loan Officer in 1982 with First Bank Austin, Minnesota
- Joined Northwestern Bank in northwest Iowa in 1985
- Named President of Northwestern Bank in 1992 and handled ag credit during my entire 27 years
- Joined Bank Iowa as President/CEO in 2012
- Continue to be active in credit as a member of Senior Credit Committee

About Bank Iowa

- Total assets $1.1 billion
- Total loans $800 million
  - Ag and farmland loans $400 million
- Offices in 21 communities
  - 18 rural offices (populations of 500 – 10,000)
  - 3 Des Moines metro offices
- 250 employees

About Bank Iowa



Borrower Financial Trends

- 650 borrowers

	2012	2013	2014	2015	Proj 2016
% Current Ratio < 1:1	13%	20%	22%	28%	35%
% Increase in Debt:Asset Ratio		52%	39%	52%	60%
Average Debt: Asset Ratio		32%	29%	31%	35%
% Positive Earned N.W. Gain		71%	76%	63%	50%

Asset Valuations in a Downturn

- Machinery values have been decreasing significantly since 2014
  - 15-20% per year in each of the last two years
  - Projected to continue declining in the near term
- Iowa Farmland values have been decreasing since 2014
  - Decreased 9% in 2014 and 4% in 2015 ($8,716 to $7,633)
  - Projected 9% decrease in 2016 ($7,633 to $6,950)
  - Compares to 16% average increase per year for 7 years in 2007 thru 2013 ($3,204 to $8,716)
  - Compares to 18% average decrease per year for 5 years in 1982 thru 1986 ($2,147 to $787)
  - Potential larger declines are currently being tempered by low interest rates
  - Excessive debt/acre loans are currently almost non-existent. Foreclosures are minimal.
    - This could change if operating losses are termed out against land while values decline
      - Need to avoid a deluge of land going on the market

4 Lender Tips in Preparing for Ag Renewal Season

- Tip 1: Prepare mentally for a more laborious and stressful ag renewal season
- Tip 2: Be pro-active in scheduling of renewals. Do as much of the work as possible prior to meeting.
- Tip 3: Prioritize riskier credits – schedule them first
- Tip 4: Be cognizant of the human aspect
  - Emotions can and likely will come into play
  - Real change only occurs when "owned" by the operator, not the banker
  - Be honest
  - But we seem to be dealing with a different type of borrower now vs. 1980s
    - Most producers aren't going to "farm until it's gone"

Handling Negative Cash Flow Projections

- With narrow margins, we expect to see some negative cash flow projections
  - FIRST: Verify accuracy of cash flow with borrower
    - Ensure all revenues are accurate and expenses are included
  - After confirming a negative cash flow, then what??
- Have a Game Plan
- Understand Your Toolbox
  - Drain Working Capital
  - Restructure Debt
  - Reducing Expenses
  - Increasing/Protecting Income
  - Asset Sales
  - FSA Guarantees to protect bank and provide staying power for borrower

Cash Flow Benchmark

- <u>"Fixed" Cost / Acre</u>
  - Attempts to standardize row crop producers by defining:
    - Cash needed to pay rent, service intermediate and long term debt, and pay property taxes
  - "Apples to apples" way to compare a cash renters to land owners while also accounting for intermediate term debt
  - Formula:
    - Total Cash Rent + Total Term Debt Service (P&I) + Property Taxes
      - Divided By
    - Total Row Crop Acres of Production
  - Does not account for family living, which can be a significant "fixed" expense
  - $3.40 corn and $9.00 soybeans w/ conservative yields allow for about $265 fixed cost / acre

Implications of the Ag Downturn

- Continued (accelerated?) consolidation of agricultural producers due to voluntary or involuntary liquidations
  - High grain prices kept inefficient producers in business and delayed retirement of older producers
- Implications:
  - Continued (accelerated?) population decline in many rural communities
    - Diminished social and economic opportunities
    - Difficulty in attracting talent to some rural communities
      - Possible need to change our delivery model on how we provide ag credit
  - The need for larger credit lines for remaining producers
  - Continued (accelerated?) consolidation of bank charters
    - Lending limit, no succession plan, credit losses, and increased regulations will take their toll
  - The need for talented lenders to handle the larger, sophisticated borrowers
    - Lenders are going to learn more in the next couple years than they learned in the previous ten
  - Increased reliance on FSA guarantees and other credit enhancements
    - Will probably require additional government funding

Other Implications?

- What will be the regulatory impact of higher problem loan classifications?
- How will regulators define Troubled Debt Restructurings on carry-over ag debt?
  - Severe regulatory responses to higher classifications and TDRs could trigger more aggressive lender action to exit troubled borrowers, potentially causing an acceleration in asset value declines
- Will bank charter consolidations in rural communities be limited by the Herfindahl-Hirschman index (HHI)?
- Will the downturn reduce the volume of supplier-provided credit?
  - Suppliers are motivated to sell a product and don't usually perform an overall credit risk assessment. This could result in credit losses and a pull-back from financing.
- Will crop farming go the route of hog production where large integrators own the growing crop with farmers providing the labor and capital assets in exchange for a fixed custom rate per acre?
  - Ethanol plants, co-ops, feed mills, large livestock producers, ag conglomerates