90th Annual Soil Management & Land Valuation Conference

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Bank Background

- East Central Iowa – 4 offices serving Scott, Cedar & Muscatine Counties
- $150,000,000 Assets
- $ 73,000,000 Loans with 70%+ in Ag
- Some livestock diversity – Small to mid size cow calf
- Contract livestock facilities continue to increase in number – Hog & Poultry
- Most grain operations are 3,500 acres or less. Commonly 700-1,500 acres.
- High quality land sales are off their highs but still showing some top end strength at $9,500 to $10,500 which is off about 25% +/- from the $14,000+ highs.

Recent Financial Trends

- Mixed Income Performances.
- Strong Yields and Slightly Better Crop prices than anticipated got us through 2016 without too much turmoil.
- Working Capital has diminished.
- Beginning to see some Short Term to Long Term restructuring.
- 2017 Cash Flows look weak.
- Risk management seems to have more influence profitablilty than size factors.
- Pressure on cash rents will continue as long as operational expenses remain high.
- Many producers have curtailed discretional spending.
- Loan losses and termination of credit lines have been minimal… <u>to this point!</u>

A New Normal
or
Back to Normal?

- Up and down economic cycles in agriculture are nothing new but the **<u>VOLATILITY</u>** in the markets affecting agriculture coupled with the speed and dynamics with which they can change is one of our bank's biggest concerns.
- Consider the V-Bottom seen in the cattle market in late 2015 as cattle futures lost $20.00/cwt from November 1st to December 15th and then rebounded $15.00/cwt by December 31st or the influence of the USDA crop reports.

Issues on Lender’s Minds Today

- Core collateral assets, land and late model machinery, are declining in value – How much devaluation will continue to take place?
- High operational costs being financed against weak cash flows.
- The increasing presence of carry-over operating expenses.
- A reluctance to see meaningful reductions in some higher priced rents.
- How will producers scale down if they are unable to align rent and operating cost with income capabilities?
- Diminishing Working Capital.
- Financing large operators working primarily with leased farmland and iron equity.

Issues on Lender's Minds Today

- The need to see personal living expenses in some situations fall in line with operational capabilities.
- The potential effects of increased interest rates.
- The challenges that face the existence of our young, beginning and small farm producers.
- A need to see better records and production details.
- A need for better marketing and risk management plans.
- What will be the affects on our rural businesses and communities if we continue to weaken?
- More consolidation leads to larger credit lines and more lending risks.
- How will our regulators and examiners respond?
- Will Congress keep FSA-Guarantees adequately funded and will they accommodate the needs of our larger producers?

Land Values - What Got Us Here?

It was a perfect storm:

-Ethanol created a demand shock.

-Global Weather issues created supply concerns.

-Long Term Interest rates fell to historic lows.

-Strong investor interest as other investment options weakened due to housing crisis.

-A willingness to lend LT money at higher LTV levels.

-A “New Normal” mentality came into play.

Typical Production Costs

- **Corn on Corn @ 200 bpa**

- P&K - Maintenance $ 49.50
- Sulfer $ 10.00
- Lime – Avg/ yr $ 8.75
- 210# Nitrogen $ 73.50
- N – Stablizer $ 12.50
- Pre-Emerge $ 24.85
- Post Emerge $ 20.24
- Seed $112.00
- Fungicide $ 27.50
- Fed Crop, Wind & Hail $ 26.50
- Dry & Store - .10/bu $ 20.00
- Trucking - .20/bu $ 40.00
- **Total** **$425.34**
- Avg / Bushel $ 2.13

- **Corn on Beans @ 225 bpa**

- P&K - Maintenance $ 49.50
- Sulfer $ 10.00
- Lime – Avg/ yr $ 8.75
- 180# Nitrogen $ 63.00
- N- Stablizer $ 12.50
- Pre-Emerge $ 24.85
- Post Emerge $ 20.24
- Seed $104.00
- Fungicide $ 27.50
- Fed Crop, Wind & Hail $ 26.50
- Dry & Store - .10/bu $ 22.50
- Trucking - .20/bu $ 45.00
- **Total** **$414.34**
- Avg / Bushel $ 1.84

Profit Projections

- **Corn on Corn – 200 bpa**

Avg Mkt Price/bu.	$ 3.75
Bushels / Acre	200
Gross Rev	**$750.00**
Production Cost	$429.54
M&E Debt Service	$ 50.00
Other Expenses	$100.00
Total Expenses	**$579.54**
Net Op Inc / Acre	$170.46

- Farm Program $0 – 75/ Acre on corn base acres only.

- **Corn on Beans – 225 bpa**

Avg Mkt Price/bu.	$ 3.75
Bushels / Acre	225
Gross Rev	**$843.75**
Production Cost	$417.94
M&E Debt Service	$ 50.00
Other Expenses	$100.00
Total Expenses	**$567.94**
Net Op Inc / Acre	$275.81

- Farm Program $0 – 75/ Acre on corn base acres only.

Typical Production Costs

- **Beans – No-Till on Corn – 62.5 bpa**

P&K - Maintenance	$ 44.80
Lime – Avg/ yr	$ 8.75
Nitrogen	$
Pre-Emerge	$ 19.55
Post Emerge	$ 14.69
Treated Seed@155,000/a	$ 95.00
Fungicide	$ 23.00
Fed Crop & Hail	$ 19.50
Dry & Store - .05/bu	$ 3.00
Trucking - .20/bu	$ 12.00
Total	**$240.29**
Avg / Bushel	$ 3.84

- **Beans – Projections – 62.5 bpa**

Avg Mkt Price/bu.	$ 9.50
Bushels / Acre	62.5
Gross Rev	**$593.75**
Production Cost	$240.29
M&E Debt Service	$ 50.00
Other Expenses	$100.00
Total Expenses	**$390.29**
Net Op Inc / Acre	$203.46

- Farm Program $0 – 50/ Acre on bean base acres only.

100 Acre Blended Projection

	Corn On Corn	**Corn on Beans**	**Beans**
Projected Income	$750.00	$843.75	$593.75
Projected Expense	$579.54	$567.94	$390.29
Net Income/Acre	$170.46	$275.81	$203.46
Acres	20	40	40
Total Net Income	$3.409	$11,032	$8138

Total	**$22,579**
Average Blended Net Income / Acre	$ 225.79
Average Potential Farm Program Pmt / All Acres	$ 0 – 50.00
Maximum Land Cost / Acre to Break-Even	$225-275

While many producers strive for a 50:50 corn / soy rotation, it is not always possible. Across our customer base we typically see 20-30% of the corn produced as corn on corn.

What’s This Mean To Land Values?

This is where we came from:

- $450 Rent/Acre / 3.00% Cap Rate = 15,000

This is where we are:

- $225 Rent/Acre @ 3.00% Cap Rate = $ 7,500
- $275 Rent/Acre @ 3.00% Cap Rate = $ 9,170
- $300 Rent/Acre @ 3.00% Cap Rate = $10,000

This is where we were 10 Years ago:

- $275 Rent/Acre @ 4.25% Cap Rate = $ 6,470

Financing Land Purchases

- Case by Case Basis – Our emphasis is on the borrower's overall average land cost / acre. Above $300/acre has been a caution flag. This equates to a loan cap of about $4,000 to $4,500 per acre on good quality farmland.
- Some exceptions may include situations where substantial manure is available to offset some production cost or other income resources are available to factor into the cash flow. The strength of the balance sheet is also a consideration.
- Without sufficient cash, diluting other real estate equity is typically required to keep average LTV and debt service on land within tolerances.

Financing Land Purchases

- We tend to look at secondary market resources more strongly now than in the past due to the increased amount of financing necessary to fund land purchases and the inherent risk of increased interest rates.

- We will make use of FSA Guarantees and down payment programs as necessary to help enhance the financing package. The use of the secondary market on the guarantees is also a good long term risk strategy against rising interest rates.

Future Expectations

- Operations with some livestock diversity, low leveraged land positions or custom income resources will likely divert profits, at least <u>temporarily</u>, to maintain or acquire increased control of land.
- Eventually lagging production costs, including land costs, will need to make economic sense.
- Stronger investor interest will eventually re-enter the land market.
- Used equipment prices will stabilize after inventories deplete.
- Some higher leveraged operators will fail.
- Small to mid-sized operators may need to outsource custom farming needs as cost of M&E ownership increases.

How Do We Move Forward

- Take action early. Recognize problems and communicate with lender to develop a plan.
- If refinancing is necessary be proactive while interest rates are low. Re-align working capital as necessary. Evaluate leasing vs financing.
- Develop a risk management & marketing plan
- Use technology to your advantage when it pays.
- Micro manage your profitability.

THANK YOU!