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Hayne's final report

Of droughts and flooding rains: Hayne's final report and lending to agricultural enterprises

Twenty-one per cent of the public submissions to the Hayne Royal Commission relating to agricultural lending raised concerns about practices involving the valuation of agricultural land and enforcement action taken following default. Two of the key themes raised in submissions included banks inflating the value of agricultural land (often using internal valuations) to facilitate the approval of loans and banks revaluing agricultural land at substantially lower values, resulting in a breach of loan-to-value (LVR) ratios.

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In his final report, Commissioner Hayne recommended a number of reforms dealing with these concerns, including enacting a national farm debt mediation scheme, revising the Banking Code to require that default interest cannot be charged in areas declared to be affected by drought or other natural disaster, as well as widening the definition of 'small business' to cover more agricultural enterprises.

Commissioner Hayne also made a number of recommendations concerning the valuation of agricultural land for lending purposes and the amendment of APRA's Prudential Standard APS 220, which requires authorised deposit-taking institutions (ADIs), including the 4 major banks, to control credit risk by adopting prudent credit risk management policies and procedures. These recommendations could significantly limit lending to agricultural enterprises.

In particular, Commissioner Hayne recommended that APS 220 be amended to mandate independent valuers to value agricultural land and to require ADIs to instruct those independent valuers to take into account the likelihood of external events (including, but not limited to, fire, drought and flood) affecting the land's realisable value, as well as the time needed to achieve that realisable value.

Commissioner Hayne's recommendation concerning the likelihood of external events affecting realisable value is not a concept that sits easily with accepted valuation practice, as it requires the valuer to take into account an uncertainty inherent in the land, being the likelihood of occurrence of unspecified natural disasters and how those external events could affect the realisable value of the land in the future.

This is likely to result in prudent valuers and appraisers discounting the value of agricultural land which could be affected by fire, drought and flood or other severe weather events across our sunburnt country by a risk premium reflecting the likelihood of those natural disasters in that area.

A consequence, unintended or not, may be that resulting lower values will have a significant impact on the amount of credit being offered to agricultural enterprises and in fact increase breaches of LVR ratios.

For more analysis on the banking royal commission, read 'Hayne's final report: The fundamental importance of leadership, governance & culture'.