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Wealth and Capital Allocations of Today's Agricultural Borrowers: Part 2

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Background

The first article in this series introduced a new way to segment a lender's customer base by household income, wealth and other characteristics. Six groups or "segments" comprise the U.S. Farm Household Typology: Single Income Ruralpolitan (SIR), Double Income Ruralpolitan (DIR), Active Seniors (AS), Farm Operator with Spouse Working Off Farm (FOSOFF), Traditional Farm (TRAD), and Commercial Farm (COM). In the first article, implications of each respective segment's sources of income were discussed. In this second installment, we focus on the implications of each segment's variation in amount of capital and wealth.

Capital and Wealth as a Gauge of Creditworthiness

Along with income, capital or wealth as reflected in typical balance sheet metrics as debt, equity and total assets is an important indicator of the creditworthiness of a borrower. Figure 1 (on page 10) shows the average of the different sources of wealth, as well as the sources of debt for each segment in the U.S. Farm Household Typology.

These sources are the value of farm and non-farm equity and the value of farm and non-farm debt. The sum of these sources or the sum of each bar in the graph represents total household assets for the respective segment. One of the most striking messages reflected in this figure is the large amount of assets and small amount of farm and nonfarm debt relative to assets used by all market segments. In general, the asset and wealth position of farm households provides strong collateral and security positions for debt compared to most nonfarm households.

Farm Households Versus Non-Farm Households

Before analyzing each segment in the U.S. Farm Household Typology separately, farm households are compared to their non-farm household counterparts. The 2003 non-farm household median wealth or equity of $89,578 is just a little over one-fifth the median equity for all farm households at $416,250. (Remember, "median" is not the same as "average." The "median" is the point

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at which half the group has a higher figure and half the group has a lower figure.)

This result is heavily influenced by agriculture being a capital-intensive industry that is dominated by agricultural real estate. Agricultural lenders benefit from farm households having higher equity relative to non-farm households, thus posing lower financial risk to the lender. (To compare non-farm household equity against the various types of farm households shown in Figure 1, the 2003 average non-farm household equity is $359,400.)

The Ruralpolitan Segments

One could argue that the ruralpolitan segments, SIR and DIR, are not "farms" because the individuals primarily work off the farm and therefore are not "agricultural borrowers." In other words, they more closely emulate a non-farm household as opposed to a farm household. Although they may not match the historical perspective of a farm, i.e. Mom and Dad working on the farm, they are a reality in today's agriculture and constitute a substantial portion of farm households today (47 percent).

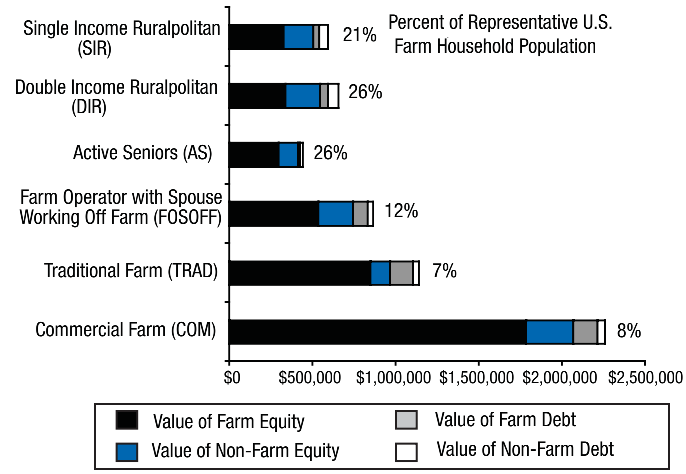
For agricultural lenders, an appealing opportunity exists with this ruralpolitan segment. Both SIR and DIR have an average farm equity that far exceeds the median non-farm household equity. Coupling this large investment in farm assets and their stable income from off-farm sources, these groups have the capital and capacity to be a profitable and reliable customer for a lender.

Also, these segments have the highest amount of diversification in their asset portfolio. SIR and DIR have an approximate fifty/fifty split between farm and non-farm assets, while all other segments have more farm assets relative to their non-farm assets. By diversifying their investments along with their income, a high level of financial stability is present in the SIR and DIR groups and lenders would agree that this is a very appealing customer segment.

Mature Farmers

In the first installment of this series last month, we stated that mature farmers or AS, may or may not be actively seeking credit. If AS are not seeking credit, this does not mean they should be ignored. Figure 1 shows that this group has very low levels of debt and a high level of owner's equity. Given their wealth position and that this is the oldest group, providing asset management financial services including farm management as well as trust services and investment counseling are an important offering for this customer segment.

FIGURE 1. AVERAGE VALUE OF EQUITY AND DEBT SOURCES FOR THE U.S. FARM HOUSEHOLD TYPOLOGY.



Once a relationship has been established, a question to ask this new customer is their succession plan for the farm. If this succession plan does not include a second-generation decision maker, the farm may be rented, share cropped, and/or sold to someone in the community. This is a perfect opportunity to leverage the relationship with the retiring farmer and offer financial services and/or credit to this new operator.

Farmer Businessmen

The farmer businessmen (FOSOFF, TRAD, COM) have substantial wealth, averaging almost three-quarters of a million dollars for FOSOFF and two million dollars or more for COM. Figure 1 shows their farm operation or farm assets make up the largest portion of their investments. These segments are making investment decisions relative to where they receive the highest return possible.

Also, the farmer businessmen have an average farm debt-to-asset ratio that is less than 14 percent. With this low amount of farm debt and a commitment to increasing the return from their farming operation, providing credit to these segments should clearly be a profitable endeavor for both parties. For these customers, effectively using debt is a way to grow the farm business and the progressive lender has the opportunity to provide other financial and investment products as well.

Since the FOSOFF has off-farm income and a substantial investment in the farm, they are a segment that agricultural lenders should actively pursue. They have off-farm income that mitigates the fluctuations in farm income and a commitment to agriculture as noted by their farm equity. TRAD and COM represent only 15 percent of the entire U.S. farm household population, but they have the largest amount of farm debt of all segments.

Coming in Future Articles

This article, similar to the first, focused on utilizing a new classification system to better inform agricultural lenders about today's agricultural borrower. The wealth position and its implication relative to the segments in the U.S. Farm Household Typology were discussed. Thus far, we have discussed two important factors when lenders make a loan decision, income and wealth. The final article in this series will focus on potential strategies to offer loans and financial products and services as well as the profitability and risks associated with serving these different customer segments. ◆

Source: 2003 Agricultural Resource Management Survey — 17,782 sampled U.S. farm households with 2,084,715 representative U.S. farm households.

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