

# CREDIT DECISIONS IN TOUGH TIMES



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## Super Global Trend Disruptors: Evolution Accelerators

- One half of the world's population will experience a major election
- \$68 trillion of wealth will transfer from 2025 to 2040
- 1/3 of wealth owned by females in 2025 & 2/3 of wealth owned by females by 2040
- Stages of diffusion of innovation for green energy/AI
  - Infatuation: 2022-2024
  - Disillusionment: 2024-2027
  - Reorientation: 2027 & beyond
- Globalization, deglobalization
- Black swans vs. grey rhinos
- Dollar vs. new digital currency



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## Pulse of the Agricultural & Rural Economy Challenges

- Margin compression, resilient, inflated cost, lower commodity prices
- Higher interest rates
  - Impact on operating money
  - Possible impact on long term rates- “resets”
- Shrinking working capital and cash positions
- Storage of grain commodities with declining prices
- Protein sector, dairy, poultry & pork margin compressions
- Beef & livestock industries continue to be economically strong
- Land values
  - Reduced number of buyers in some areas
  - Solid demand in other areas
  - Cash rents: resiliently high



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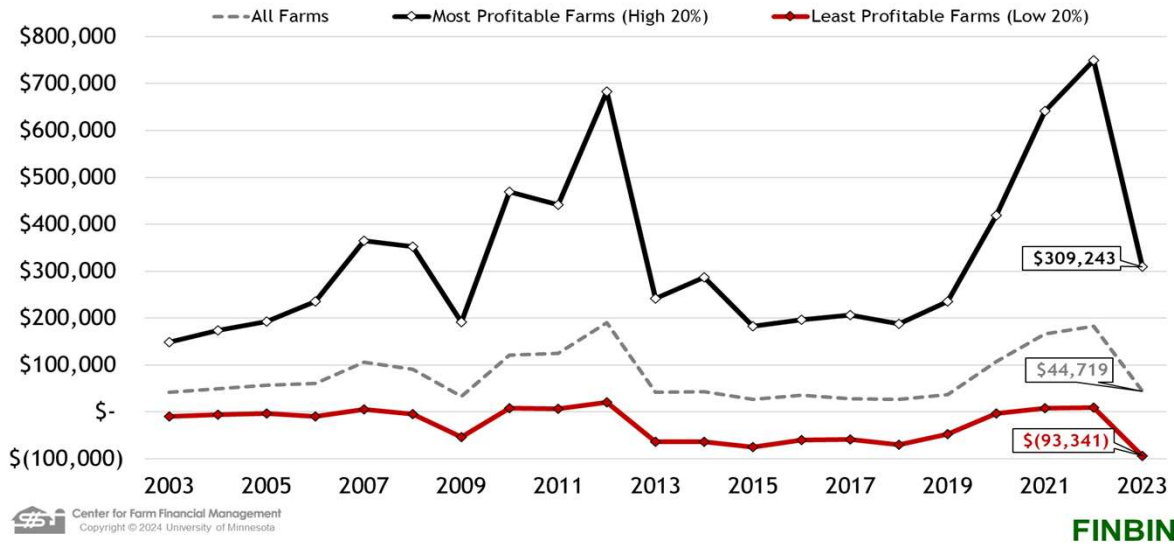
## Duration of the Economic Down Cycle in Agriculture

- Export markets – trade bill sanctions, tariffs
- Economic health of the Big Three Trading Partners
- Economic health of U.S. economy
- Weather globally
- Strength of U.S. dollar
- Monetary/fiscal policy
- Competition from Global South



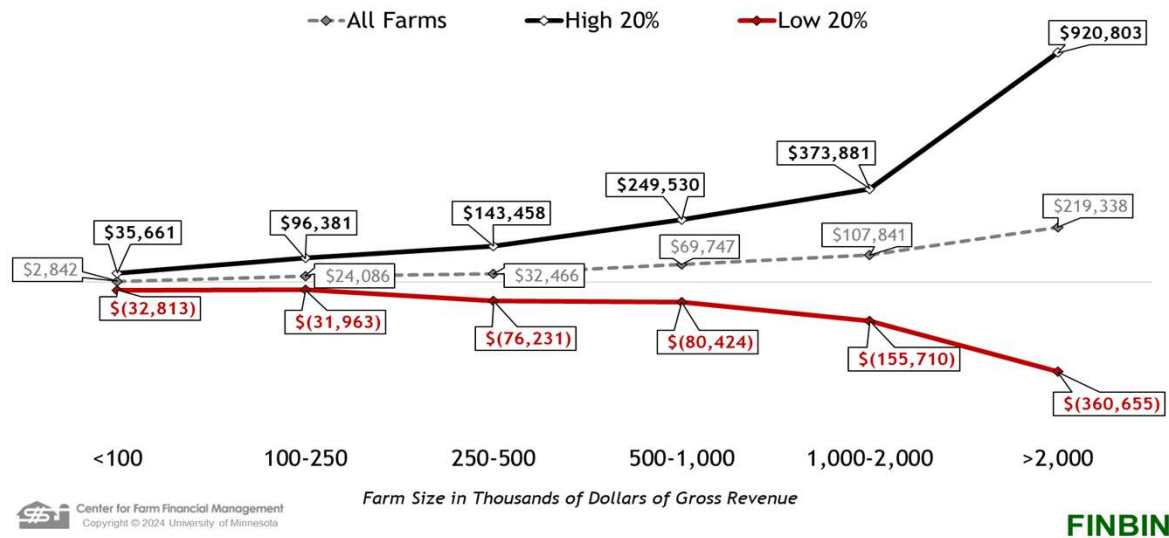
## Median Net Farm Income by Profit Group

Data: Minnesota, Sorted by Profitability Group



## 2023 Median Net Farm Income by Farm Size

Data: Minnesota, All farms, Farm size measured by gross revenue in thousands of dollars



## 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.”



## Quick Global Economic Assessment

- China
  - Demographic
  - Housing value decline
  - Stock market value decline
  - Sanction/tariffs/trade
- India
  - Farm policy protectionism
- Europe
  - Tourism
  - Greenwave/backlash
- Mexico/Canada
  - New leader, same policy
  - Canada: slow economy
- Southern Hemisphere
  - Belt & Road Initiative
  - Currency challenges



# U.S. Economy Snapshot

- ALICE (asset-limited, income-constrained, employed)
- Government debt \$1 Trillion increase every 100 days
- Credit card debt = \$1.3 Trillion
- LEI, PMI, Consumer Sentiment, Inverted Yield Curve
- Delinquency on credit card debt & auto loans highest level since 2012
- Government money driving A.I. (artificial intelligence) & green energy



9

# Watch List for Potential Recession

- High income earners
- Paper wealth devalues:
  - Stocks, investments
  - Homes, real estate
  - Other
- A.I. (Artificial Intelligence) vulnerability, geographic, mobility constrained
- Corporate restructuring
- Curtailed discretionary spending



10

## Fiscal and Monetary Trainwreck?

■ Government revenues	\$4.4 Trillion
■ Government outlays	\$6.3 Trillion
■ Govt. Deficit '24 (Projected)	≈ \$2.0 Trillion
■ Net Interest on Public Debt	\$870 Billion
■ Military spending	\$753 Billion
■ Deficit in 2023	\$2.0 Trillion

**Sources:** Congressional Budget Office, see link below.

[https://www.wsj.com/opinion/u-s-budget-deficit-government-spending-congressional-budget-office-report-d2c07021?mod=Searchresults\\_pos1&page=1](https://www.wsj.com/opinion/u-s-budget-deficit-government-spending-congressional-budget-office-report-d2c07021?mod=Searchresults_pos1&page=1)

11

## Global Indebtedness Tsunami

- \$307.4 trillion global debt Q4 2023
- Average debt GDP risen to 336% in 2024
- Average debt GDP was 110% in 2012
- Debt globally increased \$100 trillion in one decade
- 80% of global debt increase in U.S., Great Britain, Canada & Japan
- Brazil, China, India had the largest increases in debt



Economist, Arthur Laffer Jr. says “A slow fiscal death awaits some countries in this decade of debt”.

<https://www.cnbc.com/2024/02/07/debt-crisis-is-in-the-making-and-it-wont-end-well-for-the-world-economist-warns.html>

12

## Factors for Interest Rate Decline

- Issue of Federal Reserve creditability!
- Core inflation <2.5% instead of 2.0%
- Unemployment false reading!
- Retail/consumer sales decline
- Interest rates globally



13

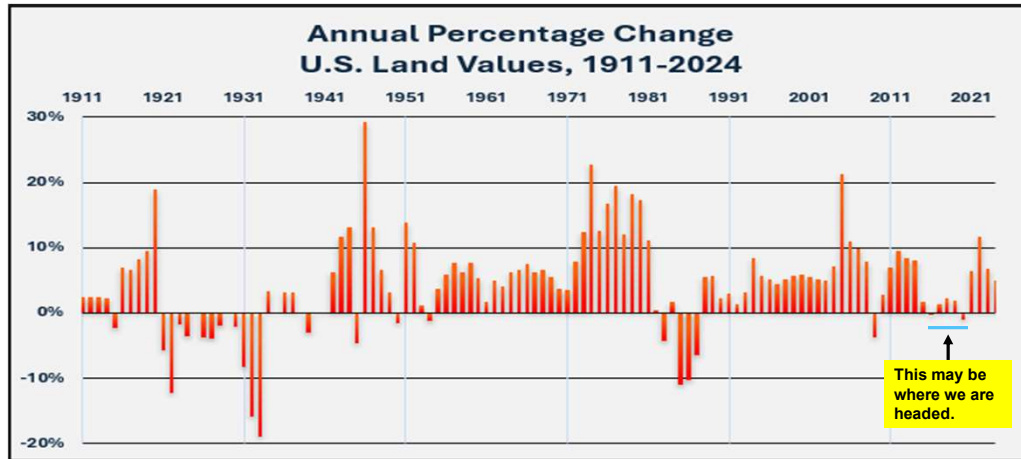
## Long Term Interest Rates

- Federal Reserve Rate 2.25% - 3.25%
- Prime Rate 5.25% - 6.25%
- Business/individual interest rates generally 1 - 4% above Prime
  - Size of the loan
  - Risk
  - Market perception of risk
- Other



14

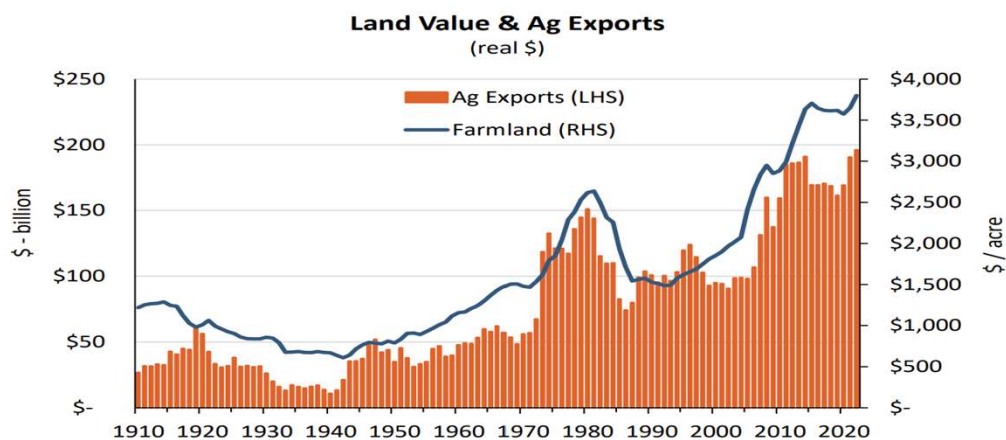
# U.S. Farm Real Estate Values



Source: Dr. Steve Isaacs, University of Kentucky

15

## Tied at the hip?



Source: Farmer Mac 2024





## Lenders: What is Headed Your Way?

17

### Lenders: What is Headed Your Way? Lower Coverage Ratios

- Operating losses
- Refinances at higher rates
- Substantially higher living costs
- Low 20% negative ratios



18

## How Do Farms Stack Up Historically? 2013 - 2023

### Historical information for Southwest, South Central & Southeast Minnesota

The source of the green, yellow, and red credit risk rating is from "Weighing the Variables" by David M. Kohl. He considers the six (6) color coded factors below to be key indicators of financial credit quality.

Green	The farm business enjoys a competitive position
Early Yellow	The farm business has some early caution signs
Late Yellow	The farm business has some major caution signs
Red	The farm business could face some major obstacles

	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023
<b>Current Ratio</b>											
Top 10 Percent	2.37	2.12	2.26	2.30	2.24	2.22	2.30	2.89	2.92	3.43	3.27
High 20 Percent	2.40	2.24	2.21	2.21	2.11	2.20	2.20	2.39	2.83	3.29	3.11
Average Farms	2.63	1.79	1.64	1.62	1.57	1.51	1.51	1.98	2.87	2.63	2.31
Low 20 Percent	1.50	1.22	1.18	1.14	1.10	1.07	1.07	1.16	1.75	1.76	1.62
<b>Farm Debt to Asset Ratio (Market)</b>											
Top 10 Percent	39%	42%	38%	39%	40%	39%	40%	40%	41%	38%	37%
High 20 Percent	38%	40%	39%	40%	41%	39%	41%	41%	41%	40%	38%
Average Farms	40%	43%	46%	45%	45%	46%	46%	44%	44%	43%	43%
Low 20 Percent	46%	52%	54%	54%	53%	55%	54%	51%	51%	53%	49%
<b>Rate of Return on Farm Assets - Rent/Lease Majority of Assets (Cost)</b>											
Top 10 Percent	7.8%	12.9%	6.6%	6.6%	6.8%	6.9%	7.8%	12.3%	16.7%	14.4%	7.6%
High 20 Percent	7.4%	10.4%	5.2%	5.6%	6.3%	5.2%	7.2%	11.4%	16.1%	14.1%	6.9%
Average Farms	6.6%	5.1%	0.8%	1.4%	1.8%	1.6%	1.4%	7.6%	11.4%	10.7%	6.1%
Low 20 Percent	-6.2%	-5.6%	-6.2%	-4.8%	-3.6%	-4.0%	-3.4%	-1.2%	-6.4%	-1.3%	-4.2%
<b>Term Debt Coverage Ratio</b>											
Top 10 Percent	236%	336%	197%	199%	210%	233%	273%	403%	574%	862%	326%
High 20 Percent	215%	287%	175%	150%	203%	208%	248%	375%	553%	529%	219%
Average Farms	136%	133%	77%	96%	102%	81%	148%	274%	389%	372%	125%
Low 20 Percent	87%	87%	46%	55%	11%	21%	8.6%	22.8%	109.6%	83.8%	23.8%
<b>Operating Expense Ratio</b>											
Top 10 Percent	73.2%	73.3%	73.8%	72.7%	72.8%	72.7%	73.3%	67.4%	62.6%	62.0%	73.3%
High 20 Percent	72.5%	73.5%	74.9%	73.9%	74.2%	74.7%	74.3%	68.4%	62.5%	63.4%	73.9%
Average Farms	81.4%	79.0%	84.9%	85.9%	82.3%	84.1%	79.4%	71.2%	66.6%	67.6%	82.3%
Low 20 Percent	89.8%	88.2%	89.6%	86.2%	86.6%	87.4%	88.3%	88.2%	87.8%	88.7%	89.8%
<b>Interest Expense Ratio</b>											
Top 10 Percent	2.9%	2.2%	3.0%	3.3%	2.2%	3.9%	3.4%	2.8%	2.0%	2.0%	2.6%
High 20 Percent	3.1%	2.4%	3.2%	3.6%	1.4%	3.8%	3.7%	3.1%	2.2%	2.2%	2.8%
Average Farms	3.9%	3.7%	4.2%	4.8%	4.8%	6.4%	6.2%	4.3%	3.1%	3.0%	4.3%
Low 20 Percent	4.6%	6.1%	4.7%	5.4%	6.1%	6.6%	7.8%	8.2%	5.1%	5.4%	5.5%



Source: Aaron Brudellie, Farm Management Instructor, Minnesota West Community & Technical College

19

## Lenders: What is Headed Your Way? Decline in Working Capital

- Devaluation of inventory
- Operating losses
- Capital expenditure decisions
- Lenders replenish working capital
  - Plan to preserve
  - Burn rate
  - Long term debt obligations



20

## Lenders: What is Headed Your Way? Monitoring Intensity!

- Once a year is not acceptable
- Accounts payable
- Credit card debt buildup
- Numbers decline, acceleration in larger customers
- Producers seeking new lenders
- Split lines of credit

21

## Lenders: What is Headed Your Way? Surprises

- Fraudulent activities
- Bills unpaid & left off payables
- Capital expenditures – deferred payments & maintenance
- Non-collectible accounts receivable
  - Custom work
  - Grain/livestock
- Loans from friends and/or relatives
- Machinery & equipment values decline by 50%
- Divorce, depression & disengagement

22

# Agricultural Lending Financial Spectrum

## Collateral Lender

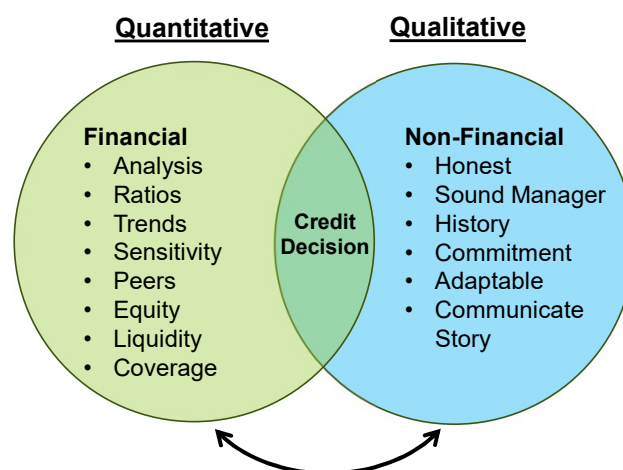
- Don't know cost of production
- Monitor financials once a year for tax reasons, no ownership of the numbers
- Shoot from the hip, marketing & risk management
- Family living cost issues
- Lender develops the statements
- <25% debt to asset ratio with land collateral

## Profit, Cash flow, Sixth C Lender

- Knows cost of production & break evens via enterprise
- Develops & monitors financials & cash flows frequently
- Marketing & risk management plan executed and monitored
- Family living budget separate from the business budget
- Team of advisors
- Aforementioned is critical for producer renting & leasing and > 50% debt to asset ratio.

23

# The Art & Science of Ag Lending



24

## Top Questions



- Is this economic cycle the same as the 1980s cycle?
- What are five positive strategies used for turn arounds in 1980s businesses?
- What are mistakes that lenders are making in the downturn?
- What are the positives of an economic down cycle in ag?

25

## Recent Questions

- What role do you see A.I. (Artificial Intelligence) playing in the next decade in ag lending?
- What would you say is most important to farmers today when seeking an ag lender?
- You have experienced two business turnarounds at your creamery, what are some nuggets as it applies to credit?
- What are your “pet” peeves of credit by borrower/lender?



26



# Q&A with Dr. Kohl

27

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## 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/>

28