



# CREDIT AVAILABILITY

## CREDIT WILL BE TIGHTER AND MORE COSTLY IN 2009

The financial markets are certainly in turmoil, and that will affect the agricultural economy. Current commodity prices are a major concern at this point, but the liquidity crisis in the U.S. economy will also impact agriculture.

Financial liquidity can be explained like the diesel fuel for your combine. Having the newest and biggest technology in a combine does you no good if you have no diesel fuel to run it.

The U.S. economy is the biggest and strongest in the world, but it is starved for the fuel of financial liquidity. Why? I have spoken and written repeatedly about the potential housing crisis – I did not think it would be this large. But as Warren Buffett has said, “When the tide goes out, you find out who has been swimming naked.”

**NOW MY CONCERN** is the crisis in the financial markets will reduce credit availability and increase cost.

We are already seeing this in Farm Credit bonds having a significant increase in their costs above treasuries. Recently a major agricultural real estate lender suspended making any new loans. On case-by-case basis we are seeing banks significantly reduce credit availability and even notifying clients that they do not want to finance them for 2009.

The change has been dramatic from one lender, encouraging borrowing more money a few months ago to allowing less or no credit now.

**BANKS AND OTHER** lenders operate with a high degree of leverage. For example, banks generally are required to keep a 6% minimum regulatory capital requirement. Many lenders are capitalized above that,

at 9% or 10% or even greater.

As a normal course of business, lenders allocate funds for potential loan losses. But, if losses become larger than expected, it affects how they must manage their business to keep it above the minimum standards.

For example, assume a lender has \$100 million in as-

sets and 8% capital, or \$8 million. If losses on assets – be it loans or securities – are \$2 million, the lender has two options: acquire more capital through the sale of stock or require the owners to pay in capital. If that cannot be done, then assets must be reduced to \$75 million for the lender to be at the desired 8% level (\$75 million @ 8% = \$6 million).

Good management at the lender’s desk then dictates they keep the best loans and encourage weaker, although still likely credit-worthy, assets to find a new home. Having been in a similar situation while managing a Farm Credit association in the mid 1980s, that is not pleas-

ant, yet is still a necessary action for the lender to take. Serving fewer customers is a better option than being out of business and serving no customers.

Where does that put you as a borrower and what can you do to manage around the situation?

A comfortable level for your working capital should be 50% of annual expenses.

However, as your expenses increase, so does the dollar amount of needed working capital. Lenders look at this carefully. As you determine your 2009 credit needs, this may play a very important role. **CSD**



### BE LENDER-FRIENDLY

Here are several suggestions for working with your lender in 2009:

1. Develop a balance sheet and profit and loss statement for 2008 actual and 2009 projected, outlining what your peak borrowing needs will be.
2. Delaying sales to capture every penny of the carry may not be as prudent as liquidating as much inventory at acceptable price levels in order to reduce borrowing needs.
3. Use point of purchase credit such as machinery or seed – if agreeable with your lender – to reduce the need for as large a line of credit.
4. Develop relationships with other lenders so they are familiar with your operation, even though you may not do business with them this year. Having a plan B may keep you in business and is always riskwise. ◀

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