



AUSTRALIAN BANKERS'
ASSOCIATION INC.

Submission

Senate Inquiry

Reserve Bank Amendment
(Australian Reconstruction and
Development Board) Bill 2013

The Australian Bankers' Association (ABA) questions the need for an Australian Reconstruction and Development Board. The Rural Adjustment Act 1992 currently exists for the specific purposes of enabling the Australian Government to provide directly or indirectly, grants and loans to farmers, for purposes related to rural adjustment.

It is not clear from commentary from the proponents of the Bill whether the purpose of the Board is for dealing with rural assistance issues in the rural sector today or providing a vision, direction and helping with policy on the future of the sector.

We support work on the future vision for the rural sector, particularly in view of the emerging opportunities in global food demand and broad structural shifts in food supply and demand. We support current work that is being done in this area, including the Agricultural White Paper and the NFF Blueprint for Australian Agriculture. We believe this work should inform industry restructuring programs and that this is possible without setting up a separate Board.

Work on industry programs should address the entire Agricultural sector regardless of whether producers hold farm debt. Industry policies need to be aligned to potential market opportunities and overall potential for market growth. Focus should be on the continued growth of 'high performing' agricultural enterprises and assisting more agricultural enterprises to join this group, as they will be integral to the sector capturing the potential global growth opportunities.

We acknowledge there is a case for government support to producers today that are struggling with changes to operating conditions whether that is due to weather, market, scale, financial performance, management or other factors. This support needs to be for all similar affected farmers and not only those with farm debt. The issue of 'exceptional circumstances' in the rural sector has been ever present in Australian Agriculture.

The ABA supports Government intervention in the rural sector where it is aimed at addressing welfare issues and specific orderly adjustment issues. To avoid unintended negative consequences of government intervention, the need for the intervention and the desired outcome of the intervention needs to be clearly defined.

Orderly adjustment of farm businesses needs to be supported to ensure that the Australian agriculture sector remains competitive and remains attractive to financial investment (debt and equity capital). Assistance and adjustment need to be considered in view of the future positioning of the sector including building resilience and viability and discouraging speculative activities or higher risk taking.

ABARES analysis¹ shows that there are substantial differences for its financial performance measures between the average financial performance of top performing farms and that of middle and bottom performing farms. There is clear evidence that the scale of a farms operation is an important characteristic in the financial performance of a farm business (See table 1).

Table 1

Family farm business performance estimates by size of business, broadacre farms, 2009-10 to 2011-12				
Average per business / household				
Size of farm business				
Size of farm operation expressed in sheep equivalents	Receipts of farm business (total business income)	Rate of return on total capital used	Farms ranked in top 25% of population by return on total capital used	Share of disposable income earned from non-farm sources
no.	\$	\$	%	%
889	64,189	-2.9	3	100
1,734	85,942	-1.5	6	97
2,413	113,750	-1.0	9	85
3,125	157,388	-0.6	15	66
3,920	191,456	-0.5	20	78
4,711	234,244	0.4	24	48
5,486	262,253	0.6	22	58
6,335	297,192	0.8	27	43
7,253	345,560	1.3	35	33
8,436	392,610	1.3	39	39
9,850	431,880	1.6	39	40
11,526	558,517	2.3	51	23
13,282	606,683	2.0	46	23
15,650	699,155	2.3	52	23
18,441	740,868	2.5	54	20
22,463	996,333	3.0	59	18
27,761	1,132,531	2.9	62	22
37,158	1,534,036	3.4	64	15
53,334	1,884,856	3.1	58	13
106,820	3,872,193	3.7	69	12

Source: ABARES Australian Agricultural and Grazing Industries Survey (AAGIS)

¹High Performing Farms, Agricultural Commodities – vol. 3 no. 4 – December quarter 2013

Concern has been raised by the proponents of the Board about the level of debt in rural Australia. While ABA recognises that rural debt has grown significantly over the past 10 years we do not believe that there is a systemic problem facing rural Australia that warrants the proposed intervention.

There are a number of reasons why rural debt has increased significantly in recent times.

They include:

- Adjustment pressure to achieve economies of scale that produce higher returns on capital;
- Adjustment pressures to change from livestock to more capital intensive cropping enterprises;
- Relatively low interest rates;
- Availability of interest only products;
- Adoption of new technologies that improve labour productivity;
- Increased reliance on off farm income to support financial sustainability, especially of small farms; and
- Financing cash flow shortfalls in some industries and some areas under financial pressure

ABARE analysis shows that as the size of the farm operation increases, returns on total capital increases, and equity levels are sustainable at lower levels. ABARE analysis of the characteristics of farm business performance indicates that on average farms in the top 25% have lower equity than farmers in middle 50% and the bottom 25% (see Table 2). On face value this highlights that debt is not necessarily a negative indicator of business performance. Our experience is that the top 25% are using debt to invest capital items that enable them to generate higher returns.

Table 2

Estimates for farms ranked by rate of return on total capital used, 2007-08 to 2011-12,									
all broadacre industries									
average per farm									
		Top 25%			Middle 50%			Bottom 25%	
Size of operation									
Total area operated	ha	11 500	(4)		5 300	(5)		4 700	(7)
Area sown to crop	ha	1 000	(2)		300	(3)		200	(6)
Beef cattle	no	600	(3)		400	(2)		100	(6)
Sheep	no	2 300	(3)		1 000	(3)		500	(6)
Financial performance of farm business									
Total cash receipts	\$	896 200	(3)		313 800	(2)		137 500	(4)
Total cash costs	\$	605 100	(3)		248 000	(2)		152 600	(4)
Farm cash income	\$	291 100	(3)		65 800	(4)		- 15 200	(23)
Farm business profit	\$	219 800	(4)		- 12 400	(19)		- 90 900	(4)
Farm business debt and equity at 30 June									
Farm business debt	\$	1 045 700	(3)		408 400	(4)		211 900	(7)
Net business worth	\$	4 830 400	(2)		3 713 100	(2)		1 661 700	(3)
Equity ratio	%	83	(1)		90	(1)		88	(1)
Liquid assets available to farm business at 30 June									
Farm management deposits	\$	74 900	(6)		28 200	(9)		6 300	(21)
Other liquid assets	\$	148 500	(6)		121 800	(6)		97 500	(13)
Debt servicing									
Interest paid to receipts percentage	%	8	(3)		9	(3)		11	(6)
Debt to receipts percentage	%	123	(3)		137	(3)		169	(6)
Household income of owner-manager and partner a									
Household off-farm income	\$	28 200	(4)		32 700	(5)		40 300	(6)
Total net household income	\$	186 400	(3)		58 700	(4)		10 600	(33)
Share of net household income earned off-farm	%	15	(5)		56	(4)		100	(31)
<p>Figures in parentheses are standard errors expressed as a percentage of the estimate provided. a Owner-manager and partner's share of net farm income (farm cash income less depreciation) plus off-farm income.</p> <p>Source: ABARES Australian Agricultural and Grazing Industries Survey (AAGIS).</p>									

If ABARES data is adjusted so that off farm income is taken into account, the interest paid to receipts percentage, for the mid 50% (9%) and the bottom 50% (11%) of farms comes back to the same level as the top 25% performing farms at 8% . This suggests that off farm income and the use of off farm assets (as security supporting farm loans) plays an important role in supporting smaller farms that lack economies of scale that are characteristic of the top performing farms. ABARES analysis shows that on average farms earning up to around \$262,000 in receipts from their farm business, earn more than 50% of their disposable income (net of farm costs) off farm (see Table 1).

When banks assess a loan application for a farmer they take into account all available sources of income to meet loan commitments and all available assets that can be used as security for a loan. Every loan is assessed and reviewed on an individual customer basis.

Focusing only on changes in rural debt to total receipts from a farm business will not tell you whether the debt level of individual farmers is either productive or sustainable, especially if that debt is supported by off farm income and off farm assets.

The ABA does not agree that there is a rural debt crisis. The banking sector has a strong record in recent times of supporting the rural sector through the 'decade of drought' on the East Coast and more recently through a prolonged drought period in the West Coast grains industry. These areas have been recovering and rebuilding equity. Bank Pillar 3² Reporting indicates that less than 1.5% of loans to agriculture are more than 90 days in arrears. Bank losses on the portfolio of rural loans are less than 0.5 %. Impaired loans, including 90 days plus in arrears are estimated by the ABA to be less than 3% of bank loans outstanding to agriculture.

We do acknowledge that there are farmers in specific areas and industries that are under financial pressure. In the case of Northern Beef Cattle producers their position has been obviously exacerbated by disruptive events such as the live export ban and more recent drought. In light of recent droughts in Western Australia and more recently in Northern Queensland it may be timely for Government to again review the effectiveness of changes made to drought programs and assistance provided. The impact of drought affects producers, at all levels, regardless of whether the hold bank debt.

While the Bill does not identify a policy to be implemented, proponents have advocated that the proposed Board will implement a policy that aims to reduce the debt levels of farmers to sustainable levels, at subsidised interest rates. There appears to be an expectation that banks would forgo debt owing to them, on problem loans, to a level that would achieve this.

There are a number of problems with this assumption. Lending to farmers is generally well secured. A bank is unlikely to forgo debt when there is security available to cover the debt owing.

Further to this, if this were to become a practice then it is likely that it would be factored into the pricing of debt, potentially affecting all producers irrespective of the resilience and management capability within their operations. It would be difficult to avoid penalising the better operators at the expense of those struggling to run viable businesses.

To avoid the impact of these issues, the proposed Board would have to buy out the debt from the bank, in effect refinancing the customer at a lower level of debt. In doing this the Board would take a loss upfront in providing the refinance. In addition to this loss the Board would also incur costs relating to the raising of funds and meeting prudential capital and loss requirements. Assuming that the interest rate charged by the Board are subsidised, this policy appears to be unsustainable.

²APRA Prudential Standard APS 330 Public Disclosure (APS 330).

Australian banks have a long history of working with farmers through business and seasonal cycles, and put in place arrangements to address special financial needs in times of financial hardship. Banks work with governments providing assistance at these times.

Banks are aware of the physical and mental stress that farmers endure at times of financial hardship. It is industry practice to try and resolve the repayment of debt without relying on the legal rights of loan contracts that enable lenders to enforce mortgage agreements. Banks encourage their customers to use Rural Financial Counsellors and will use independent mediators to help reach agreements on the repayment of farm debt.

ABA recommends that given the existence of the Rural Adjustment Act and a lack of evidence indicating any deficiencies in the provisions of this Act to address the concerns of the proponents of the Australian Reconstruction and Development Board, that the Senate Economics Legislation Committee rejects the need for the proposed Board.