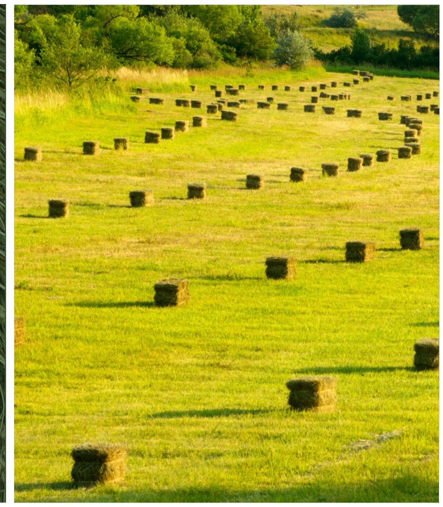
SURVEY *of* TENTH DISTRICT

Agricultural Credit Conditions



2nd Quarter 2011 | Federal Reserve Bank *of* Kansas City

Drought Wilts Farm Income

By Jason Henderson, Omaha Branch Executive, and Maria Akers, Associate Economist

In the second quarter, extreme weather and rising input costs cut District farm incomes. In the southern Plains, severe drought lowered wheat yields, and poor pasture conditions hastened herd liquidations and increased cattle feeding costs. Plentiful rainfall improved growing conditions in the central Plains but worsened flooding along the swollen Platte and Missouri Rivers. High crude oil prices and rising feed costs drove farm production expenses higher.

With shorter profit margins, bankers noted less capital spending on machinery and equipment. However, more bankers indicated that rising fuel, fertilizer and feed costs could boost operating loan demand in the fall. Several contacts noted increased competition among commercial banks, Farm Credit associations and vendor creditors to attract quality loans. Collateral requirements eased and interest rates continued to trend down.

"…severe drought lowered wheat yields, and poor pasture conditions hastened herd liquidations…"

Despite weaker farm incomes, bankers reported strong farm loan portfolios in the second quarter. Although loan repayment rates slowed from record highs, bankers expected repayment rates to rise over the next three months. Most banks had few nonperforming farm loans, and those with delinquencies felt that most repayment issues could be managed without major loan restructuring or forced sale of assets.

During the second quarter, District farmland values rose further, although the pace of gain slowed. Compared to first quarter gains, District cropland values rose moderately and remained 20 percent above year-ago levels. District ranchland values edged up and held 11 percent above year-ago levels. Oklahoma bankers reported the smallest year-over-year rise in farmland values, while Nebraska farmland values appreciated the most compared with both last quarter and last year. Looking ahead, the majority of bankers felt that farmland values would hold at current levels for the rest of the growing season.

Chart 1
Tenth District Farm Income

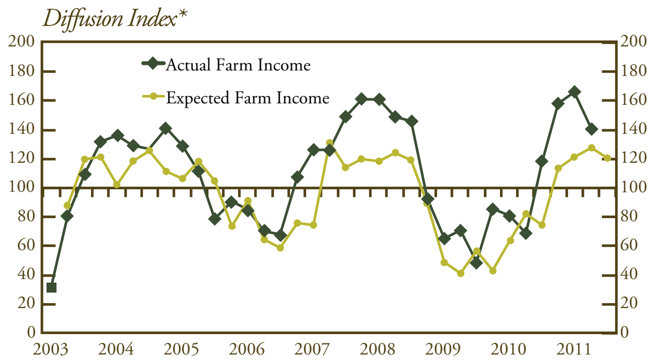


Chart 2
Nebraska and Oklahoma Farm Income

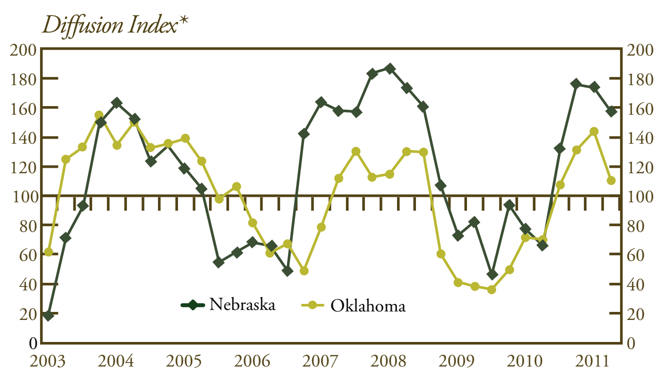
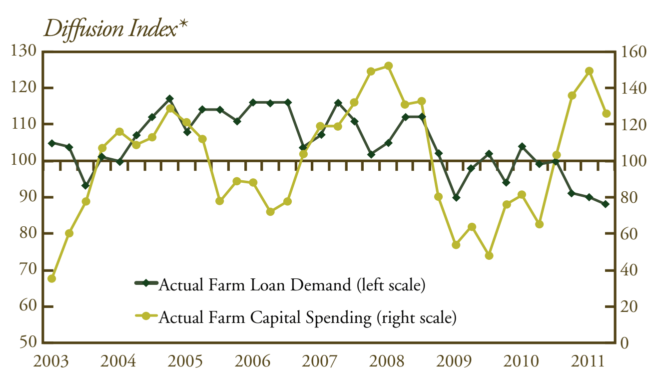


Chart 3
Tenth District Farm Loan Demand and Capital Spending



The farm income index fell in the second quarter as extreme weather conditions and rising input costs strained profit margins (Chart 1). More bankers expected farm incomes to slow further in coming months. In the southern Plains, farm income expectations wilted as drought cut District wheat production. In addition, poor grazing conditions prompted herd liquidations and increased cattle feeding costs. As a result, Oklahoma bankers reported the steepest drop in farm incomes during the second quarter (Chart 2). Several respondents noted increased reliance on crop insurance to support farm income levels.

In the central Plains, farm income expectations declined to a lesser degree. Farm profits were trimmed as crop farmers paid more for production inputs, such as seed and fertilizer, and livestock producers paid high feed costs. Yet, plentiful rainfall fostered pasture and crop development, reducing irrigation costs. Heavy snow melt and rain led to flooding along the Missouri and Platte Rivers, with the hardest hit areas in Nebraska, Missouri and Kansas.

Bankers reported that operating loan demand remained sluggish but was expected to pick up in the third quarter (Chart 3). Bankers also anticipated a further slowdown in capital spending after many farmers upgraded equipment at the end of last year. Several contacts commented on increased competition for loans among commercial banks, Farm Credit associations and vendor creditors. Bankers reiterated that ample funds were available for qualified borrowers. Less than 1 percent of survey respondents reported refusing a loan due to a shortage of funds.

** 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 4
Tenth District Farm Loan Repayment Rates

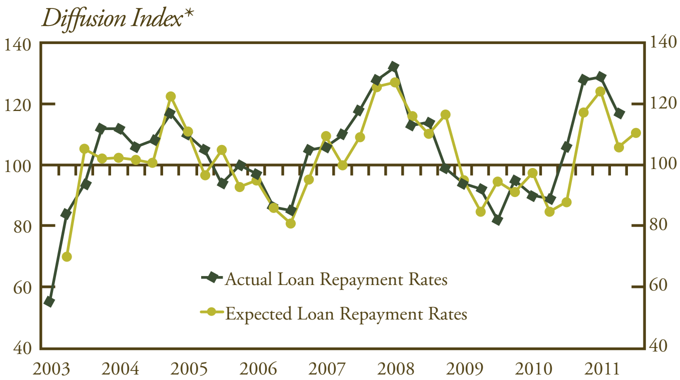


Chart 5
Tenth District Collateral Requirements and Referrals to Non-bank Credit Agencies

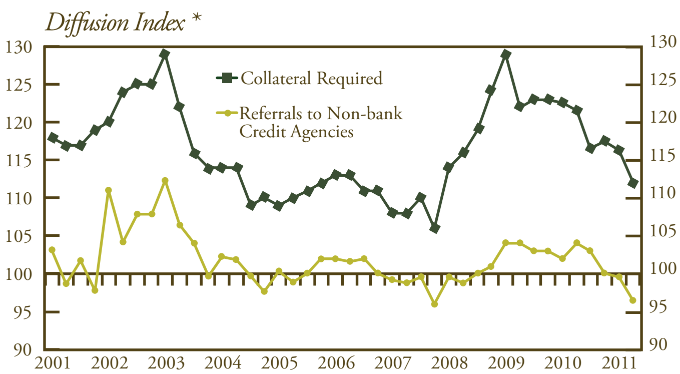
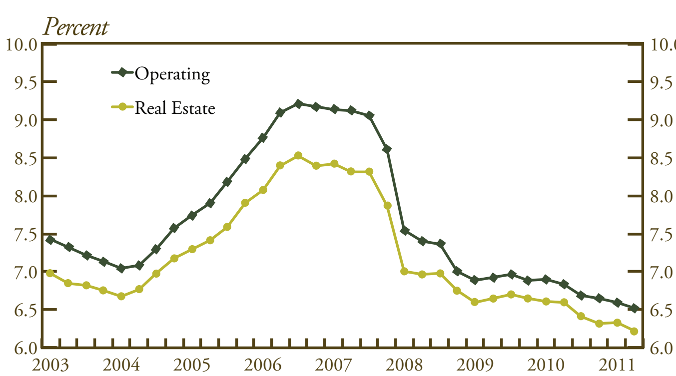


Chart 6
Tenth District Farm Interest Rates



Farm credit conditions edged down in the second quarter. After peaking in the first quarter, the farm loan repayment index eased but was expected to improve despite weaker farm income expectations (Chart 4). After rising slightly in the second quarter, the number of farm loan renewals and extensions was expected to hold steady during the next three months. Credit conditions varied across the District with fewer requests for loan renewals and extensions in Nebraska offsetting an increase in loan restructuring reported by Oklahoma bankers.

Still, most bankers reported healthy farm loan portfolios. When asked about loan repayment issues, bankers responded that, on average, 90 percent of their loans had no significant repayment problems, roughly 7 percent had minor repayment issues that could be managed easily, 2 percent would require major restructuring, and less than 1 percent would likely result in a loss or forced sale of assets. In addition, more than half of survey respondents did not have any nonperforming loans more than 90 days past due. On average, loans to livestock operators accounted for more than one-third of delinquencies, loans to crop producers made up another third, and loans for specialty crops, real estate and other purposes accounted for the remaining third.

With strong farm loan portfolios, bankers reported another round of easing in collateral requirements (Chart 5). Also, fewer bankers referred borrowers to non-bank credit agencies. Interest rates fell further as lenders competed for quality borrowers. In the second quarter, interest rates averaged 6.5 percent on operating loans and 6.2 percent on real estate loans (Chart 6).

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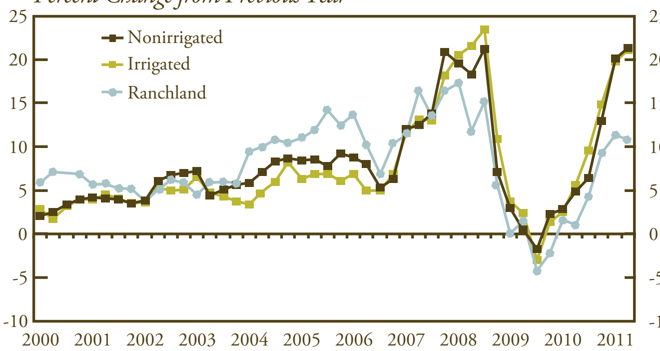
Chart 7
Tenth District Farmland Value Gains

*Percent Change from Previous Year**



Percent changes are calculated using responses only from those banks reporting in both the past and the current quarter.

Table 1
Farmland Value Gains by State

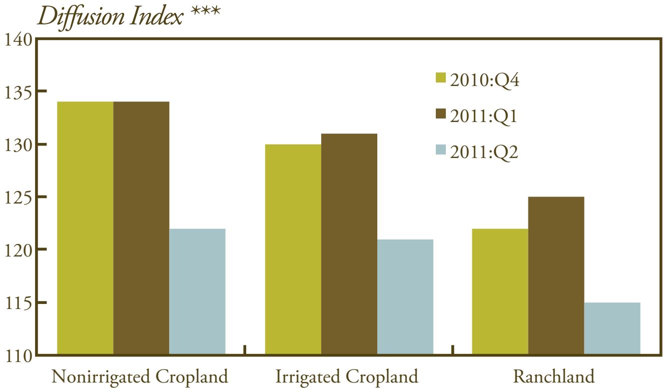
*Percent Change from Previous Year**

	Nonirrigated	Irrigated	Ranchland
Kansas	21.4	15.2	8.4
Missouri	16.7	n/a**	11.0
Nebraska	30.3	29.1	16.9
Oklahoma	10.5	n/a**	6.4
Mountain States	11.0	10.6	9.2

*** 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 8
Expected Trend in Farmland Values During the Next Three Months

Diffusion Index ***



Farmland values rose further in the second quarter, although the pace of farmland value appreciation slowed. The value of nonirrigated and irrigated cropland in the District climbed 2.3 percent and 3.9 percent, respectively, above levels in the previous quarter to remain 20 percent above year-ago levels (Chart 7). District ranchland values edged up only 1.0 percent from the first to second quarter and held at 11 percent above year-ago levels. Noting the slowdown in value gains since the end of last year, three-quarters of survey respondents felt that farmland values would level off in the coming months.

Farmland value gains fluctuated across the District with disparate weather patterns. Plentiful rain and good growing conditions in Nebraska fueled the largest jump in second quarter cropland values with a 30-percent year-over-year price gain (Table 1). In contrast, drought conditions in the southern Plains hurt wheat crop yields, prompted herd liquidations and restrained farmland value gains. Still, land lease revenues from energy exploration were expected to support farmland values in some of the drought-stricken areas, particularly in Oklahoma and the mountain states.

Most survey respondents expected that strong demand for farmland and tight supplies would keep prices elevated near current levels (Chart 8). Farmers and non-farm investors continued to compete for quality acreage with some contacts indicating that sales of marginal ground have also picked up. The number of farms on the market remained low but could increase after the fall harvest.

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BANKER COMMENTS *from* *the* TENTH DISTRICT

"No rain in our area, failed crops and high input prices will increase need for operating dollars."

– Central Oklahoma

"Farmers are holding back on capital purchases, price of crop inputs high, dry conditions increasing costs to cattlemen."

– Western Kansas

"Crop farmers are doing better as mountain snowmelt has kept irrigation water plentiful."

– Southeast Colorado

"Drought conditions on pastures are causing livestock to be sold."

– Southwest Kansas

"Severe drought hurt crops but farmers will receive income from crop insurance."

– Southwest Oklahoma

"Missouri River flooding has the potential to affect over 400,000 acres of crop production plus the cost of clean-up and building repairs."

– Eastern Nebraska

"Experiencing some flooding along the Missouri River, uncertainty high but most operations covered by crop insurance."

– Western Missouri

"Most land sales are cash from outside buyers."

– Southeast Wyoming

"Rate competition is strong from Farm Credit and banks with surplus cash."

– Northwest Kansas

"Farmers have strong cash flow, no repayment problems at this time."

– Eastern Nebraska

__Note:__ 246 banks responded to the second-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 Jason Henderson, Omaha Branch executive, or Maria Akers, associate economist, at 1-800-333-1040, or __Jason.Henderson@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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