Agricultural Finance Databook

NATIONAL TRENDS IN FARM LENDING

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Rising Farm Income Boosts Farmland Values & Bank Profits

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Strong farm income propelled farmland values to record highs and strengthened loan portfolios at agricultural banks at the end of 2011. Crop prices remained historically high but volatile through the fall harvest, underpinning robust farm income expectations in areas with favorable yields. Cropland values across the Corn Belt and northern Plains soared to all-time highs with many states posting annual value gains between 20 and 40 percent. In addition, ranchland values rose sharply compared to last year as high feed costs boosted demand for prime pasture ground. Even drought-stricken areas of the southern Plains posted modest farmland value gains as crop insurance payments and land lease revenues from mineral rights underpinned incomes. Brisk bidding at farmland auctions kept prices high and enticed landowners to place their land holdings up for sale.

> *"Cropland values across the Corn Belt and northern Plains soared to all-time highs"*

Agricultural bank profits improved as borrowers repaid farm debts. In the third quarter, the return on assets at agricultural banks rose further and remained stronger than their banking peers. The share of delinquent farm real estate loans fell, and delinquent non-real estate loan volumes hit their lowest level since 2009. Bankers reported fewer loan renewals and extensions, so the downward trend in delinquency rates will likely continue.

Rising farm incomes boosted liquidity in the farm sector and slowed non-real estate lending in 2011. Agricultural bankers reported soft operating loan demand throughout the year. With more deposits and limited gains in non-real estate loan volumes, the average loan-to-deposit ratio at agricultural banks plunged to its lowest level in a decade during the third quarter with weaker activity in the fourth quarter. According to farm loan survey data from the week of Nov. 7-11, 2011, commercial banks made substantially fewer short-term loans for livestock and operating expenses compared to last year.

Commercial banks struggled to maintain market share in an extremely competitive lending environment. Intense competition for loans led to more favorable loan terms, reduced interest rates and lengthening of some loan maturities by agricultural lenders. According to call report data, farm real estate loan volume at commercial banks for the third quarter was up just 0.6 percent compared to last year. In contrast, third quarter financial statements from the Farm Credit System reported 4.4 percent growth in farm mortgage loan volume year-to-date.

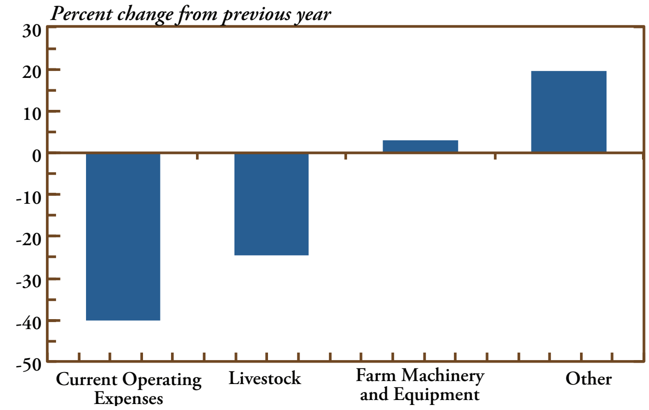
Section A Summary

Fourth Quarter National Non-real Estate Farm Loan Data

Non-real estate farm loan volumes fell in the fourth quarter as strong farm income lessened the need for financing and herd liquidations reduced livestock loan originations. According to loan survey data from the week of Nov. 7-11, 2011, operating loan volumes dropped by 40 percent compared with last year as more farmers paid cash for production expenses (Chart 1). The effective interest rate charged by commercial banks on operating loans varied by lender but averaged 5.0 percent in the fourth quarter (Chart 2). Small and mid-size commercial banks charged an average interest rate of 5.8 percent while large commercial banks offered a substantially lower rate of 4.7 percent.

Chart 1:Farm Loan Volumes by Purpose

Fourth Quarter 2011



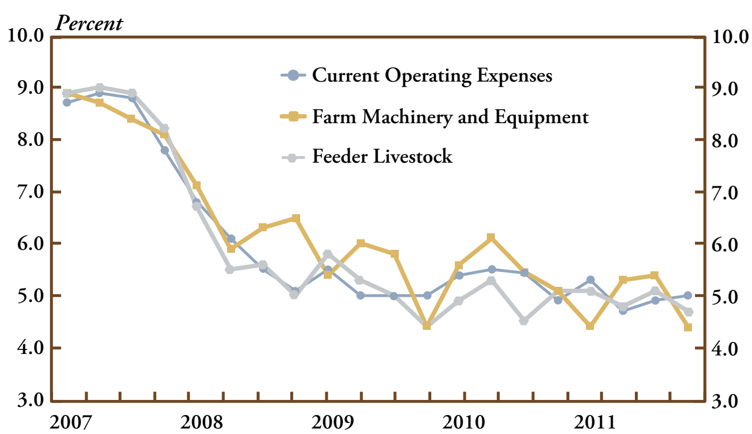
Source: Agricultural Finance Databook, Section A

Intermediate-term loan volume at commercial banks stabilized in the fourth quarter just above year-ago levels. Interest rates on farm machinery and equipment loans fell to an average of 4.4 percent in the fourth quarter and loan maturities were longer than usual at almost 3 years.

After spiking the last half of 2010, the volume of livestock loans returned to more historical levels at the end of 2011. In the fourth quarter, the volume of feeder livestock and other livestock loans fell 24.4 percent below last year's peak as herd liquidations in drought-stricken areas limited demand for livestock loans. The average maturity for feeder livestock loans rose slightly but remained under 10 months, and the average effective interest rate held around 5 percent.

Competition between lenders for a smaller pool of non-real estate loan volume shifted loan activity away from small and mid-size commercial banks toward large commercial banks. By the end of 2011, farm loan portfolios at banks with $25 million or less in farm loans contracted 19 percent year-over-year, while farm loan portfolios at banks with more than $25 million in farm loans expanded 5.8 percent. The composition of farm loan portfolios also shifted away from smaller loans toward larger loans in excess of $100,000.

Chart 2: Average Effective Interest Rates on Farm Loans



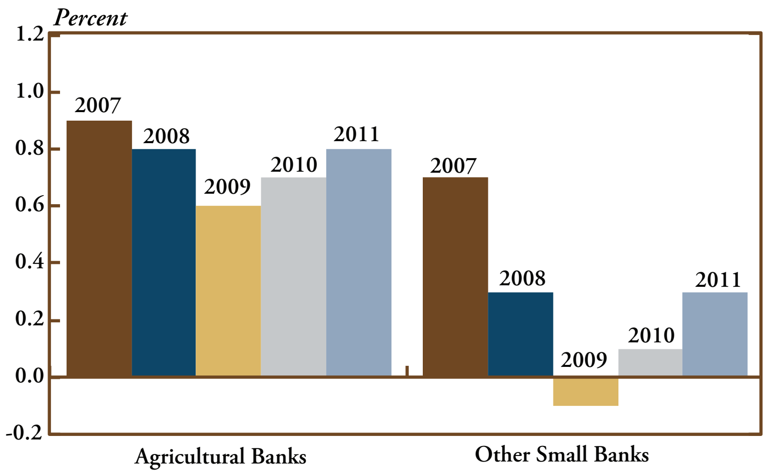
Source: Agricultural Finance Databook, Section A

Section B Summary

Third Quarter Call Report Data

Agricultural bank returns in the third quarter improved from year-ago levels and exceeded the financial performance at other small banks. The rate of return on assets at agricultural banks reached 0.8 percent, in contrast to 0.3 percent at other small banks (Chart 3). In addition, the average rate of return on equity at agricultural banks rose to 7.0 percent in the third quarter, more than double the 3.2 percent reported for other small banks. With stronger profits, average capital ratios at both agricultural banks and other small banks marched higher. The average loan-to-deposit ratio at agricultural banks, however, fell to a 10-year low, a consequence of weak loan originations and strong cash positions in the farm sector.

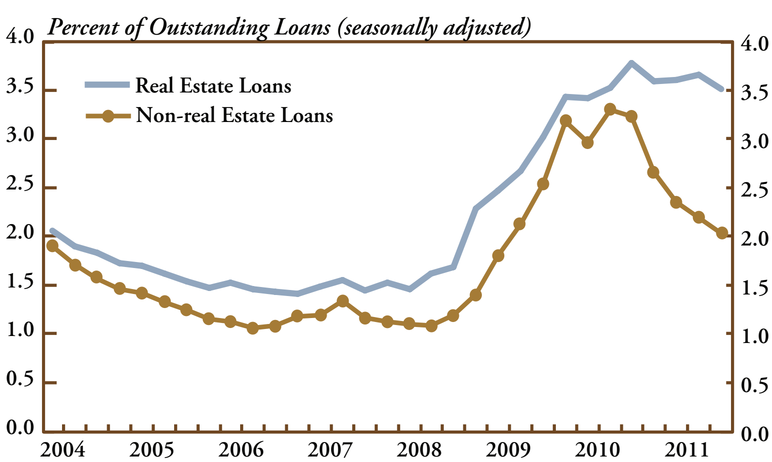
Chart 3: Rate of Return on Assets (Third Quarter)



Source: Agricultural Finance Databook, Section B

Non-real estate loan performance strengthened further in the third quarter. Delinquent non-real estate loan volumes trended down during the year, comprising 2.0 percent of outstanding farm production loans in the third quarter (Chart 4). Loan delinquency rates fell to 4.6 percent at the 100 largest banks, but remained well above the 0.9 percent rate at other commercial banks. Looking forward, a substantial drop in the share of non-real estate loans 30 to 90 days past due suggests delinquency rates could fall further. The volume of outstanding non-real estate farm loans at all commercial banks in the third quarter was slightly above 2010 levels by 0.4 percent.

Chart 4: Delinquent Farm Loans



Source: Federal Reserve Board of Governors

Loan performance measures for real estate loans also improved in the third quarter. After spiking at the first of the year, the share of delinquent farm real estate loans eased to 3.5 percent in the third quarter. Delinquency rates were poised to fall further as the share of real estate loans 30 to 90 days past due fell to the lowest level since 2006. Despite easing, the loan delinquency rate at the 100 largest banks was 5.6 percent in the quarter, well above the 2.9 percent at other commercial banks. Farm real estate loan volumes at all commercial banks edged up 0.6 percent from year-ago levels in the third quarter.

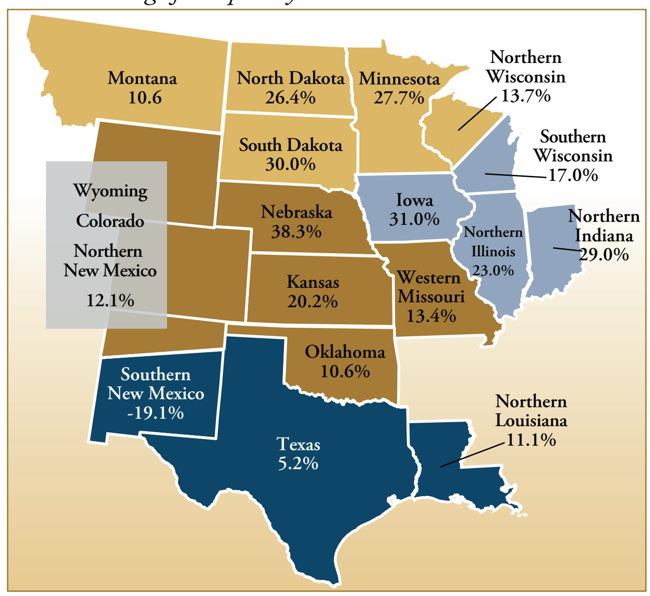
Section C Summary

Third Quarter District Agricultural Conditions

Rising farm incomes sent farmland values soaring across much of the Corn Belt and the northern Plains in the third quarter. Many states posted record annual increases in farmland values, led by Nebraska where nonirrigated cropland rose by almost 40 percent compared with last year (Map 1). Year-over-year farmland value gains reached 30 percent in the neighboring states of South Dakota and Iowa, and were more than 20 percent in Kansas, northern Illinois, North Dakota, Minnesota and northern Indiana. Farmland values rose to a much lesser extent in the southern Plains as severe drought hurt crop production and forced herd liquidations. Still, crop insurance and land lease revenues from mineral rights helped mitigate income lost from crop failure. Even with substantial gains so far this year, many bankers in the Kansas City and Chicago Districts anticipated that farmland values would rise further in the coming months. With farmland values reaching record highs, several survey respondents noted more landowners were putting farms on the market to take advantage of strong demand from farmers and nonfarm investors. The cost of financing farmland purchases dropped as interest rates on farm real estate loans trended down in all districts.

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

Percent change from prior year



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

Overall demand for farm loans continued to languish in the third quarter. Several districts noted a decline in operating loan demand as many farmers used income to pre-pay for crop inputs. In addition, average loan-to-deposit ratios fell further in the Chicago, Dallas and Richmond Districts and bankers expected fewer feeder cattle and dairy loans in the coming months. Still, farm capital spending remained solid in all districts but Dallas as farmers continued to upgrade equipment and construct grain storage bins. Interest rates for intermediate-term loans fell across the board, and interest rates on operating loans edged down in all districts except Dallas.

Farm credit conditions strengthened further as farmers used elevated incomes to pay off loans. According to Federal Reserve surveys, loan repayment rates at agricultural banks continued to climb and were markedly higher in the Chicago, Minneapolis, Kansas City and San Francisco Districts. Moreover, loan renewals and extensions fell in all Districts but Richmond. With weak loan demand, ample funds were available for qualified borrowers and collateral requirements generally held steady.