Farm Lending Takes New Direction

RACINE, Wisc. — For years, cartoonists like Ace Reid and Jerry Palen have poked fun at bankers with such lines as "I haven't been able to get in to see my banker. He's changed the locks." In the meantime, ag lenders have been portrayed as the villian by both the media and Hollywood.

According to some financial experts, agricultural lending is simply a mirror of the challenges facing today's farmers. And as farming changes, so will ag finance.

Three-tier banking

"We're already seeing the shift in agriculture to large megafarms and part-time operations," says David Kohl, associate professor of ag economics and finance at Virginia Polytechnical Institute. "So commercial banks, as well as the Farm Credit System, are trying to target their future customer and shift their services to meet his needs."

Consequently, Kohl predicts future commercial banking will fall into three categories — traditional banks, money center banks and large metro banks.

"The money bank is the one we typically think of with the large ag portfolio and a high ag loan to asset ratio," he explains. These banks, which serve most of the farms, today, are declining in numbers.

In their place, farmers are encountering money center banks, with headquarters in such agribusiness trade centers as Des Moines and Sioux Falls, Iowa, and Lancaster, Pa. Kohl claims these money centers eventually will have ag loan to asset ratios of 10 percent or less with funds being distributed through a network of their branch area banks.

The large commercial banks, according to Kohl, will be located in metropolitan areas like New York, Chicago or San Francisco.

These banks will "target themselves to the large commercial producer and offer credit that is very competitively priced."

The cooperative lender's role

While private lending institutions are redefining their commitment to agriculture, the Farm Credit System is quickly repositioning itself to fill ag's needs.

H. Brent Beesley, president and CEO of the Farm Credit Corporation of America, notes that "the Farm Credit System is the only lending institution in the nation which is totally dedicated to agriculture and rural America. Thus, the system is 100 percent exposed to the risk of the ag economy."

But the system will need to make changes to increase profitability and charge comparable rates to compete with other institutions, he contends.

To be both competitive and profitable, he insists the new Farm Credit System needs to excel at extending good credit and quality service, managing interest rate risk and operating efficiently.

Beesley explains that the system must become immune to changes in interest rate levels through a matching of assets and liabilities.

"Our system shouldn't assume interest rate risks can simply be passed on to borrowers in the form of adjustable rate loans," he says.

Instead, the remodeled system will offer a wide range of maturities on fixed and variable rate loans.

Finally, the FCCA plans to reduce its expenses in order to become a "low cost operator."

"Perhaps large and expensive branch offices can be replaced with more personal services delivered to the borrower around the kitchen table," says Beesley. "At the very least, it will mean the consolidation of Federal Land Banks and PCA offices in some locations."

More bookkeeping ahead

Regardless of where a farmer applies for a loan, he should be prepared to document his ability to repay it, says Dr. Tom Frey, professor of agricultural finance at the University of Illinois.

No longer will loans be based on assets or tax statements, he claims.

"Instead, farmers will have to provide financial statements that include a balance sheet, an income statement and a cash flow projection that compares anticipated revenue with expenditures."

Educational assistance

To help farmers understand these demands, the University of Illinois introduced a course last year called "Your financial condition." The program was then offered to farmers on a county level.

"The results were extremely exciting," Frey says. "In less than a year we had over 2,000 people participate. So this year we've added three more modules."

The modules deal with preparing and analyzing financial statements and legal issues related to ag lending. Farmers explore financial goals and the motivation for developing greater financial insights into their farm businesses.

While everyone agrees that borrowing money may be more difficult in the future, there are positive aspects. For one thing, total farm debt is on the decline. And because of the increased financial data required for a loan application, farmers will quickly discover where their inefficiencies lie and become more profitable in the long run.

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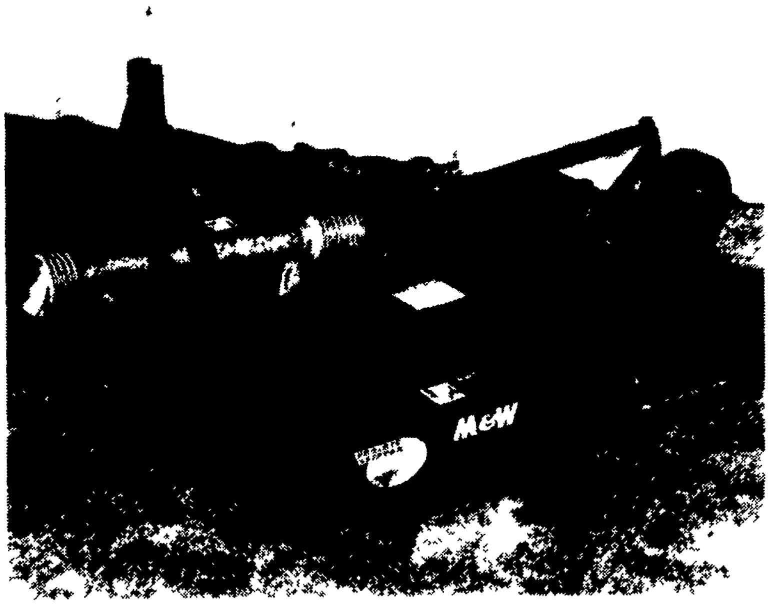

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