Survey of Tenth District Agricultural Credit Conditions

Third Quarter 2010

FEDERAL RESERVE BANK of KANSAS CITY

Farmland Values Climb and Credit Conditions Improve

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

Survey Summary

District farmland values hastened their climb in the third quarter of 2010 with rising farm income and robust demand for farmland. A summer rally in crop prices continued through the fall harvest as global and domestic grain supplies were lower than expected. Higher crop prices boosted farm incomes, supporting strong annual gains in cropland values. More district bankers reported higher farm income as many producers marketed their crops at these elevated prices. With a return to profitability for the livestock sector, ranchland values rose as well, recovering from declines earlier this year. District bankers expected further income gains over the next three months, but noted that higher feed costs could limit profit opportunities for livestock operators. Survey respondents also reported a rise in cash rental rates for both cropland and ranchland.

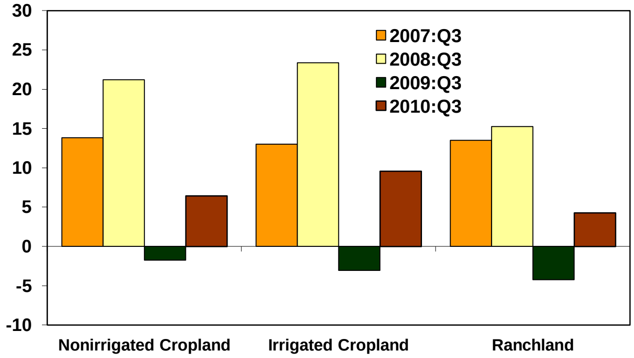
Robust demand by farmers was still the primary driver in district farm real estate markets, though investor interest in good quality farmland remained high. District bankers noted that nonfarm investors typically expected a 5 percent or better rate of return on farmland purchases. While the supply of farmland on the market has declined over the past couple of years, some survey contacts felt that current elevated prices and the prospect of higher capital gains taxes in 2011 could prompt some farm owners to consider selling before year-end.

With incomes climbing in the third quarter, farm credit conditions improved. More district bankers noted higher loan repayment rates and fewer loan renewals and extensions. Average farm loan interest rates fell to their lowest levels since the survey began in 1976 and collateral requirements eased. Farm loan demand was steady and district bankers indicated an ample supply of funds available for qualified borrowers. Survey respondents reported a significant rebound in capital spending, especially for crop equipment and grain storage bins.

For more information or to view past survey results, visit:
www.kansascityfed.org/agcrsurv/agcrmain

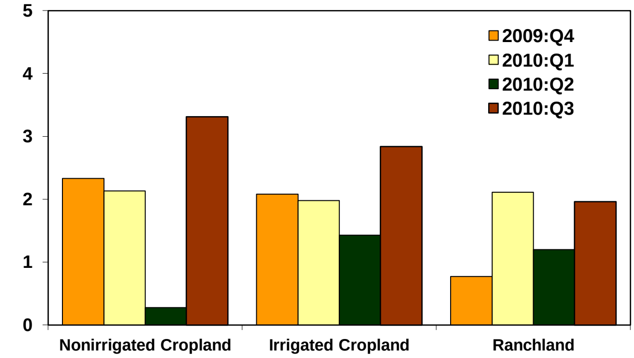
Farmland Values – Annual Gains

Percent change from the previous year *



Farmland Values – Quarterly Gains

Percent change from the previous quarter *

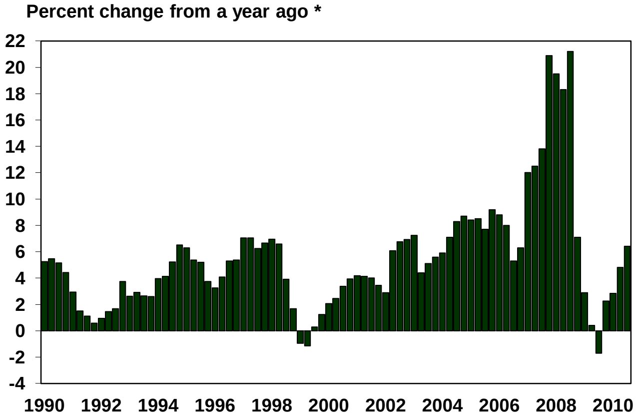


* Percent changes are calculated using responses from banks reporting in both the past and the current quarter.

- District farmland values have climbed steadily since a slight dip in value during the third quarter of 2009. Farmland values have risen each of the last four quarters, posting the strongest annual value gains since 2009. Compared to the previous year, the value of irrigated and nonirrigated cropland rose 9.6 and 6.4 percent, respectively. District cropland value gains were driven by Nebraska and Kansas, major crop producing states where farm income was up substantially in the third quarter. Profits in the livestock sector continued to rise, which helped lift year-over-year ranchland values by 4.3 percent. Annual farmland cash rental rates were also up, but the gains were not quite as dramatic. Compared to last year, cash rental rates were about 5.0 percent higher for cropland and around 2.0 percent higher for ranchland.
- Rising farmland values were also driven by strong demand for good quality farmland from both farmers and nonfarm investors. Bankers reported that investors expected an average rate of return between 5 and 6 percent for farmland investments. After a two-year decline in the supply of farms offered for sale, a number of bankers mentioned that farm owners who were considering selling may market their properties before year-end to take advantage of current elevated prices and avoid potentially higher capital gains taxes in 2011.

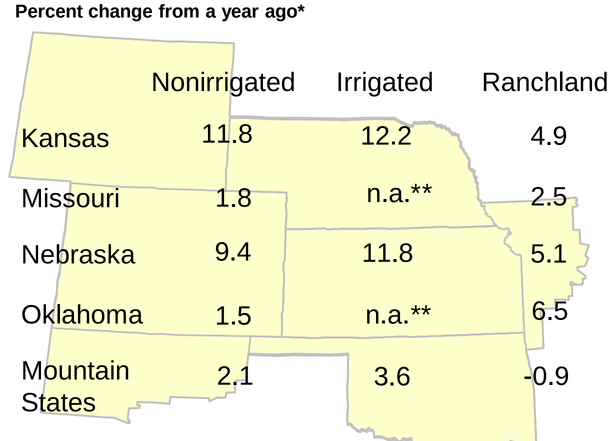
Nonirrigated Farmland Values

Percent change from a year ago *



Tenth District Farmland Values

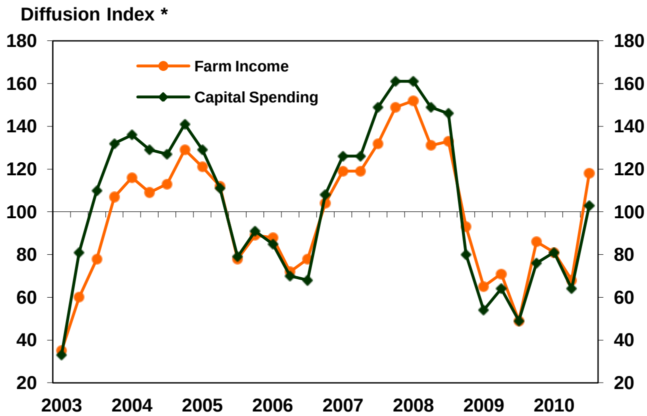
Percent change from a year ago*



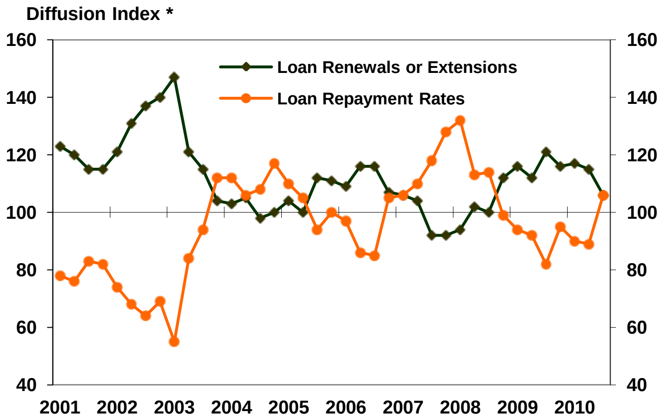
	Nonirrigated	Irrigated	Ranchland
Kansas	11.8	12.2	4.9
Missouri	1.8	n.a.**	2.5
Nebraska	9.4	11.8	5.1
Oklahoma	1.5	n.a.**	6.5
Mountain States	2.1	3.6	-0.9

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

Farm Income and Capital Spending



Loan Repayment Rates and Loan Renewals and Extensions

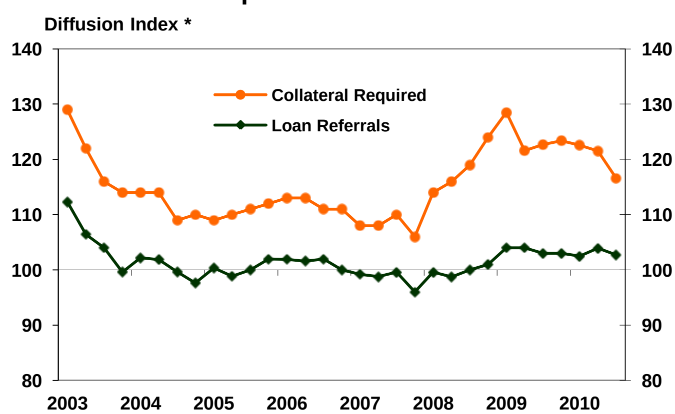


* Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percent of bankers that responded "lower" from the percent that responded "higher" and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

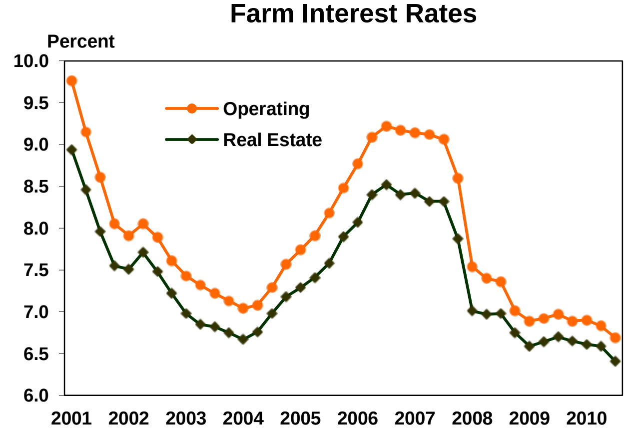
- District farm incomes strengthened substantially in the third quarter, driven by booming commodity prices. Since June, crop prices have risen on prospects of lower than expected global and U.S. grain supplies. Higher prices helped boost the farm income index to its highest level in two years, with additional gains expected over the next three months. Good weather conditions across the district facilitated an early harvest with yields less than early estimates but slightly better than their five-year average. Livestock prices generally held steady, but higher feed costs narrowed profit margins and could dampen the rebound in the livestock sector. Stronger farm incomes spurred producers to raise their capital spending on crop equipment and grain storage bins.

- Farm credit conditions also improved with stronger incomes. During the third quarter, the loan repayment index rose past 100 for the first time in two years, and the index of loan renewals and extensions fell. Collateral requirements eased and referrals to nonbank credit agencies held steady. Farm interest rates fell further, reaching a new survey low of 6.7 percent for operating loans and 6.4 percent for farm real estate loans.

Collateral Requirements and Loan Referrals



Farm Interest Rates



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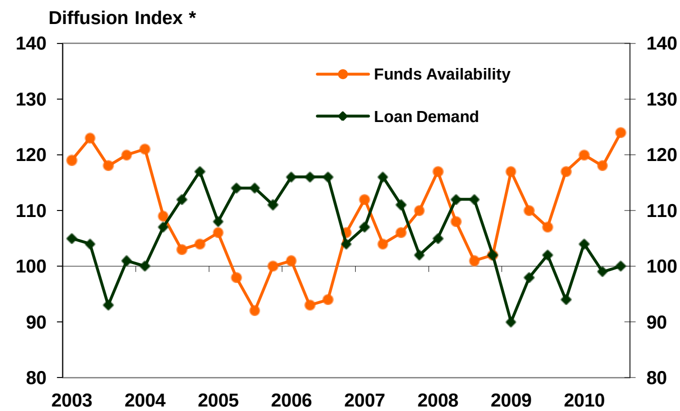
- During the third quarter, the funds availability index rose to a historically high level, indicating agricultural banks had plenty of funds available for qualified borrowers. After fluctuating widely over the past three years, demand for farm loans was essentially flat. Bankers expected only modest farm loan growth over the next three months as higher farm incomes may lessen the need for financing.

Farm Loan Demand and Funds Availability



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Selected Comments from District Bankers

"The recent spike in corn prices should allow good profits for crop farmers. Fat cattle profit margins have been good year-to-date, but increased corn prices will raise costs for livestock operators." *– NE Colorado*

"Land fever is running rampant. It appears that the combination of low investment returns for financial assets and the generally strong farm sector has spurred a voracious appetite for agricultural land." *– NE Kansas*

"Excellent crop prices lead to spending in some form. Some producers had marketed before the crop price rally, but expenses were down this year." – *SE Nebraska*

"Irrigated corn yields will be about average, but the price increase was a nice surprise." *– NE Kansas*

"With capital gains taxes increasing next year, if owners have even thought about selling they will be doing it before the year is over." *– North Central Nebraska*

"Many investors would rather have farmland than low yields on bank deposits." – *SW Oklahoma*

"I'm expecting better net income for all farmers this year due to good rainfall that lowered irrigation expenses while still maintaining yields." *– Central Nebraska*

"Capital spending may increase as farmers upgrade equipment." – *North Central Kansas*

"Good to excellent crops, strong cattle market, optimistic outlook at this time." – *Western Missouri*

"I expect there will be some profit taking in farm real estate." – *Western Kansas*

Note: 243 banks responded to the third 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.