1st Farm Credit Services

- Cooperative providing financial services to rural America
- Northern 42 Counties in Illinois
- $4.3 Billion Total Assets
- $700 Million Total Capital
- 12,400 clients
- 260 team members
- 17 offices
Scored Loan Approval (On The Spot)

- Limited information loan origination
- Loans up to $250,000 ($500,000 line of credit)
- Balance sheet and income statements not required
- Prefer balance sheet review for red flags
- Odds based filtering developed by Fair Isaac
- Separate scoring process for Ag Operating, Ag Term, Ag Mortgage, and Lease
- Multiple factors other than FICO score
- Financial information – Total Assets, Total Liabilities, Gross Farm Income, Non Farm Income
Scored Override Worksheet

- Analysis worksheet with several related ratios that are assigned points based on ranges
- When score is below approval threshold, the override worksheet can support approval
- Financial ratios
  - Loan/Net Worth
  - Owner Equity %
  - Debt Exposure – Gross Income/Total Liabilities
- Non ratios – existing client, credit score
Trade Credit & Leasing

- Trade Credit follows origination processes similar to in house underwriting.
- Dealer gathers information and processing occurs in a central location, usually through scored analysis.
- Lease application processing is usually scored as most leases are less than $250,000.
- Fixed assets would prompt greater likelihood of a balance sheet review.
Scored + Balance Sheet (AgPremier)

- Next step in limited information approval
- Loans up to $500,000 ($1.25M line of credit)
- Use the same process as scored loans with additional financial requirements
  - Higher credit score
  - Minimum 65% Owner Equity
  - Minimum 1.25:1 Current Ratio
Investor Loan Approval

• Landlords – Investors and Retired Farmers
• Three Investor segments
  – Professional/Executive
  – Business Owner
  – Wage Earner
• Rural Consumer
  – Homes, Lots, Recreational, HELOC
• Investor analysis up to $1,000,000
  – Traditional analysis above $1M
• Analysis uses an Investor Scorecard with points assigned based on strength of underwriting ratios
Investor Loan Approval

- Financial ratios
  - Owner Equity %
  - Liquid Assets/Total Monthly Obligation
  - Total Monthly Obligation/Total Monthly Income
  - FICO Score
- One non financial ratio – Loan/AV plus Term
- Rural Consumer up to $250,000 uses the Consumer Mortgage Scorecard
- Loans above $250,000 use the Investor Scorecard
- Post close minimum Owner Equity %
- Home Equity Lines of Credit use the Home Equity Scorecard

1st Farm Credit Services
1st Farm Credit Services
1st Farm Credit Services
Loan Analysis

- Loan Officer is responsible for obtaining information from the client
- Verification completed by the Loan Officer
- Initial asset adjustments by Loan Officer, further adjusted by Credit Analyst
- Financial information is entered into Excel spreadsheets by a Credit Assistant
- Financial analysis completed by a Credit Analyst
- Specialized Credit Analysts for Swine and Horticultural industries
Basic Loan Underwriting

• Owner Equity %
  – Net Worth ÷ Total Assets
  – Same as FFSC

• Working Capital to Adjusted Gross Income
  – Similar to FFSC Working Capital to Gross Revenues
  – AGI = Value of Farm Production + Non Farm Income
  – VFP = Gross Farm Income minus Purchases for Resale and Feed
Basic Loan Underwriting

• Net Capital Debt Repayment Capacity %
  – Similar to FFSC Replacement Margin Coverage Ratio
  – \( \frac{(\text{Net Earnings} + \text{Interest on Term Debt} + \text{Capital Asset Replacement Allowance})}{(\text{Term Debt Principal} + \text{Interest on Term Debt} + \text{Capital Asset Replacement Allowance} + \text{Working Capital Deficiency})} \)
  – Capital Asset Replacement Allowance = Use Cost – Principal on Term Debt
  – Use Cost 10-15% of Machinery and 4-7% of Buildings
  – Working Capital Deficiency = 25% of the shortage to lending standards
Probability of Default

• Aligned with Uniform Classification System
  – Acceptable (PD 1-9), OAEM (PD 10), Substandard (PD 11-12), Doubtful (PD 13), Loss (PD 14)

• Probability the obligor will default within 12 months

• Assigned based on:
  – Solvency – 35% weighting
  – Liquidity – 20% weighting
  – Capacity – 45% weighting
Underwriting Standards

• Underwriting standards align with PD8
• Guidelines established for:
  - Cash Grain
  - Dairy
  - Cow Calf
  - Winery
  - Fruit
  - Rural Home
  - Contract Swine/Broiler
  - Independent Swine
  - Beef Feedlot
  - Citrus
  - Permanent Plantings
  - Grain Elevator & Farm Supply

• Underwriting ratios for Cash Grain:
  - Solvency – 50% OE
  - Liquidity – 15% WC/AGI
  - Capacity – 115% Long Range CDRC
Commercial Farmers

- Clients with Gross Farm Income > $1,000,000
- Underwriting approach adjusted when client demonstrates good risk management practices

- Capacity
  - 115% Net CDRC, or
  - 110% Net CDRC and 120% SRCDRC (Term-Debt Coverage Ratio)

- Liquidity
  - 10% WC/AGI, or
  - Current Ratio > 2:1
Agribusiness

• Non Producers or very large producers
• Lease Adjusted Total Debt / Capital
  – \( \frac{(\text{Total Debt} + 7\times \text{Rent Expense})}{(\text{Net Worth} + \text{Total Debt} + 7\times \text{Rent Expense})} \)
• Fixed Charge Coverage
  – \( \frac{(\text{Operating Income} + \text{Depreciation} & \text{Amortization} + \text{Rent Expense} + \text{Interest Income} + \text{Cash Patronage Income} + \text{Cash Income from Subs & JVs} - \text{Maintenance Capex} - \text{Taxes} - \text{Cash Patronage Dividends Paid} - \text{Common & Preferred Dividends})}{(\text{Principal Payments} + \text{Interest} + \text{Rent})} \)
• EBITDA / Interest
• Lease Adjusted Total Debt / EBITDAR
### Loan Approval Types

<table>
<thead>
<tr>
<th></th>
<th>#</th>
<th>% #</th>
<th>$</th>
<th>% $</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional Analysis</td>
<td>1,704</td>
<td>24%</td>
<td>$885</td>
<td>32%</td>
</tr>
<tr>
<td>Scored</td>
<td>4,687</td>
<td>67%</td>
<td>$455</td>
<td>16%</td>
</tr>
<tr>
<td>AgPremier</td>
<td>414</td>
<td>6%</td>
<td>$164</td>
<td>6%</td>
</tr>
<tr>
<td>Agribusiness</td>
<td>89</td>
<td>1%</td>
<td>$626</td>
<td>23%</td>
</tr>
<tr>
<td>Capital Markets</td>
<td>89</td>
<td>1%</td>
<td>$649</td>
<td>23%</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>6,983</td>
<td></td>
<td>$2,779</td>
<td></td>
</tr>
</tbody>
</table>
Financial Statements

- Large variance among client segments
- Grain and Livestock producers showing some migration away from Cash
- Agribusiness generally Audited or Compiled
- Prefer Fiscal Year End statements
- Prefer a multiple year trend
- Typically market basis for producers
- Try to get cost basis on fixed assets
Balance Sheets

- Obtain on all Entities
- Consolidate when > 50% ownership
- Judgment when ownership between 20% and 50%
- Verify material assets, particularly those > 10% of total assets
- Adjust values to conservative market
- Adjust nonearning assets – a lot
- Do not reflect contingent tax liability
Balance Sheets

- Adjust current assets and liabilities
  - Principal Due in 12 months aligned with crop year
  - Livestock/Dairy/Contract producer show 1 month income in CA and 4 months Principal Due in CL
  - No Principal Due for Rural Consumer or Investor
  - Growing Crops – cost at 90 days out up to 85% last 30 days

- Leases are shown on producer statements
Income Statements

• Use what we can get
• Commonly tax returns with producers
• Some producers have good accrual records
• Less progress than we had hoped over the past couple decades
• 1st FCS will pay part of record cost for Young or Beginning Farmers
• Agribusiness and Commercial Farmers are almost always accrual
• Prefer 5 years, will accept 3 at a minimum
Capacity Analysis

- When possible, use/create accrual view
- Typically cash basis analysis
- Adjustments made for unusual years
  - Remove high/low, remove 2008, reduce high years by a %, remove drought?
- Include Capital Gains if they are recurring
- Capacity based on historical earnings, not a projection
Capacity Analysis

- Use a projection when there is a significant change in scope or change in type of ag production.
- Use a cash flow for clients with weak financial position to analyze timing of cash needs and repayment.
- Earned Gain analysis if income statements inadequate or to confirm results of cash analysis.
- Sensitivity analysis removes a % of income and/or expense.
Capacity Analysis

- Living expenses at $35k minimum, prefer closer to $60k
- Adjust tax liability to align with demonstrated capacity – you can’t avoid taxes forever
- Leases are shown as an operating expense, not a term payment (even though shown on B/S)
- Use Cost for capital expense rather than depreciation
- Material non farm business income is shown with farm income/expense rather than net non farm
Financial Analysis Spreadsheet
Financial Guidelines Adjustments?

- Long Range Repayment Capacity with a charge for insufficient liquidity
- Benchmark ranges for the existing ratios
  - Consider a stoplight chart
- Scored approval guidance
- Additional emphasis on trend