



Agribusiness Update

From the Agriculture Group of Kennedy and Coe, LLC

Dollar

Among big economic indicators today is a dropping dollar, down almost 30% in seven years and 10% in the last six months. Interestingly, the dollar spent awhile lower than this last year, leading up to and through the credit debacle on Wall Street. A dropping dollar is one of those things that even two economists can't see quite alike, but since it is regarded as a measure of confidence in the US and its economy, surely it is cause for concern. One of the positives of a weaker dollar is that our goods are less expensive to foreign buyers. Since American agriculture exports a lot of those goods, a dropping dollar does provide a boost, or at least a stronger floor, for the commodity markets. That is appealing, and considering the same is true for manufacturing and the prospect for manufacturing jobs, might even appeal to our current Treasury and Commerce Departments. Yet the Treasury Secretary maintains that

"A strong dollar is very important to this country. I mean that, and it's very important that people recognize it...It does bring special responsibilities and burdens on the United States and it is very important that we make not just Americans but the world understand that we are going to go back to living within our means. And that we are going to make sure that our independent Federal Reserve keeps inflation low and stable over time."

I can remember as a child that when someone had to say "I mean it", there was reason to suspect. And there is here as well - our economy in many ways "needs" inflation, but without somehow acknowledging that inflation, because our government debt is financed heavily with foreign investments into US dollars, and we are not "living within our means". Warren Buffet has said

"A country that continuously expands its debt as a percentage of GDP and raises much of the money abroad to finance that, at some point, it's going to inflate its way out of the burden of that debt...Every country that has denominated its debt in its own currency and has found itself with uncomfortable amounts of debt relative to the rest of the world, in the end they inflate...That becomes a tax on everybody that has fixed dollar investments."

A declining dollar and inflationary pressures go hand in hand, and given the nature of our industry as owners of land and producers of food commodities we might be positioned as well as any to weather such a storm. We won't hurt quite like those on a fixed dollar income. But given our heavy dependency on both debt financing and energy, we have our vulnerabilities as well to this risk.

Food

Michael Pollan continues to create a lot of heat in our industry, and all of it is well received by those biased against industrial agriculture. Farmer Blake Hurst from Missouri has come out of obscurity by writing an opposition piece against Pollan titled [The Omnivore's Delusion: Against the Agri-intellectuals](http://www.american.com/archive/2009/july/the-omnivore2019s-delusion-against-the-agri-intellectuals) that is worth reading. He opens it with "Farming has always been messy and painful, and bloody and dirty. It still is. This is something the critics of industrial farming never seem to understand." The subject of food today is a lightning rod issue for special interests coming from a lot of different directions - ag production, food safety, health care, animal welfare, and more. Pollan has developing quite a writing and speaking career fanning the flames where they intersect today. This raises a lot of concerns for ag producers, but I think we need to take a deep breath too, and recognize that national interest in our food supply is not a bad thing, that most of us have a defensible story to tell, and that we'll never gain any ground by defending that which is indefensible. I appreciate Hurst's honesty even in labeling industrial agriculture for what it is. Industrial agriculture and farmers markets really represent two different industries, but they are not mutually exclusive. USDA rolled out a program in the last month called "Know Your Farmer, Know Your Food", which is an attempt to "begin a national conversation to help develop local and regional food systems and spur economic opportunity." This does help signal the end of an era of food production in anonymity, but for all Michael Pollan has done, he can't claim all the credit for that.

<http://www.american.com/archive/2009/july/the-omnivore2019s-delusion-against-the-agri-intellectuals>

Capital

During the credit crisis that began back in 2008, agriculture fared better than about every other industry. We were profitable, well-collateralized, and ag banks were strong. Late in 2009, the picture looks a little less bright, although certainly not dismal. Ag profitability is down; USDA projects 2009 net farm income for the year down close to \$50 Billion, under the average of the last decade and the lowest since 2003. But even that is not the biggest issue in tightening ag credit. Rather, it is a broader recalibration of risk throughout the entire credit market, worldwide. That translates to a tightening down of credit standards and availability for everyone, and especially those on the weaker end of the credit spectrum. It is simply a natural realignment of capital with appropriate risk and reward profiles, and the lessons learned over the last year and a half are changing the nature of debt acquisition for everyone, including ag producers. This is advice that is always relevant, but seems especially so now - it is a great time to "get your financial house in order". That can mean a lot of things, but among them are your strategies around leverage, liquidity, profitability, growth, and succession. Also, there has never been a better time to strengthen your profession network and relationships, including with your lenders.

As lenders respond to this credit environment, one strategy we are seeing employed is the consolidated loan across multiple entities. This can be a good tool for streamlining credit and risk-management for both lender and borrower. However, there are at least a couple concerns, and we have written about them recently for our Feedyard Insights newsletter next month, but will quote here:

In response to the difficult credit and regulatory environment over the last year, many lenders are moving toward more consolidated loan packages. Loans that are cross-collateralized across multiple related entities, and with associated personal guarantees, are an effective way for banks to manage large, complex credits and the regulatory attention that they draw. However, these loan consolidations create many often unintended consequences, among them the effect on government farm program participation. According to April Hall of Kennedy and Coe, LLCs Farm Program Services group, these loans can easily violate capital contribution requirements and raise the risk of audit and penalty of losing farm program payments.

An even more significant concern with loan consolidation is that general partners in an entity involved in a consolidated loan could unknowingly become liable for the entire consolidated loan. A general partner in a cattle feeding entity, for example, could have been liable for a \$5 million line of credit for years with full knowledge. However, as part of a debt reorganization and consolidation, that partner could become fully but unknowingly liable for \$50 million or even more should the partnership loan be consolidated with the cattle and land loans of other entities that the partner may have no ownership of. The larger the entities, and the more consolidated their loan instruments, the more complex the risks for all parties, and the greater the need for disclosure and education regarding exposure.

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