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RURAL CREDIT CRISIS
A STATUS REPORT
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BY

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TABLE OF CONTENTS

I. The Farmers' Plight

A. Overview........................p. 1

B. Current Situation...............p. 1

C. Ohio Situation..................p 3

D. Conclusion......................p. 3

II. The Bankers' Fright

A. Introduction....................p. 4

B. Overview........................p. 4

C. Farmers Home (FmHA).............p. 4

D. Farm Credit System (FCS)........p. 5

E. Private Banks...................p. 5

F. Ohio Situation..................p. 6

G. Conclusions.....................p. 6

I. The Farmers' Plight

A. Overview

The farm credit crisis, the inability of significant number of farmers to obtain credit to remain in business has been brewing for four years. Since 1981, farm assets have declined from $952 billion to $920 billion while debt has risen from $179 billion to $200 billion. During the same time net farm income dropped from $30.9 billion to $16.1 billion in 1983. Net farm income has improved since while total debt has stabilized. However, assets have depreciated substantially in the last year and probably will continue to decline. This decline has prompted banks to draw the line, and farmers are being forced out in larger than normal numbers.

B. Current Situation

The current crisis situation for farmers has two components (a) a long term income problem and (b) a short term operating credit problem. Many farmers are unlikely to get operating credit to plant their crops this spring. The immediacy of this problem has prompted grave Congressional and Public concern. Numerous bills have been introduced which seek to alleviate this problem. How many farmers won't get credit is difficult to estimate. Estimates run from 3 to 15 percent. My guess is that the final number will be closer to the bottom number, even if Congress does nothing.

The short term credit problem is really an extension of a long term credit problem, which is caused by the factors mentioned in the overview. Thus, a short term credit bailout will not solve the problem. Consequently, Congress will have to deal with the credit crunch again.

Which farmers are in serious financial trouble and who are they? In seeking to answer this question, it is important to keep in mind that hard data is limited. Fortunately, USDA has just recently completed a study which enhances our understanding.

Before discussing this study, the variability in the financial picture of farms needs to be stressed. Similar farmers can be in dissimilar situations: one in good shape, one on the verge of bankruptcy. However, in general, it is thought that the larger the farmer, the greater the amount of nonfarm income, the greater the efficiency, the lower the debt load, and the earlier the debt was acquired, the lower the debt stress.

Having stated the above, crucial indicators of stress are cash flow and debt/asset ratio. The latter indicates the potential borrowing ability of the farmer: the higher debt/asset, the smaller the potential collateral. Cash flow measures the amount of cash available to the farming operation. It can be figured many ways but one common definition is: gross farm income - operating expenses + off-farm income - interest payments - debt repayment - family living expenses. If this is less than zero, then the farmer must either cut his living standard, borrow more money, or not pay principal and /or interest.

Assuming the farm family will consume only at the poverty level, USDA estimated that 294,800 farms in 1983 had a negative cash flow (13.4% of all farms). These farmers have debt/asset ratios over 40% and gross farm sales under $100,000 or debt/asset ratios over 70% and gross farm sales between $100,000 and $250,000.

Seventy thousand of the farms with negative cash flow (3% of all farms) were estimated to be technically insolvent (debt/asset ratios over 100%). These farmers probably are not farming today.

Farms with negative cash flow had 26.6% of the farm debt whereas 11% of the farm debt was owed by farms which USDA considered to be technically insolvent.

There is one other element that needs to be kept in mind: USDA data shows that farmers who had little or no off-farm income and less than $100,000 in farm sales and farmers with cash sales over $100,000 and a debt/asset ratio over 40% and little to no nonfarm income were probably experiencing stress. Thus, part of the problem is lack of nonfarm income. How many additional farmers does this observation add to the financially stressed. This cannot be estimated accurately.

There is a myth that declining asset values endangers the survivability of a farm. It does endanger the survivability to the extent that a farmer can't borrow additional funds, but with stagnate income borrowing additional money probably only prolongs the agony. What really determines the survivability is if cash flow can cover debt and interest payments. This number is not affected by asset value. You do have a loss of wealth however when asset values decline.

C. Ohio Situation

Many Ohio farmers are experiencing the same stress as farmers in other areas of the U.S. However, the situation is not quite as bad as in the central states. According to USDA, Ohio farm operators had a debt/aset ratio of 18 percent while U.S. farmers and Iowa farmers had a debt/asset ratio of 21 and 26 percent respectively.

In March 1984, 13% of Ohio farm operators had debt/aset ratios greater than 50%. USDA data suggests the national number is 14%.

Generally, Ohio farmers in financial problem have, unfortunately, experienced 3 or 4 weather reduced crops in the last 5 years. Thus, Mother Nature has caused some of the debt stressed.

D. Conclusion

- Even if Congress approves a short term credit plan some farms will not get credit. Maybe as many as 3%. These will be mostly small and middle size farmers so impact on total production will be minimal.

- Five percent of U.S. farmers are probably lost even if Congress acts with a substantive bail out and no reduction in current price supports.

- A bail out plan would mostly help medium and small producers

- Situation is apparently showing signs of stabilizing, but stabilizing at a bad level. Specifically, debt has been stable over the last few years.

- Any decrease in prices for crop and livestock, assuming production costs don't decline as much, will further curtail cash flow. The result will be more bankrupt and financially stressed farmers. Thus, the best intermediate credit public policy for agriculture is to maintain existing price support levels.

II. THE BANKER'S FRIGHT

A. INTRODUCTION

Farm lenders are in trouble and they are scared. They see farmers in trouble and the agribusinesses that supply them. Farmers Home and Farm Credit system seem to be in particularly bad shape. Bankers are especially alarmed at the recent rapid de preciation in land values, which means that they cannot recoup the original value of the loan if the farmer goes under. That, in turn, erodes their capital base, which puts them in trouble.

B. OVERVIEW

Farmers had $213 billion in debt at the end of 1984. Sources of this credit and their relative share are: Individuals and others (23 percent), Farm Credit System (31 percent), banks (24 percent), life insurance companies (6 percent), Farmers Home Administration (12 percent), and Commodity Credit Corporation (4 percent)

This brief will concentrate on Farmers Home, Farm Credit System, and private banks. Individuals and others are important sources of both real estate and non-real estate loans. The farm credit crisis has a direct impact on them since they generally don't have a capital reserve or insurance funds. However, this market is very difficult to describe. What data is available on life insurance companies indicate that they have experienced significant deterioration in their loan portfolios. For instance, as a percent of outstanding farm loans, delinquent loans stood at 10.4 percent on June 1984. This is a record high since the data series began in 1954. While life insurance companies have had a rough last two years and bad farm debts will hinder their recovery, it is important to note that farm mortgages total only 2.2 percent of total life insurance company assets and 9.2 percent of their mortgage assets.

C. FARMERS HOME (FmHA)

Farmers Home has traditionally had the role of lender of last resort for farmers who can't get operating or ownership loans elsewhere. They also provide loans for disasters, both natural and economic.

Given the tough times in U.S. agriculture, Farmer Home's share of the farm loan market has grown from 7% in 1978 to 12% in 1984.

Agricultural banks are almost 30 percent of commercial banks (4,146 banks). Sixty percent of agricultural banks are in Iowa, Illinois, Kansas, Minnesota, Nebraska, and Missouri.

During first eight months of 1984, agricultural banks represented 24 percent of total failed banks. In the last four months agricultural banks were 71% of failed banks.

Banks have about $50 billion in agricultural loans.

Problems with private agricultural loans are greatest in California and the Midwest. Because of the small percent of all loans which are agricultural loans, the California, however, banks are not in trouble.

The deterioration in agricultural banks appears to have been in part a catching up with the rest of the banking system. On average ,agricultural banks have capital to total asset ratios which average around 9%. Thus, most agricultural banks are in a strong position to absorb current foreseen losses.

What scares private bankers is the rapid decline in land values and therefore the liquidation value of bad loans. The present is not the concern, the future is.

F. <u>OHIO SITUATION</u>

Ohio is much better off than the central states: this is not to imply that Ohio doesn't have any problems.

There are ten national banks in Ohio which are on the Federal Deposit Insurance Corporation's problem list. Five are agricultural banks. Some state agricultural banks are on the state bank examiner's problem list, but a specific number could not be obtained.

Ohio has not had a bank failure for the last 15-20 years. Reasons are strong state bank holding companies, an active merger market, and good state regulation.

No foreclosures are seen this year.

G. <u>CONCLUSIONS</u>

o FmHA has significant financial problems. Forty-seven percent of their agricultural loans are delinquent. Eventually, most of these loans ($11 billion) will have to be absorbed by the Government.

As of October 31, 1984, FmHA had $25.5 billion in outstanding farm loans: farm ownership - $6.8 billion; farm operating - $4.1 billion; disaster emergency - $10 billion, and economic emergency - $4.3 billion. Delinquency rates as a percent of loans: farm ownership - 26%; farm operating - 32%, disaster emergency - 65%, economic emergency - 53%.

Currently, FmHA's best guess is that it is holding 29,512 acres off the market. They must eventually sell these to family farmers. Most of the acres are in the Southeast, where FmHA has upwards to a 50% share of market, and Midwest, where FmHA has only about a 10% market share.

D. FARM CREDIT SYSTEM (FCS)

FCS is composed of the Production Credit Associations, which make operating loans, Federal Land Banks, which make ownership loans, and Bank for Cooperatives which lends to Cooperatives.

FCS is regulated by the Farm Credit Administration, which is an independent agency that has repaid its original capital to the Federal Government. FCS's sole purpose is to make loans to farmers and farmer cooperatives.

FCS has a current loan portfolio of $80 billion with $50 billion in the Land Banks.

FCS recently had to infuse its Spokane district with $300 million to keep it afloat. Problem stems from agricultural loans but also loans to fishing boat owners in the Northwest. FCA also expects that it may have to bail out its Omaha and Wichita districts.

Farm Credit System currently has $2 - 2.5 billion dollars in nonearning assets. It is holding $500 million dollars of property off the market. Most is in the Central States.

Although FCS earned $440 million (estimate) in 1984, it charged off $368 million (estimate), the largest ever. It believes the Production Credit Association have bottomed but the problems are just starting at the Land Banks.

E. PRIVATE BANKS

Banks which have agricultural loans that comprise 25 percent or more of total loans are considered agricultural banks.

- Farm Credit System has significant financial problems, especially in Spokane, Omaha, and Wichita. The problem is that, in using the system to bail out the weak brothers, the system itself is weakened. Substantial problems are developing at the Land Banks.

- Agricultural loans at private banks have deteriorated in general over the last 12 months. However, only those private banks which have a heavy portfolio of agricultural loans (over 50%) are probably in immediate danger. In a 16 state midwestern/high plain area, over one-fourth of 2,935 agricultural banks had a ratio at least this high.

- Private agricultural banks do not see a current operating funds problem. They will lend this money, but what they fear is the errosion in capital, i.e. land, values. If they have to foreclose, their assets have less value and consequently their capital base is eroded. When capital is only 9% of assets, it does not take many liquidations to wipe out a capital base. Thus, the fear of agricultural bankers of declining asset values, particularly those with heavy agricultural portfolios. The immediate future is their focal point. This future, with declining land values, makes banks reluctant to lend operating money.

- Excluding Farmers Home, on January 1, 1985, Farmers had $168 billion in debt. The national banking system (insured commercial banks) has about $2.4 trillion in assets while the national securities market is $6.7 trillion.

- For comparison's sake, when Penn Square failed, it had $511 million in assets and when Continential Illinois was bailed out by the Federal Reserve Board, it had $41.8 billion in assets. If 30 percent of non-FmHA farm debt has to be foreclosed, which is considered possible, you have bad debt of $50.4 billion. This number is comparable to Continental Illinois. So, there is a danger to the banking community, but I don't think it should be overemphasized <u>at present</u>. But, there is a clear threat to regional banking in central states (Iowa, Kansas, Nebraska, Missouri, Colorado, and South Dakota.)

- In examining the Bankers' Fright, it is important to keep in mind the testimony of Charles Thacker, Associate Director, Division of Bank Supervision, Federal Deposit Insurance Corporation, before the Senate's Committee on Small Business:

  "Insofar as agricultural banks are concerned, we have yet to see an agricultural bank fail solely because of the condition of the agricultural ecomomy."

- Thus, the farm crisis is not likely to send shock waves through the banking community by itself. But this is the third shock to the banking system -- foreign debt and energy loans were the first two. How much more can the banking system take, especially if a fourth shock hits or the foreign debt shock occurs again before the agricultural banking crisis passes?

- A short term credit bailout of farmers does little to help banks, who are more concerned about declining asset values.

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