Cultivating Good Citrus Loan Relationships

by J. Collins Hewes

The Florida citrus industry has undergone significant transition and declining land values since 1990 because world demand has failed to keep pace with increasing production, thus causing lower fruit prices. As a result, some growers are facing trying economic times. Lenders who make land, capital and/or operating loans to citrus grove enterprises should closely monitor these properties to avoid a loan default.

But they needn't go it alone. A management or consulting firm can help head off grove problems by periodically assessing an operation to look for signs of grove decline. If a default situation should occur, a consultant can provide grove care consistent with the owner's goals. If handled properly, the property can be operated in a manner that maximizes its resale potential.

The Big Picture

Let's begin with an overview of Florida's citrus industry – both oranges and grapefruit. The state's primary citrus-growing regions are the Indian River area, the central ridge and the southwest flatwoods. Three major freeze events during the 1980s caused a major shift in acreage from the nor-thern ridge to the southwest flatwoods. Because new citrus plantings begin to reach peak production around age 10, trees planted after the December 1989 freeze are now about 8 years old and are providing high yields. The new plantings have mostly been made using better technology and infrastructure. As a result, Florida achieved record citrus production of 244 million boxes of oranges and 49.5 million boxes of grapefruit in the 1997-98 season.

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Florida ranks second in world orange juice production – behind Brazil. Production in both regions has steadily increased, although Brazil is expecting a decline in yields this season.

World demand for orange juice has grown, especially in Europe, but demand/movement has not kept pace with production during the past two years. The result has been an overall decrease in fruit prices. Orange juice prices bottomed out at 65 cents per pound solid in the fall of 1997 but have since increased to $1.00 to $1.20 because of Brazil's decreased yield projections. Depending on production levels, operating efficiency and debt service, most Florida orange growers want at least $1.00 per pound solid. For the past few seasons, orange growers have held their own, but most have not generated the returns they desire.

Florida is the world's dominant grapefruit producer. Red and white grapefruit are intended for fresh consumption, but the overage and packing house "eliminations" are processed for juice.

Grapefruit was very profitable in the 1980s, resulting in overplanting in the 1990s. Current grapefruit supplies are well beyond what the market is absorbing, despite good export markets to Japan and Europe. The result is lower prices/returns.

Grapefruit growers have been in a difficult situation for the past couple of years, with most just breaking even or posting negative returns. The typical grapefruit grower also has oranges, which have helped carry the financial burden.

How have increased production and lower prices affected grove real estate values? Since 1989-90, there's been a decrease of 50 percent in ***average*** orange grove values and a 60 percent decrease in grapefruit grove values. Groves with the ability to generate decent annual returns have held their values pretty well, while groves with negative returns are in poor demand.

In a nutshell, the operations that have weathered the storm well are those with high production, desirable varieties and low operating costs.

Signs of a Failing Operation

Besides the obvious financial indicators such as delinquent payments, lenders need to be aware of key operational and horticultural signs on grove properties. A management or consulting firm has experts who can explore these issues in-depth.

• *Variety mix.* Some varieties have become obsolete because of narrow marketing windows caused by competitive fruit. For example, the Robinson and Dancy tangerines have very narrow marketing windows because of superior Florida tangerine varieties and fruit produced in California during the same time frame. Grapefruit returns are currently very low. For processed oranges, most processors prefer a 50/50 or at least a 60/40 split between Early Mids and Valencias. A grower with strictly Early oranges can be at a marketing disadvantage in times of oversupply.

• *Rootstocks.* Each rootstock has advantages and weaknesses. For example, Sour Orange, one of the dominant rootstocks used for the past 40 years, is very susceptible to the Tristeza virus, which kills the tree.

• *High attrition.* A normal grove can lose 1 percent to 3 percent of its trees annually. Greater attrition re-

quires an aggressive reset program and diligent young tree care if a grove is to maintain long-term production levels. This can sometimes be expensive, but it is necessary to maintain the value of the grove asset.

• *Irrigation.* Microjet is the delivery system of choice for most growers, unless water salinity is a concern, thus requiring drip irrigation. Irrigation is valuable for increased production, long-term tree health, cold protection and growth of young trees. The quality/dependability of water source, condition of pumps, power units, filtration systems, irrigation lines and emitters are all important. A trained eye can recognize areas of concern that may cause problems. Preventive maintenance needs to be completed prior to the time a grower depends on the system.

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• *Drainage.* Good drainage is critical, especially in regions outside the central ridge. The drainage system needs to complement soil types and grove conditions. For bedded groves, swale (row) lengths of 1,320 feet work fine in some soil types, but row lengths should be reduced to 660 feet or less in heavy soils with poor internal percolation. Ditches and the pumping/reservoir system need to be kept in functional condition.

• *Equipment.* The condition of farming equipment is always important. However, it is common for citrus growers to custom hire most or all of their work through grove caretakers or custom contractors. Some caretakers are better than others, so lenders should be aware of how a grove is being operated. Efficiency and effective application are important when growers are trying to minimize trips across the grove. Employing modern technology such as "seeing eyes" can reduce herbicide/spray material costs by 30 percent or more.

• *Management.* In addition to handling the daily requirements of a grove, a long-term horticultural plan needs to be implemented, using best management practices and cost-conscious planning. A good horticulturist always looks three to five years into the future when making grove decisions.

• *Crop marketing.* How is the grower positioned to market his crop? Are there long-term contracts, cooperative memberships or packing house relationships which maximize the returns? Cash sales, seasonal pools and basis futures contracts are all viable alternatives, depending on market conditions.

Dealing with a Default

Lenders should consider several factors when a default occurs. Because the grove is a permanent crop, be sure to quickly assess the condition of the asset. The key parts of the asset are: 1) the land and improvements such as buildings and irrigation; 2) the trees themselves; 3) the fruit crop; and 4) farming equipment, if included in the security. A good management firm can have a grove operation up and running in a short time by using cost-effective custom contractors, so the presence of on-site labor or farming

equipment is not a necessity.

Typically, production and/or harvest work is under way on a grove. Hopefully the borrower relationship is workable enough to continue the operation until a transition can be achieved. However, sometimes immediate management assistance is needed to ensure preservation of the asset and a smooth transition of grove management.

The first step is to inspect the grove and assess the status of crop harvest, tree condition and ongoing horticultural activities. Depending on the varieties present, Florida's citrus harvest can extend from October through June, so harvesting can extend over nine months. Determine if the grower has a good market for the fruit, has scheduled daily harvests adequate to complete the variety in a timely manner and if the returns are appropriate. Is a harvest crew arranged and is the cost reasonable? Does the fruit buyer know where to send the proceeds? Many times fruit is entered into seasonal marketing pools. These pools sometimes can take almost two years to fully pay out. Who gets the proceeds from prior crops – the borrower or the lender?

Situations such as a freeze event, heavy rainfall and insect infestation can have a major effect on a grove. An experienced management professional can assess these risks and their seasonal likelihood and place priority in establishing a plan to address the critical grove management issues. Left untended, any of these events could have a major effect on the value of the asset. The key for lenders is to get a handle on the situation as early as possible. For example, if it is Dec. 1 and the microjet system is in poor condition, the lender needs competent assistance to evaluate how to economically mitigate its freeze risk.

Fresh fruit horticultural programs are very time-sensitive, especially during the spring and summer months. The programs need to evaluated and carried to completion, unless the variety or fruit load indicates that it would not be cost-effective.

Irrigation and drainage permits are required by the state of Florida. Their presence, status, expiration/renewal and reporting requirements need to be assessed. If a change of ownership occurs, the permit needs to be placed in the new owner's name.

Once the critical management areas have been addressed, the lender needs to have a cost-effective operating plan for the grove. Management services, cost of material/applications and crop marketing strategy are all critical components of grove profitability.

Some long-term decisions need to be made. If there are areas with rapid tree decline or unprofitable varieties, the lender may be well-served to address these issues in order to maximize the real estate sale potential of the property. Resale potential normally relates directly to the expected financial performance of the grove during the next five to 10 years.

Variety, increasing vs. declining production and operational efficiency are all important aspects contributing to the desirability of a grove to an investor. A knowledgeable grove management company can address the problems and opportunities and can provide good advice and implement a management plan. jal