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# FEDERAL RESERVE BANK OF CHICAGO AGRICULTURAL

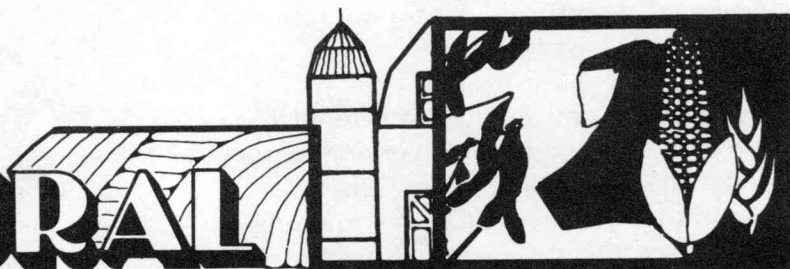
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# LETTER



**NEW MEASURES FOR RESTRUCTURING PROBLEM FARM LOANS** were announced by the Administration on September 18. One permits the Farmers Home Administration (FmHA) to grant its borrowers a deferral on the repayment of up to 25 percent of the borrower's total FmHA indebtedness. The other permits the FmHA to guarantee up to 90 percent of the remaining indebtedness on a problem loan between a commercial lender and a farmer, provided the lender writes off at least 10 percent of the indebtedness. The new measures, in conjunction with the other ongoing FmHA farm loan restructuring actions, will be helpful in addressing the high level of financial stress among a number of farmers. But by design, the measures are not intended to alleviate all the problem farm loans.

Details of the debt restructuring measures will not be available until final regulations are published. That might occur in mid-October, but could be delayed until early November. However, some of the FmHA's initial plans to implement the debt restructuring measures are beginning to take shape.

Determining what loans are eligible for restructuring will be a sticky issue. The FmHA's intent is to limit eligibility to problem farm loans (basically, those that are delinquent in repayment) held by efficient farmers. Beyond those general guidelines, the FmHA will apparently rely on cash flow analysis as the major determinant of eligibility. The cash flow analysis for a potential restructuring applicant will consider cash receipts, cash operating expenses, family living expenses, and debt-repayment requirements. Preliminary plans stipulate that cash inflows must exceed the debt-restructured cash outflows by 10 percent in order for a farmer with problem loans to be eligible for the debt restructuring programs. Farmers who are current in their debt repayments and those whose debt burdens are so heavy that the limits of existing and new debt-restructuring programs will still preclude a positive cash flow presumably will not be eligible for the new restructuring programs.

**Under the new debt-deferral measure** the FmHA will permit its own eligible farmer-borrowers to defer

loan repayments on up to 25 percent of their FmHA indebtedness, including principal and accumulated interest. The exact percentage that will be deferred will depend on what is needed, up to the 25 percent maximum, to generate the required positive cash flow. In no case, however, will the amount deferred for an individual borrower exceed \$200,000. During the deferral period, interest charges will not accumulate against the deferred portion of the FmHA indebtedness. The deferral period will be five years, but could subsequently be shortened if the borrower's financial situation improves.

The loan deferral measure will apparently be used as a supplement to other practices that the FmHA adopted earlier and will be using more routinely in the months ahead for restructuring problem loans. The other practices include extending loan maturities and switching some borrowers to a "limited resource" classification in order to lower interest rates on their FmHA indebtedness. Since the maximum maturity on FmHA farm operating loans is 15 years and the interest rate on farm operating loans to limited resource borrowers is 7¼ percent, these measures can have a substantial impact on the cash outflows required to cover FmHA loan payments. A \$200,000 loan amortized over five years at 10 percent interest requires an annual payment of \$52,760. In contrast, amortizing the same amount over 15 years at 7¼ percent interest requires an annual payment of \$22,307. If, in addition, a fourth of the loan was deferred, the annual payment on the remaining \$150,000 note would be lowered to \$16,730. These differences, while primarily benefiting FmHA borrowers, can have important benefits to commercial farm lenders as well. To the extent that FmHA borrowers are also indebted to other lenders, the restructuring of FmHA loans can improve the borrower's ability to repay their other indebtedness.

**The FmHA guarantee on restructured problem loans** between private lenders and their borrowers will come from a pool of about \$650 million. The pool can be used to cover restructured loan guarantees as well as the FmHA's regular loan guarantee programs. As such, it is not yet known how much will be allocated to restructured loan guarantees. However, most FmHA officials

believe that restructured loans will account for most, if not all, of the available pool.

To be eligible for the restructured loan guarantee, the loan must be in a nonperforming status and the lender must be willing to write off at least 10 percent of the outstanding principal and accrued interest. In order that the restructured loan can meet the requirements of a positive cash flow and be adequately collateralized, the lender may have to write off more than 10 percent and/or be willing to alter other terms—such as the interest rate or maturity—of the loan. The FmHA guarantee will cover up to 90 percent of any losses on the indebtedness remaining after the writedown. Some officials indicate it is the FmHA's intent to go to the maximum 90 percent guarantee as much as possible, but the guarantee percentage could be smaller if the collateral is regarded as inadequate to fully secure the remaining indebtedness. In any event, the maximum guarantee on a loan to an individual borrower will be \$400,000 if it is extended under the FmHA's farm operating loan program, and \$300,000 if it is extended under the farm ownership loan program.

**THE FARM SECTOR'S BALANCE SHEET** indicates that erosion of farm assets and equity continued in 1983. According to a recent USDA report, the value of farm sector assets, excluding farm household data, stood at \$928.6 billion at the beginning of this year, down almost 2 percent from a year ago and almost 6 percent below the 1981 peak. Moreover, proprietors' equity in farm businesses declined 2 percent last year to \$727.6 billion, almost 11 percent below the 1981 high. Although a slight decline in farm debt during 1983 partially offset the declines in asset values, the debt to asset ratio of the farm sector remained at a historically high level at the start of this year.

The decline in farm sector assets centered on the value of physical assets, with financial assets, excluding those of farm households, registering an increase. After falling 6 percent in 1982, the drop in the value of farm real estate assets slowed considerably last year, recording a 0.6 percent decline for the year. However, changes in real estate values varied considerably across the country. USDA estimates indicate that farmland values rose in 24 states, declined in 17, and remained stable in 7, with many Midwestern states registering the largest declines. Despite the decline in values, farm real estate accounted for more than three-fourths of farm sector assets at the beginning of 1984, down only slightly from the levels of the early 1980s.

The value of nonreal estate assets fell almost 5 percent last year. The value of crop inventories, down more

**The implications** of the new debt restructuring measures are hard to gauge. Without a doubt, there are a large number of problem farm loans that will be considered for restructuring. Nearly a fourth of the FmHA's portfolio of \$25 billion in farm loans was delinquent as of the end of the first quarter. The FmHA's overall package of restructuring tools would presumably afford positive cash-flow prospects for many of the borrowers of these delinquent loans.

With respect to FmHA guarantees on restructured loans between farmers and private lenders, the available evidence on problem loans held by such lenders as PCAs, FLBs, and banks suggests that the \$650 million pool may be quickly exhausted. However, lenders will be apprehensive about taking a 10 percent write-off to get a 90 percent guarantee on the remaining indebtedness of a problem loan. Their willingness to do so will depend on how well the problem loan is collateralized and a comparison of what their prospective loss would be with and without a guarantee. In many cases, lenders may prefer to deal directly with a problem farm loan rather than seek an FmHA guarantee.

Gary L. Benjamin

than 18 percent from the previous year's level, registered the largest decline. The sharp drawdown of stocks following the PIK- and drought-reduced crops in 1983 was only partially offset by gains in prices, reducing the value of crop inventories to \$33.7 billion in January of this year. The value of livestock inventories also declined in 1983. At \$49.8 billion, livestock inventories in January were down more than 6 percent from the previous year's level and at the lowest level since 1978. As high feed costs created an incentive to reduce livestock inventories, increased marketings pressured prices lower, resulting in the decline in livestock inventory values. The value of farm machinery and motor vehicles fell by more than 2 percent in 1983, marking the first decline in ten years. A 3 percent drop in the inventory value of tractors and other machinery, reflecting the sluggish pace of farm equipment sales, was partially offset by a 4.5 percent rise in the value of motor vehicle inventories.

Financial assets of farm businesses—demand deposits and currency, and investments in farmer cooperatives—were valued at \$36.4 billion at the beginning of this year, up 5 percent from the previous year's level. The rise in net cash income in 1983 likely contributed to an increase of almost 4 percent in the demand deposits and cash held by farm businesses. The value of investments in farm cooperatives rose by about 5 percent during 1983, a somewhat smaller increase than had been registered in recent years. PIK and other acreage reduction programs, which curtailed farmer's purchases of inputs from cooperatives and other sources, limited the growth



**Balance sheet of the farm sector<sup>1</sup>**  
**(January 1)**

	<u>1981</u>	<u>1982</u>	<u>1983</u>	<u>1984<sup>2</sup></u>
	(billion dollars)			
Physical assets				
Real estate	762.5	754.6	709.2	705.2
Nonreal estate				
Machinery	96.8	103.0	105.8	103.5
Livestock and poultry	60.8	53.6	53.0	49.8
Stored crops	<u>35.9</u>	<u>36.3</u>	<u>41.3</u>	<u>33.7</u>
Total	956.0	947.5	909.3	892.2
Financial assets				
Demand deposits and currency	8.1	7.6	7.8	8.1
Investments in cooperatives	<u>22.8</u>	<u>24.8</u>	<u>26.9</u>	<u>28.3</u>
Total assets	986.9	979.8	944.0	928.6
Liabilities				
Real estate debt	87.7	97.0	100.8	102.8
Nonreal estate debt	<u>82.3</u>	<u>91.5</u>	<u>102.0</u>	<u>98.2</u>
Total	170.0	188.5	202.8	201.0
Proprietors' equity	816.9	791.4	741.2	727.6
Debt-to-asset ratio	.172	.192	.215	.216

<sup>1</sup>Totals may not add due to rounding. Data exclude farm households.

<sup>2</sup>Data for 1984 are preliminary.

Source: USDA

in net worth of farm cooperatives in 1983.

**Total farm debt outstanding**, excluding farm household debt, fell almost 1 percent in 1983. At \$98.2 billion in January of this year, total outstanding nonreal estate debt was down 3.8 percent from the previous year's level, registering the first decline since 1956. The decline was due to reduced demand for operating loans, as PIK and other acreage reduction programs substantially lowered input use, and to efforts by farmers to reduce their outstanding debt. Farm real estate debt, at \$102.8 billion at the beginning of this year, was up 2 percent from the previous year's level, partially offsetting the drop in nonreal estate lending. However, the small increase last year in farm mortgage loans outstanding contrasted sharply with the 12.6 percent compound annual growth rate of the previous ten years. The low growth rate in real estate debt reflects the financial stress experienced by many farmers who, rather than expand their operations, used the opportunity afforded by increased net cash income in 1983 to restructure or reduce their existing debt loads.

The amount of farm debt held by most lenders declined in 1983. However, much of the decline in debt in 1983 was accounted for by a sharp drop in Commodity Credit Corporation (CCC) outstandings. Farm debt outstanding at the CCC fell more than 30 percent last year

with the transfer of PIK entitlements, the repayment of loans on grain released from reserve, and very little new grain going under loan. Outstanding debt held by the Cooperative Farm Credit System declined 1 percent last year as gains in farm real estate loans outstanding at federal land banks (FLBs) were more than offset by continued declines in production credit association (PCA) loans outstanding. Outstanding farm debt held by life insurance companies and by individuals and others also declined in 1983, but by less than 1 percent. Farmers Home Administration (FmHA) outstanding debt rose 1 percent last year despite a slight drop off in nonreal estate lending. Outstanding farm debt at commercial banks jumped more than 8.5 percent last year as both real estate and nonreal estate lending rose sharply.

These trends in farm debt outstanding at the various lending institutions have continued through the first half of 1984. Loans outstanding at PCAs continued to register year-to-year declines, falling almost 6 percent below last year's level at the end of the second quarter, while farm mortgages at FLBs were almost 1 percent above the year-ago level in June. The farm mortgage portfolios of life insurance companies were down 1 percent from the previous year's level in June, continuing the trend started in 1982, while CCC loans outstanding were almost 60 percent off the year-ago level. In contrast, farm debt outstanding at commercial banks and the FmHA in June was up 8 and 5 percent, respectively, from last year's level.

**The debt-to-asset ratio** of the farm sector, with the decline in asset values more than offsetting the small decline in debt, rose slightly in 1983. At 21.6 percent, the farm sector debt-to-asset ratio at the start of this year was at its highest level since 1940 when this information was first recorded. Despite expected gains in the value of crop and livestock inventories, it appears that continued declines in farmland values across much of the country and additional declines in farm machinery inventory values will likely reduce farm sector assets further by the end of this year. Moreover, a rise in farm sector debt outstanding is expected in 1984 despite the decline registered at mid-year. The increase in acreage planted and a rebound in CCC lending by year end as grain from the expected large crops moves under loan will likely boost farm debt outstanding above year-ago levels at the end of 1984. As a result, farmers' equity and the debt-to-asset ratio of the farm sector, which are indicative of the level of financial stress in agriculture, may show further deterioration in 1984.

Peter J. Heffernan

	Latest period	Value	Percent change from		
			Prior period	Year ago	Two years ago
<b>Receipts from farm marketings (\$ millions)</b>					
Crops*	June	9,523	- 9.0	-11	- 3
Livestock	June	3,653	- 3.3	-11	- 8
Government payments	June	5,680	-13.5	0	- 2
	June	190	+50.8	-78	+363
<b>Real estate farm debt outstanding (\$ billions)</b>					
Commercial banks	June 30	10.0	+ 3.8†	+13	+18
Federal Land Banks	August 31	48.2	+ 0.1	+ 1	+ 3
Life insurance companies	July 31	12.5	- 0.5	- 1	- 4
Farmers Home Administration	June 30	10.1	+ 2.2†	+ 5	+10
<b>Nonreal estate farm debt outstanding (\$ billions)</b>					
Commercial banks	June 30	41.3	+ 5.4†	+ 7	+16
Production Credit Associations	August 31	19.2	- 0.3	- 5	-13
Farmers Home Administration	June 30	16.7	+ 8.1†	+ 5	+ 4
Commodity Credit Corporation	June 30	6.53	-25.9†	-59	-34
<b>Farm loans made (\$ millions)</b>					
Production Credit Associations	August	1,792	-13.2	- 8	-15
Federal Land Banks	August	225	-11.7	-22	-39
Life insurance companies	July	67	-43.0	-16	+16
<b>Interest rates on farm loans (percent)</b>					
7th District agricultural banks					
Operating loans	July 1	14.34	+ 3.7†	+ 6	-17
Real estate loans	July 1	13.89	+ 3.5†	+ 5	-17
Commodity Credit Corporation	October	11.75	- 1.1	+13	+ 7
<b>Agricultural exports (\$ millions)</b>					
Corn (mil. bu.)	August	2,587	- 3.8	- 1	+ 4
Soybeans (mil. bu.)	August	136	+ 4.6	+13	+19
Wheat (mil. bu.)	August	31	-21.7	-49	-47
	August	148	+ 7.2	+53	+15
<b>Farm machinery sales<sup>P</sup> (units)</b>					
Tractors, over 40 HP	August	3,843	- 6.7	-11	-23
40 to 139 HP	August	2,808	-18.3	-14	-30
140 HP or more	August	1,035	+50.9	+ 2	+ 8
Combines	August	957	+17.6	-14	-27

\*Includes net CCC loans.

†Prior period is three months earlier.

<sup>P</sup>Preliminary



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