Compliance counts with lenders

Words by: **Phil Edmonds**

Little can be said about banks at the moment that doesn't raise heartless sighs. The credit squeeze (call it what you will) is no longer a 'what if', but real in the agri sector, with much anecdotal experience pointing to very tough conversations being had between rural bankers and both indebted and debt-seeking clients.

The fallout is likely to be significant and felt widely among farmers. But perhaps the lasting impact of banks stemming the flow of agri lending will be felt more widely still, by all New Zealanders, as an inevitable slowdown in environmental 'catch up' investment will weaken our long-term competitiveness in premium-paying markets.

Realignment of the rural banking landscape is now well rehearsed. Banks are focused on repairing their balance sheets to address what the Reserve Bank has for some time referred to as an overly indebted and therefore vulnerable dairy sector. That means calling in principal repayments, and any prospect of new lending being firmly tied to profitability.

The RBNZ has proposed new capital requirements on banks to deal with the ongoing debt risk, and in turn banks have said the cost of new restrictive practices would be passed on to farmers.

Massey University banking expert David Tripe says lending is going to get more expensive because if banks are going to have to hold more capital with the same levels of return they themselves will have to earn a bit more.

In a submission to the Reserve Bank's capital framework review, accounting firm KPMG estimates the five banks that hold 98% of all agri lending will reduce their lending by between 15% and 25% – mainly in dairy, if the new rules are adopted.

In response, ANZ has signalled its intention to reduce its dominant market share of rural banking and others are restricting their lending to the dairy sector. Rabobank though has stood apart and assessed the landscape as an opportunity to increase its presence. It recently started a television advertising campaign highlighting how online deposits with the bank are exclusively used to fund New Zealand's food and agricultural producers.

"In some respects we are just doing more of the same and being consistent in the marketplace," Rabobank NZ chief executive Todd Charteris says. "But if we look at the outlook from a commodity return point of view, the markets look strong and there is an opportunity in the marketplace right now.

"From a cash flow point of view, all farmers have a really good opportunity to create more stability in their balance sheet through investment or debt reduction. And that is a positive. As well as supporting our existing customers, our priority will be to look for opportunities to grow within our risk profile."

Rabobank's outward enthusiasm for the sector is encouraging, but comes with a noteworthy caveat – it is only interested in low hanging fruit. "We will absolutely explore growth opportunities, but we have no intention to operate outside our own risk appetite," Charteris says.

In line with the value not volume mantra, Rabobank's enthusiasm for the sector's growth potential is more sophisticated and nuanced than rural lending strategies of the past. Rather than limit its focus on the impact its lending will have on increases in economic production, Rabobank says its lending support needs to help create sustainable businesses and recognises some of those sustainable indicators are non-financial, including higher animal welfare standards and sustainable freshwater resources.

"The word sustainable is overplayed at times, but what we want to do is help create sustainable business models that can endure. And if farms are wanting to invest in measures that will make their long-term sustainability sound, we would look favourably on that," Charteris says.

It's not only Rabobank talking about the sector facing a transition period, and the need to finance it. ANZ agricultural economist Susan Kilsby notes the industry, including Government and lenders are working with producers on how to best help farms transition to economically sustainable and resilient businesses by minimising environmental impacts.

Great – the banks say they are keen to play their part. But all said and done, the onus remains on farmers to show banks they are able and committed to play theirs.

ANZ's Kilsby says that while New Zealand producers are working hard on this, stronger commitment to compliance is needed to drive higher prices. For Rabobank, any discussion of further lending starts with a compliance check. Charteris said the bank will ask questions like do you have a farm plan, what proportion of your waterways are fenced off or planted as a means to really get an understanding of the business readiness for potential changes.

So how well placed are farmers to prove their existing economic and environmental resilience to justify new lending for further sustainability enhancements?

Massey University management lecturer James Lockhart suggests many farmers are not well positioned for this transition.

"Historically as a sector we have ignored the cost of environmental expenditure. Now we are in catch up mode. If you take it back to decision making and farmer owners attitude to risk, typically what they have done is discounted the cost of environmental compliance or enhancement and haven't seen it as a capital expense that sits in the short-medium term.

"You have farmers who have discounted their equity structure and as the compliance regime has gained traction they are going to struggle to meet the associated costs."

Todd Charteris, Rabobank NZ CEO.

While the banks are outwardly positive about their willingness to assist farmers in this period of transition, Lockhart doubts the extent to which banks will be able to help, given their determination to see farmers focus on debt repayment.

"I suspect there will be reluctance among lenders to finance environmental enhancement as it asks the question of where the security of that additional lending comes from. Heavily indebted, heavily geared dairy farms in particular will have lenders increasingly reluctant to put more debt on those properties to meet environmental compliance," Lockhart says.

This sense is certainly backed up by individual farmers' experiences.

One farmer spoken to by *Dairy Exporter* said no one facing imminent investment

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Banking: A new norm

Peter Flannery.

Before 1984, banking in New Zealand was heavily regulated. There was no incentive for banks to compete on any level.

New Labour Finance Minister Roger Douglas opened up the banking industry to free market forces, but it wasn't until 1990 that banks really started to compete in the rural market. With access to unlimited funding, banks had plenty of money to lend, and farmers were willing to borrow it, Southland based Agri Business consultant Peter Flannery writes in a special report published on NZ Dairy Exporter's website.

From 1990 to 2019, farm debt has lifted 15-fold. Farm values lifted nearly 12-fold and are now declining, but debt is not. Since the global financial crisis banks have had to operate under increased scrutiny and regulation from the RBNZ, and this change is now impacting on banks and therefore their client. This is going to cause significant change and maybe disruption. How banks respond will set them apart from each other, and the same applies to their/our clients.

"Nice to see you Mr.Smith. Now how much were you thinking of lending us?"

See the full story by Peter Flannery at: https://nzfarmlife.co.nz/banking-back-to-the-future-or-forward-to-the-past/