

## Sourcing the Funds.

Read the following article, and answer the following questions regarding agricultural financing trends and alternatives in New Zealand:

### Questions

#### Non-Bank and Novel Financing

1. Why are non-bank providers entering the agricultural finance market?
2. What is "embedded finance" in the context of agricultural lending?
3. What specific niche does the 'Dairy Flexi Credit' product serve?

#### Financing for Environmental Change

4. Why might traditional banks be reluctant to fund land-use changes driven by environmental sustainability?
5. What are some examples of alternative funding sources for environmental projects that do not rely on bank finance?
6. What is the premise of the 'Novel financing models for supporting land use change' project?

#### The Role of Traditional Banks

7. Why is it in the interest of main banks to offer 'green loans' to farmers?
8. According to the Federated Farmers Banking Survey, why has farmer satisfaction with banks reached its lowest level since 2015?

UPFRONT FINANCE

# Sourcing the funds

When banks won't lend, it's the place of other institutions to step in. By **Phil Edmonds**.



**A**n expansion of lending for farmers beyond conventional finance providers, and with that, speedier decisions on approvals are two possible outcomes from non-bank providers entering the market for farm finance, and a government-funded project into novel finance for agri customers.

It's nothing new, but there is a growing awareness that the main New Zealand banks do not fill all the financing needs of the agri sector.

It's always been the case that where a combination of risk (question marks around farm profitability, for example) and inadequate security exist, some farmers have not been able to generate bank lending for onfarm investment projects. In addition to individual cases, there has also always

been difficulty for entry level farmers to borrow from banks, particularly where their only security is livestock.

Late last year, farm financial management software firm Figured decided to enter the lending market to support those in the latter camp who were struggling to borrow.

In partnership with Heartland Bank, Figured launched 'Dairy Flexi Credit', a flexible revolving credit offering for NZ dairy contract milkers and sharemilkers. Dairy Flexi Credit offers loans up to \$100,000 to help farmers cover unplanned operational costs, invest in plant, equipment and livestock, and bridge short-term gaps in cash flow.

Figured chief executive Dave Dodds acknowledges this is a niche service, but it is an obvious place to start to complement its existing strengths in

financial management data.

"It is a really important niche, supporting the next generation of high-quality farmers into the sector. If you look at contract milkers and lower order sharemilkers, they don't really have the balance sheet to support a conventional asset-based loan. Yet they are running quite sophisticated businesses. They have stress on working capital, but risk is actually quite low."

Dave says the initial uptake has more than met Figured's expectations. But equally encouraging has been the support shown from industry groups and accountants, who recognise the industry needs this. Contract milkers and lower order sharemilkers (who are existing Figured customers) has been an easy market to walk into. Their businesses are well understood (via

their evident financial performance) as are their needs.

Figured is now looking beyond that specific market to develop other lending products and sees plenty of opportunity with new types of borrowing needs emerging across a much wider population of farmers.

“The obvious ones relate to addressing environmental pressures, in the form of land use change and operational change onfarm.”

Investment in environmental compliance is, it must be acknowledged, being served by conventional lenders, although as demands increase, so will the need for targeted lending products.

As far as the banks are concerned, lending for environmental compliance and anticipation of new regulation represents a core need for ongoing farm viability, and ‘green’

finance is becoming increasingly competitive.

All the main banks offer ‘green loans’ in one form or another, and their motives to support green investment are quite understandable – it is clearly in their interests to see farms fully compliant; if funding isn’t easily accessible then the risk to servicing existing debt could well be heightened if farms subsequently have trouble generating revenue that becomes tied to compliant onfarm activities. Not only that, banks also now have their own compliance reporting requirements. They need to make sure their own agri lending book fits that bill.

However, banks do draw lines in the sand. There will be some farms that can’t access new capital because they are already up to limits in what they can borrow. If there happens to

be no clear line to profitability banks are inevitably going to be reluctant.

Profitability, however, doesn’t necessarily go hand-in-hand with land use change, whether it be driven by improving environmental sustainability or otherwise. Transitioning land use means you are probably going to reduce production for a period, which will almost certainly reduce a farm operation’s profit.

The need for new types of lending that enable land use change has been the basis for an Our Land and Water National Science Challenge project, entitled ‘Novel financing models for supporting land use change’.

The project began in September last year, and is due to be completed by the middle of 2023. The premise is that new and innovative financing solutions are needed to help

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overcome the barriers to land use change, which typically involve capital-intensive work.

The project is being carried out by PerrinAg Consultants and accounting firm GHA. Perrin Ag principal consultant Carla Muller says research into the barriers clearly identified some types of land use change were struggling to obtain the necessary funding to get them off the ground. Where changes deliver financial benefits along with environmentally positive outcomes banks are still likely to be interested. But for those that require considerable upfront capital without an obvious near-term financial return, alternative finance is needed.

Muller says examples of projects that have been initiated without bank finance include the turning of some central South Island sheep and beef stations into conservation estates. This has largely been funded through philanthropic sources or groups like Trees that Count.

But for farmers, many existing types of non-bank funding either require expertise in seeking it out and managing the (sometimes lengthy) process to obtain it or necessitate them ceding some control over the land they own.

"There is a whole heap of government funding available, along with regional council grants around planting waterways. However, you do need someone in your team or business that knows how to access it and apply.

"If you don't have the capacity it can be hard. Equally, for blended finance models like this, there are examples where tension arises when those providing funding (government, regional councils, equity investors etc) stipulate how and for what the money is used."

The Our Land and Water project has identified 20 possible options, which it will narrow to those that meet an evaluation criteria. This includes control over funds, desirable outcomes, certainty of outcomes, and risk. The list of solutions incorporates those already in use and well understood (processor incentives, sustainability-linked and green loans) to those that have yet to gain widespread traction (endowment funds, impact investment and pooled capital).

So much for solving the problem of getting environmental projects off the ground. There is still a perceived need for lending products for purposes beyond environmental mitigation in the farm financing market that are not banks.

Figure's Dave Dodds thinks this need will only grow. Part of it, he says, will be driven by wider banking trends, where commentators are predicting that within the next five to 10 years, embedded finance will account for up to 30% of all lending.

Embedded finance essentially means loans being placed via non-financial platforms (think private-label credit cards, or car dealerships lending for vehicle purchases). For agri, this will likely mean more lending embedded inside finance management software data. If your farm data tells a story, you might not have to go to a bank.

For those (perhaps the majority of farmers) with good relationships and debt servicing records, the emergence of novel finance products might not need to be considered.

However, successive editions of the Federated Farmers Banking Survey show some farmers are increasingly less satisfied with the service banks are providing, so openings may spur unexpected interest.

The latest Banking Survey found that while 60% of respondents were satisfied with their bank relationship it was the lowest level since the bi-annual survey began in 2015. This trend was attributed in December to the decline in personal contact from bank staff. This perhaps reflects the fact that banks have established minimum loan values (some around \$1 million) that will justify a farm visit from a bank representative.

Dave Dodds suspects this trend will continue as banks assess the cost of providing personal services.

"I imagine some levels of strong relationship management might decline. Looking forward, that might mean banks saying we are the best provider of capital, but we might not be the best at providing financial advice for your farm. It might not be a sudden development but could evolve over time."

If this does play out, it will create opportunities for other providers of professional services to move into delivering financial services.



## Answers

### Non-Bank and Novel Financing

1. Why are non-bank providers entering the agricultural finance market?  
*Non-bank providers are entering the market because of a growing awareness that traditional New Zealand banks do not meet all the financing needs of the agricultural sector, particularly when there is a combination of high risk and inadequate security. These new providers can offer speedier approval decisions and expansion of lending beyond conventional limits.*
2. What is "embedded finance" in the context of agricultural lending?  
*Embedded finance refers to loans being placed via non-financial platforms rather than traditional banks. In the agricultural sector, this likely means lending that is integrated directly into financial management software data.*
3. What specific niche does the 'Dairy Flexi Credit' product serve?  
*This product, launched by Figured in partnership with Heartland Bank, is designed for New Zealand dairy contract milkers and sharemilkers. It supports those who may not have the balance sheet for conventional asset-based loans but are running sophisticated businesses with working capital needs.*

### Financing for Environmental Change

4. Why might traditional banks be reluctant to fund land-use changes driven by environmental sustainability?  
*Transitioning land use often results in a period of reduced production, which almost certainly lowers a farm operation's short-term profit. Banks may be reluctant if there is no clear and immediate line to profitability, or if the farm is already at its borrowing limit.*
5. What are some examples of alternative funding sources for environmental projects that do not rely on bank finance?  
*Alternative sources include philanthropic funding, groups like 'Trees that Count', government funding, and regional council grants for activities like planting waterways.*
6. What is the premise of the 'Novel financing models for supporting land use change' project?  
*The project's premise is that innovative financing solutions are necessary to overcome the barriers to land-use change, which is typically capital-intensive work and may struggle to obtain necessary funding from traditional sources.*

### The Role of Traditional Banks

7. Why is it in the interest of main banks to offer 'green loans' to farmers?  
*Banks want to ensure farms are fully compliant because failure to meet environmental regulations could heighten the risk to a farm's ability to service existing debt. Additionally, banks have their own compliance reporting requirements to meet regarding their lending books.*
8. According to the Federated Farmers Banking Survey, why has farmer satisfaction with banks reached its lowest level since 2015?  
*The decline in satisfaction is attributed to a decrease in personal contact from bank staff. This trend may be driven by banks establishing minimum loan values (sometimes around \$1 million) to justify a personal farm visit from a representative.*