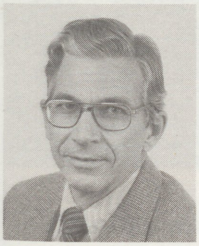


William McD. Herr is Professor and Chairman, Department of Agribusiness Economics, Southern Illinois University, Carbondale, Ill. He has analyzed the results of the ABA's mid-year survey of agricultural bankers for nearly 15 years.

Survey reports signs of slowed deterioration

by William McD. Herr

Deterioration in the quality of ag bank farm loan portfolios in the year ending mid-1986 continued at nearly the same pace as in most other years of the 1980s. However, for the current year ending mid-1987, ag bankers expect a substantial slowing in the rate of deterioration. If this occurs, the deterioration in the quality of bank farm loan portfolios would be the smallest of any year since 1980.

This general picture of farm credit conditions represents the composite views of over 900 ag bankers surveyed by the American Bankers Association (ABA) in mid-1986. The most recent survey indicates that for each bank reporting an increase in the overall quality of their farm loan portfolio in the past year, there were more than two bankers reporting the decline in the overall quality of their farm loan portfolio. This indicates deterioration at nearly the same pace as in other years of the 1980s. (Figure 1)

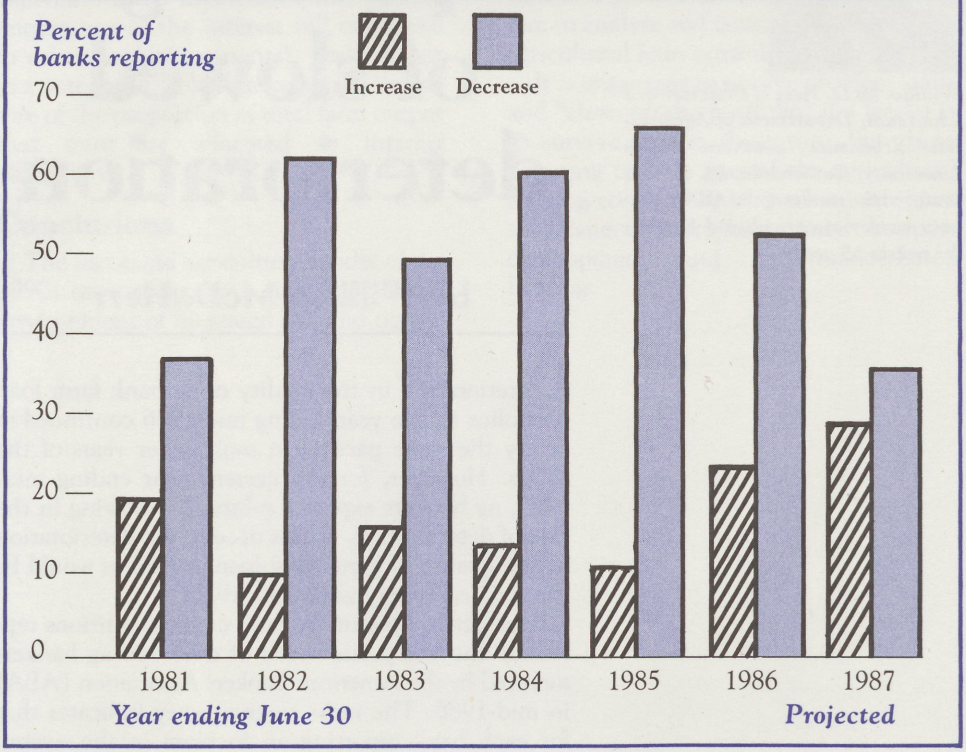
However, for the year ending mid-1987, the number expecting decreases and increases in the overall quality of their farm loan portfolios are more evenly balanced than in any year since 1980.

Mid-year surveys of ag banks have been conducted by ABA for many years. Successive survey results permit the examination of farm credit conditions over time.

Evidence of continued deterioration through mid-1986 is indicated by ag bankers' answers to a series of questions about selected attributes of their farm loan portfolio. Approximately two-to-four times more

Figure 1

Bankers reporting decreases in the overall quality of farm loan portfolios far outnumbered those reporting increases in quality between 1981 and 1986. Narrowing of decreases over increases indicates expected slowing of deterioration in 1987.



bankers reported increases in loan losses, delinquencies, renewals and refinancings during the year ending mid-1986 than the number reporting declines. For every banker reporting an increased rate of loan repayments, more than two reported loan repayment rates decreased. (Table 1) All of these measures indicate continued deterioration in farm credit conditions during the past year.

The seriousness of farm financial problems in mid-1986 is portrayed by the following ag bankers' estimates.

- Nearly 40 percent of their borrowers are loaned up to their practical limit—this compares to 36 percent in mid-1985.
- Lenders discontinued 5.6 percent of their farm borrowers in the year ending mid-1986. This was up from 4.5 percent in the previous year. Increasing rates of discontinuances do not necessarily translate into farm terminations, but it does mean that many of these farmers must obtain financing from other lenders in order to continue farming. This can be a difficult task for the farmer who has been denied credit.
- About 6 percent of lenders' total outstanding farm loan volume was 30 days or more delinquent in mid-1986. This represents an increase from the 5.3 percent rate reported a year earlier.
- Of all farmers in lenders' trade areas—customers and noncustomers—4.2 per-

Table 1.
Indicators of the quality of bank farm loan portfolios continue to show deterioration but point toward stability in the current year.

Indicator and time period	Percent of banks reporting specified change during year			
	Increase	Decrease	Same	Index[1]
Farm loan losses				
1981-85 average	41	7	52	134
Year ending mid-1986	55	13	32	142
Projected for year ending mid-87	32	33	35	99
Rate of delinquencies				
1981-85 average	43	10	47	133
Year ending mid-1986	42	17	40	125
Projected for year ending mid-87	26	24	50	102
Rate of renewals and extensions				
1981-85 average	63	8	29	155
Year ending mid-1986	41	18	41	123
Projected for year ending mid-87	31	20	49	111
Rate of refinancings				
1981-85 average	60	6	34	154
Year ending mid-1986	50	11	39	139
Projected for year ending mid-87	35	17	48	118
Repayment rates				
1981-85 average	12	55	33	57
Year ending mid-1986	20	42	38	78
Projected for year ending mid-87	19	33	48	86

[1]Index computed by subtracting the percentage reporting decreases from the percentage reporting increases and adding 100. Index values of 100 indicate as many bankers report increases as the number reporting decreases and hence imply no change or overall stability in the specific attribute.

cent filed for bankruptcy in the mid-1985 to mid-1986 period. This represents an increase from 3.8 percent reported by the 1984-85 survey.

• Ag bankers reported that 6.2 percent of the farmers—customers and noncustomers—they know in their trading areas went out of business between mid-1985 and 1986. In the previous year the rate was 5.2 percent. About 30 percent of those going out of business in the past year were estimated to be due to normal attrition (retirement or divorce). The other 70 percent was estimated to be due to the poor farm economy and legal foreclosures.

Bankers estimated that nearly 30 percent of their farm borrowers had debt-to-asset ratios of more than 60 percent. In today's economic environment, debt ratios of this level generally indicate borrowers with serious financial problems. This suggests that typical ag bankers face substantial challenges in financing a large proportion of their farm borrowers.

One technique banks use for some of their financially stressed farm customers is FmHA guaranteed loans. Nearly two-thirds of the ag banks surveyed are approved FmHA lenders. And about the same proportion, 65 percent, made one or more FmHA guaranteed loans during the past year. However, less than one-fifth reported they used FmHA's Interest Rate Buydown Program.

Ag bankers' responses also provide indications of why FmHA's guaranteed program may not be used more fully. On a scale of 1 to 5, (with 1 indicating complicated and 5 easy to understand), nearly three-fifths of the bankers gave the loan application process a ranking of 1 or 2. Others reported the application procedure was lengthy, the paperwork burdensome and loan servicing requirements were more demanding than those of the banks' regular farm loans.

1987 outlook

Following six consecutive years of worsening farm credit conditions, ag bankers project only a modest decline during the current year ending mid-1987. This would represent some stabilization of the farm lending and financial environment.

Bankers' projections of changes in five attributes of their farm loan portfolio show a considerable narrowing between the number expecting worsening conditions and those expecting improvement. Virtually the same number of bankers expect increases as expect decreases in loan losses and delinquencies (charge-offs) during the current year. (Table 1) The number of bankers expecting increases in loan renewals exceeds the number expecting decreases by only 1.5-1.

Another way to portray this slow-down in deterioration is shown by Table 1.

These projections by ag bankers are welcome news because they indicate some stabilization in the credit situation.

One factor easing many borrowers' financial situations has been declining interest rates. In mid-1986 the most common interest rate charged on farm operating loans was 11.5 percent. On loans secured by farm real estate, the typical rate was 11 percent and trending lower. Farm operating loan interest rates in mid-1986 were 1.2 percent lower than in mid-1985. Real estate secured loans were nearly 1.7 percent lower. Current rates are substantially lower than 1981 rates. In that year, the mid-year survey reported typical farm loan rates of about 18 percent.

Farmland values

Declining farmland values continue to be one of the more troublesome areas in the farm financial picture. Declines adversely affect farm lending by reducing collateral values and farmers' net worth. Current and future trends in land values are especially important to the viability of bank farm borrowers with high debt-to-asset-ratios.

Bankers estimated that land values fell nearly 16 percent between mid-1985 and mid-1986. This follows a 17 percent decline in the previous 12-month period. Their expectation for the current year is for a further decline but by about half as much—8 percent.

Conclusion

Despite six years of very difficult farm financial problems which resulted in the failure of many farmers, ag business and farm lending institutions, 80 percent of the ag banks reported they expect to continue farm lending at the same level or increase it during the next three years. Under one-fifth expected to become less active in farm lending in the intermediate term. This represents a substantial commitment by ag banks to a troubled industry. Based on this survey, the outlook is that farm credit problems, while remaining serious, may not get much worse.