

1999 Iowa Agricultural Lender Survey

Background

Throughout most of 1998, economic conditions in agriculture continued to decline. Prices for all of Iowa's major farm commodities were down significantly from a year earlier. Further, current near term forecasts indicate that there is little likelihood for a rapid recovery. Once again there are increasing reports about eroding financial and economic conditions for farmers, some agricultural businesses, and rural communities.

There are two key factors at play. First, the current period of low prices is due largely to overproduction relative to our capacity to process and market what we produce. Some of this overproduction is cyclical – “normal” if you will. Some is due to growth in our domestic industry as well as our foreign competitors. In addition, demand for agricultural products has been reduced, in part, because of the difficult economic conditions experienced in Asia and Russia.

The second major factor is the ongoing restructuring of the agricultural industry. These trends have been particularly apparent in the pork sector. Large scale, highly efficient livestock businesses have entered the market over the past 10 years or so and displaced many of the small operations that once characterized the Iowa pork industry. This transformation poses a clear competitive threat to Iowa's family-owned, diversified pork producers. Furthermore, restructuring may change the way markets behave, as well as access to processing facilities, business relationships, and even the meaning of family farming. Whether these changes are good or bad for society remains to be seen. But it is

clear that the rules of the game have been significantly altered for all of Iowa's farm businesses – not just those producing pork.

We know from the 1980s that periods of depressed farm income can have an adverse impact not only on farm families, but also on financial institutions, asset markets, and rural communities. Careful monitoring of farm financial conditions is essential for good decision making whether by farmers, lenders, or elected officials. This report summarizes information provided by agricultural lenders on the financial status of their farm borrowers. Lender information can be used in conjunction with farm level and sectoral level reports to better understand the extent and possible consequences of farm financial stress.^{1/}

Approach

Information used in this report was obtained from a survey of Iowa commercial banks, Farm Credit Services (FCS), and the Farm Service Agency (FSA) operating in Iowa. The survey was mailed out on Feb. 19, 1999. All returns used in this report were received by March 12, 1999. A copy of the survey instrument is available on request.

Commercial banks were surveyed by mailing the instrument to all known agricultural departments in the state. The mailing list was provided by the Iowa Bankers Association. Approximately 450 surveys were mailed and 145 were

^{1/} For farm-level information see Robert W. Jolly and Alan Vontalge. 1999. Examining the Survivability and Competitive Readiness of Iowa's Commercial Farm Businesses, FM-1863, Iowa State University, Ames, Iowa.

returned. The usable response rate was 32 percent. Responses were evenly distributed across the state with an average of 16 surveys returned for each of Iowa's nine crop reporting districts.

The FCS agreed to participate in the survey. However, it chose to report centrally. Consequently one survey instrument was returned representing the entire Iowa agricultural loan portfolio for FCS.

The FSA mailed the survey to its local Farm Loan Program Supervisors. A total of 41 supervisors responded – nearly 100 percent return. Note that the FSA was only asked to report on their direct loan portfolio.

Net Worth Trends

Net worth trends for farm borrowers since January 1996 are summarized by lender in Table 1. This time period begins just ahead of the high income years, 1996 and 1997 and ends following the sharp price declines experienced in 1998.

Table 1. Net Worth Trends Since January 1996 (percent of farm borrowers)

Net Worth Change	Banks	FCS	FSA
A. Increased more than 50%	1.1	11.3	2.6
B. Increased 25-50%	5.2	17.3	5.2
C. Increased 5-25%	20.8	39.8	18.6
D. Remained within +/-5%	37.6	23.2	36.4
E. Decreased 5-25%	26.7	6.0	19.6
F. Decreased 25-50%	6.7	1.0	12.1
G. Decreased more than 50%	1.5	1.4	5.4

Source: 1999 Agricultural Lender Survey

Commercial banks and the FSA report similar balance sheet trends. More than a third of their borrowers maintained net worth with nearly equal proportions showing gains and losses in the 5-25 percent range. Approximately 18 percent of FSA borrowers experienced net worth losses in excess of 25 percent. The FCS reports an overall net gain in net worth for its borrowers since the beginning of 1996. Less than 10 percent of FCS borrowers show declines in net worth.

Agricultural Loan Portfolio Quality and Protection

The proportion of farm borrowers considered by the lenders to be financially stressed is reported in Table 2 along with the associated loan volume. Since FSA is by design the lender of last resort, their direct loan portfolio consists almost entirely of financially vulnerable farm businesses. FSA respondents were asked to estimate the proportion of borrowers experiencing above average financial problems.

Table 2. Agricultural Loan Portfolio Quality and Protection

	Banks	FCS	FSA
Financially Stressed Borrowers			
Borrowers (%)	19.8	6.0	38.1
Loan Volume (%)	23.7	6.0	46.4
FSA or SBA Guarantee Coverage			
Financially Stressed Borrowers			
Borrowers (%)	22.1	<1	NA
Loan Volume (%)	25.4	<1	NA
All Borrowers			
Borrowers (%)	7.8	<1	NA
Loan Volume (%)	9.9	<1	NA

Source: 1999 Agricultural Lender Survey

Commercial banks reported nearly 20 percent of their borrowers are financially stressed. There was a great deal of variability across banks however with estimates ranging from 0 to 90 percent. Approximately 23 percent of banks' agricultural loans are held by financially stressed borrowers. FCS reported 6 percent of borrowers and loan volume as financially stressed. This relatively low level is consistent with their reported net worth trends. For FSA, 46 percent of borrowers were considered to be financially stressed. They owed 38 percent of the direct loan volume. Reported estimates ranged from 5 to 100 percent.

The use of loan guarantees available through FSA or through the Small Business Administration (SBA) allows commercial lenders to mitigate some of the risk associated with financially stressed borrowers. Table 2 summarizes this information for banks and FCS. Commercial

banks report approximately 25 percent of financially stressed loan volume is covered by guarantees. In contrast, the FCS reports that guarantees have been used on less than 1 percent of their financially stressed loans.

Age Profile

Many previous studies have shown that financial stress is more likely to be experienced by younger borrowers. This is usually the result of increased debt levels associated with expansion early in the farm business life cycle. Information reported in Table 3 is generally consistent with these trends for banks and the FSA when compared to the 1997 Iowa Census of Agriculture. For the FCS, financially stressed borrowers tend to be somewhat older.

Table 3. Age Profile of Financially Stressed Borrowers (percent)

Age Groups	Banks	FCS	FSA	1997Ag Census
A. Under 34 years	11.7	1.4	8.7	9.9
B. 34-44 years old	33.7	9.0	24.9	23.0
C. 45-54 years old	33.5	22.0	33.9	23.7
D. 55-65 years old	17.3	25.7	24.5	21.1
E. Over 65 years	3.1	27.5	7.3	22.3
F. Other entities	*	14.4	*	*

*not reported

Source: 1999 Agricultural Lender Survey

Reasons for Financial Stress

Lenders were asked to assess the reasons for financial stress using a five-point scale from 1 (least important) to 5 (most important). Table 4 reports average scores for banks and the FSA. Because FCS submitted a report for their entire Iowa loan portfolio, only a single score is given.

There is a great deal of consistency across all three lenders on the reasons for financial stress – low cattle, hog, and crop prices and inadequate marketing skills. Loss of off-farm jobs, animal disease problems, and personal health problems were generally not felt to be important. Accumulated or carryover financial problems and recent expansion were ranked as somewhat important.

Table 4. Reasons for Financial Stress (average score)^{1/}

	Banks	FCS ^{2/}	FSA
A. Weather-reduced yields	2.6	1	3.0
B. Poor hog and cattle prices	4.5	5	4.6
C. Poor grain prices	4.5	4	4.6
D. Animal disease problems	1.9	1	2.1
E. Carryover financial problems	3.3	3	3.6
F. Recent expansion	2.9	2	2.6
G. Inadequate management skills	3.2	2	3.5
H. Inadequate marketing skills	4.1	4	4.3
I. Personal health problems	1.6	1	1.9
J. Excessive family living expenses	3.0	2	3.0
K. Farm business too small to support family	3.6	3	3.5
L. Loss of off-farm job	1.7	1	1.8

^{1/} Five point score from 1, least important to 5, most important

^{2/} Consolidated report for entire state

Source: 1999 Agricultural Lender Survey

Lenders also could identify other sources of financial problems not included on the survey. The most frequently mentioned were excess credit card debt and gambling.

Borrowers' Expected Intentions

Lenders were asked to assess the likely prognosis for their farm borrowers for 1999 and the next 2 to 3 years. This information is summarized in Table 5.

For all three lenders, only 1 to 3 percent of their farm borrowers were expected to be denied credit for the coming year. However an additional 3 percent were expected to voluntarily leave farming in 1999.

Looking ahead over the next two to three years, however, the lenders do see some changes in their farm borrowers and loan portfolio. Banks estimate 20 percent of their farm borrowers will require major restructuring if they are to continue operating. This contrasts with only 10 percent reported by FCS and 28 percent reported by the FSA. Again there is a great deal of variability in the assessed restructuring levels. Both banks and FSA report restructuring levels

ranging from 0 to 70 percent of borrowers.

The lenders are consistent with their estimates of farm borrowers who would continue with their present operation – 40 to 47 percent. Banks and the FSA reported only 10 percent of current borrowers would expand over the next two to three years. The FCS is more optimistic with 35 percent of their borrowers and half of their agricultural loan portfolio expected to expand. Finally, all lenders estimated retirements and exits to off-farm work at 10 to 15 percent of farm borrowers.

Table 5. Borrowers' Expected Intentions, 1999 and Beyond

Action	Banks	FCS	FSA
Will not receive financing for 1999			
Borrowers (%)	2.3	1	3.4
Loan Volume (%)	2.5	1	3.3
Will voluntarily leave farming in 1999			
Borrowers (%)	2.9	3	3.8
Loan Volume (%)	2.4	2	3.3
Will operate in 1999 and over the next 2-3 years:			
Will require major operating and financial changes in order to survive			
Borrowers (%)	20.0	10	27.8
Loan Volume (%)	22.0	8	31.1
Will continue operating in their present situation			
Borrowers (%)	47.3	42	39.6
Loan Volume (%)	46.0	35	39.4
Will likely expand their farm operation			
Borrowers (%)	10.4	35	10.2
Loan Volume (%)	12.9	50	10.3
Will retire from farming with a successor			
Borrowers (%)	4.9	5	3.7
Loan Volume (%)	4.3	3	2.6
Will retire from farming without a known successor			
Borrowers (%)	6.1	1	5.3
Loan Volume (%)	4.8	1	4.5
Will voluntarily cease farming and shift to off-farm employment			
Borrowers (%)	6.8	3	6.8
Loan Volume (%)	5.3	<1	7.1

Source: 1999 Agricultural Lender Survey

Summary

This lender survey provides an interesting perspective on farm financial conditions. Some of the key inferences are that:

- Financial stress exists, but that it varies widely in extent across individual lenders.

- For the year ahead, most lenders appear to be making a significant effort to continue with their financially stressed farm borrowers.
- In the near term, the next two to three years, lenders reveal a great deal of uncertainty about their farm borrowers. This is particularly apparent in their estimates of the number of borrowers requiring significant restructuring and those planning to expand.
- It is generally agreed that approximately 40 percent of existing farm borrowers will not make significant changes over the next few years.
- Financial stress, in the eyes of Iowa's farm lenders, is considered to be the result of markets and marketing.

Iowa's experience in the 1980s would suggest that financial problems in agriculture develop over a period of time. Duration is key. If prices remain relatively low over the next year or two, it will become increasingly difficult for lenders to continue to extend credit to financially stressed farm businesses. Further, the number of farms requiring major restructuring is expected to increase. If, on the other hand, prices increase sharply in the coming year, most lenders and their farm borrowers have sufficient financial strength to shake off the impact of the past year. In the coming year, lenders and borrowers must carefully monitor economic conditions as well as individual loan performance.

IOWA STATE UNIVERSITY

University Extension

Helping you become your best.

Prepared by Robert W. Jolly, Professor of Economics, Iowa State University, Ames, Iowa. I appreciate the cooperation of the member banks of the Iowa Bankers Association, Farm Credit Services of the Midlands and the Farm Service Agency. Thanks also to Katie Hensley, undergraduate assistant, for data analysis.

File code: Economics 1-5

... and justice for all

The U.S. Department of Agriculture (USDA) prohibits discrimination in all its programs and activities on the basis of race, color, national origin, gender, religion, age, disability, political beliefs, sexual orientation, and marital or family status. (Not all prohibited bases apply to all programs.) Many materials can be made available in alternative formats for ADA clients. To file a complaint of discrimination, write USDA, Office of Civil Rights, Room 326-W, Whitten Building, 14th and Independence Avenue, SW, Washington, DC 20250-9410 or call 202-720-5964.

Issued in furtherance of Cooperative Extension work, Acts of May 8 and June 30, 1914, in cooperation with the U.S. Department of Agriculture. Stanley R. Johnson, director, Cooperative Extension Service, Iowa State University of Science and Technology, Ames, Iowa.