Primary Production Committee *Briefing on rural bank lending*

Federated Farmers of New Zealand

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SUBMISSION TO PRIMARY PRODUCTION COMMITTEE BRIEFING ON RURAL BANK LENDING

TO: **Primary Production Committee**

DATE: **12th May 2024**

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ABOUT FEDERATED FARMERS

Federated Farmers of New Zealand is a membership organisation, which is mandated by its members to advocate on their behalf and ensure representation of their views. Federated Farmers does not collect a compulsory levy under the Commodity Levies Act and is funded from voluntary membership.

Federated Farmers represents rural and farming businesses throughout New Zealand. We have over a 100-year history of representing the needs and interests of New Zealand's farmers.

1. SUMMARY

1.1. Federated Farmers strongly urges the Primary Production Committee to initiate a full Select Committee Inquiry into rural bank lending.

1.2. Federated Farmers members have observed a steady and significant decline in communication, service, and willingness to lend by New Zealand's five major rural lenders. Surveys show that while ten years ago less than one in twenty farmers stated they felt they had been put under undue pressure by their bank, this level has now risen to a massive one in four farmers viewing that they are under undue pressure from their bank.[1]

1.3. Bank pressure on farmers is not just an issue for New Zealand's farmers and rural communities, but for New Zealand's broader economic potential and well-being. Primary production is responsible for over 80 per cent of New Zealand's exports. The Government has a goal of increasing New Zealand's productivity and prosperity by doubling exports, including from agriculture, over the next 10 years. This will not be achieved if farmers don't have access to finance for investment in productivity and environmental improvements and are under undue pressure just to keep operating.

1.4. Federated Farmers is also concerned that undue pressure from banks has a severe mental health toll on farmers. Older farmers who have worked for decades, getting out of bed at 5am to milk cows and build wealth, now find themselves facing forced sale of their farm and their life's work disappearing. Young farmers find they are facing changing and unrealistic expectations from banks. This situation is enough to put many farmers into a state of poor mental health. Our most recent rural banking survey found that over half of sharemilkers state they believe issues related to banking have impacted their mental health.

1.5. In preparing this submission, Federated Farmers has spoken to several farmers, ex-rural bankers, lawyers, and economists. Each has come to us on their own as they feel passionately about this issue and want to see Federated Farmers push hard for a rural banking inquiry. The consistent stories we are hearing are of farmers who have high equity positions but are unable to access new capital for spending on things like new effluent management systems, seasonal finance, or unexpected bills. Farmers who were considered safe a few years ago are being recategorised as distressed lending despite no change in their financial circumstances. We have included three representative farmer case studies as an appendix to this submission (Appendix 1). One of the bankers we spoke to in preparing this submission, Michael Smith, felt significantly alarmed by the changing relationships farmers had with bankers that we've included a letter by him in the appendix of this submission (Appendix 2).

1.6. In speaking to these experts, a consistent issue raised is the various Reserve Bank regulations that set requirements for banks to hold capital and control the risk models that banks use. The RBNZ regulations were put in place to fortify banks against a potential 'one-in-200-year shock'. Such a goal may seem laudable: avoiding a shock is always a good thing. Of course, fortifying against such a shock is not without cost. Are we sure the medicine isn't worse than the disease?

[1] See Federated Farmers November 2023 Banking Survey here: https://www.fedfarm.org.nz/FFPublic/FFPublic/Policy2/National/2023/Federated-Farmers-Banking-Survey---November-2023.aspx

1.7. Our submission includes reference to a briefing to the previous Minister of Finance where it is noted banks claimed the changes would result in a 0.5 and 1.2 per cent increase in interest rates. To put a 0.5 to 1.2 percent increase in rural lending costs in context, with total rural lending of approximately $62 billion, this equates to an additional cost of $310 to $720 million per annum of interest costs.

1.8. Note this is a higher cost than that which was forecast for the He Waka Eke Noa policy. A 0.5 to 1.2 per cent increase in interest costs equates to $310 million to $740 million per annum. The He Waka Eke Noa policy was forecast to levy $220 to $290 million from the sector by 2030.

1.9. The Committee will be aware that the Commerce Commission has begun a market study on personal banking. Frustratingly, however, rural lending is outside the scope of the Commerce Commission study. The Commerce Commission draft study identified "Bank prudential capital requirements are the most significant regulatory barrier."

1.10. The Commerce Commission is not alone. S & P Global called the Reserve Bank regulations "Some of the toughest bank capital standards worldwide," stating "The risk is that the caution may squeeze access to credit." Geof Mortlock, head of Mortlock Consultants Ltd, said the regulations will "slow the rate of new lending," and "This will bite especially hard if and when NZ enters a recession — as is just a matter of time."

1.11. However, while the Commerce Commission and others tell us it is Reserve Bank regulations that are having the most significant impact, the Reserve Bank points the finger in another direction. In a press release "RBNZ releases submission on draft Commerce Commission market study," RBNZ Deputy Reserve Bank Governor Christian Hawkesby stated;

> *"We disagree with the Commission's analysis regarding our prudential capital settings and the recommendation for us to re-review them."*[2]

1.12. In an interview with NewstalkZB host Heather du Plessis-Allan speaking to this press release, the Deputy Reserve Bank Governor went on to say,

> *"Our analysis is that the return on equity for the risk that banks take is higher in New Zealand than other countries, so there does seem to be something about the New Zealand banking industry, and maybe it is this lack of competition that isn't there and maybe would eat away bit at this return on equity."*[3]

1.13. This all creates a fairly frustrating and problematic situation:

1.13.1. Farmer bank satisfaction is rapidly deteriorating,

1.13.2. This places the entire New Zealand economy at risk,

1.13.3. The Commerce Commission and global experts are suggesting the Reserve Bank capital requirements are to blame,

[2] Source: RBNZ releases submission on draft Commerce Commission market study - Reserve Bank of New Zealand - Te Pūtea Matua Page 4 of 31

Source

[3] Source: Newstalk ZB here: https://www.newstalkzb.co.nz/on-air/heather-du-plessis-allan-drive/audio/christian-hawkesby-reserve-bank-pushes-against-comcom-proposal/

1.13.4. The Reserve Bank is saying there does “seem to be something… [but] maybe it is this lack of competition.”

1.14. Federated Farmers isn’t able to tell who is right, but we can tell that farmers are hurting, rural communities are hurting, and this is likely creating a drag on the overall New Zealand economy.

1.15. In the face of a different agencies and experts pointing the finger in different directions, an independent analysis is needed, and a Select Committee Inquiry is an appropriate mechanism that can call on experts to give evidence and get to the bottom of where the problem lies.

2. KEY QUESTIONS FEDERATED FARMERS WANT ANSWERED BY A SELECT COMMITTEE INQUIRY

Impact of Reserve Bank regulations

- How do the Reserve Bank of New Zealand’s capital requirements influence lending rates to farmers?
- What are the long-term impacts of increased lending costs on farm sustainability and the broader agricultural economy?
- How does regulation of risk models reduce the diversity of approach and therefore competition in the market for rural lending?[4]
- What are the mental health impacts of reduced willingness to lend by rural banks?

Differences between rural lending and residential lending

- What is the difference in interest rate paid for by farmers compared to homeowners, and is this difference justified by increased risk?
- What is the difference in margin between farming and residential loans in New Zealand, and how does this compare to overseas counterparts?
- Can transparency mechanisms be added so that the rate paid by farmers can be monitored and the impact of new regulations understood? *We suggest an inquiry require banks provide a long-term series on the profitability of agricultural loans versus residential loans to investigate any recent divergence.*

Other issues raised with us

- Have regulations preventing bonus payments being offered to rural bank managers meant that the incentive for competition at the personal level has been lost?

[4] Banks are either accredited to use the RBNZ internal models-based (IRB) approach to calculate their capital requirements or must use the standardised approach. The effect of this may be that, even if there is more than one bank offering lending to a farm, all banks are required to use a regulated approach to assessing risk, reducing overall competition. See Reserve Bank “Capital requirements for banks in New Zealand” (1 July 2022) available at: https://www.rbnz.govt.nz/regulation-and-supervision/oversight-ofbanks/standards-and-requirements-for-banks/capital-requirements-for-banks-in-newzealand#:~:text=Under%20Basel%202%2C%20banks%20may,sometimes%20called%20'IRB%20banks'

- Has the Reserve Banks approach to greenhouse gas risk (including risk of government policy) further increased costs to rural lending?
- What is the impact of the Net-Zero Banking Alliance’s uniform approach on competition within rural lending, and do such greenhouse gas commitments restrict competitive options and financial flexibility for farmers, promoting cartel-like behaviour among banks?
- Are rural lenders too constrained in their ability to offer basic advice to farmers, such as advice related to how risk models work and making farmers aware of behaviours that alter their risk rating?
- How can programs be developed or improved to increase access to digital financial tools for farmers and boost financial literacy, specifically addressing the unique challenges faced by the agricultural sector?
- How effective are the current dispute resolution mechanisms between farmers and banks, and what improvements or new processes might be necessary to better serve both parties?

2. SUMMARY OF RECOMMENDATIONS

2.1. Federated Farmers recommends that a Select Committee Inquiry is held into Rural Banking.

2.2. Federated Farmers recommends that this inquiry consider a range of factors that are reducing the ability of farmers to access finance, including regulatory and non-regulatory developments.

3. INTRODUCTION

3.1. This submission by Federated Farmers to the Primary Production Committee outlines the reasons Federated Farmers believes a Select Committee inquiry is needed into rural banking.

3.2. It is clear that the quality-of-service farmers are receiving from bankers has fallen markedly in recent years. This is evident in Federated Farmers banking surveys presented in this submission. The issues that drive this appear complex and multi-faceted. They range from Reserve Bank regulations, government regulations, changes to the way banks measure risk, lack of competition, and changing banker culture. As these issues are broader than any one single act of Parliament, it is appropriate for the Primary Production Committee to consider these complex issues through a thorough inquiry.

3.3. Over the last several months, since first calling for a rural banking inquiry, Federated Farmers has been approached by a range of farmers, ex-bankers, economists and industry leaders, all supportive of this call and who wanted to provide us with information that would help Federated Farmers bring light to these issues.

3.4. Federated Farmers has interviewed each of these experts and heard their stories. This submission is based off the information provided to Federated Farmers. To the extent possible, we have tried to understand some of the detail underlying the concerns they have raised. For example, the detail of the changes to bank capital requirements made by the Reserve Bank.

3.5. This submission begins by outlining the role of agriculture in the New Zealand economy. We then outline how survey data shows farmer banking experiences have changed and how this has translated to reduced finance available to agricultural sectors. The submission then outlines some individual experiences to highlight how this sector level change impacts at the individual level. We conclude by touching on some of the changes that have occurred, regulatory and non-regulatory, that may be driving this.

4. FARMING IN THE NEW ZEALAND ECONOMY

4.1. New Zealand is a small open economy that relies on selling goods to the rest of the world so we can access things we don't have or can't produce. Every time a Kiwi buys a computer, a medicine, or a car, this is typically imported. To access these imported goods, we need to sell something to the rest of the world.

4.2. Four out of every five dollars brought into the New Zealand economy through exports comes from New Zealand's primary sector. Put simply, without a growing primary sector, New Zealanders will struggle to grow their ability to buy things from the rest of the world like

technology, medicine, and machinery. We are unlikely to increase our well-being if our primary sector isn't improving its productivity.

4.3. In dollar terms, exports from the primary sector are increasing (Figure 1). Dollar value export figures however hide underlying trends in on-farm production. Over the last eight years, total exports of milk, sheep meat and wool have not increased (Figure 2, Figure 3). Increased export revenue has largely come from changes in commodity prices and exchange rates, which can't be relied upon to always continue.

4.4. We highlight this to draw attention to a broader issue: agricultural output in New Zealand has begun to stagnate, at least in pastoral sectors. In order to grow New Zealand's productivity and prosperity, we need to understand why pastoral production is stagnating and if government action is needed to address this.

	Actual					Forecast	
Sector	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
Dairy	18,107	20,102	19,055	21,998	26,008	24,090	25,520
Meat and wool	10,176	10,617	10,373	12,310	12,114	11,560	11,830
Forestry	6,883	5,452	6,499	6,578	6,353	5,810	6,100
Horticulture	6,134	6,541	6,579	6,815	7,066	7,000	8,190
Seafood	1,963	1,857	1,789	1,919	2,097	2,260	2,400
Arable	236	289	261	252	272	290	300
Processed food and other products*	2,854	2,988	3,087	3,228	3,491	3,310	3,310
Total export value	**46,355**	**47,846**	**47,642**	**53,100**	**57,402**	**54,320**	**57,650**
Year-on-year % change	**9%**	**3%**	**0%**	**11%**	**8%**	**-5%**	**6%**

Figure 1: New Zealand Primary Sector Exports (Source: MPI)

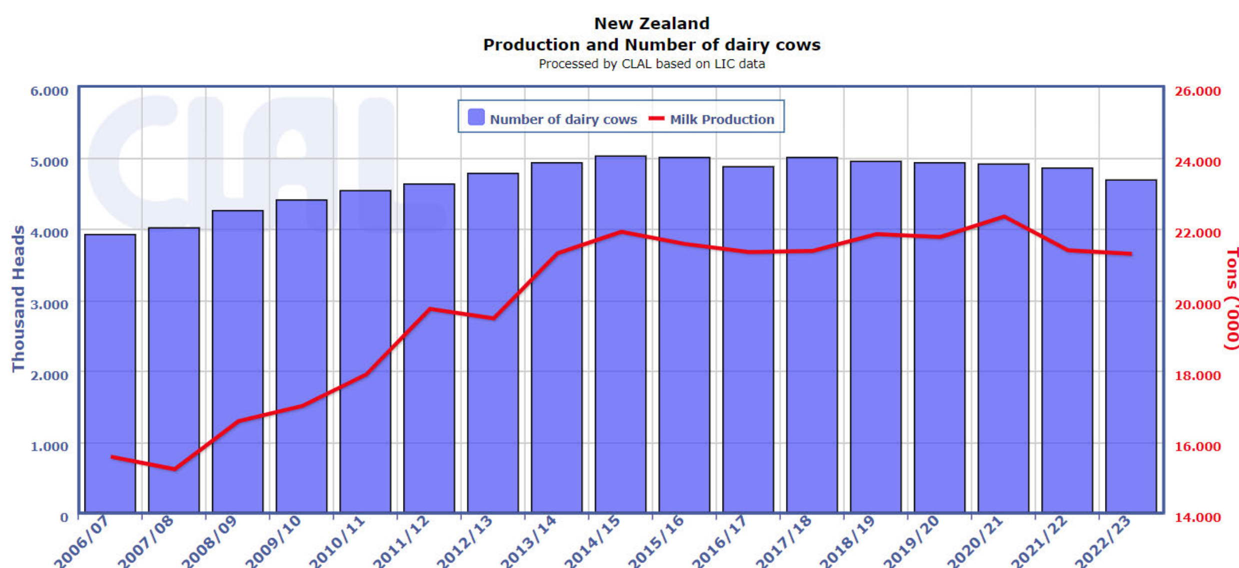


Figure 2: New Zealand Milk Production (Source CLAL; LIC Data)

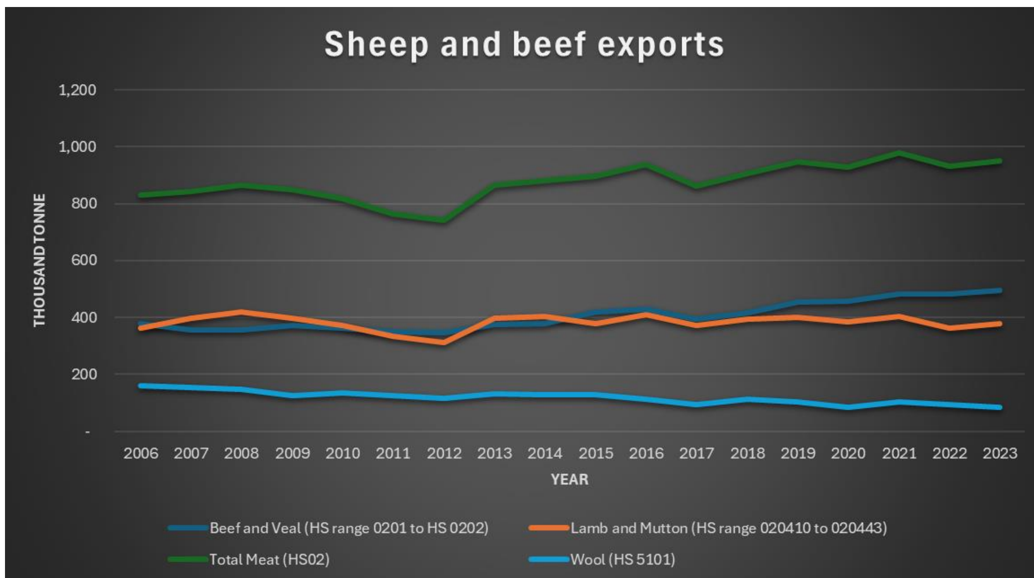


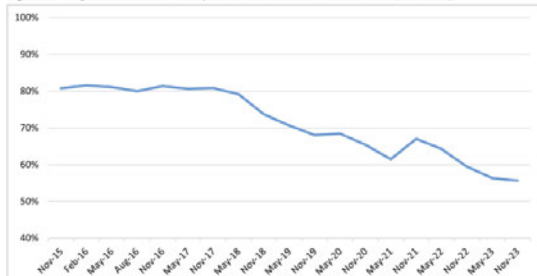
Figure 3: Sheep and beef exports (Source: StatsNZ InfoShare)

5. FARM ACCESS TO FINANCE HAS BEEN CURTAILED

Changing farmer sentiment towards banks

5.1. Federated Farmers has undertaken a banking survey of members since 2015. Our surveys show that 81 per cent of farmers have a mortgage. The average farm mortgage in the November 2023 survey was $4.26 million, illustrating the significant individual investment needed for farm ownership in New Zealand. The average interest rate paid was 8.26 per cent, equating to around $350,000 of interest cost per farm per annum.

5.2. Over the last five years, there has been a significant shift in farmer sentiment towards banks. The number of farmers saying they are either 'Satisfied' or 'Very Satisfied' with their bank has fallen from being consistently just over 80 percent prior to 2018, to recently reach a record low of 55.8 percent (Figure 4). The number of farmers who say they feel they have been put under undue pressure by their bank has increased from only one in 20 in 2015 (5 percent) to an incredibly worrying one in four today (25 per cent).



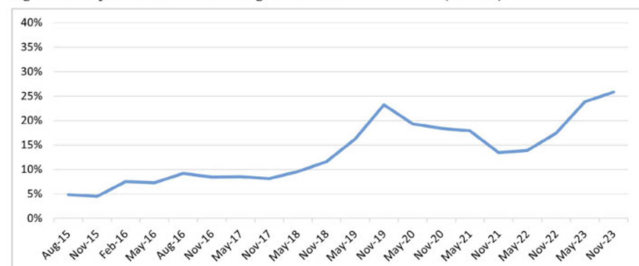


Figure 4: Farmer sentiment under rural banking survey (Source: Federated Farmers)

5.3. Federated Farmers observed that an alarming increase in the occasions of farmers noting that stress with their banker has had an impact on their mental health. In our most recent rural banking survey, we asked if issues with banking have had an impact on mental health. Alarmingly 44 per cent of farmers answered "Yes" to this question. Of particular

concern is that over half of sharemilkers answered yes to this question (Figure 5). This points to a strong potential that changing banking rules are having a significant impact on succession issues in farming.

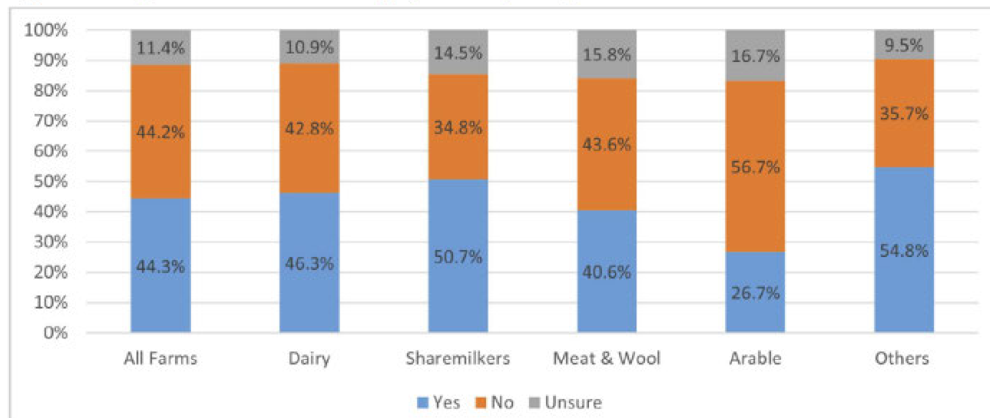


Figure 5: Impact on mental wellbeing of banking issues (Source: Federated Farmers)

5.4. Historically, the interest margins between home lending and business/agricultural lending have been similar (Figure 6). However, data since early 2021 indicates a dramatic expansion in the margins for business/agricultural loans to just over 2% greater than those for home loans.

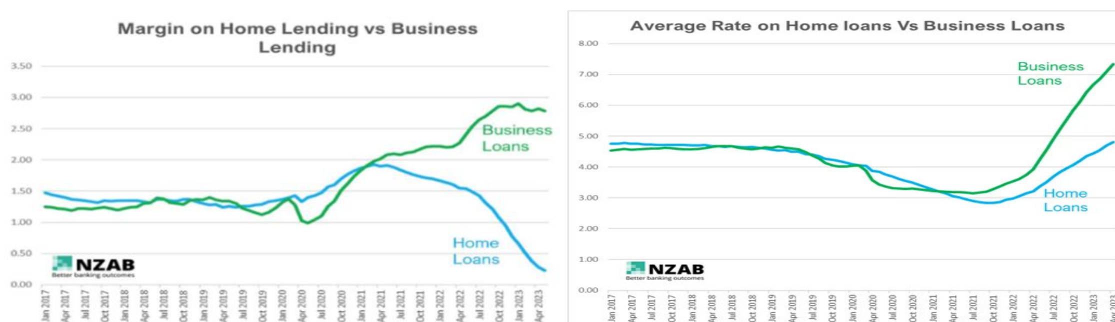


Figure 6: Bank margin on home and business loans (Source: NZAB)

5.5. Bankers note that some of this difference is due to farms often opting for floating rates while homeowners may opt for fixed rates. This has reduced margins for home loans because as bank interest costs have risen there is a lag before mortgage rates paid increase, as it takes time for homeowners to move onto a new fixed rate. This explanation may explain the decrease in margin for home lending, as banks are suffering from being on the wrong side of fixed rate mortgage agreements, but this doesn't explain the increase in the margin on business loans observed at the same period (unless banks are cross-subsidising losses in one portfolio with increased margins in another). It is also observable in Figure 6 that the margin on business loans began increasing in late 2020, while interest rates only began increasing in late 2021.

5.6. We are told that it is increasingly common for farmers to pay interest rates of over 10 percent. It is hard however to obtain data that clearly tracks the rates paid by farmers compared to other lending, and the margin applied to farm loans. The Committee should consider if mechanisms can be introduced to provide more transparency on the average interest rates paid by housing, business and rural loans. This would allow easier identification of discrepancies when they occur.

Total rural debt

5.7. Rural debt in New Zealand has been relatively stable over the last seven years (Figure 7). When considering sub-sectors, however, dairy loans have fallen from a peak of $41.6 billion in July 2018, to 36.5 billion today, a fall of 12 per cent. Horticulture lending has seen a substantial increase over the same period, while sheep and beef lending has been stable.

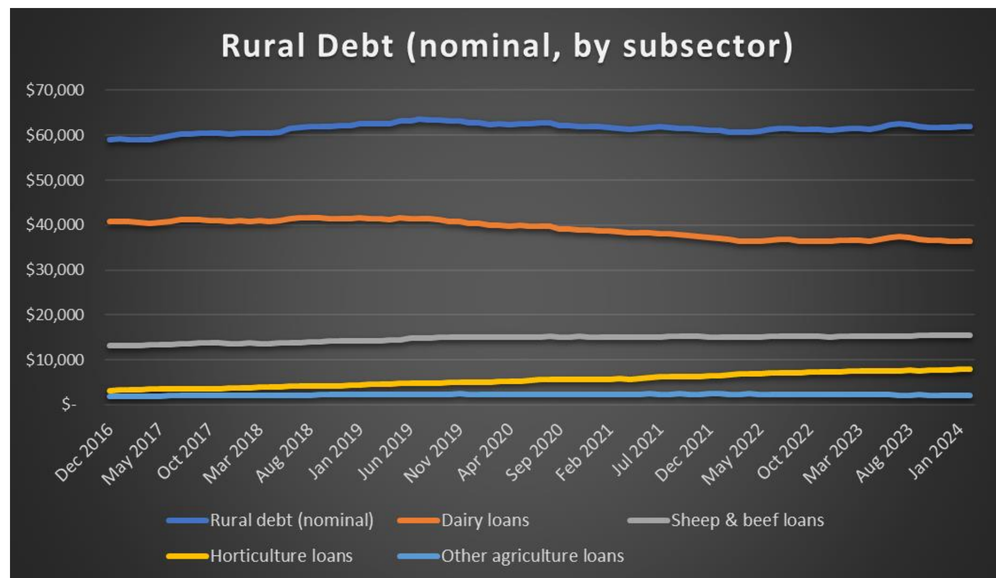


Figure 7: Rural debt since 2016, by subsector (Source: RBNZ data)

5.8. It is important to note that the period since 2016 has seen 28 per cent inflation. In real terms, rural debt has actually fallen 23 per cent since January 2019 (Figure 8). This is even more pronounced when considering only dairy debt. Total dairy lending, in real terms, has fallen 29 per cent since January 2019.

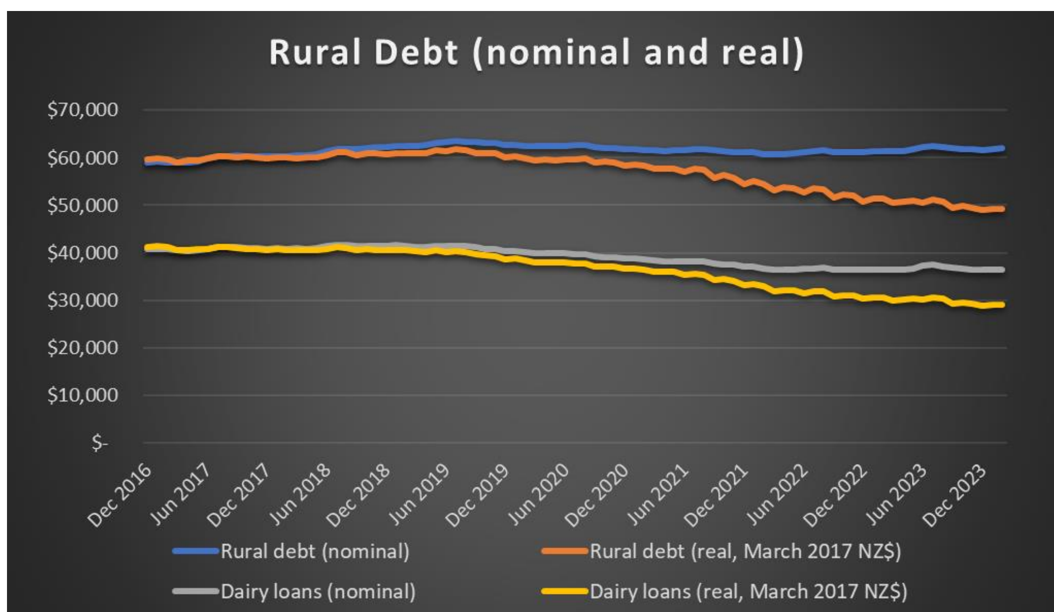


Figure 8: Rural debt since 2016, real and nominal (Source: RBNZ data)

5.9. Dairy products are New Zealand's largest export earner. In coming years, farmers will be expected to make investments to grow New Zealand's productivity and improve environmental performance. It is hard to see farmers being successful in undertaking such investments if their access to finance, in real terms, is rapidly falling.

5.10. We have also been told four out of the five rural lenders are presently trying to reduce their exposure to dairy lending, and this is confirmed in briefings to the previous Minister of Finance.[5] This approach can be observed in Figure 7, where total dairy lending is falling.

5.11. This has the impact of making it both hard to get a loan and hard to change banks. From a dairy farmer's perspective, if four out of five banks are trying to reduce total dairy debt, it means that actual competition for you as a customer is severely curtailed. This is likely partly to blame for the falling bank satisfaction and increase in customers coming under undue pressure noted in Federated Farmers banking survey.

6. FARMER'S PERSPECTIVE ON THE CHANGING NATURE OF THE BANKING RELATIONSHIP AND WHY IT NEEDS A REVIEW.

6.1. In preparing this submission, we have talked to a range of farmers, economists and ex-bankers. This section is based on these conversations.

6.2. These people have all approached Federated Farmers because they feel passionately about the need for a rural banking inquiry and want to assist Federated Farmers in

[5] In 2019 an RBNZ briefing note to the Minister of Finance stated, "Bank are of the view that current dairy debt levels are unsustainable, particularly for the most indebted farmers. As a result, banks have tightened their dairy lending standards and increased their margins over the last 2-3 years."

https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/part-9-briefing-for-mof.pdf

understanding this issue. These stories help provide context to the survey data that shows farmer bank satisfaction falling.

6.3. This section explores the evolving dynamics between banks and their rural clients, a relationship that has undergone significant changes in recent years.

6.4. The shift from relationship-based banking to more transactional, risk-focused interactions has introduced new challenges for farmers, who often rely on strong personal relationships with their lenders to navigate the complexities of financing.

Evolving Banking Dynamics

6.5. Farmers have historically benefited from banking relationships that valued personal interaction and mutual understanding. However, feedback from a number of farmers indicates a shift towards more transactional relationships, with banks increasingly prioritising risk management and regulatory compliance over personalised service.

6.6. This transformation is partly attributed to law changes such as the Financial Advisers Act introduced after the Global Financial Crisis. Ex-bankers conveyed to us that it has become much harder to give general advice to farmers on how to structure their business to reduce perceived risk and that rural bankers are no longer provided bonus payments from securing new clients. The two factors together means that rural bankers are more incentivised to avoid legal risk and less incentivised to try and help farmers secure finance. While both changes may have been aiming to address issues of concern, it could be that the pendulum has swung too far from one direction to another (policy has shifted from too loose to too restrictive).

Bank mortgages and credit ratings

6.7. In recent years, the nature of farm bank relationships in New Zealand has undergone significant transformation. Traditionally, bankers considered a wide range of factors including Loan to Value Ratios (LVRs) and the overall health of the farm, which allowed for a nuanced understanding of each farmer's unique circumstances. However, modern banking practices have moved towards more formulaic methods, where credit ratings are often determined by algorithms that focus heavily on calculated profitability (rather than equity position).

6.8. Around 70 per cent of dairy farmers are owner operated. For these farms, the owner will need to take drawings every year from the farm. This will be measured as a cost by the bank risk model. The level of drawing cost inputted into the model we are told will generally be based off historical farm drawings figures.

6.9. This leads to a very common situation. A farmer may enter a period of life where they have managed to pay down debt and become comfortable. Feeling that they can now begin to enjoy the fruits of their years of labour, they take an action such as renovating the house, going on a family holiday or buying a new boat. This appears in the books as a steep increase in drawings. This increase is assumed to be a long-term annual cost on the business.

6.10. From the algorithm point of view, the farm is no longer profitable and risk has rapidly increased. From the farmers point of view, if they fall on hard times, they can easily defer decisions to spend money on discretionary personal purchases. What's more, if they fall on very hard times, (and need to sell) their equity is still worth a lot more than their debt.

6.11. What may then happen is farm product prices may fall, or an unexpected bill arrives in the mail. The farmer needs to increase their working capital or go on interest only for a time, but the bank is unable to grant this request, despite a farm having a very healthy equity ratio, because risk models show the farm as unprofitable.

6.12. Secondly, banks are being measured on the number of 'interest only' loans they have. This doesn't always lend itself easily to farming. Farmers may look to pay down debt rapidly when payouts are high and go on interest only when payouts are low. It isn't always possible or practical to just pay the same amount of capital down every year.

6.13. The focus on profitability, forcing principle payments and how drawings are calculated outlined above can lead to very bizarre situations. For example, a common situation presented to us by an ex-banker was the following,

> 6.13.1. A 1,000 hectare sheep and beef farm may have a book value of $10 million dollars but a mortgage of $1 million. Note sheep and beef farm book values have been driven up recently by the current high returns from carbon farming.
>
> 6.13.2. Forcing principal payments, if the farmer is in their later years, may mean the farmer needs to find $100,000 surplus each year for principal.
>
> 6.13.3. But with current meat prices this may be impossible. The loan is then viewed as unserviceable, and the farmer may be forced to sell.
>
> 6.13.4. The farmer sells the farm, which is purchased by a forestry company, and finds they now have $9 million in cash.
>
> 6.13.5. At the end of this journey the farmer sits there with significant cash wondering why the bank forced them to sell up. Unfortunately, the answer may simply be because regulations and computer models forced the situation. It seems to the farmer the bank was never in any risk of not recovering it's debt.

6.14. This shift has made it increasingly difficult for farmers to secure favourable lending terms, as the personalised, knowledgeable oversight by bankers familiar with the specific challenges and cycles of farming operations is replaced by impersonal, data-driven assessments.

Farm-Debt Mediations

6.15. Based on the discussions we have had it appears the Farm Debt Mediations are being offered very late in the processes and are not having the uptake we expected. As it is being offered too late, the common outcome from mediation is a farm sale.

6.16. It may be worth the Select Committee looking at the Australian farm debt mediation scheme to understand differences in the results achieved and ways New Zealand's scheme may be able to be improved.

Impact of regulatory changes

6.17. In interviews, the main regulations raised were the Reserve Bank changes to capital requirements. Regulations outside the control of the Reserve Bank, such as the Financial Advisors Act and Credit Contracts and Consumer Finance Act, were also often raised.

6.18. In the time available to prepare this submission, Federated Farmers has not been able to untangle the requirements of all of these laws and how they may be impacting rural lending. Section 7 provides more detail on Reserve Bank capital requirements, the regulation of risk models, and the increasing concern bankers have for greenhouse gas emissions.

6.19. We note that Reserve Bank regulations seem to be having the largest impact, but issues may not be limited to Reserve Bank regulation only. In conducting a full Select Committee Inquiry, we recommend the Select Committee consider the broad range of regulations impacting rural banking.

Farmer case studies

6.20. Federated Farmers have heard from several farmers at different stages of their farming journeys. Three of these conversations stood out as useful reference cases that represent different parts of a farmers ownership journey. We have chosen three of these stories which we believe provide a cross-section of farmer experiences and included these in this submission in Appendix 1 (Page 23). Experiences include challenges accessing savings in KiwiSaver, new farm owners being forced into a distressed situation due to the changing nature of banks requests and absurdly restricting term finance while providing overdraft extensions to pay back principal. Finally, the reality of an older farming couple pressured into selling their farm, despite more than five million dollars equity, as they couldn't get a loan to cover a $90,000 bill.

Letter from an ex-rural banker

6.21. It was surprising for us that ex-rural bankers who had been forced to decline finance were just as passionate about this issue as farmers who had been on the receiving end. We observed that many rural bankers have left the industry as they cannot in good conscious participate in activities that they view as placing their clients under needless financial and mental hardship. One such ex-rural banker outlined his views to us in writing and agreed that we may share these with the Committee. We thank him for speaking out and his letter is in Appendix 2 (Page 29).

7. WHY HAS A CHANGE OCCURED

7.1. So far, this submission has highlighted that farmers are experiencing a rapid deterioration in their bank satisfaction, more farmers are coming under undue pressure, and total lending is falling in some sectors. Noting a problem however is only half of the picture, it is important to understand why: is this simply of changing bank attitudes, or have external forces created new pressures?

7.2. Economists and ex-bankers we spoke to suggest a combination of factors. Firstly, changing bank regulations across the Reserve Bank and other government agencies is increasing the cost and complexity of rural lending. Secondly, changing bank culture means rural lending is viewed as less appealing from head office and staff aren't incentivised to find ways to provide loans. Finally, perceptions that pastoral agriculture is not compatible with a low emissions economy is resulting in an additional pressure to reduce rural exposure.

7.3. Federated Farmers has been unable to fully untangle each of these challenges in the time available to prepare this submission. Below are some initial thoughts on these challenges.

Overall, while we have done our best to understand the complexities of the situation, we view a Select Committee Inquiry as better placed to do this.

Reserve Bank regulations

7.4. From 2017 to 2019, the Reserve Bank undertook a review of the capital adequacy framework for locally incorporated registered banks in New Zealand.

7.5. Banks can fund lending via equity or debt. The more that lending is funded by debt, the higher the risk that, in a shock, a bank's equity may be eroded, and the bank may become insolvent. Reserve Bank capital requirements set minimum levels of equity that banks must comply with in order to reduce the risk of bank failure.

7.6. In 2019, the Reserve Bank completed a review of the capital requirements for banks. Final decisions were announced by the Reserve Bank on 5 December 2019. One of the key decisions was to increase banks' total capital ratios from 10.5 percent to 18 percent for the four large banks (identified as 'Domestic Systemically Important Banks') and 16 percent for the remaining smaller banks (Figure 9). In dollar terms, this was characterised as a total of $20 billion extra capital required to fund New Zealand's banks. These changes were to be phased in over a seven-year period ending in 2028.

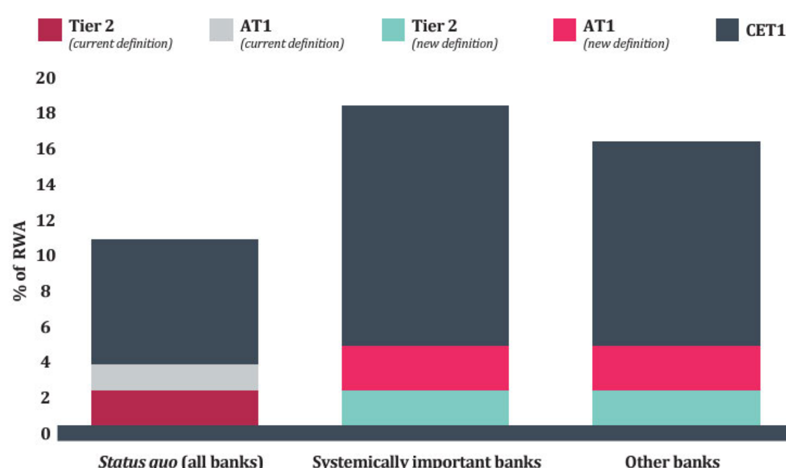


Figure 9: RBNZ review of bank capital requirements

7.7. While these changes were characterised as requiring banks to increase capital to maintain historic lending levels, note there are two different ways to comply with the regulations. A bank could *increase* its equity to maintain current lending levels. Alternatively, a bank could *reduce* total lending levels to fit with its present equity position. This is an important note as it may explain why total lending levels for pastoral agriculture have reduced.

7.8. Increased capital requirements were always expected to have an economic cost. The Regulatory Impact Statement associated with the changes, published in 2019, assumed the regulations would reduce GDP by 0.48 per cent, made up of a combination of a wealth transfer overseas from higher interest rate costs and a loss of economic growth from higher interest rate costs. Due to the benefit of reduced bank failures outweighing this cost, the RBNZ estimated an overall net-benefit of 0.43 per cent of GDP.

7.9. The RBNZ Cost Benefit Assessment assumed the regulations would increase interest rates by 0.2 per cent. Note however this is a standard average across all asset classes. We have not been able to find an estimate of the impact on rural lending specifically.

7.10. Within these regulations, different asset classes attract higher capital requirements. We are advised via our engagement with economists and ex-bankers that requirements for farm lending are higher than those for housing.

7.11. In a briefing to the Minister of Finance in 2019 titled "Potential impact of higher bank capital on the agricultural sector: RBNZ meeting with Minister of Finance",[6] the RBNZ noted that, "Banks estimate farm repricing of 50 bps to 120 bps, given their estimate of a total increase in cost of lending of 50 bps." Note part of this briefing is withheld under the Official Information Act, we suggest the Committee request full access to this briefing note.

7.12. Note that, with total agricultural lending of $62 billion, an increase in cost of 0.5 to 1.2 per cent equates to $310 to $740 million tax on the agricultural sector. For comparison, the Ministry of Primary Industries (MPI) estimated a Farm Split Gas Levy (He Waka Eke Noa) would result in a levy of $255 million per annum. In other words, the changes by the RBNZ in 2019 have the potential to be a much bigger cost to the New Zealand agricultural sector than He Waka Eke Noa was.[7]

7.13. Note, with an average farm mortgage of $4.26 million, an increase interest cost of 0.5 to 1.2 percent equates to $21,000 to $51,000 per farm per year cost from these regulations, assuming no change in access to credit. Where the regulations mean a farmer can't access finance, the regulations may be the difference between keeping on farming and a farm converting to forestry.

7.14. MPI estimated that the flow on effects of the $255 million He Waka Eke Noa levy would reduce milk production by 5.3%, lamb production by 21% and beef production by 37%. The Primary Production Committee should ask for advice on the medium-term impact of a 0.5 to 1.2 per cent increase in rural lending costs on agricultural production.

7.15. Note that, as this cost is related to banks having to hold extra capital against loans, and this capital is often foreign, the majority of this $310 to $740 million will flow out of New Zealand, as a deadweight loss to our economy. This is different to, for example, government spending of $300 million per annum on an education project, as the expense of such a project would flow through the economy.

7.16. Note the Reserve Bank disputes these findings. The Reserve Bank recently published it's 'Assessment of Capital Review Implementation'.[8] This assessment found:

- 7.16.1. "While implementation is still only in its early stages, the costs of capital are tracking broadly in line with estimates in the 2019 Regulatory Impact Assessment."
- 7.16.2. "We have not found any evidence of financial market disruptions from changes to capital requirements."

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[6] The briefing is available here: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/regulation-and-supervision/banks/capital-review/part-9-briefing-for-mof.pdf

[7] See MPI report 'Impacts of climate change mitigation policy scenarios on the primary sector'. Here: https://www.mpi.govt.nz/dmsdocument/53632-Impacts-of-CC-mitigation-policies-on-the-primary-sector

[8] See here: https://www.scoop.co.nz/stories/BU2403/S00223/rbnz-publishes-assessment-of-capital-review-implementation.htm

7.17. The Reserve Bank has also expressed a view that banks may actually be using the changes as ‘cover’ to increase margins. The Reserve Bank stated,

> *“The Reserve Bank has concerns that some banks may be using the bank capital review to expand rural lending margins to an unreasonable degree, using the bank capital proposal as ‘cover’ (i.e. to minimise the reputational harm that would otherwise accompany an expansion in margins). Based on the anecdotes shared in these meetings, we remain concerned about the aggressive repricing behaviour of some banks and plan to raise this issue with the banks concerned.”*

7.18. The RBNZ has also expressed a view that Commerce Commission concerns related to the capital requirement regulations are misplaced. In a press release *“RBNZ releases submission on draft Commerce Commission market study,”* RBNZ Deputy Reserve Bank Governor Christian Hawkesby stated;

> *“We disagree with the Commission’s analysis regarding our prudential capital settings and the recommendation for us to re-review them.”*[9]

7.19. In an interview with NewstalkZB host Heather du Plessis-Allan speaking to this press release, the Deputy Reserve Bank Governor went on to say,

> *“Our analysis is that the return on equity for the risk that banks take is higher in New Zealand than other countries, so there does seem to be something about the New Zealand banking industry, and maybe it is this lack of competition that isn’t there and maybe would eat away bit at this return on equity.”*[10]

7.20. Not everyone agrees with the Reserve Bank that the regulations are not having a concerning impact,

7.20.1. The Commerce Commission Draft Report “Personal banking services market study” found “Capital requirements are a key constraint on competition, particularly for smaller banks”.

7.20.2. S & P Global called the Reserve Bank requirements “Some of the toughest bank capital standards worldwide.” S & P Global stated that the new capital requirements for smaller banks were “double that of European lenders and significantly higher than in Australia”. They went on to say, “Meeting the high requirements will likely force New Zealand banks to cut riskier exposure, such as loans to smaller businesses, and require billions of dollars in extra funding.”[11]

7.20.3. Geof Mortlock, head of Mortlock Consultants Ltd., told S&P Global Market Intelligence in 2021 the new capital requirements announced by the Reserve

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[9] Source: RBNZ releases submission on draft Commerce Commission market study - Reserve Bank of New Zealand - Te Pūtea Matua Page 18 of 31

Source

[10] Source: Newstalk ZB here: https://www.newstalkzb.co.nz/on-air/heather-du-plessis-allan-drive/audio/christian-hawkesby-reserve-bank-pushes-against-comcom-proposal/

[11] See article “World's toughest capital requirements in New Zealand may squeeze credit” here: https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/world-s-toughest-capital-requirements-in-new-zealand-may-squeeze-credit-65720981

Bank of New Zealand will "slow the rate of new lending." "This will bite especially hard if and when NZ enters a recession – as is just a matter of time."

7.21. This leaves a situation where the Reserve Bank's own review is saying one thing, but what seems to be the majority of external commentators are saying something different.

7.22. Federated Farmers isn't able to work out who is right. What we can tell is that a highly significant issue is emerging, and potentially severely impacting rural communities and the broader New Zealand economy. This is an opportunity for a Select Committee inquiry to speak to experts and get to the bottom of what is going on.

7.23. Note that all of the parties involved seem to agree that there is a problem, they just disagree on who is to blame.

Regulation of risk models

7.24. In addition to regulation of capital requirements, the Reserve Bank regulates the risk models used by commercial banks.[12] This seems to be where the intersection between the capital requirements and rural lending occurs: because these risk models deem rural lending to be high risk, greater capital is required for a farm loan than a home loan.

7.25. There is also an issue of competition here: if all the banks use similar risk models, then potentially, even if five different banks offer rural lending, they may all price an individual farm the same, meaning there is little real competition. For an analogy, consider the following: five different petrol stations offer the same uniform product, while there are five different options, they all use the same model to calculate the retail price of petrol, does the consumer have any real competition?

The emerging issue of greenhouse gas emissions

7.26. Ruminant livestock production is a significant source of global greenhouse gas emissions. The United Nations Food and Agriculture Organization (FAO), in its "The State of Food and Agriculture 2023" report notes also that livestock production has many important global benefits, including reducing poverty (SDG 1), reducing hunger (SDG 2) and improving health and well-being (SDG 3). These benefits need to be considered alongside environmental costs.[13]

7.27. The Reserve Bank 2022 Climate Change Risk Assessment for Agricultural Lending considered as a scenario a situation where the Government prices 100 per cent of agricultural emissions at a price of $150 per tonne. At such a level it was found that over 80 per cent of sheep and beef lending is unprofitable and over 40 per cent of dairy lending is unprofitable.[14] This scenario goes far beyond what has been ever previously considered by New Zealand's Parliament.

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[12] Banks are either accredited to use the RBNZ internal models-based (IRB) approach to calculate their capital requirements or must use the standardised approach. The effect of this may be that, even if there is more than one bank offering lending to a farm, all banks are required to use a regulated approach to assessing risk, reducing overall competition. See Reserve Bank "Capital requirements for banks in New Zealand" (1 July 2022) available at: https://www.rbnz.govt.nz/regulation-and-supervision/oversight-ofbanks/standards-and-requirements-for-banks/capital-requirements-for-banks-in-newzealand#:~:text=Under%20Basel%202%2C%20banks%20may,sometimes%20called%20'IRB%20banks'

[13] See UN FAO here: https://openknowledge.fao.org/items/ca815d26-c876-4d54-9e90-f34432442bf2

[14] See RBNZ analysis here: https://www.rbnz.govt.nz/-/media/project/sites/rbnz/files/publications/bulletins/2023/rbb-2023-86-07.pdf

7.28. There are different ways of interpreting such a finding. Federated Farmers would lean towards a view that, as such a policy would have a huge impact on the New Zealand economy, it is unlikely to be implemented, especially in such a raw and abrupt way.

7.29. The Reserve Bank, unfortunately, took a different approach. In March 2024 the Reserve Bank released its guidance for "Managing climate-related risks." In this guidance, banks are told to:

7.29.1. Consider setting climate-related exposure limits at sector level

7.29.2. Consider ruling out providing products altogether, such as mortgages, or loans to customers highly vulnerable to "transition risk"

7.29.3. Reflect the cost of additional risk through risk-based pricing measures

7.30. It is unclear to us if risk models have been adjusted to reflect the risk of a $150 emissions price with zero free allocation.

7.31. In our view, the Reserve Bank may be clumsily stepping into an area it seems to know little about:

7.31.1. As the FAO has pointed out, pastoral agriculture has many social, economic and health benefits that will be considered before any government prices agricultural emissions in such a harsh way.

7.31.2. The New Zealand Government has agency. It is unlikely to implement policies that place 80 per cent of sheep and beef farmers into negative profitability without any countervailing measures.

7.31.3. Greenhouse gas emissions are a global problem. New Zealand is unlikely to price agricultural emissions if there is no prospect others also will. In a world where multiple countries priced agricultural emissions, costs would increase, but, if trade competitors also priced emissions, the price received for agricultural products would also rise. The Reserve Bank modelling assumes farmers pay a levy, but their competitors do not (as it does not assume prices received rise). As New Zealand farmers are amongst the most emissions efficient in the world, if all countries priced emissions, our profitability may actually go up.

7.32. The Reserve Bank guidance for climate risk is a recent development and one an Inquiry should consider further. Much more care is needed by the Reserve Bank before it launches into such guidance.

Net Zero Banking Alliance

7.33. The United Nations Framework Convention on Climate Change 26th Conference of the Parties was held in Glasgow in 2021 (COP 26). At COP 26 the Glasgow Financial Alliance for Net Zero was launched. This included a 'Net Zero Banking Alliance', a 'Net-Zero Asset Owner Alliance', a 'Net-Zero Asset Mangers imitative', a 'Net-Zero Financial Service Providers Alliance", a 'Net-Zero Investment Consultants Initiative' and a 'Net Zero Export Credit Agencies Alliance'.

7.34. The power of the Glasgow Financial Alliance for Net Zero is clearly immense. With over 600 member firms covering banks, asset owners, financial service providers, etc, the alliance has the ability to direct the flow of money across huge areas of the world, including in

New Zealand. It may be observed that the policies of the Glasgow Financial Alliance will have more power and influence than some national Governments.

7.35. New Zealand's five major rural lenders are either members of the Net Zero Banking Alliance or are wholly owned by a parent company who is a member.

7.36. The initiative requires members to sign a 'Commitment Statement' that includes a commitment to:

7.36.1. Transition the operation and attributable greenhouse gas emissions from their lending and investment portfolios to align with pathways to net-zero by 2050 or sooner,

7.36.2. Within 18 months of joining, set targets for 2030 or sooner and a 2050 target, with intermediary targets to be set every 5 years from 2030 onwards,

7.36.3. Banks' first 2030 targets will focus on priority sectors where the bank can have the most significant impact, i.e. The most GHG-intensive sectors within their portfolios, with further sector targets to be set within 36 months.

7.37. Note that, for New Zealand banks, agricultural lending will be a sector with significant impact.

7.38. Westpac has set a target of a 10 per cent reduction in dairy emissions intensity by 2030 from a 2021 baseline, and a 9 per cent reduction in sheep and beef emissions intensity. BNZ has set an 11 per cent reduction target. Other banks are expected to follow (and are required to by their Net Zero Banking Alliance commitments).

7.39. Some on the Primary Production Committee may view the Net Zero Banking Alliance as a positive development, as greenhouse gas emissions reductions are a global priority. However, it is important to be cognisant of the potential negative sides of such an approach to greenhouse gas mitigation.

7.40. Companies in New Zealand will, and already are, developing their own individual strategies for reducing greenhouse gas emissions. This will be based off what the company believes is customers and suppliers expect it to do. This is happening already in the agricultural sector with dairy and meat processors adopting greenhouse gas mitigation targets.

7.41. The key difference with the Net-Zero Banking Alliance is that banks have collaborated and agreed a strategy *together.* This makes the commitment pre-competitive.

7.42. When such an approach is applied in any other area of competition between banks it is called collusion and is expressly disallowed.

7.43. The banks involved are all also foreign owned and effectively cooperating to take actions to effectively regulate the actions of New Zealand farmers.

7.44. From a farmer's perspective, rather than have access to a variety of bank strategies, they are faced with a situation where all banks will adopt the same mitigation strategy. This means they are forced to reduce emissions along the lines demanded by the bank, regardless of customer opinion or government policy.

7.45. From a national perspective, we have assumed that our greenhouse gas mitigation policies would be developed by Parliament, with a democratic mandate. The Net-Zero Banking Alliance risks a situation where policies are developed by overseas banks acting as pseudo-regulators.

7.46. Finally, while our focus is on the Net Zero Banking Alliance, the impact of the Net Zero Asset Owners Alliance and Net Zero Asset Managers Alliance may also be considered. These alliances include the funds that loan money to banks (and businesses), so can also have a pseudo regulatory impact if they agree to impose policy requirements.

7.47. In the United States, regulators have begun investigating whether commitments under the Glasgow Financial Alliance breach 'anti-trust' laws. S & P Global Market Intelligence reports that, since these investigations have begun, more than a dozen insurance companies have left the Net-Zero Insurance Alliance.[15] The Financial Times has reported that the EU has moved to relax its own anti-trust laws for companies that team up to combat climate change in response to similar concerns.[16]

7.48. Reuters reported in February of this year that JP Morgan Chase, State Street and Blackrock had removed their membership of a different group, 'Climate Action 100+'. Each of the companies cited concerns on the ability to act independently, while JP Morgan Chase said it was now building up it's own internal capabilities instead.[17]

7.49. The Primary Production Select Committee should consider if the actions of the Glasgow Financial Alliance, and membership by New Zealand's five rural lenders, is compliant with New Zealand competition law.

Commerce Commission guidelines on collaboration and sustainability

7.50. The Commerce Commission released guidelines on collaboration and sustainability in November 2023.[18] In this guidance the Commerce Commission noted that "Industry commitments to sustainability-related standards" "may impact competition".

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[15] See here: https://www.spglobal.com/marketintelligence/en/news-insights/latest-news-headlines/net-zero-alliances-jittery-as-gop-attorneys-general-play-antitrust-card-76075679

[16] See here: https://www.ft.com/content/97fbacfa-cc95-47ac-874e-75cb79ec6c7d

[17] See here: https://www.reuters.com/sustainability/sustainable-finance-reporting/jpmorgan-fund-arm-quits-climate-action-100-investor-group-2024-02-15/

[18] See here: https://comcom.govt.nz/__data/assets/pdf_file/0033/335985/Collaboration-and-Sustainability-Guidelines-30-November-2023.pdf

1. **APPENDIX 1: Stories and Testimonials of Rural Banking Experiences**

1.1. In preparing this submission we spoke to a number of farmers who had heartbreaking experiences with banks in recent years.

1.2. In this section are three stories about different farmers at various stages of their farming careers. These narratives each illustrate a personal example that represents a common financial challenge that farmers encounter today.

1.3. The challenges start with acquiring a farm and being unable to access their own capital. Secondly, to being put in distressed positions by banks where they are compelled to pay principal out of their overdraft while subdividing productive land. Thirdly, to being forced to sell their family farm despite high equity, because they couldn't get bridging finance to pay a tax bill.

**For privacy reasons, all names have been changed in this section*

Case Study one: A first time farm buyer

1.4. Sally's* experience as a young sharemilker in New Zealand represents the financial challenges and disparities facing the rural community, with significant relevance in the context of the Rural Banking Inquiry. Her journey and advocacy efforts underscore the urgent need for to support economic equality and sustainable growth within the agricultural sector.

1.5. Her story below is the result of an interview, which shows her very real situation. She has done all the right things, built up her capital, but has been unable to access it due to regulatory difficulties.

Current financial situation

1.6. Sally is in her early 30s. She has saved through her working life and accumulated a substantial KiwiSaver fund. Her vision of retirement is one where she and her partner own their own farm and can shift from farm owner-operator to farm owner with a contract milker or sharemilker.

1.7. After working on a variety of farms for a number of years, she is ready to commit to the industry by investing in her own farming enterprise. For a young dairy farmer, the main options are to become an equity manager or a share milker. Note, an equity manager refers to a farm manager who also owns an equity stake (typically from 5 to 50 per cent of a farm) and receives a share of profit. A share milker refers to a farm manager who owns a herd of cows. Under a share farming arrangement, the herd owner will agree with the farm property owner mechanisms for how income and expenses are shared.

1.8. Most of Sally's savings are however tied up in KiwiSaver. She is unable to access this money. This results in this next step on the farming ladder being deferred and, when it arrives, Sally needing to take on a larger loan than she otherwise would. Sally is forced to finance her investment with a large loan rather than the equity she has built up.

Implications for the Rural Banking Inquiry

1.9. Sally's story is a stark reminder of the critical need for financial systems that support rather than hinder the next generation of farmers. Government needs to remember that now

all Kiwis wish to retire simply with a large stockpile of NZX shares, for many, retirement dreams are about owning a productive small business. By aligning KiwiSaver and other financial policies with the demands of farming, the government can both support farmers and boost investment in New Zealand's primary sector.

Case Study 2: A rural Chartered Accountant steps into farming

1.10. This case study is an increasingly common story of the resilience and frustration felt by Kiwi farmers. Where a rural Chartered Accountant, deeply knowledgeable in finance, becomes the victim of banking mismanagement. This includes a revolving door of relationship managers, a disregard for her equity position or compliance risks, and poor communication leading them into credit management. Shockingly, the bank compels her to pay back principal using an overdraft facility. In short, this is the typical service farmers are facing in their banking experience today.

1.11. The amount of pressure being exerted on farmers is excessive. Fewer and fewer bankers understand the rural sector, or even pretend to care. It's frustrating beyond belief and crippling for many farmers mental health. They are farming the land, making plans, doing all the right things, and yet, at every juncture, the tightening of the screws by the banks, and lack of care is driving farms out of business.

1.12. The account below is in this farmers words, what you can't tell is just how harrowing and challenging this has been for her and her family, who were being punished while doing all the right things.

Starting the farm: My husband and I initiated an equity partnership to purchase a $6 million farm, with a $2 million deposit. Our equity position has always been strong.

Bank arrangement and milk pricing: We set up a financial plan with the bank, this included a six-year plan to buy Fonterra shares (allowing the sale of milk solids), it outlined purchasing a third of shares needed in each of years 4, 5 and 6 of operation.

Risk mitigated: We owned 200 cows and leased another 275 for a total of 475. We opted to lock in a fixed milk price to protect against market volatility. Therefore, we were not heavily affected in the dairy downturn and did not require additional bank support over the first three years.

Financial milestones and bank resistance: By the sixth year, despite having achieved all set milestones, we faced a major hurdle with the bank. They now refused to lend more money for the purchase of the final tranche of Fonterra shares - despite this being in the plan all along. The bank suggested we "renegotiate with Fonterra," which was not possible. The shares were needed to supply as per our contract.

An opportunity to increase revenue: In year 5, an opportunity arose to lease a runoff, requiring $250,000 in additional working capital over 5 years to initially increase livestock numbers. After receiving verbal approval from the bank manager, delays ensued.

Verbal assurance: Upon contacting the bank manager to express urgency in signing the lease before the offer expired, we were given assurance funding would be approved. Despite reservations about committing without confirmed funding, we accepted the verbal reassurances, prompting us to sign the lease.

The first overdraft created: After 9 weeks of no communication, it was revealed that funding was declined at credit. As an alternative, the bank offered us a $250k overdraft facility instead – an expensive option. This decision led to ongoing profitability challenges. We acknowledge the mistake of signing without written confirmation, however explicit assurances were given. This marked the first instance of needing an overdraft. This subsequently became a burden due to the bank continuously loading term debt onto it.

Interest rate challenges: With the expiration of the fixed rate terms, the bank labelled our position as "stressed" and declined to offer new fixed rates stating this would need to be subject to review with credit, pushing us into expensive floating rates. We were told we were considered stressed as we could not pay off entire principle on the farm over a 15-year term.

Increased costs and reduced profits: Transitioning to floating rates significantly impacted our profitability due to higher interest cost. It was also against our initial shareholder agreement to hedge by having loans rolling off at various times.

Compliance and operational needs: The farm needed a new effluent system, which was flagged with the bank on purchase of the farm. The bank declined additional funding, which was crucial for maintaining regulatory compliance and operational functionality.

Risk of non-compliance: Without funding for Fonterra shares and the effluent system, the farm risked falling out of compliance, threatening its operational viability and income generation.

Mortgage broker and credit management: We retained the services of a rural mortgage broker at our cost. At this stage we had 2 bank managers leave, our usual bank contact on maternity leave. It was at this stage we were told we had been transferred to credit management in Auckland some 6 months prior – this was never communicated to us and nor could the bank answer why this had happened.

Partial solution through sustainability loan: Through significant fighting, and a rural banking advocate, we managed to secure a partial term loan for the shares and the balance being put on the overdraft. For the effluent system, this was funded by a 'Green loan' that partially covered the cost of the new effluent system at which stage we were able to refinance some of the overdraft onto this, the balance being put on a 2nd tier financing solution with Heartland Finance.

Ultimatum from the bank: The bank imposed a condition that they could not receive further loans unless we listed the farm for sale. This was considered an "out of the box" solution to "get around" credit – which seems bank policy from higher up the chain was hamstringing farms.

Overdraft to pay principal: The bank also pressured us to use their overdraft facility to pay down the principal on their fixed-term loan, an unusual and financially risky practice.

Interest rate rises: the rates started at 7.83% in January climbing to 9.13% by May 2023. Transparency on overdraft interest rates is minimal however we calculated them at 11% plus.

Overdraft extension vs. fixed rate loan: The bank chose to extend their overdraft instead of providing a more stable fixed rate loan, which would have addressed many of their financial challenges.

Financial position: Total equity 2.7 million (37.5%). Total debt with bank 4.5 million (62.5%). History of monthly reporting to the bank, proactive communication, and cost control.

Key Issues in this story study:

1. **Frequent changes in bank management**: The revolving door of bank managers contributed to inconsistent handling of their case.
2. **Achievement ignored**: Despite meeting every milestone, they were repeatedly denied further assistance.
3. **Risky financial demands**: The bank's insistence on using overdrafts for principal payments and the refusal to provide fixed rates placed undue pressure on the farm's finances.
4. **Threat to farm's integrity**: They were compelled to consider subdividing their productive farm into housing to meet financial obligations.
5. **Regulatory compliance risk**: The bank's lending decisions nearly pushed the farm out of Fonterra compliance, which would have halted their operations.
6. **Strong financial standing ignored**: Despite a solid equity position in the farm and a low risk profile, the bank's stringent policies overlooked the farm's financial health.

Case Study 3 – Waikato farming couple nearing retirement

Background

We are a couple dairy farming in the Waikato. My husband is now early 70s and I am almost 70. Around five years ago we were farming around 450 cows, over 140 hectares and producing around 150,000 kilograms of milk solids. On top of this, I was earning a second income as I worked full time in town. Our farm is now sold, and takeover date is June 1st this year.

Financial Situation

Around 15-20 years ago we had gotten into a position of having low debt. At this time, we were farming around 90 hectares and 300 cows. The advice from the bank at the time was we should be looking to invest and leverage our equity. We made some offers on second farms but were unsuccessful. In the end we purchased an equity share in a second farm and also purchased a smaller neighbouring farm to increase out total hectares on the home farm to around 140 hectares.

Around 2019 we sold the equity share at a loss to reduce our debt. During this period, we also invested around $400,000 in upgrading our effluent systems and pond to 90 days of storage. With the purchase of the neighbouring farm, and associated increase in cows and increase in total effluent, there was further upgrades that needed to be done to be compliant with regional council rules, we were told, and we had this quoted at around $200,000.

Further important context

It may also be important to note that, as we were in our early 60s and had managed to build up some wealth, we had decided we wanted to enjoy some of this wealth while we still could. We had a period of time where our drawings were high as we did some overseas trips and

spent money renovating the house. On paper however, I was of the view we were still very wealthy by most people's standards.

A second thing to note for context is that my husband has suffered from mental health challenges in the past. From 2010 to 2020 he had (separately) knee, shoulder and hip surgery. These injuries can be put down to milking cows every day: walking on concrete in gumboots and calving cows. He spent a lot of time in pain and unable to do physical work. My husband was treated for depression during this period.

First signs of trouble

The upgrading of the effluent pond was the first sign of challenges with the bank. We were declined the finance from the bank so put this investment off for as long as we could.

During the seasons 2020 - 2022 we had droughts. We incurred higher feed bills annually of around $70,000 – Palm Kernal appears to have doubled in price from 2021 to 2023 according to our accounts.

Note that for dairy farming milk cheques come in progressively with most money coming in during the tail of the season, and some not until the next season. We knew the coming milk cheques would cover this cost but needed seasonal capital to pay this bill. We were declined an increase in our short-term finance (current or working account).

At this time we were upgraded to a new bank manager who dealt with distressed clients. We were aware also that our interest rate seemed to be rising and, after checking with friends, it was clear we were being forced to pay higher interest rates.

Facing the stress of not being able to pay for feed and potentially wages, my husband's depression returned. We decided that maybe it was time to sell. It was now early 2020 and Covid arrived.

We didn't receive any good offers for the entire farm, so we kept farming. We were able to sell around one third with June 2020 takeover, and this reduced both operating pressure and financial pressure.

In 2020-21 we actually made a good profit with low interest rates and moderate pay-outs.

During this time we had $600,000 limit on our general overdraft. This wasn't being utilised as we had a high profit. The bank contacted us to say that as we weren't utilising the full amount they would reduce this down to $300,000. I tried to explain to the bank at the time that we would need this money again in the future for feed and tax.

The amount was reduced anyway.

While we made good profit in 2021, this came with a high tax bill that wasn't due until mid-2023. By the time we got to 2023, interest rates were rising and our profit had fallen, but the tax bill was due. We now didn't have enough money to pay our tax bill and other unexpected farm costs.

This turned into a massive drama with numerous calls and visits with the bank representatives to convince them to relend us money to pay a $90,000 tax bill. We now had to complete new paperwork for an overdraft increase back to $400,000 and pay the costs to get back part of a facility that we previously had.

This was highly stressful time as once again we faced the prospect of not being able to pay bills. We did eventually get this money from the bank, but the stress of this process was immense.

We have now sold the farm completely with takeover date of June 1st this year. We calculate with all assets liquidated and confirmed land & stock sale prices we will now have over $5 million in cash.

Since the partial sale in 2020 we were over 60 percent equity.

It is strange to us that for five years we have been viewed by the bank as a distressed lender despite making profit during this time and now, following sale, have $5 million equity.

There is some irony here for us as we are now struggling to work out what to do with this money. With high inflation, putting it in the bank will mean, after tax, we may lose money (as the interest after tax will be lower than the rate of inflation).

Some suggest we should put our money in housing to inflation proof it. This seems like a poor commentary on the countries situation where farming has become very hard and housing is considered the way to go.

2. APPENDIX 2: LETTER TO THE COMMITTEE FROM MICHAEL SMITH, A RURAL BANK MANAGER FOR 35 YEARS.

Michael Smith
467b Omokoroa Road
RD2, Tauranga 3172

Primary Production Committee
2 May 2024

Dear Committee Members
Re: Letter in support of Federated Farmers Submission to the Primary Production Committee briefing on Rural Bank Lending.

My name is Michael Smith.

I graduated from Massey University with a Degree in Agriculture in 1984.

I am a Senior Member of the Property Institute of New Zealand, Registered Valuer, Director & Trustee of several New Zealand farming operations and an Agribusiness Consultant.

I started my Rural Banking career in 1985 with 7 years in the Rural Banking and Finance Corporation NZ including 3 years as a Branch Manager.

I then completed 30 years with 2 major banks in New Zealand in various Rural Banking roles including Rural Manager, Area Manager, 5 years as Manager Operations Rural Banking.

I resigned from my last rural banking role in February 2023.

The fundamentals around banking and lending to farmers hasn't changed in those 37 years – with lending decisions based mainly on *personal factor, viability, security, and risk.*

What has changed is the complexity and pressure imposed on the banks farming clients by the Reserve Bank of NZ and various regulators, impacted further by the adoption of wokeness and the overall perception of farmers regarding the environment, climate change, etc. I believe this perception then consciously and sub-consciously has an influence on bank willingness to support farmers.

My thoughts and comments below…

The Financial Markets Authority, Reserve Bank of New Zealand, and other regulators have over the past 10 years introduced more control, rules & regulation directly affecting banks farming clients, including the following ….

- Regulators advised the banks that there was too much rural debt. Part of the solution was to push rural lenders to focus on "rural resilience" – debt reduction pushed on farmers.
- Rural debt and dairy debt limits put in place - e.g. dairy debt limited to 10% of total bank exposure - some banks actively pushing big clients to change banks - criteria tightens, lending gets more difficult.
- Pressure was applied to banks to have more clients paying principal – imposed on farmers regardless of debt level and very few exceptions.
- Rural bankers regularly complete client budgets based on bank criteria as part of the credit assessment process. Any budgeted status quo losses are capitalised (in the system)

into "debt overhang" - rural managers told reduce it by any means - sell Fonterra shares, sell other investments, sell the farm, etc. This put a lot of pressure on farming clients and bank staff, particularly when many clients had recent lending and now told to pay it back. In my last banking role 10% of my farming clients were seriously depressed – largely caused by banks applying unnecessary pressure. Experienced rural managers under pressure and protecting clients from some of the bank requirements. Inexperienced managers do what they are told.

- Regulators & woke thinking pushed banks to remove sales targets due to concerns of potential unethical selling. Staff bonuses were removed or rolled into salaries - performance and service levels crashed - just decline it is easy with no consequence.
- CCCFA & Covid made it more difficult to change banks. Banks had a more captive client base - banks client margins & fees increased.
- Banks closed branches & reduced operating hours - mainly in rural areas. Banks used the opportunity to reduce costs by cutting front line staff and services.
- Significant training put on bank staff around CCCFA, not giving advice, recording discussions, etc. Serious consequences for staff & banks if they go outside the rules & regulations. Easier to decline lending if it fell within CCCFA.
- Banks have minimum capital requirements increased by RBNZ to approx. 14% weighted capital. Rural Banking is perceived to be higher risk (APRA & Basel III regulations) than housing therefore has higher capital requirement. Rural Banking is now competing internally for capital with banks prioritising capital to the best returns e.g. housing 22%, Commercial 17%, Rural 10% ROC. Why give it to rural banking?
- Rural Banking now has set ROC targets to achieve set by bank executive e.g. 20% ROC Target. Lift margins or move on. Higher margin is less farmer profit, Credit Rating worsens, higher margins required again. Real stress on farmers and rural lending staff.
- Rural clients with rural facilities over $1m are reviewed in detail each year - valuation of assets updated, accounts analysed, budgets done next 1-2 years & Status Quo. SQ budget deficit is unacceptable. A Credit Rating is assessed based on agreed criteria including net profit last 3 years, next year budget, SQ Budget, Equity, LVR, Interest cover, Personal Factor, Management, Risks, etc. The Credit Rating determines capital & provisioning required. Also determines the interest margin to be applied. Profitability models are then completed to see if the farming business reaches required target ROC. The annual review process dictates the discussion & requirement put back on the client - Credit rating, principal reduction required, reduce debt overhang, margin & interest rate increase, overall strategy. A poor credit rating or a review with a SQ Budget deficit is not acceptable. The pressure applied to farmers to satisfy the bank in many cases (in my opinion) is/was unnecessary and unethical.

Banks are driven & monitored to meet the requirements of the Regulators. Many of the rules & regulations are excessive, unnecessary and negatively impacting on banks farming clients.
I feel an inquiry into Rural Banking is required to help support and protect our most valuable resource in New Zealand.

What needs to be achieved from a Rural Banking Inquiry - in my opinion include…

- Increase competition between rural lenders by relaxing overreach and unnecessary banking regulations, giving more control back to banks.
- Provide farmers with more flexibility around their own secured banking assets – giving some control back the farmers.
- Reduce unnecessary financial pressure on farmers by changing requirements specifically of "Risk Rated" clients.

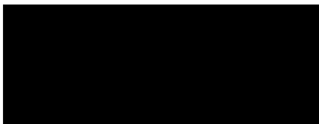
Solutions: RBNZ & regulatory authorities ….

- Allow reverse lending (increased lending with a SQ Deficit) for strong LVRs e.g. less than 40% - reduces financial pressure on farmers, makes them instantly bankable - increased competition, reduced rates.

- Reduce requirement for strong LVR farming clients to be paying principal. Allow interest only on term loans, at clients request, as of right when below 50% LVR. Some banks will argue they are doing this – although from experience doesn't happen.

- Change the weighting of the client credit rating analysis - e.g. change to majority weighting (75%) on LVR & equity and less weighting (25%) on historical / budgeted net profit.

- Change policy for farmers under $5m facilities and less than 50% LVR to be classified as non-risk rated - no annual reviews, no pressure on farmers, reduced bank costs, increased bank competition.

 **Valuer.**

Disclaimer:
These notes and comments are entirely the opinion of the writer from personal experience of more than 35 years Rural Banking.
These comments are generalised and not specific to any particular bank.

ENDS