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AGRICULTURAL CREDIT: LEGISLATIVE CONCERNS AND CONSTRAINTS

A Position Statement for the Governor's Commission on Agriculture

by

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SITUATION

Ohio farm families are experiencing a degree of economic distress that some say is reminicent of the "depression era." The situation, although serious, does not approach the catostrophic failure rate of the 1930s. Surfacing from this concern is the judgement that somehow creditors are not sympathetic enough to farmers who are experiencing difficulty paying principal and interest that are due. Concern is expressed that interest rates are too high and that credit institutions have changed the "rules of the game" by not renewing loans, not extending loan repayment periods, not granting "needed" operating loans, changing from asset-based to cash-flow lending, and encouraging farmers to liquidate assets to reduce debt and/or enable them to make loan payments. This concern is heightened by the increase in, and public awareness of, farm foreclosures and bankruptcies.

Arising out of this expressed concern about the "less than sympathetic lender" comes the political request and desire to do something in the legislative arena to alleviate the perceived problem. Thus, "Foreclosure Moratorium," "Aggie Bonds," and "Family Farm Assistance" bills are introduced to legislate solutions to problems resulting from factors largely beyond the control and purview of state government.

PROBLEM

The problem is not "unsympathetic lenders that are changing the rules of the game and charging interest rates that are too high." The problem is more fundamental--the economic climate, agricultural and non-agricultural, has changed. This change has resulted in some farmers perceiving lenders as the cause of their financial strife. Lenders have not changed the rules. The elements of successful lending continue, as they have been, to be--security, profitability, and repayment capability. The changing economic climate has resulted in eroded security, reduced profitability, and a reduced ability to repay debt, on the part of most if not all farmers. The "changing rules," as perceived by some farmers, legislators, and public, are simply a matter of lenders and borrowers adjusting to the new economic realities. For certain, all of what some people are perceiving as rule changes has happened, but the rules did not change. The economic performance of the farm business, current and expected, has changed, resulting in the need for precedent adjustment in agricultural credit--supply and use.

LEGISLATIVE RESPONSE

Given that the agricultural economy, not the lending institutions, is the cause of economic stress farmers are experiencing--what is Ohio's legislative responsibility and capability to deal effectively with the problem? The depressed and adjusting agricultural sector is controlled by factors over which the Ohio legislative body has no control. As such, it is difficult to envision what, if anything, the Ohio legislature can or should be doing to "solve" the problem or "cushion" its impact.

The state government has the responsibility for assuring that the legal, economic, and social infrastructure exists and is maintained that will permit and encourage lenders to supply adequate loanable funds to the agricultural sector. It also has the responsibility to ensure that those who do lend money to farmers have proper and due recourse if loan terms are not adhered to by borrowers; likewise for borrowers in the event lenders do not fulfill their obligation.

The recent action of the Ohio legislature spear-headed by the Ohio Farm Bureau, to permit farmers access to lower interest rate funds supplied through the tax-exempt Industrial Revenue Bonding process (i.e. Aggie Bonds) is a good example of what can and should be done. The legislature acted in prudent fashion to increase the supply of loanable funds to farmers at a reduced interest rate. Other actions under development for presentation to the legislature or under consideration by the body are less favorable. These would include the proposed "Family Farm Assistance Program" and the "Foreclosure Moratorium."

Although the proposed "Assistance" program has lofty goals it appears to be duplicating the efforts of a long-established federal program that is administered by the Farmers Home Administration (FmHA) for beginning, limited resources, and financially distressed farmers. Such a program at the state level, operated with state funds, cannot expect to have a better performance (repayment) record than FmHA has had. To use state tax dollars in this manner would be unconscionable. FmHA has direct loans and guarantee loan programs for ownership and operating funds and special programs for emergencies and beginning limited resource farmers. It is correct to say that FmHA rarely has enough capacity (supply of money or guarantees) to meet the demand from Ohio's agricultural community. The proposed "Assistance Program" would increase the supply of funds for such purposes. The decision rests on the cost to Ohio taxpayers--administrative, monitoring, delinquencies, and "write-offs." The costs will be very high in all categories. There is little reason, beyond that of political pacifism, for the state of Ohio to proceed with such a program.

House Bill 61 (foreclosure moratorium) is sensitive politically and economically. Just as farmers need seed, fertilizer, livestock feed, and good weather, farmers need capital. It is, therefore, a mistake to approach the relationship of farmers and agricultural lenders as necessarily adversarial. The relationship is really symbiotic, with each side providing a necessary service to the other. The lender provides the farmer with the necessary capital to farm and to maintain the farm, and often his household, until a crop is sold. The farmer provides the lender with a market for the lender's "product" --money.

However, the farmer has a limited number of sources to obtain his necessary capital, while many lenders have a diversity of choices of outlets for marketing their product. Banks, thrift institutions and insurance companies always have the option to divert available funds to commercial, industrial, and residential borrowers if the farm lending climate entails a higher risk of loss for a comparable return on their investments.

The Farm Credit agencies, Production Credit and Federal Land Bank Associations, enjoy an even more symbiotic relationship with the agriculture industry. While these institutions lack the ability to divert funds to other uses, the sheer availablity and cost of funds to these agencies depend on the financial health of their farm clients. If farmers default on loans to these institutions and the institutions cannot cover their losses by collecting on their collateral, the institutions in turn have less money to lend and losses to their investors which must be compensated for by higher interest rates to farmers on future loans. The same is true for other lenders.

Farmers and the public officials who serve them ignore these basic financial realities at their peril. Blaming the financial institutions for the problems created for farmers by climate, market and inflation in recent years is pointless demagoguery. State imposition of protective measures such as moratoriums on farm foreclosures may be politically popular in the short run but is guaranteed to have an adverse impact on availability and cost of farm credit in the long run. It is a simple fact that lenders who see a potential for protracted delay in realizing on farm collateral in default situations will protect themselves from the resulting potential loss by charging farmers compensatingly higher interest rates in making loans. This assumes that farm loans will be made in that state at all. It is also a fact in the lending industry that in states with strict protectionist legislation for farmers, such as Minnesota where farmers have a one-year redemption period following foreclosure sales, lenders with the option of diversifying their market will choose to make no or few farm loans. This, of course, impacts on the demand for funds upon other sources, with a corresponding effect upon cost to farm borrowers. Savings and loan companies, with the recent deregulation of the financial markets, are wanting to expand their portfolios to agriculture. Passage of a "moratorium" bill will diminish this interest and reduce funds available to farmers.

Furthermore, state action is unnecessary to protect farmers whose situations can be salvaged given time to work out difficulties. The Federal Bankruptcy Code's Chapter 11 reorganization proceeding provides a mechanism for farmers to buy time and freedom from creditor harrassment while they seek alternative remedies for their problems. The farmer is already most generously protected under the Federal bankruptcy laws; a Chapter 11 instituted by a farmer, unlike Chapter 11's instituted by most other classes of debtors, cannot be converted upon creditors' motion to a Chapter 7 liquidation. Only if the Bankruptcy Court determines that a reorganization of a farmer cannot be affected, that a farmer's situation is so bleak that it cannot be salvaged, can a farmer be removed from the protection of the Bankruptcy Court.

Devices such a moratoriums or protracted redemption periods are arbitrary and shield both good and bad farmers across the board to the detriment of creditors and the individuals who are investors in those creditors. The Federal Bankruptcy Court examines each situation on an ad hoc basis and tailors the remedy accordingly. With this protection available to farmers who can be saved, it is hard to see what further protection is necessary or beneficial fram state intervention.

The results from a recent (July 1984) survey of Ohio farmers will shed some light on how they feel about such a moratorium. The 426 farmers responding to the survey were a mix of crop, dairy, and livestock operators. Below are some statements characterizing the respondents:

1. Farmed an average of 372 acres.
2. 76% farmed less than 500 acres.
3. 49% had $40,000 or less gross sales.
4. 74% had less than $100,000 gross sales.
5. 41% reported zero debt.
6. 25% reported a 1-25% debt/asset ratio.
7. 14% reported a debt/asset ratio greater than 50%.

This group is representative of Ohio's family farm businesses. In the context of this discussion concerning the moratorium bill it is important to note their response to the following question, "What credit policy should it (FmHA) follow with present borrowers?" It is reasonable to extrapolate their response to other agricultural creditors. Their response:

50% - Continue to present policy of not foreclosing unless all repayment efforts have failed.

14% - Provide a moratorium on all foreclosures to keep distressed borrowers operating until the economy improves.

9% - Provide a moratorium on foreclosures only for selected young "deserving" farmers.

21% - Set a stricter policy on delinquent loans and increase the number of foreclosures.

5% - Other.

These respondents, in general (71%), favored continuation of present or stricter policies regarding foreclosures. Only 14% were in favor of a general moratorium on foreclosures.

RECOMMENDATION

The Ohio legislature should not create a "Family Farm Assistance Program." The primary objection to such a program is cost, expected poor performance of borrowers, and duplication of FmHA efforts. The Ohio legislature should not pass a "Moratorium on Foreclosures" bill. The primary objections here are: (1) It is not needed because the current bankruptcy laws (Chapter 11) are already operative to provide a means for protecting borrowers during period of reorganization; (2) Such a bill will result in lenders decreasing and/or eliminating the supply of loanable funds to Ohio farmers; (3) Lenders will be forced to raise interest rates to all farm borrowers to compensate for additional risk, time, and loss incurred, and (4) Most Ohio farmers (nearly three-fourths) do not favor such legislative action.

The legislature, however, sees a need and wants to help farmers through this adjustment period. The most productive thing it can do is to provide funds for developing and conducting research and education programs in farm financial management; including credit supply, use, analysis and legal environment. These programs will assist farmers, lenders, and public decision makers to understand and implement the sound use of credit in Ohio's farm businesses.