

## AG BANK UPDATE: Rains came too late

What ag banks are doing to offset effects of the 2012 drought

By Ashley Bray, freelance writer

The USDA has designated 1,820 counties as disaster areas due to drought, and that number is growing. As the world's largest producer and exporter of corn, the US' recent drought will have effects that go far beyond those 1,800 counties.

Nate Franzen, senior vice-president & agribusiness division manager of \$871.6 million-asset First Dakota National Bank in Yankton, South Dakota, always knew the cyclical nature of agriculture could bring a change in prosperity at any time. "I've been talking about that for a couple of years now to our ag producers to say, hey this is great, but be smart with your earnings now so that when the cycle changes, which it always does, we're prepared to weather a storm. And that's certainly what's happening now with the drought," he says.

This drought may be something the industry has seen before, and parallels are being drawn to the great drought of 1988, but today's circumstances are a stark difference from those of 1988. According to the USDA, farm income has grown 147 percent since 1988, which may have to do with the fact that farms have increased total output by 50 percent since 1982. Plus, farmers are coming off an especially profitable few years. "For the last decade, US agriculture, financially, has done really well. So farmers have very good cash reserves, very high equity levels, and the things that farmers own, mostly real estate, is in high demand," says John Blanchfield, senior vice-president, ABA Center for Agricultural and Rural Banking. "They have cash, and cash is the best thing to have when your income dips."

The Federal Crop Insurance Program also marks a major difference between today and 20 years ago. The program currently insures 265 million acres of crops. This insurance will help keep crop farmers with little to no output afloat. Farmers who do see output will fetch high prices for their goods.

However this insurance also signals a divide. It does nothing for livestock farmers, who depend on certain crops and grazing areas to feed their animals. This feed may now come at a very high price because of lack of supply. "The drought is probably going to affect our livestock industry more than the crop end of it for the fact that the majority of our customers have federal crop insurance, and that's going to do exactly what it was created to do and avert a disaster," says Kim Greenland, market president at \$9 billion-asset Great Western Bank in Mount Ayr, Iowa.

Federal programs have been set up by organizations like the USDA and the Farm Service Agency to help ease the strain on livestock farmers. These programs include emergency assistance for livestock or grazing losses, as well as disaster loans with low interest rates. In addition, the US Congress is currently considering legislation that would give assistance to livestock farmers.

Ag bankers are in a unique position to help because of their relationships with their customers. Bankers are currently looking at solutions ranging from federal programs to ideas like relocating livestock. "This is not a new event for most of us," says Greenland. "We're trying to be proactive with our customers and sit down and try and anticipate today what timing changes may occur on what their income is, are federal crop payments going to come in later, and what things are going to affect that cash flow."

Proactive is a key term when dealing with the effects of this drought. "We're trying to be very proactive as far as stress testing and what we call shocking our portfolio," says Franzen. "What that means is we run some scenarios as far as significant drop in revenue, significant increases in expenses to people, and project out what the impact might be to their operation. And that's helping us identify earlier customers that might be vulnerable. It's also giving us an opportunity to have a real valuable conversation with our customers."

A major consideration for bankers is possibly easing loan terms to help their ag customers. With this solution, however, comes questions about regulators and if certain loans will then be considered troubled debt restructure. Since 2008, regulators have focused much more on commercial loan performance, and it is not clear whether certain practices such as rescheduling principle payments or creating a new payment schedule will be considered TDR.

"I have no reason to believe that the regulators won't be understanding of the situation, but nonetheless may push the TDR button, causing again a certain amount of difficulty at the bank level," says Blanchfield. "This could be one of those situations where the regulatory response could be as damaging as the drought itself. I don't want to be an alarmist, but I think this is something that needs to be discussed openly with the regulators."

Bankers agree. Many plan on approaching the situation case-by-case. "If it's a high-risk borrower that doesn't do the right things, and then we have a natural disaster, we're going to be less apt to work with that type of client," says Julie Wuthrich, vice-president at \$9.3 billion-asset Citizens Bank in Wisconsin. "We're looking at each individual client, looking at the risk of the credit, looking at the history of the credit, and what we can do for that particular farm to help them through this. Is it easing working capital? Maybe rewriting debt over a longer period of time?"

As long as regulators cooperate, many bankers are optimistic about the outcome of this drought and their ag customers. "We may have to do a little restructuring here or there, but if you look at the history of the profitability of their operation and what we think is a reasonable projection going forward, they should show the ability to repay those loans after we've done some restructuring in most cases," says Franzen.

Of course the full effects of the drought have not been felt yet, and much remains to be seen as to how far the ripples will stretch outward. As farmers reduce or stop their spending, secondary suppliers and businesses many even begin to feel some ill effects. "[Farmers] want to tighten the belt and conserve as much of that cash flow as possible for them," says Franzen. "That's going to trickle down through a lot of main streets in the Midwest that are dependent on that ag revenue to keep the economy flowing."

One of the biggest questions that remains is whether this drought will be a one-year event or something longer. "My feel today in general is that the ag industry as a whole will be fine if this is a one-year drought," says Franzen. "Where I'm concerned is if this turns into a multiple year event where we have two or three years of drought. Then we're going to have more problems and more serious issues to work through."

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