Agricultural Finance Databook

NATIONAL TRENDS IN FARM LENDING

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Large Banks Cut Rates and Boost Farm Lending

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Despite softer national farm loan activity, larger banks cut interest rates on non-real estate loans to boost farm lending in the third quarter. Large banks, those with farm loan portfolios greater than $25 million, dropped the average effective interest rate on non-real estate farm loans to 3.6 percent during the quarter, well below the rate charged at small or mid-sized banks. These lower interest rates spurred sharp annual gains in non-real estate loan volumes at large banks, compared to declines at small or mid-sized banks. Large banks originated most of their loans with floating interest rates, whereas small and mid-sized banks extended variable rates on less than half of their loans. Despite a recent decline, the risk ratings and delinquency rates on farm loans at large banks remained well above levels at other small and mid-sized banks.

> *"lower interest rates spurred sharp annual gains in non-real estate loan volumes at large banks"*

Still, overall farm lending was flat in the third quarter as strong agricultural profits limited non-real estate loan demand. Operating loan volumes held steady with higher input costs, but equipment and livestock loan volumes fell below year-ago levels. Loans for farm machinery plummeted as many producers already upgraded equipment following last year's harvest. Bankers indicated ample funds were available for qualified borrowers, and some bankers eased collateral requirements on non-real estate loans.

In contrast, farm real estate loans accounted for a larger share of farm lending during the third quarter. National farmland values climbed higher in the second quarter, with anecdotal evidence of further gains during the third quarter. Annual farmland value gains reached record levels in many states, most notably in the Corn Belt and Northern Plains where land prices rose more than 25 percent above year-ago levels.

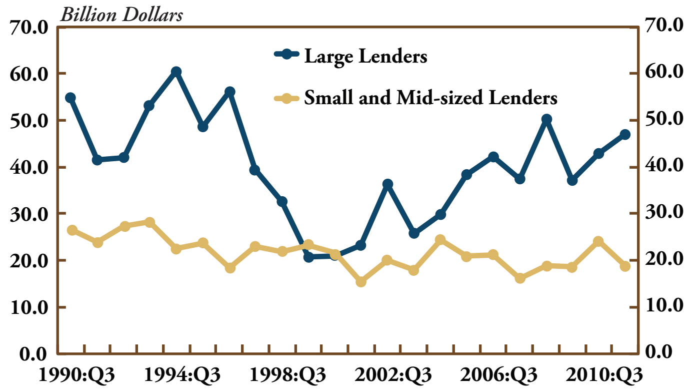
Agricultural banks posted solid profits in the second quarter as improved repayment rates trimmed farm loan delinquencies. Lower delinquency rates on non-real estate loans and steady delinquency rates on real estate loans helped strengthen bank profits. Moreover, a decline in the volume of farm loans 30 to 90 days past due suggests that additional declines in farm loan delinquency rates may be forthcoming.

Section A Summary

Third Quarter National Farm Loan Data

Large banks with farm loan portfolios greater than $25 million boosted non-real estate farm lending activity in the third quarter to roughly offset declining loan volumes at small and mid-sized banks (Chart 1). The average effective interest rate fell well below 4 percent at large banks where more than 90 percent of loans were originated with a floating interest rate (Chart 2). In contrast, effective interest rates at small and mid-sized banks held at 5.8 percent and 40 percent of loans were extended with a floating interest rate.

Chart 1: Non-real Estate Loan Originations During the Third Quarter

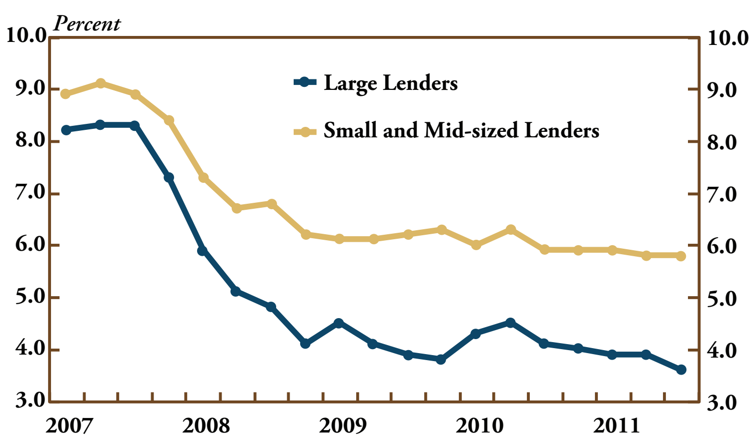


Source: Agricultural Finance Databook, Section A
Note: Large lenders had more than $25 million in their farm loan portfolio. Small and mid-sized lenders typically had less than $25 million in their farm loan portfolio.

Farm real estate loan activity accelerated in the third quarter and accounted for a larger share of commercial bank lending activity, especially at large banks. Real estate loans comprised more than 12 percent of large bank lending activity, almost double the rate during the past year. The average effective interest rate on farm real estate loans has hovered around 5.5 percent the past two quarters, with moderately lower rates charged at larger banks.

In contrast, non-real estate loan volumes edged down during the quarter. Steady operating loan volumes and a jump in the volume of farm loans for other purposes helped underpin non-real estate lending activity in the third quarter. Operating loan volume shifted away from small and mid-size lenders to larger agricultural banks where average effective interest rates were lower.

Chart 2: Average Effective Interest Rates on New Non-real Estate Farm Loans



Source: Agricultural Finance Databook, Section A
Note: Large lenders had more than $25 million in their farm loan portfolio. Small and mid-sized lenders typically had less than $25 million in their farm loan portfolio.

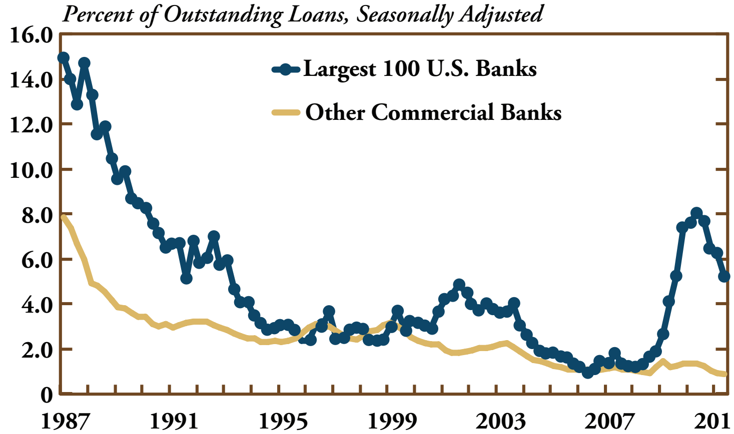
After spiking earlier this year, loan volumes for farm machinery and equipment dropped by almost half compared to the third quarter of 2010. The volume of loans to the livestock sector also fell during the quarter and contributed to shrinking farm loan portfolios at small and mid-sized agricultural banks. The average effective interest rates on farm machinery and equipment held steady, but interest rates on feeder livestock ticked up. The average maturity on most non-real estate loans lengthened slightly during the quarter.

Section B Summary

Second Quarter Bank Call Report Data

Non-real estate loan performance strengthened in the second quarter, especially at the largest 100 U.S. banks. Delinquent non-real estate loan volumes declined further and comprised 2.3 percent of outstanding farm production loans in the second quarter. The biggest decline emerged at the largest 100 U.S. banks where delinquency rates on non-real estate loans fell below 6 percent for the first time in 2 years (Chart 3). Still, non-real estate delinquency rates at large banks remained well above the rates at other commercial banks. Looking ahead, the volume of non-real estate loans 30 to 90 days past due dropped to its lowest level since 2007, which could push delinquency rates down further during the coming months.

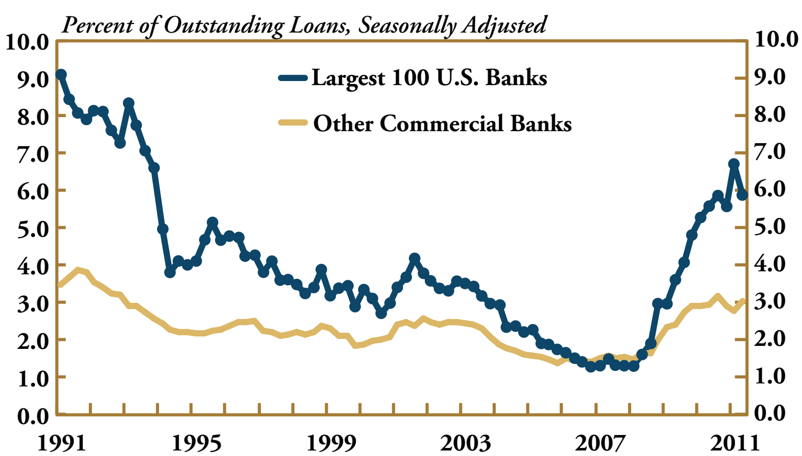
Chart 3: Delinquency Rates on Non-real Estate Farm Loans



Source: Federal Reserve Board of Governors

Delinquency rates on farm real estate loans stabilized during the quarter. After steadily rising the past 4 years, delinquency rates on real estate loans fell below 6 percent at the largest 100 U.S. banks (Chart 4). In contrast, at other commercial banks, delinquency rates on non-real estate loans edged up. Still, delinquency rates at larger commercial banks remained significantly higher than at other banks. With strong demand for farmland, farm real estate loan volumes rose slightly from last quarter and last year.

Chart 4: Delinquency Rates on Farm Real Estate Loans



Source: Federal Reserve Board of Governors

Agricultural bank returns in the second quarter remained solid, and improvements in farm loan delinquency rates could lift future profits. Compared to a year ago, the rate of return on assets at agricultural banks held at 0.5 percent, while returns edged up to 0.2 percent for other small banks. The average rate of return on equity at agricultural banks was 4.5 percent in the second quarter, more than double the 1.9 percent posted at other small banks. With stronger profits, average capital ratios at both agricultural banks and other small banks rose.

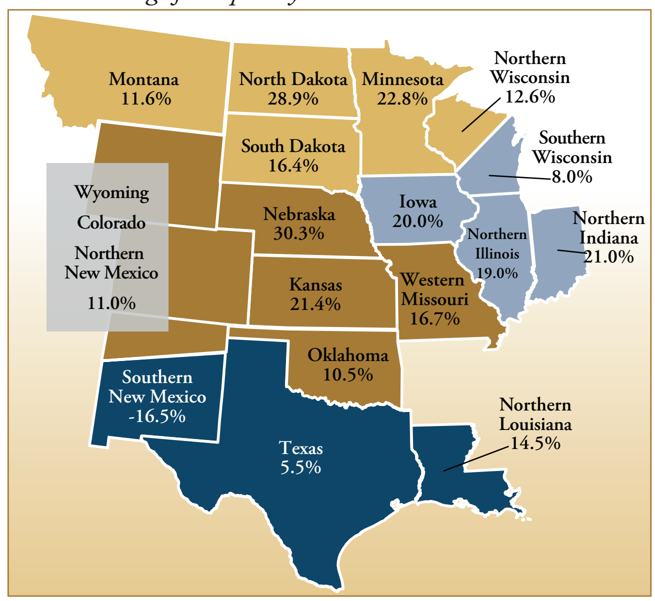
Section C Summary

Second Quarter District Agricultural Conditions

Though rising input costs narrowed profit margins, high energy and agricultural commodity prices continued to support farm income and farmland values in the second quarter. Reductions in crop production forecasts and strong export demand kept crop prices high and land lease revenues boosted farm incomes in energy producing regions. Still, extreme weather conditions affected farm income in specific locations. The Dallas and Kansas City Districts reported crop losses in the Southern Plains due to drought, while summer flooding and hurricanes damaged fields in the Minneapolis, Kansas City, and Richmond Districts. However, crop insurance was expected to help mitigate lost farm income due to natural disasters.

Map 1: Value of Non-Irrigated Cropland
Second Quarter 2011

Percent change from prior year



Source: Federal Reserve District Surveys (Chicago, Minneapolis, Kansas City, Dallas)

Farmland values rose further in the second quarter, but gains varied with weather patterns. Most states in the Chicago, Minneapolis and Kansas City Districts posted additional gains in year-over-year cropland values, with annual appreciation as high as 30 percent (Map 1). Ranchland value gains, however, were not as robust, especially in states suffering from drought. The Chicago District noted a slight increase in number of farmland auctions, but fewer farms were for sale in the Kansas City District during the growing season. Overall demand for farmland remained strong from both farmers and nonfarm investors. Though most survey respondents expected farmland values to stabilize, some bankers in the Chicago and Kansas City Districts felt farmland values would continue to rise, albeit at a slower pace.

With strong farm incomes, agricultural credit conditions improved while farm loan demand languished. Survey respondents in every district reported steady to lower demand for operating loans in the second quarter as producers paid for rising input costs out-of-pocket. Bankers in the Dallas, Chicago and Richmond Districts reported declining volumes for feeder cattle, crop storage and dairy loans. Capital spending on farm machinery and equipment also fell in all districts as many farmers completed equipment upgrades earlier in the year. During the second quarter, loan repayment rates at agricultural banks remained high, and the number of loan renewals and extensions held steady or fell in all districts except Richmond. Survey respondents reported ample funds were available for farm loans at low interest rates, and collateral requirements eased at some banks in the Kansas City District.