Drought hits the farm banks

The Southwest oil patch has hitherto borne the brunt of the banking collapse, but now the farm states are hard hit too.

As the list of bank failures published by the Federal Deposit Insurance Corporation (FDIC) came off the wires in August, in addition to the failures in California and other oil states, there appeared occasional failures in places like Iowa and South Dakota, farm states which were hit hard by this year's drought.

This, as the federal government continued to wrangle with the problem of keeping the nation's bankrupt savings and loan institutions afloat.

Most of the new failures were banks with relatively smaller holdings than those banks bearing the brunt of the collapse in the Southwest region. Nevertheless, these failures signal a steadily growing problem, in an area which has been on the brink for some time.

Farm banks have just gone through a period of reconsolidation, in the aftermath of record farm failures during the last few years. The number of imperiled U.S. farm banks had shrunk from a peak of 230 on June 30, 1986 down to 126 on Dec. 31, 1987. But the unexpected drought this year forced banks in some farm states to accept charges against earnings as they rebuilt the loan loss reserves that had been allowed to shrink last winter. While 1987 had been billed as a recovery year for farm banks, the "recovery" was more than wiped out by the drought.

The situation is most serious in the Midwest corn belt and spring wheat areas of the Upper Plains states. Ironically enough, many of the farmers who were in the weakest financial situation at the beginning of the year were among those most hurt by the drought.

Rural banks are experiencing a dual problem. Not only are farmers having problems keeping up their loan payments, but the demand for new loans is fast disappearing. Many farmers scrapped plans to buy more land or new equipment as the drought worsened. Nobody has any idea as yet how many farmers are going to miss their loan payments, as they pocket less money from their shrunken crops.

Much will depend on the effect of the $3.9 billion federal drought relief package signed by President Reagan. Some details of the package, however, will not be worked out until the fall. According to some estimates, a farmer who lost 30% of a corn crop to the drought would receive about two-thirds of his normal income under the relief program. State officials in Iowa are estimating that farmers will have trouble making payments on roughly 20% of their loans.

In the other major problem area of the financial spectrum, the Federal Home Loan Bank Board agreed on Aug. 23 to provide $565 million in financial assistance to an investor group that intends to merge two California savings institutions. The group, DP Holdings, Inc., headed by former Treasury Secretary William Simon, will invest $207.5 million.

Under the agreement, the Bell Savings and Loan Association, an insolvent savings institution based in San Mateo, California, which has assets with a current value of $953 million, would be merged with the Western Federal Savings and Loan Association, a healthy savings unit based in Marina del Rey, California, with assets of $2.5 billion.

Bell was one of the most notorious of California's fast-growing savings institutions. By aggressively soliciting $100,000 certificates of deposit, the company grew from $400 million in assets in 1982 to $1.9 billion by 1984. Bell managers then issued loans on a number of commercial construction projects, many of which eventually went into default. In March 1986, the Federal Savings and Loan Insurance Corporation (FSLIC) filed a lawsuit in federal district court in San Francisco against Bell's top officers and directors for fraud and misappropriation of funds. The case is still pending.

Questions are being raised as to how long FSLIC can continue its bailouts of the S&Ls without overriding its present financial limits. Many people fear that Congress will have to increase FSLIC's funds considerably, if it is to keep ahead of the game.

On Aug. 25, Danny Wall, chairman of the Federal Home Loan Bank Board, the organization responsible for FSLIC, predicted that Congress would extend a key tax benefit for acquirers of failed thrifts that expires at the end of the year. Wall expects Congress to extend the tax benefit provisions for at least six months, and perhaps for as long as three years.

So far, the Bank Board has not succeeded in getting the extension included in any legislation moving through the House of Representatives. But Wall remains confident, and probably rightly so; for Congress knows that if it plays hardball on the tax benefit issue, it may be forced to foot the entire bill as the S&Ls start tumbling down.