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Financial Conditions of and Availability of Credit to South Dakota Agricultural Producers

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Declining agricultural prices and adverse weather in western South Dakota contributed to a further deterioration in the financial condition of many South Dakota farmers and ranchers during the past year. As the spring planting period approaches, the availability of producer credit becomes a major concern for producers and agribusinesses. Producers are concerned about the availability of credit for their operations. Agribusinesses are concerned because the availability of producer credit will affect the demand for their products and their management of accounts receivable.

In this newsletter, the findings from the 1985 South Dakota Agricultural Lender survey on the financial condition of and the availability of credit to South Dakota agricultural producers are discussed.

Description of 1985 Survey

In November 1985, a questionnaire was sent to the senior agricultural loan officers of 344 lending institutions in South Dakota. Included in the survey were commercial banks, Production Credit Associations (PCAs), Federal Land Banks (FLBs) and Farmers Home Administration (FmHA) county offices. Commercial banks, PCAs, and FLBs are referred to as "private" lenders, while "all" lenders includes private agricultural lenders and FmHA county offices.

The survey response rate was 54 percent -- 188 of 344 lenders returned a completed survey. This response rate is slightly higher than that for the 1984 Agricultural Lender survey. The researchers would like to thank the participating lenders for their assistance in providing useful information to those concerned and involved with South Dakota agriculture.

Financial Condition of Producers

The average agricultural loan portfolio reported by the private lenders showed a slight deterioration in quality between November 1, 1984 and November 1, 1985 (Table 1). Lenders were asked to indicate the percentage of their borrowers in five credit risk classes ranging from "superior" to "inferior." The average percentage of producers in the "superior" and "good" risk categories has declined, while the percentage of producers in the "average" and below risk categories has increased. In 1984, 38.2 percent of producers represented either a "superior" or "good" credit risk, while in 1985 this percentage declined to 33.7 percent.

Private lenders indicated that on average 5.5 percent of their November 1984 farm borrowers did not qualify for financing during 1985. Thus, the deterioration in the private lenders' portfolios took place even with a significant number of producers being denied credit during the past year.

West River Shows Stress

Unlike the 1984 Agricultural Lender Survey, the 1985 survey showed the quality of the private lender portfolio to differ significantly among regions in South Dakota. The state was divided into three regions: "West River," and the "Northeast" and "Southeast" east of the Missouri River.

In the West River Region, private lenders indicated approximately 80

Table 1: The Average Percentage of Farm Borrowers in Specific Risk Categories on November 1, 1984 and 1985 as Estimated by Private Lenders.

Description	Superior	Good	Average	Weak	Inferior
			Risk Classification		
			Statewide Estimates*		
1. 1984 Survey	14.6%	23.6%	38.5%	15.7%	8.2%
2. 1985 Survey	11.7%	22.0%	41.4%	16.0%	9.2%
			Regional Analysis for November 1, 1985*		
3. West River	8.2%	13.5%	49.0%	18.1%	11.3%
4. Northeast	14.6%	23.4%	36.4%	16.5%	9.3%
5. Southeast	10.3%	23.6%	43.1%	14.8%	8.4%

*Rows may not sum to 100 percent because of rounding error.

percent of their portfolio to be in the "average" and below risk categories (Table 1). This was a much higher proportion than for the other regions. Sixty percent of the farm borrowers in the Northeast Region and 66 percent in the Southeast Region had this classification.

The percentage of producers increasing their total debt during the past year was the highest in the West River Region. Fifty-two percent of their borrowers increased their total debt. In the other two regions, only 31 to 32 percent of producers increased their total debt.

Inclusion of the FmHA survey responses indicated even a higher proportion of producers increasing their debt levels. The West River Region was the highest with 53 percent of the producers increasing their debt load, while the other two regions were in the range of 36 to 37 percent.

Credit Availability

To gain a perspective on the financial strength of producers classified to represent "average" credit risks in the survey, the lenders were asked to indicate to which risk classes they would lend if the farmer was a NEW customer at their lending institution. Because the FmHA is perceived as being the "lender of last resort" and has a distinctly different role in agricultural credit than private lenders, only private lender responses are reported. This section is directed towards identifying the ability of producers in different risk categories to obtain credit from a new private lender.

The responses of private lenders clearly indicate that a major proportion of the South Dakota's agricultural producers would have difficulty obtaining credit from an alternative private lender (Table 2). Private lenders reported two-thirds of their farmer borrowers were "average" or below "average" credit risks. None of the private lenders indicated that they would provide a farm operating loan to a new customer with a "weak" or "inferior" credit rating. Only 17 percent of the private lenders would provide operating capital to an "average" credit risk.

Even producers classified as being a "superior" or "good" credit risk would find their ability to obtain farm operating loans from an alternative private lender to be limited. Only 61

Table 2: The Percentage of Private Lending Institutions That Would Lend to New Customers with the Specified Credit Risk Rating.

Description	Risk Classification				
	Superior	Good	Average	Weak	Inferior
1. Farm Operating Loans	89.1%	60.9%	17.4%	0%	0%
2. Farm Real Estate Loans	57.4%	27.9%	8.1%	0%	0%

percent of the private lenders would accept a "good" credit risk as a new customer and 89 percent would accept a "superior" credit risk.

Availability of real estate credit from an alternative private lender is even more limited (Table 2). Only 28 percent of the private lenders would provide a loan for real estate to a new customer with a "good" credit risk rating. Even for "superior" credit risks, the percentage of private lenders willing to loan for real estate is only 57 percent. For an "average" credit risk the percentage is 8 percent.

Why Tight Credit Availability?

Potential reasons for the tight credit availablity are many. The 1985 farm bill had not yet been passed at the time of the survey. Given the importance of the farm program in determining cash flow projections of grain producers, the hesitancy of private lenders to lend to new customers is not surprising. Also, private lenders may be following a policy of meeting the credit needs of their current customers first rather than taking on new customers. Private lenders may have expected the downward trends in land values and other assets to continue--thus implying an expectation of further financial deterioration for producers. Bank managers, with and without bank regulator encouragement, are probably evaluating closely how much agricultural loan risk they can accept in their total loan portfolio. Decreasing this risk exposure implies not taking on new customers.

But all these reasons do not lessen the significance of private lenders being very hesitant to lend to producers, whose risk classification is as high as "average." Clearly this implies something about their expectations concerning the ability of these producers to survive in the current economic environment.

Implications for Producers and Lenders

Based on the survey results, the majority of producer borrowers would appear to have limited ability to move to alternative private lenders. This implies that producers--representing even "good" and "superior" credit risks--must strive to maintain good working relationships with their current lenders.

In some ways these results would appear to indicate that the lenders have considerable power in the lender-borrower relationship. However, lenders should keep in mind recent lawsuits concerning how far a lender can intervene in the management decisions of producers. More importantly, producers that are abused during "bad times" are not likely to stay when the "good times" return. The proportion of loan portfolio currently classified as being "average" or below will require cooperative rather than confrontational efforts.

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