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A Survey of Bankers: Credit Conditions after the 1976 Drought

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Greenbaum, H., "A Survey of Bankers: Credit Conditions after the 1976 Drought" (1979). *Agricultural Experiment Station Circulars*. Paper 256.
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A Survey of Bankers: Credit Conditions After the 1976 Drought



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A Survey of Bankers:

Credit Conditions After the 1976 Drought

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South Dakota's economy is heavily influenced by agriculture. The credit markets in South Dakota are, therefore, closely related to conditions which prevail in the farm sector. This report, for example, deals largely with bankers' reactions, in early 1977, to conditions immediately after the 1976 drought. A brief updating of events in South Dakota will precede the presentation of their reactions.

The farm credit market in South Dakota is influenced by a variety of national and local factors. Commercial bankers, who obtain their funds largely from local sources, were finding it difficult, in early 1979, to meet the loan demands of their customers, and interest rates were substantially higher than in 1977.

A number of reasons were given by bankers for this condition. Large outlays for the replenishment of cattle herds, depleted as a result of the poor grazing conditions during the drought, contributed to the situation. Herd replenishment coincided with sharply higher prices for feeder cattle, adding to the sharp increase in credit needs. Further aggravating the need for credit was an increase in farm operating costs and the cost of farm related capital equipment, while the prices for most field crops grown in the state were rather stable.

The availability of credit to farmers was also influenced by an increase in demand for credit by non-farm customers, especially in those regions of the state undergoing substantial commercial and industrial growth.

*The author expresses gratitude to Wayne Fischer for his considerable assistance especially in the tabulation of the data and also to Hilda Lo for her contributions.

At the same time, credit to commercial banks was impaired by higher interest rates in the national money markets. This further reduced the availability of funds to borrowers in South Dakota.

Despite the resumption of favorable weather in 1977 and 1978 and improvements in livestock prices, cash receipts from farm marketing in South Dakota did not fully recover in relation to the rest of the country (Table 1).

THE SETTING

In 1976, South Dakota encountered both drought and low agricultural prices. Precipitation in the state averaged only 12.91 inches, nearly 5.5 inches below normal.¹ Farmers' receipts from the sale of crops decreased from \$545 million in 1975 to less than \$381 million in 1976.²

At the same time livestock sales increased slightly as a result of drought related herd reductions. The parity ratio (the relationship between prices paid and prices received by U.S. farmers) dropped from 76 in 1975 to 71 in 1976. Many farmers in South Dakota were engaged in the types of production where the cost-price relationship was even more adverse than the decrease in the national parity ratio indicates.

In South Dakota, commercial banks are the major source of short- and inter-

1

William F. Lytle, Agricultural Engineering Department, South Dakota State University, Brookings, SD 1977, unpublished South Dakota Weather Information.

2

Farm Income Statistics, Statistical Bulletin No. 609. Washington, D.C., July, 1978.

Table 1. Cash Receipts from Farm Marketing, South Dakota and United States, 1972-1978.

Year	United States (billions of dollars)	South Dakota	South Dakota as a percent U.S.
1972	61.190	1.290	2.11
1973	87.068	1.899	2.18
1974	92.449	2.065	2.23
1975	88.209	1.798	2.04
1976	94.501	1.799	1.90
1977	96.084	1.610	1.68
1978*	110.000	1.974	1.79

*Preliminary estimates for 1978 were obtained from unpublished ESCS data for South Dakota and from Farm Index, April 1979, for the United States.

Source: Farm Income Statistics, ESCS, September, 1978 (for years 1972-1977).

mediate-term agricultural credit and also supply considerable funding for the purchase of farm real estate. In rural areas of South Dakota, agricultural loans constitute the major part of the banks' total loan portfolio. Consequently, a healthy agricultural economy is of extreme importance to rural bankers, and a sound banking community is essential for a prosperous agriculture.

A SURVEY OF BANKERS

In early February 1977, a mail survey was distributed to the main offices of South Dakota commercial banks. A total of 158 questionnaires was mailed; 105 were returned (a response of 66.5%).

Banks located in the three largest cities were placed in a single district to observe the differences between urban and more rural banks. The remainder of the state was subdivided into three areas.

The largest cities include the banks headquartered in Sioux Falls, Rapid City, and Aberdeen. The Western District includes banks west of the Missouri River other than Rapid City (Table 2). Figure 1 shows the outline of the districts and the 1976 growing season precipitation as a percent of normal.

The responses by the various banks were not weighted by differentials in bank assets; large banks with a number of branches were treated as a single unit. The banks in the largest cities include many of the state's larger banks. A number of these banks have branches in other districts; information received from banks in this district reflects considerable activity originating in rural areas.

Areas of Loan Expansion

More bankers wanted to increase installment and personal loans than any other loan category (Table 3). Several mentioned loan categories not presented

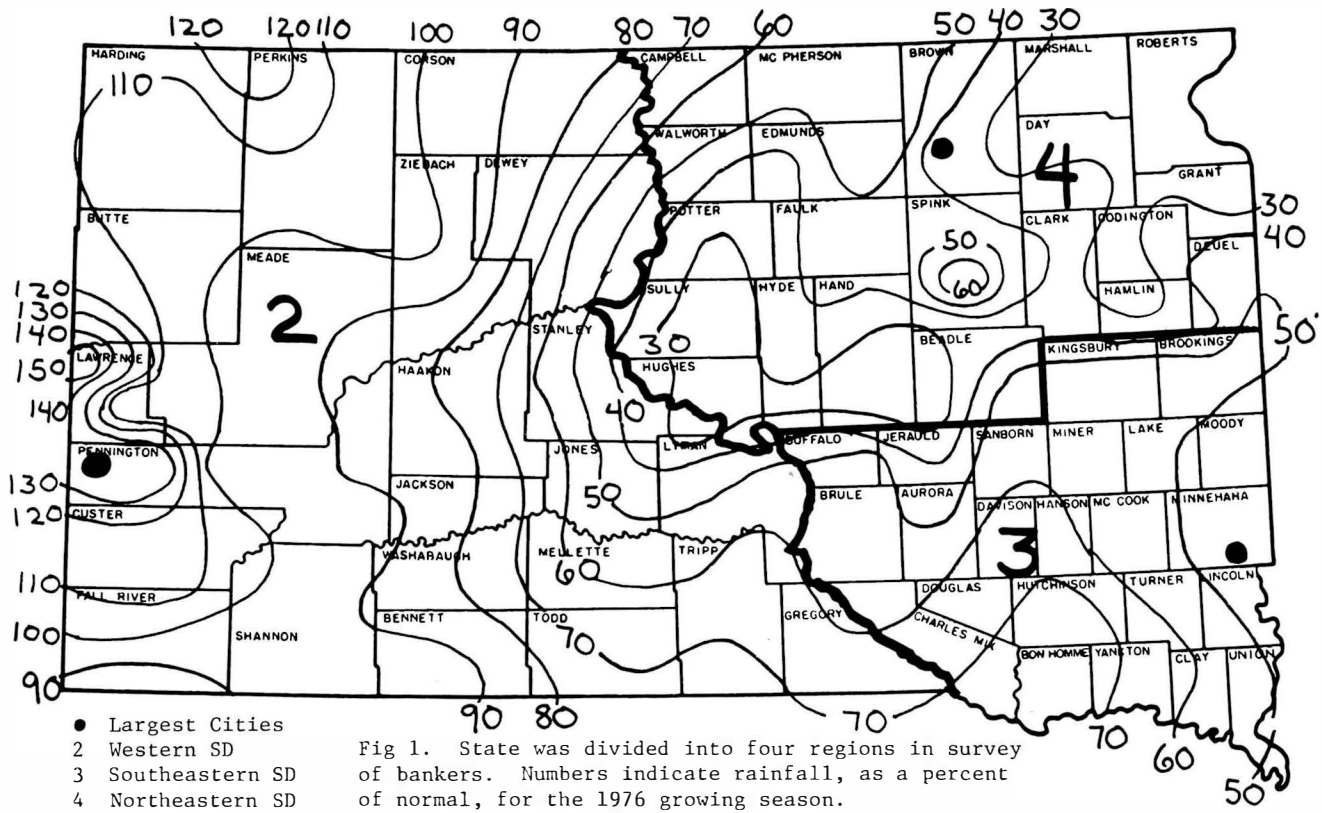


Table 2. Number and Percentages of Banks Responding to South Dakota Bankers Survey, February, 1977.

	Numbers of Banks	Numbers of Banks Responding	Percent Responding
Largest cities	13	9	69
Western SD	26	16	62
Southeastern SD	61	35	57
Northeastern SD	<u>58</u>	<u>45</u>	<u>78</u>
State Total	158	105	66

in the table; these included irrigation loans (especially in southeastern South Dakota) and student loans.

Maximum Capacity

More than half of the bankers indicated that there were no loan categories in which they considered themselves to

be operating at maximum capacity in early 1977. A few commented along these lines: "We always have loans available to our regular customers."

On the other hand, some respondents indicated that they were "loaned up" in all categories.

Table 3. Types of Loans Bankers Want Expanded, South Dakota Bankers Survey, February, 1977 -- (Percent of Respondents).

	State Average	Largest cities	Western SD	South-eastern SD	North-western SD
Industrial and Commercial	51	56	47	57	46
Installment and Personal	71	89	67	61	76
Agricultural Production	54	44	40	43	70
Agricultural Land and Buildings	27	11	13	32	32
Non-Farm Real Estate	30	33	20	32	32

Among bankers who wanted to restrict their lending, long-term loans were frequently mentioned. Responses like "We prefer not to expand longer term loans, but remain flexible and interested in sound short-term loans" were interpreted for tabulation purposes to mean that both agricultural land and building loans and real estate loans were considered to be at maximum capacity in terms of lending preferences.

Most of the comments were included in the categories in Table 4; in addition, three bankers indicated a desire

for no further student loans and one indicated that no further loans would be extended for irrigation.

Proportion of Agricultural Loans

Bankers were asked to indicate the percentage of their total loan portfolio that was composed of agricultural loans. The median responses, by district, are given below:

Largest Cities	Western SD
26 %	75%
Southeastern SD	Northeastern SD
63%	70%

Table 4. Types of Loan Bankers Consider to be at Maximum Capacity, South Dakota Bankers' Survey, February 1977 -- (Percent of Respondents).

	State Average	Largest cities	Western SD	South-eastern SD	North-eastern SD
None	52	56	46	57	49
Industrial and Commercial	11	0	0	11	18
Installment and Personal	6	0	0	7	10
Agricultural Production	20	0	30	18	23
Agricultural Land and Buildings	26	11	38	24	26
Non-farm Real Estate	30	44	23	32	28

These results give an equal weight to all banks independent of size. Since larger banks tend to be located in urban areas where a relatively higher proportion of the loans are of a non-farm nature, the above information tends to overstate the percentage of agricultural loans in the state as a proportion of the total loan portfolio. Aggregate data for the state, based on total loan volume, indicate that on June 30, 1976, nearly 40% of the total loan portfolio and approximately 22% of the total assets of commercial banks in the state involved loans to farmers or loans secured by farmland.

For the entire United States, these types of loans accounted for less than 6% of the loans and about 3% of the bank footings. This same source indicates that total loans secured by farmland

amounted to approximately \$36 million; and loans to farmers, excluding loans on real estate, amounted to about \$691 million in South Dakota.³

The Use of Overlines

A large proportion of the bankers reported utilizing overlines during 1976 (Table 5). An overline is a situation where another agency assumes part of the loan to an individual or corporation.

Agencies for Overlines

Lending agencies that bankers would consider in requesting an overline are ranked in order of importance in Table 6.

³Federal Deposit Insurance Corporation, Assets and Liabilities Commercial and Mutual Savings Banks, June 30, 1975, Reports of Income, Washington, D.C.

Table 5. Percentage of South Dakota Bankers Using Overlines in 1976, South Dakota Bankers Survey, February 1977.

Percentage of Bankers Using Overlines	State Average	Largest cities	Western SD	South-eastern SD	North-eastern SD
For Agricultural Loans	72	33	73	78	73
For Non-agricultural Loans	35	44	53	36	33

Table 6. Sources Considered for Overline Requests, South Dakota Bankers Survey, February 1977 (In Order of Importance).

Type of Bank	State Average	Largest cities	Western SD	South-eastern SD	North-eastern SD
Similar Size S.D. Bank in Another Community	3	2*	3	3	3
Larger Size S.D. Bank in Another Community	1	2*	2	1	1
Bank in Same Community	4	2*	4	4	4
Out-of-State Bank	2	1	1	2	2

*Indicates a tie.

A rating of one indicates an item is most important. For example, of the banks reporting statewide "Larger size S.D. banks in another community" were most strongly favored for overlines; "Banks in the Same Community" were in fourth place.

Several other sources were mentioned; they included correspondent or affiliate banks without further specification and a number of non-bank sources including state government related agencies.

Most frequently, bankers had used a larger size bank in another South Dakota community for overlines in the 2 years before the survey. Banks located in the larger South Dakota communities, however, listed out-of-state banks as their number one response.

Government Participation

Most of the banks were involved in some kind of government related loan program (Table 7).

The Impacts of Current Conditions

When asked if current factors acted "as serious impediments to your lending capacity", the majority of the bankers answered "yes" (Table 8).

Among the respondents not considering the situation at the time the survey was taken to be an impediment to their lending capacity, there were a number of comments to the effect that "so far we have not been affected, but if the drought continues we will be in a bad way."

The Northeastern district, parts of which had less than 40% of normal rainfall, had the same percentage of bankers restricting their lending capacity as in western South Dakota, which was least affected by the drought. The three largest cities, as expected, encountered the fewest impediments to their lending capacity.

Table 7. Government Loan Participation by South Dakota Bankers, South Dakota Bankers Survey, February 1977 (In Order of Most Frequent Response).

	State Average	Largest cities	Western SD	South-eastern SD	North-eastern SD
FmHa Guaranteed or Subordinated	1	2	1	1	1
FmHa Disaster	2	3	3	3	2
FHA or VA	4	1	4	4	4
SBA	3	4	2	2	3

Table 8. Bankers' Perceptions of "impediments" to Lending Capacity, South Dakota Bankers Survey, February 1977.

	State Average	Largest cities	Western SD	South-eastern SD	North-eastern SD
Percent Considering Current Factors to be Serious Impediments to Lending	81	67	80	88	80

Causes for Restrictions

In order to further gauge factors associated with decreased anticipated lending, bankers were asked about the causes for their restrictions (Table 9).

Western South Dakota had respondents who felt that low agricultural prices and other non-drought related factors were responsible for the major part of the impediments to their lending. This region has a large amount of ranching and was least influenced by the 1976 drought. Some of the bankers in this district also

specified high production costs by farmers and ranchers, lack of state jurisdiction over Indian areas, and poor management by some customers as reasons for their reduced lending capacity.

Impacts on Bank Activity

The bankers of South Dakota were further asked to specify in what ways the problems, shown in Table 9, are likely to influence their bank's lending position to their customers. These responses were tabulated in Table 10.

Table 9. Current Factors Hindering Lending Capacity, South Dakota Bankers Survey, February 1977 (Percent of Responses).

	State Average	Largest cities	Western SD	South-eastern SD	North-eastern SD
Drought	70	100	30	67	89
Low Livestock Prices	11	0	10	33	0
Low Prices (General)	14	0	40	0	11
Others	5	0	20	0	0

Table 10. Lending Restrictions Created by Current Factors on South Dakota Banks, South Dakota Bankers Survey, February 1977 (Percent of Responses).

	State Average	Largest cities	Western SD	South-eastern SD	North-eastern SD
Creates a Problem of Loan Collection	19	22	19	19	19
Greatly Increases Loan Demand	20	16	24	18	21
Reduces Time and Demand Deposits Within Your Bank	12	16	10	9	14
Reduces Future Income Earning Capacity of Your Customers	26	22	26	26	26
Anticipate a Need of Having Your Bank Require Greater Security from Marginal Customers	23	22	21	28	20

Bankers' Evaluation of the Credit Structure

The lending practices by commercial credit institutions and the attitudes of commercial bankers are strongly influenced by prevailing economic conditions.

During 1976, rainfall conditions and farm price structure in South Dakota had adverse impacts upon the state's agriculture. The federal government's programs to provide emergency credit and other economic assistance to some of the farmers in drought stricken areas also influenced the farm credit situation.

At the same time, the national economy continued its slow recovery from the worst recession since before World War II, and national monetary markets adjusted to a loosening of credit and a reduction of interest rates from the peak levels of 1974 and 1975.

Credit problems in South Dakota are also influenced by regional differences within the state. For this reason, the bankers' reactions to problems related to the handling of credit in South Dakota are summarized by geographical districts:

Sioux Falls, Rapid City and Aberdeen

Bankers headquartered in the larger cities commented more frequently about problems associated with agriculture than about any other subject. It was mentioned that potential difficulties in the repayment of agricultural loans was a far more serious problem than the availability of funds for agricultural loans.

It was also suggested that commercial banks should become "more informed and more involved" in their lending to agriculture.

Other comments included a suggestion that bankers commit at least half of their total deposits to loans in their community. The need for the consistent and uniform application of credit programs by government agencies was also mentioned.

Western South Dakota

Excessive government regulations were widely criticized by West River bankers. It was felt by some that too much control of farm products is likely to have an adverse effect on agriculture. Governmental regulations involving the

treatment of loan applications were likewise criticized. More effective funding for the Farmers Home Administration was also suggested.

High land prices were considered to be a severe impediment to lenders in the state; it was felt that if economic conditions change and land prices drop, economic disaster would occur. The feeling that "financial people have carried the farmers to the limit" sums up the reaction of several respondents.

The cultivation of marginal farmland is a "sin against our nation" according to one of the bankers; it was suggested that range and farm lands should be handled in such a way as to provide "maximum sustained production."

Some optimistic comments were also made. One respondent stated that South Dakota banks are doing a good job and will meet the challenges of "this spring and summer." Another indicated that "all we need is rain and better prices."

Southeastern South Dakota

Government programs were also in the thoughts of a number of southeastern South Dakota bankers. In general, bankers in this part of the state were somewhat more favorable to the government than bankers in the western district.

Comments ranged from strong condemnation of the red tape and excessive information required by government agencies to pleas for more assistance to farmers who lack good collateral.

Low and fluctuating agricultural prices, especially for cattle, were said to be a major reason for the serious credit problems. The drought was mentioned, although less frequently than might have been expected.

One banker suggested a parity subsidy to farmers to reduce instability, thereby reducing the risk of agricultural loans.

Credit availability for long-term loans (especially real estate and, in one case, irrigation loans) was considered by some to be a particularly serious problem. Several bankers also commented on the variation in the credit repayment abilities of their customers and for the need of bankers to position themselves "to keep their loans from being adversely classified."

An interesting prophecy from one of the bankers involved the establishment of an agricultural credit company, formed by commercial banks, to make it more easily possible to pool credit for agricultural purposes.

Northeastern South Dakota

The drought, farm prices, credit availability, government programs, and high agricultural production costs were on the minds of bankers in the part of the state most adversely influenced by the drought.

Reactions, however, were far from unanimous. One banker expressed the opinion that farmers will need more government aid if they are to continue their operations; another felt that lending by banks and other agencies and government assistance resulted in the creation of a framework in which sufficient agricultural credit is available.

Government programs were evaluated as being both helpful and harmful. Some bankers felt that cooperation between the banks, Farmers Home Administration, and the Small Business Administration was helping to provide a better loan framework for their communities. One respondent felt that banker input is needed in the formulation of FmHA and SBA policies; he stated, "We need a voice for the farmer and his banker."

A number of bankers favored more assistance to farmers by the government, several mentioned drought relief, others favored programs to help young farmers get started.

Government price support, import controls, and other programs that influence farm incomes in South Dakota were also commented on by the respondents.

Great concern existed about credit availability and the repayment of loans. Some felt that low profit margins by farmers, not the availability of funds, was the real problem. Others stated that loan demands were increasing while deposits were going down. The feeling that greater emphasis needs to be placed on the repayment ability of customers was expressed by several bankers.

The credit structure of South Dakota varies from that of the more urban areas of the United States in a number of ways. In South Dakota there is a heavier dependence on commercial banks and other financial intermediaries. The direct placement market plays a much smaller role.

Relationships between the individual and his banker are generally of a more personal nature than in the more populous areas. Agriculture influences the credit markets very strongly. Personal income in South Dakota fluctuates more widely than in most other regions. Agriculture, the state's major industry, is faced with changing weather conditions and erratic changes in the prices for farm products.

At the time that this study was undertaken, uncertainties resulted from the most severe drought in four decades and an adverse price structure for many agricultural products. Even during this unstable period, most bankers indicated a willingness to meet the needs of their customers for short and intermediate term loans. Long-term lending, an area where many commercial banks are reluctant to commit a large part of their portfolio under normal circumstances, encountered the greatest skepticism.

Land has been going up in price more rapidly than can be justified by productive capacity of the land, in the opinion of this writer. As a result problems exist both for farmers, especially young farmers wishing to establish themselves in business, and lending agencies. Respondents, especially in the West River area, were very concerned about this matter. Banker's responses, varied widely in their evaluation of problems related to land prices and in their policy suggestions.

The complexity of the credit structure can be demonstrated by a number of other examples. A number of bankers commented that high land prices create severe problems for borrowers and lenders alike and make credit agencies reluctant to extend long-term credit to farmers. It was also argued, however, that these high real-estate values increased the equity of existing farmers and thereby enabled agricultural lenders to extend more credit

for production types of loans during the drought of 1977 than might otherwise have been possible.

The material presented in this report is almost entirely based upon responses from the state's bankers. In the evaluation of the data it should be taken into consideration that the responses to questions were in part influenced by the unusual economic conditions faced by the state as a result of the drought and other factors during February, 1977. A determination of how changing economic conditions are likely to influence future attitudes by bankers will require additional study and analysis.

No attempt was made to explore the reasons behind the attitudes that were expressed. It is realized that bank management involves a number of--often partially conflicting--objectives. These include profit maximization, low risk, consumer satisfaction and supplying the credit needs of the community.

It is not uncommon for bankers to make decisions which conflict with the goal of short-term profit maximization. During the period of extremely high interest rates in 1975, for example, most

South Dakota bankers extended loans to their customers at interest rates well below those that could have been obtained in the federal funds market. By following this course, however, these bankers helped retain customers, met the economic needs of their community, and possibly improved their own bank's longer-run position.

In view of the many changing conditions influencing banking in South Dakota the value of the information presented in this paper will be enhanced if compared with follow-up studies. Such studies should have the purpose of evaluating fluctuations and presenting a framework for better policy decisions by members of the South Dakota financial community. A study of the various non-bank segments of the credit structure is also needed. A number of bankers mentioned a desire for cooperation with some of these agencies, especially for high risk or long-term loans. An investigation of the feasibility for the greater use of overlines and other forms of cooperation among the diverse segments of the state's credit framework should be a part of such a study.

*A SURVEY OF BANKERS:
CREDIT CONDITIONS AFTER THE 1976 DROUGHT*

*Circular 230
South Dakota Agricultural Experiment Station*