District farm income fell in the second quarter and bankers expected a further drop in coming months. A poor winter wheat harvest in the Tenth District and a decline in wheat prices brought on by strong global production pushed farm income lower. Ongoing weakness in the livestock sector also limited farm income growth as operators continued to endure high feed and forage costs combined with falling cattle prices. Bankers expected income to drop further in the next few months due to the possibility of sharply lower corn and soybean prices at harvest.

Despite lower farm income and expectations of additional declines, farmland values surged further during the second quarter. Irrigated cropland values in the District jumped 25 percent from a year ago. Nonirrigated cropland values advanced 18 percent from the previous year, a slightly slower pace of growth than in the first quarter. Ranchland values also rose, gaining 14 percent year-over-year. However, more bankers expected farmland value gains to moderate slightly in coming months.

Bankers indicated that expected farm income was not the main factor contributing to the value of farmland. Instead, bankers cited the overall wealth level of the farm sector, supported by several years of strong income, as the primary driver of farmland values. Low interest rates and a lack of alternative investment options were also noted as significant factors, ahead of farm income expectations.

Lower farm income boosted operating loan demand and hindered loan repayment rates in the second quarter. According to survey respondents, operating loan demand rose to its highest level in more than two years. Loan repayment rates improved modestly, but bankers expected repayment rates to fall in the future with weakening farm income. In addition, interest rates for farm real estate loans edged up during the quarter, which could make repayments more difficult. Interest rates on farm operating loans decreased slightly in the second quarter, but by the smallest percentage in three years.
Below-average revenue from wheat production and further losses in the cattle sector reduced District farm income during the second quarter (Chart 1). The combination of lower winter wheat yields and falling prices contributed to weaker revenue from wheat production in the District. In regions where the wheat harvest was complete, overall yields were notably lower compared with last year, but varied widely by region depending on drought and freeze damage. Furthermore, global wheat production rebounded in 2013 and dampened prices at harvest. Despite a fall in wheat prices, feed and forage costs remained high, depressing profits in the livestock sector. Cattle operators also struggled with falling cattle prices, although an uptick in hog prices improved profitability for some hog producers.

Farm income prospects remained weak for the rest of the year throughout the District. Corn and soybean prices were expected to drop this fall if improved growing conditions in the eastern Corn Belt boost U.S. production. Not only would lower crop prices reduce farm income, but persistent drought in parts of the District could limit yield potential, particularly in areas without irrigation. With lower expected prices and the possibility of a poor harvest, survey respondents expected farm income to be less than last year in each state in the Tenth District (Chart 2).

The expectation of weaker farm income, however, does not appear to be a main factor underpinning farmland values. In ranking factors that contribute to farmland values, more District bankers pointed to the overall wealth level of the farm sector, the current low interest rate environment and a lack of alternative investment options (Chart 3). Fewer bankers cited farm income expectations as a primary driver. Landlease revenue from mineral rights was noted as a lesser factor and, while real-estate tax policies may influence the timing of farmland sales, they were not seen as a major contributor to farmland values.
Despite expectations of weaker farm income, District farmland values continued to set records. With drought persisting across much of the District, farmland with access to irrigation posted the strongest gains. In the second quarter, the value of irrigated cropland jumped 25 percent from a year ago (Chart 4). This jump marks the ninth consecutive quarter in which irrigated cropland values have risen more than 20 percent year-over-year. Nonirrigated cropland value gains moderated slightly in the second quarter, but were still 18 percent higher than a year ago. Annual gains in ranchland values held steady near 14 percent.

Irrigated cropland values increased more than 30 percent in the dry Mountain States of Colorado, New Mexico and Wyoming during the last year, far outpacing the gains in nonirrigated farmland values (Table 1). In contrast, easing drought conditions in Missouri helped push nonirrigated cropland values up more than 25 percent year-over-year. Ranchland values posted some of the weakest gains during the second quarter, particularly in Oklahoma and the Mountain States where pasture conditions remained very poor.

While most bankers expected farmland values to remain at current levels, an increasing number of respondents felt farmland values may have peaked. Compared with previous surveys, fewer bankers expected farmland values to keep rising (Chart 5). More bankers also expected farmland values to drop after harvest likely due, at least partially, to expectations of lower farm income. Among bankers anticipating a decline, though, a majority estimated farmland values would fall less than 10 percent during the next year. Very few bankers expected that farmland prices would drop more than 10 percent.

Table 1
Farmland Value Gains by State

<table>
<thead>
<tr>
<th></th>
<th>Nonirrigated</th>
<th>Irrigated</th>
<th>Ranchland</th>
</tr>
</thead>
<tbody>
<tr>
<td>Kansas</td>
<td>22.2</td>
<td>29.9</td>
<td>16.9</td>
</tr>
<tr>
<td>Missouri</td>
<td>25.8</td>
<td>n/a**</td>
<td>11.9</td>
</tr>
<tr>
<td>Nebraska</td>
<td>14.9</td>
<td>22.6</td>
<td>18.4</td>
</tr>
<tr>
<td>Oklahoma</td>
<td>10.0</td>
<td>19.3</td>
<td>9.3</td>
</tr>
<tr>
<td>Mountain States</td>
<td>14.0</td>
<td>33.2</td>
<td>4.5</td>
</tr>
<tr>
<td>Tenth District</td>
<td>18.3</td>
<td>25.2</td>
<td>14.4</td>
</tr>
</tbody>
</table>

**Not reported due to small sample size.

Chart 5
Expected Trend in Farmland Values During the Next Three Months

***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 percentage of bankers who responded “lower” from the percentage that responded “higher” and adding 100.
Lower farm income lifted operating loan demand in the second quarter and may curb future farm capital spending. More bankers reported increased demand for operating loans as input costs for both crop and livestock producers climbed during the second quarter. After several years of farm sector profitability limited the need for financing, the index of farm operating loan demand rose above 100 for the first time since early 2010 (Chart 6). However, bankers noted that loan demand for farm machinery and equipment may fall if lower farm income curtails capital spending.

Even with higher demand for loans, bankers reported funds were available to satisfy the financing needs of qualified borrowers. Collateral requirements for operating loans remained steady during the second quarter, and very few banks referred borrowers to nonbank credit agencies. Financing costs for farm operating loans remained low though interest rate declines moderated (Chart 7). At 5.77 percent, the average interest rate on farm operating loans decreased by only 0.5 percent from the previous quarter, the smallest quarterly decline since early 2010. Meanwhile, the average interest rate on farm real estate loans rose slightly to 5.38 percent, marking the first advance in more than two years.

Farm loan repayment rates softened in the second quarter and were expected to weaken in coming months with lower farm income (Chart 8). In addition, the index of requests for loan renewals or extensions edged up from recent levels. Still, most bankers reported few nonperforming farm loans, and those with delinquent loans indicated that most repayment issues could be managed without major loan restructuring or forced sale of assets.

*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 percentage of bankers who responded “lower” from the percentage that responded “higher” and adding 100.
Agricultural Credit Conditions

2nd Quarter 2013

Federal Reserve Bank of Kansas City - Tenth District

BANKER COMMENTS from the TENTH DISTRICT

“Late freeze hurt our wheat crop with yields about half of normal.”
–Southern Oklahoma

“Very marginal wheat harvest expected. Crop income will certainly be affected by drought.”
–Western Kansas

“Drought will have a major impact on cash flows, wealth and spending on Main Street.”
–South Central Nebraska

“Farm income expectations are down from previous wet years. Most borrowers are not making capital purchases and trying to minimize operating expenses with anticipated lower income from crop sales.”
–Southeast Colorado

“Our area remains very dry. Livestock producers will continue to struggle with lack of grass and feedstocks.”
–Northwest Kansas

“Livestock prices are declining and input costs are at record highs.”
–Southeast Kansas

“There are still more buyers than sellers of farmland. Rising interest rates will almost certainly have some effect on farmland values, although gradual.”
–North Central Missouri

“We anticipate farm real estate values will back down as commodity prices fall and interest rates go up.”
–Southwest Kansas

“Most customers have sold off at least half of their herd and no yearling cattle are going to pasture.”
–Northeast New Mexico

Note: A total of 208 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 Nathan Kauffman, economist, or Maria Akers, associate economist, at 1-800-333-1040, or Nathan.Kauffman@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.

For more information on agricultural and rural economies, visit…

www.KansasCityFed.org/Research/regionaleconomy/agriculture.cfm

www.kansascityfed.org/agcrurv/agcrmain