Nontraditional Finance: Overview and Trends

Jennifer Ifft, Associate Professor

2020 Risk and Profit Conference

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Introduction

I've been in Manhattan for almost a month and was most recently part of the faculty in the Charles. H. Dyson School of Applied Economics and Management at Cornell University.

Over the next year, I'll be developing a research, extension, and teaching program in agricultural policy. Expect to hear from me!

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Introduction: traditional background

Ifft Yorkshires
@ifftyorkshires Follows you
Fairbury, Illinois ifftyorkshires.com

Sabetha

ILLINOIS ACES
Agricultural & Consumer Economics

Does federal crop insurance lead to higher farm debt use? Evidence from the Agricultural Resource Management Survey (ARMS)

Jennifer E Ifft , Todd Kuethe , Mitch
Agricultural Finance Review

Buying seed corn: What's your discount?

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Introduction: nontraditional background

Apple Harvest Platforms: Quantifying Efficiency and Determining Economic Benefits

Matt Wells[1], Jennifer Ifft[2], Jacob Marc Freedland[2]

ELSEVIER

China Economic Review
Volume 54, April 2019, Pages 147-159

Risk preferences, production contracts and technology adoption by broiler farmers in China

Hui Mao, Li Zhou, Jennifer Ifft, RuiYao Ying

Potential Impacts of Minimum Wage Increases on New York Dairy Farms

Jennifer Ifft & Jason Karszes

Old Order Amish Settlements and New York Farmland Markets

By Jennifer Ellen Ifft and   Abstract

The Impact of Energy Production on Farmland Markets: Evidence from New York's 2008 Hydraulic Fracturing Moratorium

Jennifer Ifft, Ao Yu

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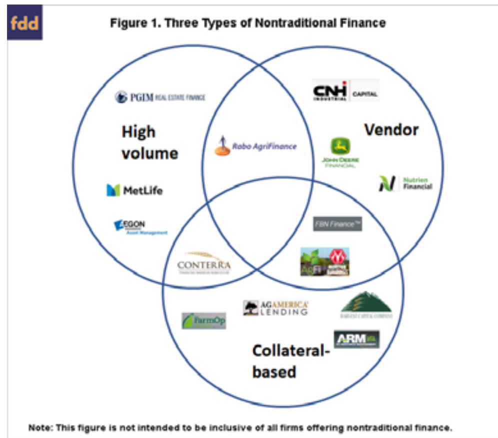
What is nontraditional finance?

Current definition: lenders working outside of the ("traditional") local branch-loan officer model

"Nontraditional credit suppliers or lenders…are those whose primary contacts with producers historically have been for goods and services other than credit" (Sherrick, Sonka, & Monke, 1994)



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2 stories about nontraditional finance

Financial distress

- Lender of last (second?) resort
- "Financial bridge to struggling farmers"
- "Prolonging the agony and potentially building up [farm] losses instead of cutting the pain, cauterizing the wound and stanching the flow of financial blood now"

https://www.wsj.com/articles/farmers-in-crisis-turn-to-high-interest-loans-as-banks-pull-back-11573381801
https://www.wsj.com/articles/americas-farmers-turn-to-bank-of-john-deere-1500398960

Modern agricultural credit markets

- Almost everyone that *sells something* to farmers sells credit too
- Increasing competition
- Segmentation
- Differentiation
  - Convenience
  - Service
  - Bundling
  - Standards
  - Source of collateral

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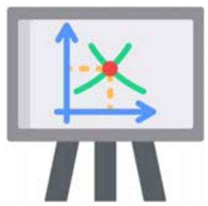
What drives the growth in nontraditional finance?

Supply side factors

- Outside capital
- Innovation
- Lending standards



Demand factors

- Diverse U.S. farm business
  - Large and small
  - Complex
  - Fast-growing
  - High share of rented land
  - Increased appetite for risk?
- Financial stress

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How big is nontraditional finance?

Short answer

We don't know, anything between 10-15% of farm lending nationally would be a conservative or reasonable guess (higher for KFMA farms)

Longer answer

- Estimate/educated guess by lending category
  - High-volume, branchless: 8-10%
  - Vendor: 1.5-2.5%
  - Collateral based: 1-2%

Reference: https://farmdocdaily.illinois.edu/2020/03/how-big-is-nontraditional-finance.html

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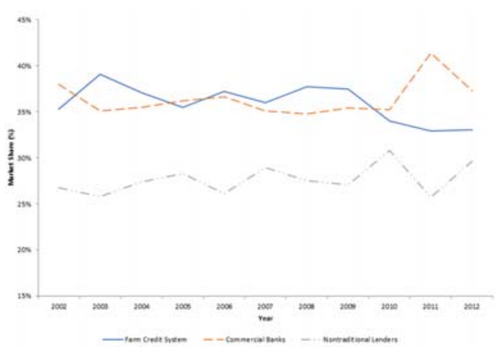
Some nontraditional lenders rival largest Farm Credit lenders

- Farm Credit Services of America: $29.7 billion loan volume in 2019
- Metlife: $21.0 billion agricultural loan portfolio (as of March 31, 2020)
- Rabo Agrifinace: $15 billion loan volume reported in 2019 (not based on regulatory reports)
  - Rabobank N.A. had ~$4.7 billion in non-real estate & real-estate ag production loans on Dec. 31 2018
- American AgCredit: $11.8 billion loan volume in 2019
- Conterra: $4 billion in loan assets across portfolios in 2020
- John Deere Financial: $3.1 billion in "loans to finance agricultural production" reported June 30, 2020
- Frontier Farm Credit: $2.0 billion loan volume in 2019
- Farm loans holdings of the largest 30 U.S. banks declined 17.5% between Dec 2015 and March 2019 ($18.3 billion held in March 2019)
- 2020 USDA farm sector debt forecast: $425.3 billion

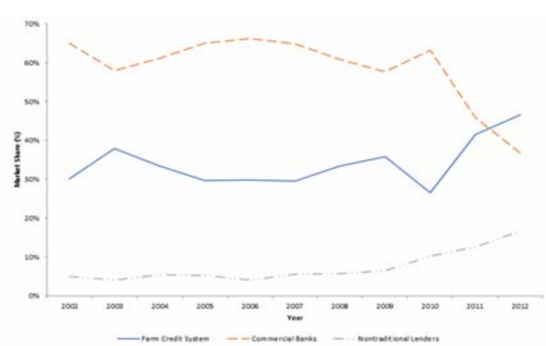
https://www.fcsamerica.com/about/newsroom/financial-reports
https://investments.metlife.com/financing-solutions/agricultural-finance/
https://www.bankingdive.com/news/rabobank-us-agriculture-lending-gap/559142/
https://www.agloan.com/wp-content/uploads/2020/03/American-AgCredit-2019-Annual-Report.pdf
https://cdr.ffiec.gov/public/
https://www.frontierfarmcredit.com/about/newsroom/financial-reports
https://www.reuters.com/article/us-usa-farmers-lending-insight/wall-street-banks-bailing-on-troubled-u-s-farm-sector-idUSKCN1U618F
https://www.ers.usda.gov/topics/farm-economy/farm-sector-income-finances/highlights-from-the-farm-income-forecast/

NTF market share is growing in Kansas

Share of loans

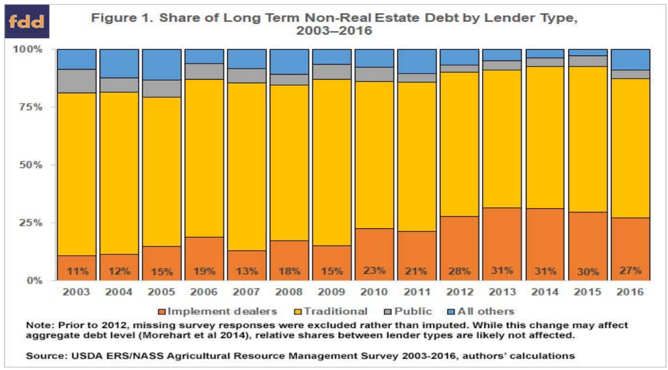


Share of loan volume



Source: Brewer et al 2019

NTF market share appears to be growing nationally



Source: Kuethe, Ifft, and Patrick (2018)

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Ag lending 101

- Requires
  - Overcoming serious information barriers (moral hazard)
  - Collateral *and* the ability to collect collateral
- Not "easy money"
  - Competitive market facing same risks as production agriculture
  - Interest rates vary widely, but terms, risks and associated product costs are also relevant

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Some nontraditional finance providers have competitive interest rates

- Interest rates not consistent across type of nontraditional lender
  - Can be higher, same, or lower
- Commercial farms report better rates *in general*
  - 92 basis points
- Implement dealer financing may be more competitive for smaller farms
  - 52 vs 3 basis points
- But what about input costs?

Average equipment* interest rates and loan volume, 2012-2016

Table 1: Average interest rate and loan size by sales class and lender type, 2012-2016 average

	Low sales farms	Moderate sales farms	Midsize farms	Small million dollar farms	Large million dollar farms
Traditional	4.75%	4.74%	4.63%	4.38%	3.83%
Implement dealers	4.23%	4.28%	3.94%	3.98%	3.80%
Public	3.39%	3.61%	3.81%	3.65%	4.55%
All others	4.76%	4.40%	4.32%	3.89%	3.72%
Traditional	$35,929	$94,035	$156,735	$300,930	$1,293,482
Implement dealers	$39,284	$95,154	$138,515	$206,850	$452,403
Public	$36,427	$80,639	$117,815	$172,721	$1,252,160
All others	$31,674	$141,427	$134,720	$211,444	$740,652

Source: USDA ERS/NASS Agricultural Resource Management Survey 2012-2016, authors' calculations

*Non-real estate long term loans, typically equipment or machinery
Source: Ifft, Kuethe, and Patrick (2018)

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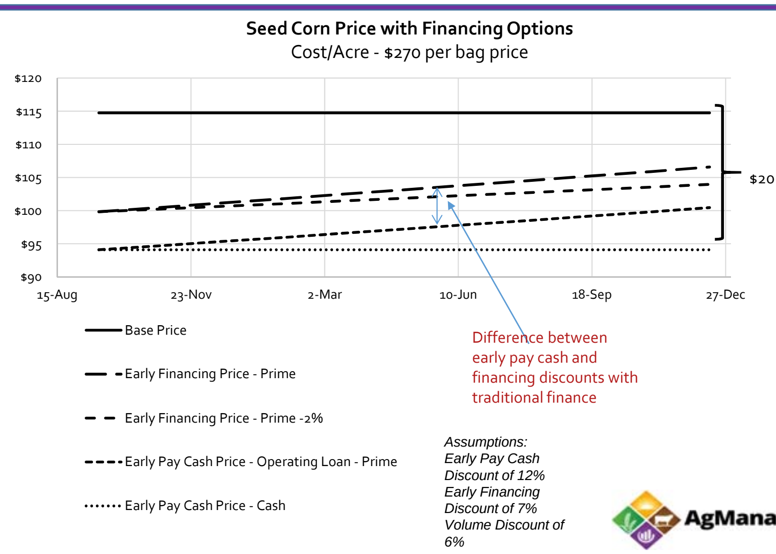
Vendor credit may come with higher effective input costs

- Seed corn discount case study
  - Traditionally-financed cash price often lower than effective vendor financed price
  - Due to loss of early cash pay discount, promotional financing will usually be more expensive than 'traditional financing'



Fiechter & Ifft, *farmdoc daily* series, October 2019

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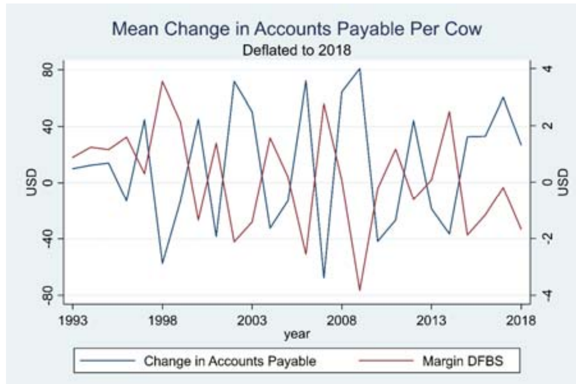
Nontraditional finance is sometimes related to financial status

Findings from KFMA data

- Brewer et al 2019
- Farms using nontraditional lenders are younger with more equipment and less land
- Farms that have use both traditional and nontraditional lenders are more leveraged

In NY dairy farm accounts payable go up when margins go down



Nontraditional finance is sometimes **not** related to farm stress

For implement financing: no observable differences

Table 1. Share of Farms with Long-Term Non-Real Estate Debt and Experiencing Potential Financial Stress by Lender Type, 2012-2016

	Solvency	Liquidity	Profitability	Repayment Capacity
	D/A ratio > 50%	Current ratio < 1	Net cash income < 0	Debt coverage ratio < 1
Implement Dealer	15%	48%	41%	44%
Traditional	14%	44%	42%	44%

Note: Traditional lenders include commercial banks, Farm Credit System lenders, credit unions, and Farmer Mac.
Source: USDA ERS/NASS Agricultural Resource Management Survey 2012-2016, authors' calculations

Source: Patrick, Kuethe, and Ifft (2018)

Nontraditional lender "survey"

- Observations based on available (limited) data and recent conversations with nontraditional lenders
- Margins are low to negative, generally challenging lending environment
- Business appears to be growing for many nontraditional lenders
  - Demand for refinancing
  - Greater flexibility offered
  - "Big banks" are getting out
  - Some indications of new hiring
  - New entrants (GreenSill)
  - Adaptability to remote work/lending environment
- Government payments are important
- "Haven't seen anything like it" vs shocks accelerate existing trends

Takeaways: nontraditional lenders….

- Create additional value and risk in agricultural credit markets
- Make farm management more interesting
- May partially be motivated by strategies to maintain or increase market share (applies to vendor credit)
- Make tracking financial stress in agricultural more challenging

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Moving forward

Nontraditional finance

- Research on UCC filings
- KFMA data analysis
- Special issue of *Agricultural Finance Review*

Other areas

- Crop insurance
- Farm programs?
- Energy, labor, other relevant policy issues?

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Questions?

Comments?

Thank you!

Dr. Jennifer Ifft

Associate Professor

Email: jifft@ksu.edu

Phone: 785-532-4468

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