Frequently Asked Questions

Ag Solutions Capital Team

What does Ag Solutions Capital bring to the market?

We bring simple and straightforward alternatives to the conventional ag loan market. Our goal and passion are to innovate loan structures that (i) align more appropriately with the operations they finance than do conventional loans and (ii) are less costly and complicated that traditional private equity arrangements that are the primary alternative to the conventional loan market.

What distinguishes the Ag Solutions Capital team?

Our breadth and depth of experience and relationships within the agricultural and capital markets is extremely unique and valuable. Our experience and relationships are necessary not only to underwriting loans, but to originating loans where many ag borrowers are highly skeptical of outsiders that do not know agriculture and do not know their business. We focus our business and engagements in areas of our experience and success to limit risk and enhance our value and service.

Who does Ag Solutions Capital work with?

We work with a wide variety of market players such as global, national, regional and local banks, private and institutional investors, life insurers, private equity funds and their managers, consultants, lawyers, accountants, operators, and others we know and have worked with.

Do you assign roles and responsibility among the team members?

Yes. For each significant task, we assign roles and responsibilities. In each primary category of our work, we each take leadership roles. For example, Justin Burns leads our loan documentation and legal review, Lindy Widner and Justin Ersch lead loan underwriting, and Todd Johnson leads investor relations and fund management.

However, given our broad and overlapping experience and relationships in the ag industry, each of us has the ability to and will play some part of each role we cover including loan marketing, origination, underwriting, structuring, managing, servicing, and oversight. While each of us has certain strengths, our cross-over skills combined with our individual perspectives generates thorough analysis and reasoned and practical outcomes.

Sourcing, Underwriting & Exiting Ag Solutions Capital Loans

What is your underwriting and due diligence process?

Data Gathering and Analysis: We gather and analyze available relevant data about operators and their financial condition and assets. Given our history in the agriculture sector, we often have direct and indirect knowledge with respect to middle market operators and their operations, which knowledge often adds significant value to traditional underwriting. Lindy Winder and Justin Ersch lead our underwriting, and their experience, enhanced by their personal work in production agriculture, results in exceptionally thorough, insightful, and reliable underwriting and due diligence investigations.

Site Visits and Inspections: We require site visits and consider them critical to underwriting. We interview operators, inspect the proposed collateral, and often meet with key managers, employees, and professional advisors such as attorneys and accountants.

Appraisal: Loan collateral is appraised subject to applicable or useful standards and form.

Legal Review: We review management structure and agreements, asset structure and agreements, operational risks and liabilities, title condition, water rights, key agreements and arrangements, and other material matters pertaining to the value, priority, validity, and enforceability of liens, security interests, and agreements. Justin Burns leads our legal review, and his experience and personal background in agriculture yields practical and dependable legal analysis and, correspondingly, practical and dependable loan structures and agreements.

Credit Memo: The results of our due diligence and underwriting are described in a comprehensive credit memo prepared for our investment team.

What is your underwriting methodology?

Generally: Agriculture is a closed community and it can be arcane. Traditional underwriting and investment strategies often fail. Consistent success in ag finance and investment requires specialized experience, relationships, and approach. We have these qualifications and have employed them reliably over time in traditional finance and equity arrangements. We are confident that our experience translates to non-traditional finance arrangements and creates opportunities for innovative structures and favorable risk-return spreads.

Operators: We target operations that have historically demonstrated strong performance while having sustainable, continuing, and healthy organizations along with other attributes that suggest an interest in and ability to adapt and succeed as markets and circumstances evolve. Generally, we target operations that are multi-generational, vertically integrated and structurally important in one or more ways that create or enhance asset and/or enterprise value. We believe these attributes, especially in combination and when considered with traditional underwriting criteria, can be the best indicators of risk, success, and, ultimately, loan performance. Accordingly, we exert considerable effort to identify and understand operators' bases for success in historical, present, and future contexts.

Assets: We generally lend with a first lien position on all assets including real, personal, and intellectual property used in a borrower's operations. We look beyond current asset value to the underlying conditions that create asset value. Understanding such conditions is fundamental to evaluating the risks to and sustainability of current asset value.

Cash Flow: We underwrite a borrower's financial projections with an emphasis on evaluating assumptions critical to (i) loan performance, (ii) asset value, and (iii) refinance prospects. While projections sufficient to satisfy loan performance and sustain asset value are essential conditions of our loans, equally essential are projections sufficient to support traditional refinance options on or before the end of our loan term.

Do we expect frequent loan defaults and foreclosures on our loans?

Originated Loans: Given our approach to underwriting, we typically do not anticipate loan defaults and completed foreclosures with respect to originated loans. We also believe that the multi-generational, vertically integrated, and structurally important nature of our loan targets supports repayment either through equity recapitalization, sale-leaseback transactions, or outright sales, among other things. In short, we believe it is unlikely that our borrowers will forsake their hard-earned family equity without exhausting all available repayment options, of which many should be available.

Acquired Loans: Since acquired loans (i) are likely to be in or near default at acquisition, (ii) are not subject to our original underwriting, and (iii) and will likely have limited, if any, opportunities for typical due diligence, we anticipate more frequent defaults and foreclosure. Regardless, we still intend to target the same types of borrower and collateral quality we would originate or that otherwise have attributes mitigating performance and collection risk. We pay special attention to loan-to-value ratios and asset quality to safeguard complete recovery of all recoverable principal, interest, default interest, prepayment / make whole fees, and all other fees and costs.

What is an example of a loan origination story?

Based on our principals' observations and experience, we believe the following example is typical. A tree fruit grower undertakes a well vetted, reasonable, multi-year orchard redevelopment plan to maintain and enhance operational importance and returns. Such plan is reviewed and approved — explicitly or implicitly — by the grower's lenders. Conditions outside of the borrower's control or expectations (such as trade wars, weather conditions, processing plant problems, labor shortages, and so forth) result in defaults of cash flow covenants under borrower's loan. Despite the borrower's continuing loan payments, low loan to value ratio, historical loan performance, and reliable indicia of future loan payment and performance, among other things, the lender declares a loan default and either accelerates the loan or notifies the borrower that it will not renew and extend the borrower's annual operating loan. The borrower is forced to refinance on short notice with substandard financial performance metrics under conventional underwriting standards. Given current market conditions, few lenders are making ag loans and, those that are, are largely limiting new loan relationships to high quality credits that satisfy conventional underwriting standards. As a result, and in the worst case, the borrower is unable to refinance and is threatened with the loss of a historical family operation and considerable equity. In the best case, the borrower is distracted from operations — often during critical times like harvest — and is required to commit significant amounts of time, effort, and money to identify, negotiate, and close new loans with new terms and new lenders under challenging and uncertain conditions.

It is easy to appreciate the appeal of a lender, like Ag Solutions Capital, that fundamentally understands these dynamics and offers innovative loan structures that appropriately accommodates the realities of agricultural markets and finance.

What is an example of a loan acquisition story?

Current market conditions have resulted in numerous and increasing numbers of agricultural loan defaults. Conventional lenders are required to reserve capital for defaulted loans even if the loans are paying. In order to reduce their capital reserve requirements, among other things, lenders often sell defaulted or otherwise distressed loans.

In our view, ag lenders are frequently reluctant to sell loans in light of possible reputational harm. In order to minimize such harm, we expect such lenders to seek loan buyers that are familiar with agriculture and agricultural finance and who are, therefore, likely to manage acquired loans reasonably. Since we know and have worked directly and indirectly with many of the largest national and regional ag lenders, we expect unique opportunities to acquire ag loans, especially in the middle market.

What are the exit strategies for Ag Solutions Capital's loans?

Originated Loans: As addressed above, our expectation for originated loans is short-term financial rehabilitation that supports conventional financing during the term of our loans. The tenors of our loans are also expected to bridge poor current market conditions to better and improving market conditions where conventional financing is more broadly available. If conventional financing is not available, the nature of our borrowers and their assets suggests that borrowers will likely resort to private equity arrangements or asset sales. In the event that our loans cannot be paid, we expect to be repaid in full through the foreclosure process.

Acquired Loans: Our expectation for the refinancing of acquired loans are lower than that for originated loans, but the same sources of refinancing are applicable. Furthermore, borrowers will be motivated to refinance to preserve their operations and to secure reduce their debt service costs. However, we expect foreclosure to be more likely with acquired loans than with originated loans, so our underwriting focuses on loan collateral, its value, and its marketability. To this extent, our relationships are again central to our strategy. Knowing and working with a variety of agricultural investors, we are aware of such investors' investment parameters. Therefore, our acquired loan targets are those that have collateral of such size, nature, condition, and location as tend to be acquisition targets for agricultural investors in the event of foreclosure.

The Agriculture Market

Is the agriculture loan market safe?

There are fluctuations in every market. To wisely operate within any market, a deep understanding of the risks associated with the market is paramount. In the ag loan market, we have found that accurate and reliable information is scarce and is held by a limited number of insiders who have meaningfully participated in the market for an extended time. We believe our broad and lengthy participation in the market qualifies us as insiders capable of accurately identifying and assessing loan risk. In addition, we believe that middle market ag borrowers (whose operations are multi-generational, vertically integrated, structurally important) possess higher intangible motivation for loan repayment relative to non-ag commercial borrowers (whose operations are straight asset plays with limited personal downside risks to such borrowers). Accordingly, we are confident that ag borrowers will exhaust all available options to pay their loans on or before maturity. As a result, we believe the agricultural loan market is safe overall, especially with the benefit of accurate and reliable market information.

What are the primary government supports for agriculture in the US?

Government aid for agriculture varies greatly by region and commodity. One of the largest programs is crop insurance subsidies, which subsidizes insurance premiums for farmers covering over 100 crops – the largest benefit going to the most widely produced row crops (corn, soybeans, cotton and wheat). Another big historical support for agriculture is disaster aid for various sectors of agriculture when unforeseen events effect demand and pricing for ag commodities. An example of the disaster relief was the $2.9 billion allocated to dairy farmers in response to the demand drop due to the COVID-19 pandemic. In our view, US public policy has historically prioritized a vibrant and sustainable agricultural sector as vital to our national security interests and we fully expect that ongoing governmental support will continue.

How does agriculture correlate with other markets?

Agricultural land values over time are the best proxy available for returns in the agricultural lending market. The table below shows very little correlation with US Equities, US Bonds and Commercial Real Estate, which implies great portfolio diversification benefits with exposure to agricultural markets.

Correlation of Annual Returns from 1998-2019

	U.S. Equities	U.S. Bonds	Commercial Real Estate	U.S. Farmland	Pacific Farmland
U.S. Equities *(S&P 500)*	100%	-28%	51%	-10%	-5%
U.S. Bonds (*Barclays US Agg Bond)*		100%	-2%	-9%	-18%
Commercial Real Estate *(CPRI)*			100%	15%	10%
U.S. Farmland *(USDA Cropland)*				100%	65%
Pacific Farmland *(USDA Cropland)*					100%

US Agricultural Loan Market

Why are banks selling loans?

In our experience, banks are generally in the business of generating interest on performing loans within the boundaries of banking regulations. When loans are in default – even though loan payments are current – they become classified and create adverse consequences for regulated lenders. Such consequences may include increased capital reserve requirements and increased costs from more demanding loan administration and enforcement, both of which materially reduces lenders' returns. We have observed that lenders are, therefore, motivated to restructure, call, sell, or otherwise exit defaulted loans. we have also observed that, due to reputational considerations, banks often seek to avoid foreclosure and other default remedies. Therefore, in our experience lenders often choose to sell defaulted loans rather than incur the costs and possible reputational harm arising from default enforcement actions.

Why are banks exiting or not renewing loans for long-term borrowers and what will happen to such loans? We observe that banks are reducing their allocations to agriculture on a portfolio level for a number of reasons relating to the US economy generally and the agricultural economy specifically. In our experience, this macro decision to downsize ag loan allocations – combined with many borrowers' current cash flow pressures – has considerably suspended historically available ag credit. As a result, we think that many foundationally solid long-term lending relationships need reliable short-term loans to bridge the current capital shortages.

In our experience, banks are reducing their loan exposures by reducing, terminating, or failing to renew all but the "best loans" with the "best loans" often being determined solely on the basis of current cash flow performance. We believe current cash flow performance should not be the sole or even the primary consideration for evaluating loan risk. Instead, we believe that careful underwriting can identify loans that are likely to pay and perform independent of current cash flow performance.

Why is the conventional loan structure inappropriate for middle market ag borrowers?

A vertically integrated middle market ag operation has two distinct pools of collateral on which it can borrow, real property and personal property consisting primarily of inventory and accounts receivable. In our experience, the value of personal property is more variable than the value of real property. Many ag loans are structured as two separate loan facilities with the same lender or different lenders: a one-year revolving line of credit secured by personal property and a longer-term loan secured by real property. In our view, the annual tenor of revolving lines of credit creates refinance risk that often requires borrowers to manage their finances to satisfy their lenders' financing standards instead of managing their finances for long term success and profit. We believe that managing to lenders' standards usually emphasizes cash performance and often conflicts with sound and strategic business plans, especially when such business plans include innovation, redevelopment, succession planning and other customary and commendable business strategies.

In our view, single advance, multi-year, unitranche loan structures solve many of the problems inherent in conventional ag loan structures. Under unitranche structures, loan payment and performance are often underwritten at origination with appropriate but limited financial covenants. Such structures tend to give borrowers flexibility to manage their finances for operational success and not for annual loan renewal requirements and mis-aligned covenants.

IMPORTANT INFORMATION

Certain information contained in this Frequently Asked Questions this ("FAQ") constitutes "forward-looking statements," which can be identified by the use of forward-looking terminology such as "may," "will," "should," "expect," "anticipate," "intend," or "believe" or the negatives of those terms or other variations of them or by comparable terminology. Any such forward-looking statements should not be construed to be indicative of the actual events that will occur. Actual events are difficult to project and often depend upon factors that are beyond the control of the AG Solutions Capital and its affiliates. Unless the context otherwise requires, the words "include," "includes," "including" and other words of similar import are meant to be illustrative rather than restrictive.

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