Credit Position Paper – Future of Farming Project

Note: This position paper is a stand-alone assessment reflecting the expertise of agricultural credit professionals. Clearly, credit is a critical input to the complex system of production and merits comprehension.

Introduction

A positive business environment will ensure the viability of agriculture in Washington. Essential to a financially healthy agriculture industry is for policy makers to make certain Washington is competitive with other states' business environments. Agricultural producers need a level playing field to effectively compete in the global marketplace.

Business environment must be favorable to the 20 percent of agricultural producers that provide 80 percent of the revenue and a higher percentage of the profits. These operations must continue to grow and become more efficient through large investments in capital to be globally competitive. These primarily family farm businesses provide a large share of Washington's economy and tax revenues through jobs, construction, and required services.

The financial health of Washington's agricultural industry must remain strong for its future to be certain. This means not only in helping future producers pursue careers in agriculture, but also for those currently involved to remain in business.

Ultimately, agriculture benefits wholly when financial institutions are actively competing for producers' business. Competition ensures producers have choices and the best available interest rates and terms.

<u>Initiatives for Washington State Legislators to consider:</u>

- State-sponsored subsidized financing for beginning and minority producers.
- Positive public relations (through programs like the Heart of Washington) and education with the urban public about the importance of Washington agriculture.
- Improve the conditions and environment in order to attract labor critical to agriculture's success in the next 20 years.
- Complete the Columbia Basin Irrigation Project's East End.
- Ensure a strong Land Grant University and Community Colleges system with solid agricultural programs providing an advanced education for young people and minorities wanting to begin a career in agricultural and/or related services field.

Current General Credit Assessment

Overall, Washington's farm financial health is strong. Most commodities have had several years of good prices—some commodities have had record high prices. Most producers have relatively strong balance sheets overall and adequate-to-good liquidity resulting from strong earnings and cash flows in recent years.

More financing is now available for traditional and established producers than there has been in a long time. Competition is keen among financial institutions. Regardless of the sub prime headlines in the last nine months, access to credit for agricultural producers has been very reasonable and other non-traditional sources have been willing to flow capital into agriculture. Investors today consider agricultural real estate a good investment. Large conglomerates are looking to expand their value proposition by moving down the food chain.

Throughout the state—whether dryland, irrigated or orchard—farm real estate prices have steadily increased over the last decade. USDA reports that Washington farm real estate prices have increased by 8.6 percent in the last year alone. However, the increased land values may not have resulted in increased debt service per acre as many purchases have been funded by cash or equity

Current Credit Gaps

This abundance of credit is not readily available to all segments. Beginning producers (many of which are minorities) may have some difficulty obtaining credit. For these prospective producers, the issue is often credit risk and the inability to come up with the extensive amount of capital needed to begin in an agricultural endeavor. The increase in asset values makes it difficult for new producers or small operators to come up with larger down payments on real estate. Also often for minorities there is a general lack of awareness of financing alternatives. In order to maintain a healthy agricultural industry, barriers to entry must be addressed.

Many producers are passing retirement age and are transitioning out of their operations. Succession planning will help identify some of the next generation of producers. Additional avenues to increase interest in agricultural careers must be considered as well.

The Washington State Legislature and Washington State Department of Agriculture should examine the possibility of creating some form of state-sponsored subsidized financing for beginning and minority producers expanding and improving beyond the “AggieBond” program. This program would need to be structured to encourage lenders’ participation to invest their resources into the program. Washington agriculture must have new and younger producers continually entering the business to maintain long-term viability of the industry.

Opportunities to Seize

Washington has some of the most productive agricultural attributes in this country: growing conditions, fertile ground, availability of water, and access to foreign markets. The geographic diversity of Washington creates many different opportunities for high income crops on smaller acreage. More than 175 different commodities can be grown within our state’s borders. Washington is the eleventh largest agricultural state and third largest producer of fruits and vegetables in the nation.

With the increased focus on food prices in the media, consumers are even more aware of food and agriculture. Washington has an opportunity to provide positive public relations (through programs like the Heart of Washington) and education with the urban public about the importance of Washington agriculture. Consumers (several generations removed from the farm) need to understand the value of agriculture, which contributes to the vibrancy and economic health of our state.

As many emerging countries’ population and income rise, they are looking to supplement their diet with more protein products. Additionally, the relatively low value of the U.S. dollar has fueled export growth opportunities, particularly to Pacific Rim countries. The state needs to continue its trade missions and exploration of new markets for our agricultural products.

Currently, there is a renaissance of interest in food and where it comes from; many non-traditional producers are interested in beginning a career in agriculture. Adequate credit options must be available for these prospective producers. The aforementioned state subsidized loan program for beginning producers could assist in financing this new wave of producers.

Challenges to Address

The State Legislature must maintain a long-term view and play a critical part in solving some large, omnipresent challenges which have loomed over agriculture for decades: labor, water, energy, and infrastructure of roads and rails. Although answers are not easy, these issues have the most potential for disruption and present the biggest unknowns to the future of Washington's agriculture. Leadership is needed in making some difficult and arduous decisions surrounding these complex issues. If the results provided adequate labor, water, and energy for a reasonable price—without a myriad of regulations attached to the changes—it would be very positive for the future of this industry.

Some of the state's most productive commodities are highly dependent on labor. Public policy makers need to help resolve the issue and improve the conditions and environment to attract labor critical to agriculture's success in the next 20 years.

State agencies governing water issues should be reasonable and willing to work with producers. In the long-term, the Columbia Basin Irrigation Project's East End should be completed. The boon in both increased food production and jobs created would be an incredible boost to the state's overall economy.

The price of energy is a key to the future and is an unknown at this time—regardless of the source it will cost more. If the trend continues, input and energy costs could be up 20 to 40 percent depending on the enterprise.

The impact of global oil prices on agriculture is a **major** unknown in the next 10 to 12 years. Because much of agriculture is so reliant on petroleum-based products, alternative resource choices must be considered. The balance between food, fuel, and energy must be determined by both state and federal government so that all three are at a level consumers and agricultural producers alike can afford.

Today's positive profits in agriculture stem from an abundance of land in production, healthy and strong rural communities, and rural spending going towards Washington's overall economy. If this profit portrait changes, the financial health landscape will change dramatically and most likely take agriculture into a two-to-three-year down cycle.

What could make the portrait change? Primary concerns center on record increases of input costs (labor, power, fertilizer, equipment and land prices).

The risk the State Legislature needs to consider is **if** current high commodity prices do not remain at the same levels and the input costs continue to increase (which has been consistent over the past several years), there could be an agriculture downturn in the next several years. Without high levels of profits, producers might need more credit to fund their production costs.

If increasing commodity prices are sustained over a period of time, additional credit will be needed by the livestock and dairy producers to purchase feed for their animals. Increased costs and commodity prices will drive up costs of infrastructure and land. If that happens, producers will need more credit. We also expect to see an increased volatility of prices (the highs will be steeper and the lows deeper).

When the next down cycle hits agriculture, if lenders turn their backs on agriculture during difficult times—it will directly impact rural communities as well. Lenders must commit to provide financing for rural homes and small businesses. A concern is that competition would shrink until there is only one lender in town, which would then have a monopoly on interest rates and terms–ultimately a very negative impact for rural communities.

As some producers continue to get larger while their neighbors retire without a successor, diminished numbers of ag producers will have an impact on rural communities and their sustainability. Less people mean fewer students for schools and less commerce for small rural communities, especially those far from trade centers.

Within the support infrastructure for agriculture, another important element to ensure success is the recruiting, educating, and training of the next generation of producers and those in related services careers. The State Legislature must ensure a strong Land Grant University, Extension, and Community Colleges system with solid agricultural programs providing advanced education for young people and minorities wanting to begin a career in an agricultural and/or related services field. These agricultural programs need educators who can bring practical application to build a future base for strong leaders in Washington’s agriculture. The recruiting and training of the future generations of producers, managers of agricultural businesses, lenders, and technical specialists is another critical aspect for the vibrancy of Washington’s agriculture.

As agriculture continues to become more specialized and highly technical, the need for agricultural lenders to understand their customers’ operations—both opportunities and challenges—will become even more important in the future. Lenders must have knowledgeable loan officers who understand the financial risks and opportunities that agricultural operations present. The more complex agricultural operations need a team of experienced professionals (lenders, accountants, lawyers, and production specialists) to provide knowledge, trends and assist in their operation and their future plans.

Washington Agriculture’s Future

Agricultural producers of 2020 will have a much different look and feel than today’s producer. There will be a tremendous transition of land to either the next generation or a new generation in the next 10 to 15 years. Through consolidation is expected to persist, agriculture will continue to have many faces. Small entrepreneurial producers which grow, provide, and present their product directly to the consumer, either through Community-Supported Agriculture or local Farmer’s Markets, will continue to increase. More traditional producers who are older with low debt load can continue farming until they retire. Vertically integrated family businesses will continue to grow and expand with multi-generations involved as well as hiring professionals as a part of their managerial team.

Different segments within agriculture represent the diversity of Washington’s future, and must include both specialized and consolidated producers—one size does not fit all. Economic opportunities must be available for both large and small producers as well as lenders willing to finance the entire producer spectrum.

Washington’s agriculture has always played a vital role in the state’s economy. If some of the opportunities are seized upon and if the long-term challenges of labor, water, and energy are addressed, the future viability of Washington agriculture and its financial condition will be the better for it. A vibrant and profitable agriculture industry in Washington will continue to attract not only lenders and investors, but more producers as well.

Here is an at-a-glance review of agricultural producers' financial health SWOT analysis.

Washington Ag Producer's Financial Health

Strengths

- Current strong commodity prices have most producers positioned well for future downturns.
- Many producers are established and have low debt levels.
- Multiple financial institutions and investors are currently interested in lending in agriculture.
- Many producers have experienced past downturns and learned from it.
- Washington's agriculture is very diverse.
- Most producers/commodities are not reliant on government subsidies.

Weaknesses

- The average age of producers continues to rise.
- Risk that with record high prices, some producers are excessively spending profits that might be better put aside for future use.
- Many older producers are out-of-step with contemporary management practices and don't want to make necessary changes to their operations to position them for future success.
- Many prospective next generation producers are not interested in returning to the operation.

Opportunities

- Land ownership transitions within the next five to 15 years provide opportunities for current and new producers.
- The trend of consumers to have an interest in sustainability and the supporting of local farmers.
- Washington's proximity to Asian Markets combined with other countries' rising middle classes with desires to improve their diet.
- Many commodities can be high income producing with small acreages.
- Producers who incorporate traceability into their products will have a marketing advantage.
- Rewarding careers are available in agriculture and related services for enterprising new producers and students.
- If the large unknowns can be proactively addressed–labor, water, and energy–Washington's business environment will improve and be more stable than other states that have not addressed the issues.
- With today's increasing food prices, consumers are now more aware of food and where it comes from. It may be a teachable moment for the public to learn about the importance of maintaining ag land in production within the state.

Threats

- If high commodity prices drop, producers' profit-margins will be squeezed due to the ever increasing input costs.
- More producers and employees are needed to begin farming and related services career as large number of producers reach retirement age.
- If agriculture takes a down turn, some lenders might pull back from ag lending.
- If public policy makers do not address the large unknowns–labor, water, and energy–the ability and profits in producing food will be greatly diminished.
- Demand is increasing land values without associated projection of cash flows to match the increase.
- If infrastructure for agriculture is not maintained, transportation costs will increase.
- Urban legislators and regulators have a general lack of knowledge of agriculture. They often create and mandate regulations that put onerous burdens on Washington's ag producers.
- More volatility in commodity prices will cause the downturns to be steeper and more frequent.
- As experienced ag lenders retire, young loan officers who've not gone through the commodities' downturns are making credit decisions based on current record high prices.