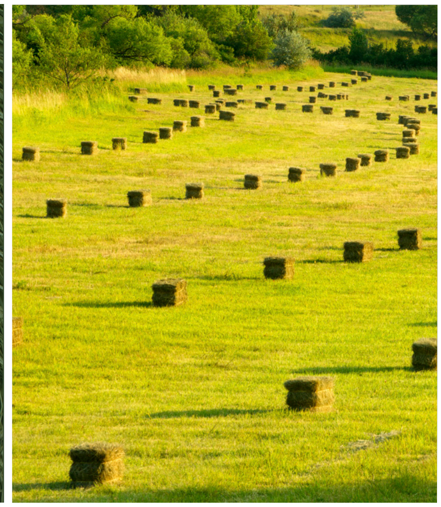
SURVEY *of* TENTH DISTRICT

Agricultural Credit Conditions

1st Quarter 2011

Federal Reserve Bank *of* Kansas City



The Farm Boom Continues

By Brian Briggeman, Economist, and
Maria Akers, Associate Economist

District farm income and farmland values rose further in the first quarter of 2011. Shrinking crop inventories and intense competition for planted acreage lifted crop prices, while stronger protein demand boosted livestock prices. With robust farm income, farmland values posted sharp gains akin to the swift rise in 2008. Across District states, cropland values surged 20 percent above year-ago levels, particularly in Kansas and Nebraska. Bankers also reported a sharp jump in cash rental rates that echoed the rise in cropland values, especially for irrigated acreage. Most bankers expected farmland values to stabilize during the next three months.

> *"With robust farm income, farmland values posted sharp gains akin to the swift rise in 2008."*

Farmers continued to finance farm real estate purchases with cash payments and existing equity. With stronger farm income, more borrowers boosted cash down payments and pledged existing equity for farmland purchases. Overall, bankers reported that borrowers financed about half of the total value of new farmland purchased with new debt. One contact noted that young and beginning farmers used USDA loan guarantee programs to secure farm real estate loans.

After strengthening at the end of last year, farm credit conditions held steady in the first quarter. Loan repayment rates remained strong, and loan renewals and extensions held at low levels. Oklahoma bankers, however, were concerned that a severe drought could slash yields, lower farm income and lead to a deterioration in loan repayment rates. In addition, some District bankers expressed concerns that elevated crop and livestock prices might fall and narrow profit margins. With higher loan repayment rates, District bankers reported that ample funds were available for farm loans at historically low interest rates. Many bankers reported weak loan demand as producers paid for higher fertilizer, fuel and feed costs with cash. Still, some bankers expected farm loan demand to rise during the next three months.

Chart 1
Nonirrigated Farmland Values:

*Percent change from the previous year**

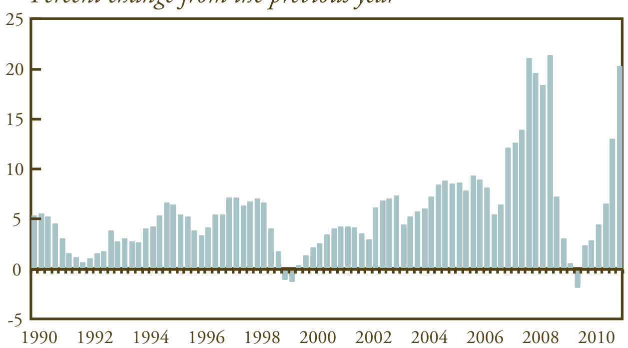
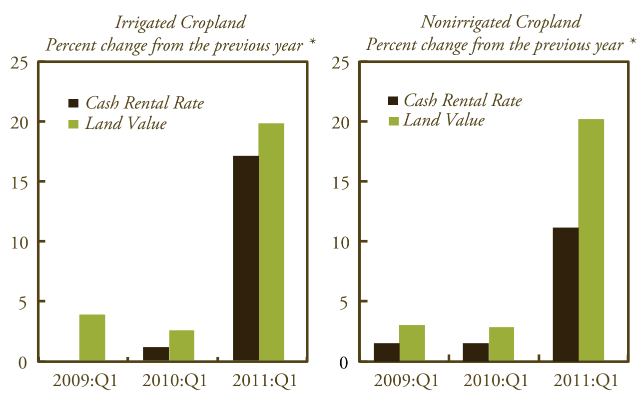


Table 1
Farmland Value Gains by State:

*Percent Change from the previous year**

	Nonirrigated	Irrigated	Ranchland
Kansas	23.8	18.3	11.2
Missouri	16.9	n/a**	12.1
Nebraska	23.7	23.5	11.0
Oklahoma	14.5	n/a**	10.4
Mountain States	10.6	12.4	11.2

Chart 2
Farmland Values and Cash Rental Rates-Annual Gains:



District farmland values climbed higher as rising crop and livestock prices strengthened farm income. In the first quarter of 2011, the value of nonirrigated and irrigated cropland in the District soared 20 percent above year-ago levels, rivaling some of the record increases seen in 2008 (Chart 1). Nebraska and Kansas enjoyed the strongest cropland value gains, with nonirrigated cropland rising roughly 24 percent during the past year (Table 1). Strong demand for farmland and limited supplies of farms for sale continued to support record-high cropland values. More than two-thirds of survey respondents expected cropland values to level off as the growing season gets underway.

Ranchland values also climbed sharply, rising 11 percent above year-ago levels. Stronger profits for livestock operators and increased demand for cattle grazing boosted ranchland values across the District. In addition, booming energy exploration lifted land lease revenues and farmland values, especially in the mountain states and Oklahoma.

Bankers reported that gains in cash rental rates have begun to accelerate, especially for irrigated acreage (Chart 2). Compared to last year, District cash rental rates for irrigated cropland rose an average of 17 percent, close to the 20 percent annual gain in land values. The change in nonirrigated cash rental rates, however, varied widely due to disparate soil conditions across the District. In Nebraska, where soil moisture was generally adequate, nonirrigated cash rental rates rose 18 percent, whereas in Oklahoma, nonirrigated cash rental rates rose a modest 1.6 percent, due in part to severe drought conditions.

**Percent changes are calculated using responses only from those banks reporting in both the past and the current quarter.*
***Not reported due to small sample size.*

Chart 3
Farm Income and Capital Spending:

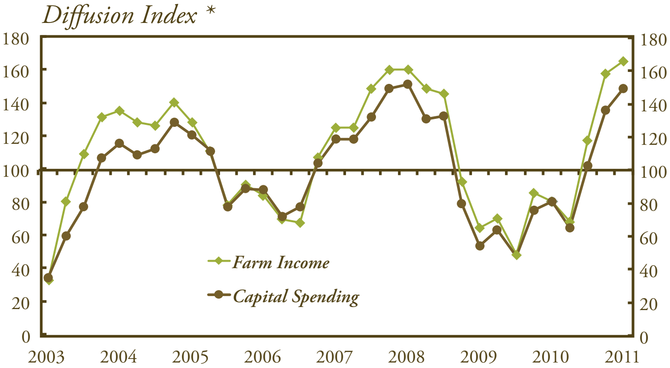


Chart 4
Farm Income, Capital Spending and Household Spending:

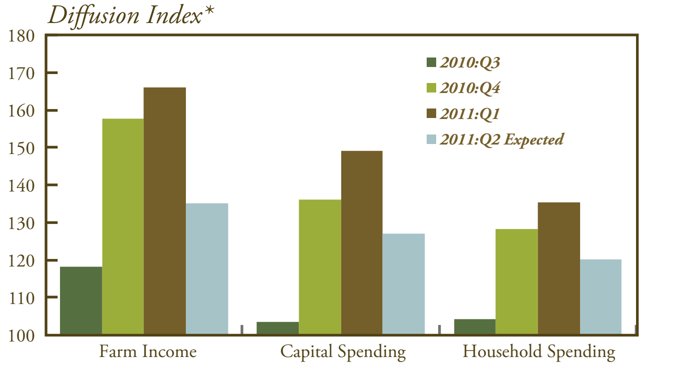
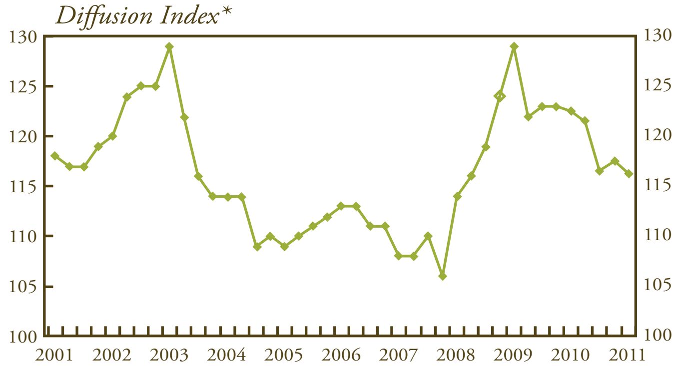


Chart 5
Collateral Requirements:



Similar to 2008, farm income soared with higher commodity prices. In the first quarter of 2011, the farm income index rose to its highest level in a decade (Chart 3). Crop prices rose steadily with shrinking crop inventories, adverse weather conditions and competition for acreage as spring planting approached. Cattle and hog prices also moved higher with stronger global demand for protein. Elevated farm income continued to support robust capital spending.

Most bankers felt that farm income would hold at elevated levels, although a small number felt that rising input costs or poor crop and grazing conditions would limit incomes during the next three months. As a result, farm capital and household spending was expected to decline slightly but remain at elevated levels (Chart 4).

District bankers reported that farmers were increasing the use of cash payments and equity to finance farmland purchases. About a third of those surveyed noted an increase in the use of cash as a down payment. Nearly a quarter of the bankers reported that more borrowers were pledging existing equity in real estate holdings to secure farm real estate loans. For new farmland purchases, on average, 20 percent of the financing came from a cash down payment, 30 percent with a pledge of existing equity and the remaining 50 percent with new debt. After easing since early 2009, bankers reported holding collateral requirements steady for the last three quarters (Chart 5).

**Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.*

Chart 6
Farm Loan Repayment Rates and Renewals and Extensions:

*Diffusion Index **

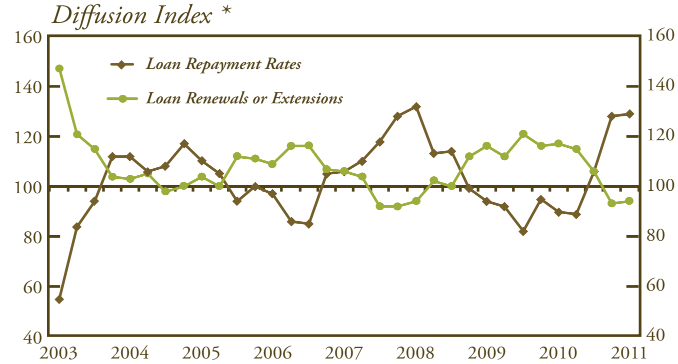


Chart 7
Farm Loan Demand and Funds Availability:

*Diffusion Index **

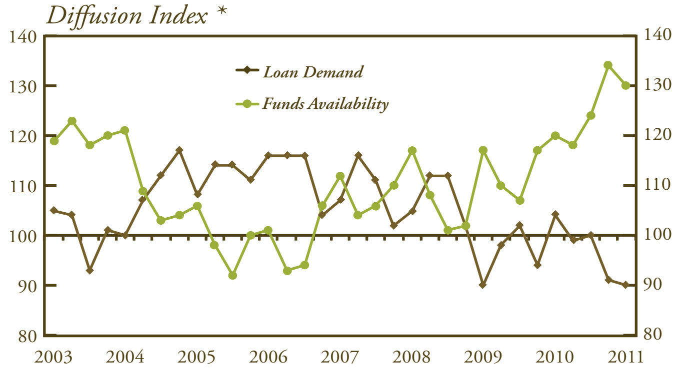
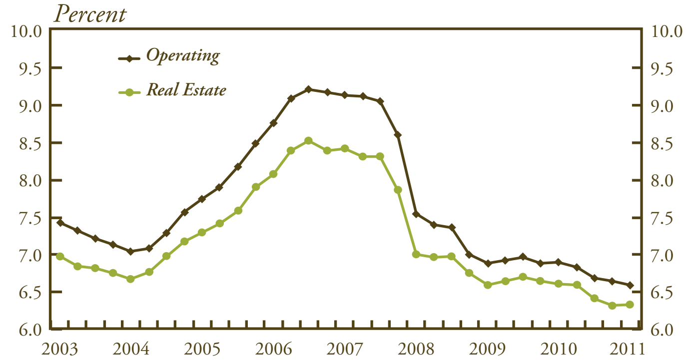


Chart 8
Farm Interest Rates:

Percent



After improving at the end of last year, farm credit conditions generally held steady in the first quarter of 2011. The loan repayment index remained elevated as farmers continued to use profits to pay down debt (Chart 6). Bankers also reported the number of loan renewals or extensions held at a relatively low level. In addition, there were very few referrals to nonbank credit agencies. Looking forward, Oklahoma was the only state where more bankers anticipated loan repayment rates would fall, largely due to deteriorating wheat crop conditions that could hurt farm income prospects.

Farm loan demand remained weak (Chart 7). Many farmers ended 2010 with strong financial statements and high levels of liquidity, allowing them to pay for production expenses with cash rather than debt. More bankers reported lower demand for operating loans despite higher farm input costs. Just over half of survey respondents expected farm loan demand would remain flat, while a third thought demand for farm loans would increase during the next three months.

With soft farm loan demand, the funds availability index remained high. In fact, less than 2 percent of bankers refused a loan due to a shortage of funds. Most survey respondents expected that funds available for farm loans would be more than sufficient to satisfy future loan demand. Interest rates on operating loans edged down further, averaging 6.6 percent, while interest rates on farm real estate loans held at an average of 6.3 percent (Chart 8).

**Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and adding 100.*

BANKER COMMENTS *from* *the* TENTH DISTRICT

"Strong grain and cattle prices have helped with debt paydown while encouraging some equipment and real estate purchases." – Western Missouri

"2011 appears to have the potential to repeat excellent gains, even with increases in cash rents and other crop inputs." – Northeast Colorado

"Current agricultural land prices are a concern to me as I am afraid they may be a bubble in the making." – North Central Missouri

"Operating lines of credit are smaller due to excellent income last year. " – Southwest Kansas

"Volatile times in the ag industry. Cash flows work well at today's crop prices, but not if prices fall." – Southeast Nebraska

"Demand for agricultural properties is still very strong from farmers, ranchers and outside investors." – Southeast Colorado

"With land values rising so quickly, we are requiring larger down payments in the form of cash or equity on farmland loans." – Eastern Nebraska

"We have had a lot of oil and gas leases in the last three months, paying a higher rate per acre." – South Central Kansas

"The Oklahoma panhandle remains very dry, rain is needed to help producers take advantage of high market prices." – Western Oklahoma

"Loan demand will be up due to higher feeder livestock prices and input costs for fuel and fertilizer." – Northeast New Mexico

Note: *256 banks responded to the first-quarter Survey of Agricultural Credit Conditions in the Tenth Federal Reserve District—an area that includes Colorado, Kansas, Nebraska, Oklahoma, Wyoming, the northern half of New Mexico, and the western third of Missouri. Please refer questions to Brian Briggeman, economist, or Maria Akers, associate economist, at 1-800-333-1040, or* ***Brian.Briggeman@kc.frb.org*** *or* ***Maria.Akers@kc.frb.org****. The views expressed in this article are those of the authors and do not necessarily reflect the views of the Federal Reserve Bank of Kansas City or the Federal Reserve System.*

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