High Growth Farms and Capital Access
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One of the emerging concerns of growth oriented producers is continued access to capital. The group I’m referring to are those targeting an annual growth rate of 10 percent or more. Among crop producers most of the growth has been through renting additional acres. Just as a point of reference, using the rule of 72, a business growing at 10 percent a year would double in size every 7 years and at a rate of 18 percent would double every 4 years.

Many conventional lenders are applying higher standards in terms of working capital, financial leverage, operating leverage, debt coverage and risk management to borrowers who are outside their experience or represent a significant percent of their capital exposure.

There are several areas that are of particular concern to both lenders and their regulators. These include the following, although the list isn’t inclusive:

- Working capital to gross revenue of less than 25-30 percent.
- Equity of less than 50 percent
- Fixed cash rental arrangements of more than one year, particularly those where rental rates are above the market norm or that exceed the time producers are able to lock in the costs or output prices.
- Increased volatility in weather (yields), input prices and output prices.
- The potential for declines in asset values and commodity prices which have been on extended positive runs. Experience has taught them that agriculture is cyclical and significant downturns can and will occur.
- Although rental rates would come down if farm income and land values decline, they tend to lag.
- Potential large margin calls which can cause lender lending limits and underwriting standards to be exceeded in a very short period of time.
- Counter party risks on contracts such as those with grain and fertilizer dealers, hog integrators, and high profile bankruptcies such as VeraSun and MF Global.
- The willingness and ability of participating lenders to remain committed if a borrower becomes stressed or requires debt restructuring, or if the participating lender develops problems in their own portfolio which puts them under regulatory pressure
- The potential impact of higher interest rates.
- Recent congressional discussions about a dollar ceiling on revenue insurance
- Increasing pressure from financial regulators for lenders to avoid concentration risk and to become more anticipatory about potential
risks, i.e., to consider plausible not just historical experience when shock testing their loan portfolios.

- Lenders are increasingly focused on not just the probability of default, but also the probability of loss given default. Remember, lenders are highly leveraged by both design and regulation. But just like a borrower, being highly leveraged increases the impact of adverse outcomes.
- Without significant appreciating assets, any business growing at a rate faster than the rate of increase in their earned net worth is also increasing their leverage.
- Although agricultural lenders are much more focused on cash flow, working capital, debt coverage and profitability than they were in the 1980s, most still rely on chattel or real estate collateral as their back-up. Many high growth farms don’t have large amounts of equity in these assets and lender/regulator level of uncertainty and assessment of risk increases exponentially when requests fall outside their experience and normal underwriting standards, even if the borrower’s performance has been strong and the quality of management is exceptional.

In the future, many high growth farms may have to find an equity partner and/or pay a higher risk premium in their interest rates. It is also likely that will be only a few lenders with the capital base and the specialized lending staff to deal with their type and size of credit needs. While a significant downturn in the agricultural economy would increase their opportunity to acquire more land, it would also accelerate the trends just mentioned.