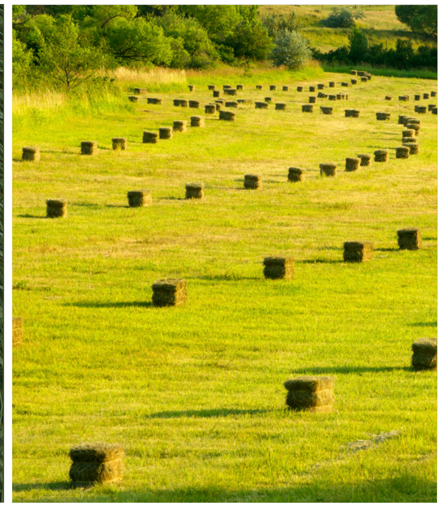
SURVEY *of* TENTH DISTRICT

Agricultural Credit Conditions



1st Quarter 2013 | Federal Reserve Bank *of* Kansas City

Farm Income Growth Slows

By Nathan Kauffman, Economist and
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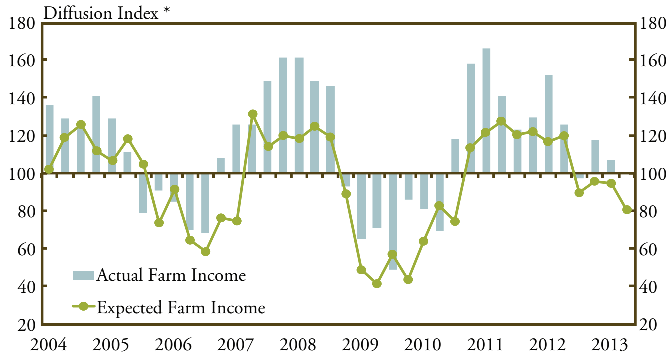
Rising production costs and falling crop prices curbed farm income growth in the first quarter of 2013. High feed and forage costs continued to stifle profitability in the livestock sector, where losses were compounded by declines in livestock prices and the persistence of intense drought. Crop production expenses, particularly for seed and fertilizer, climbed higher as planting season approached. Higher than expected inventories dampened crop prices at the end of the quarter, further limiting farm income gains. Crop prices were expected to fall throughout the growing season and wheat harvest, potentially restoring livestock and ethanol sector profits but restraining farm income from crop sales.

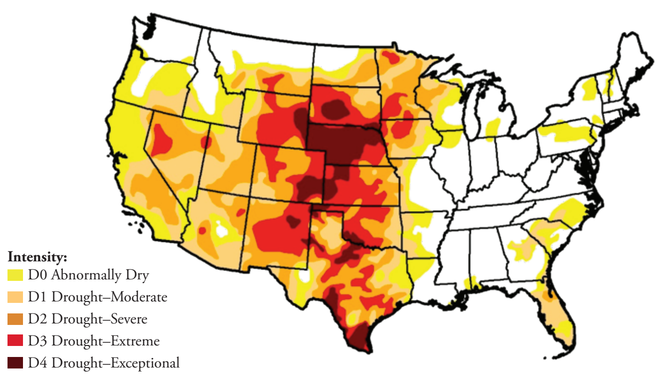
Land values climbed further in the first quarter of 2013. District cropland values rose 20 percent and ranchland values rose 14 percent year-over-year, a modest slowdown compared with the first quarter of 2012. Rising land values strengthened the balance sheet of farmers who own land but boosted debt levels for others financing farmland purchases. Even though most bankers commented that debt levels have remained manageable, some noted that record land prices were raising the debt obligations for young and beginning farmers and producers expanding their operations. Bankers also indicated that livestock producers were more highly leveraged due to recent losses accentuated by drought.

After a robust first quarter, farm household and capital spending were expected to slow in the coming months amid softening incomes and higher operating costs. According to survey respondents, capital spending was stronger than expected in the first quarter even after a surge in equipment purchases at the end of 2012. Producers appeared to be taking advantage of record low interest rates to finance capital purchases but were using cash to cover operating costs, limiting overall operating loan demand. In addition to weak demand for operating loans, bankers reported fewer requests for farm loan renewals and extensions compared with last year. Although loan repayment rates remained higher than the previous year, the pace of improvement was expected to slow considerably with mounting production costs and expectations of lower farm income.

Chart 1
Tenth District Farm Income

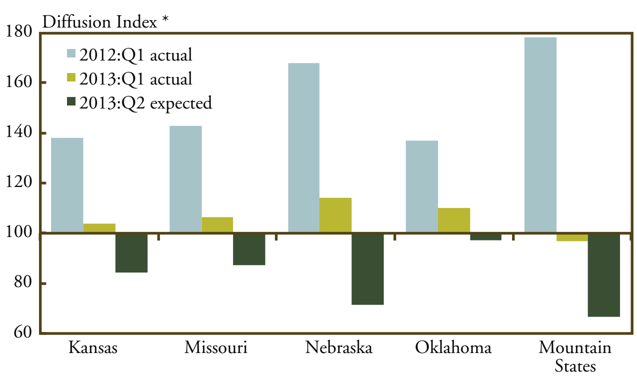


Map 1
U.S. Drought Monitor April 2, 2013



Source: National Drought Mitigation Center.

Chart 2
Tenth District Farm Income by State



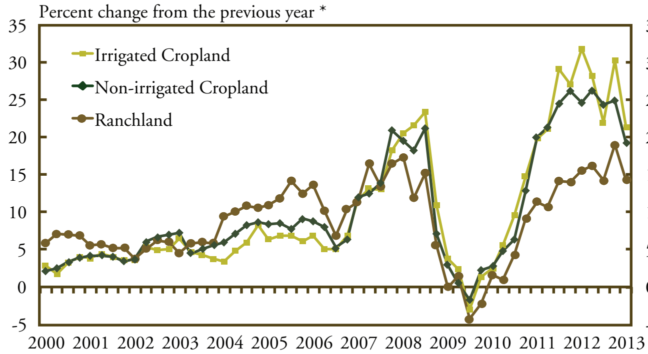
*Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index numbers are computed by subtracting the percentage of bankers who responded "lower" from the percentage who responded "higher"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

Farm income in the District remained high in the first quarter, but income growth was limited by declining crop prices and higher production costs. Bankers reported that farm income was slightly higher than a year ago as crop prices remained elevated (Chart 1). However, bankers reiterated that high feed and forage costs were hurting livestock profits, which were also shrinking as cattle and hog prices declined with demand in the first quarter. As planting season approached, higher crop input costs constrained farm income further. Seed and fertilizer costs have continued to advance steadily, limiting potential income gains from historically high crop prices. Crop prices, however, dropped at the end of March, though, with an announcement that more grain was available in storage than previously thought.

Bankers expected farm income to weaken over the next quarter. Wheat prices fell in the first quarter, which could keep farm income in the District subdued through this year's spring harvest. Futures markets also suggest that corn and soybean prices may drop if normal weather patterns return, boosting U.S. crop supplies. Lower crop prices, however, could eventually lead to improved profit margins in the livestock and ethanol sectors. Still, despite the potential for falling prices, crop insurance prices for corn and soybeans were set at levels that should ensure strong income for many crop producers in 2013.

Farm income expectations in the District varied based on the persistence and intensity of drought. Drought conditions have largely dissipated in the Eastern Corn Belt. However, there was concern that planting could be delayed due to wet fields in some areas (Map 1). However, drought remained prevalent in the Central Plains and water shortages in the region have kept feed and forage costs for livestock producers exceptionally high. As a result, bankers in the Mountain States, particularly Colorado and New Mexico, indicated expectations of significantly weaker farm incomes next quarter (Chart 2).

Chart 3
Tenth District Farmland Values–Annual Gains



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

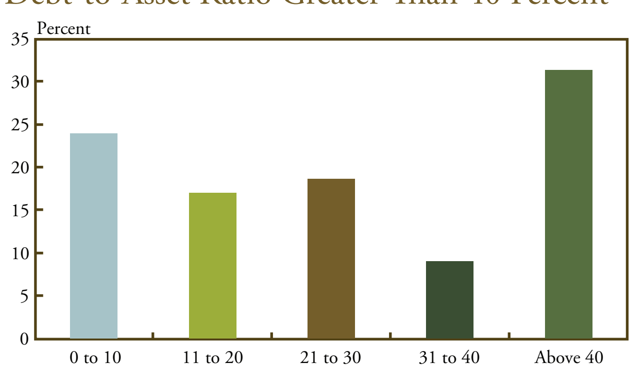
Table 1
Farmland Value Gains by State

Percent change from the previous year*

	Non-irrigated	Irrigated	Ranchland
Kansas	19.1	21.77	15.0
Missouri	28.1	n/a**	16.8
Nebraska	17.3	22.6	17.0
Oklahoma	6.5	12.1	18.2
Mountain States	19.2	24.0	2.8
Tenth District	19.3	21.5	14.3

**Not reported due to small sample size.

Chart 4
Percentage of Bankers Reporting Producers with a Debt-to-Asset Ratio Greater Than 40 Percent



In the first quarter, District farmland values posted double-digit annual gains for the third straight year, setting a survey record (Chart 3). Compared with the first quarter of 2012, the value of non-irrigated cropland in the District rose 19.3 percent, with the strongest increase in Missouri, where drought conditions have improved (Table 1). With drought conditions lingering in other District states, irrigated farmland values jumped 21.5 percent above year-ago levels. Ranchland values also moved higher, increasing 14.3 percent compared with last year, but rising only minimally in Colorado where drought remained intense.

Though District farmland values climbed further in the first quarter, the pace of appreciation moderated somewhat with slower growth in farm income. After rising 7.7 percent and 9.0 percent in the first quarter of 2012, the value of non-irrigated and irrigated cropland rose 3.4 percent and 2.9 percent, respectively, in the first quarter of 2013. Cropland value gains slowed compared with last year due to falling crop prices and rising input costs. Ranchland values strengthened the most in the District, jumping 4 percent above the previous quarter. Ranchland value gains were driven by a lack of adequate pastures and the prospect of improving profits in the livestock sector.

Surging farmland values have reshaped farm balance sheets. Rising farmland values have significantly reduced debt-to-asset ratios for many farmland owners. For producers looking to buy farmland with limited cash or equity, though, higher prices have translated into higher debt levels. Many bankers reported that their farm customers had debt-to-asset ratios less than 40 percent. However, nearly one out of three survey respondents indicated that a substantial share of their farm customers had debt-to-asset ratios greater than 40 percent (Chart 4). Bankers noted young and beginning farmers and those expanding their farming operations were typically the most leveraged. Some bankers expressed concern that a downturn in farm income or land values could impact the ability of more leveraged operations to meet debt obligations, particularly for borrowers using land as collateral on other loans.

Chart 5
Tenth District Farm Loan Demand and Funds Availability

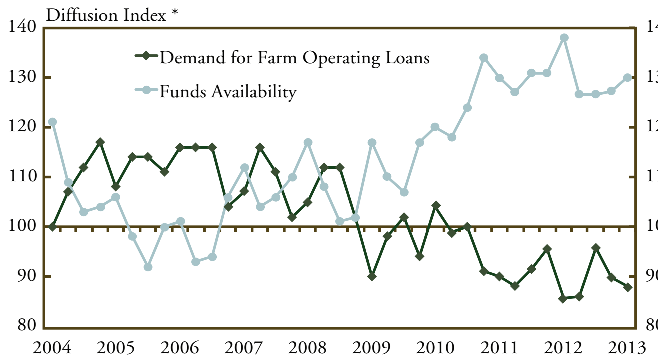


Chart 6
Tenth District Farm Loan Repayment Rates

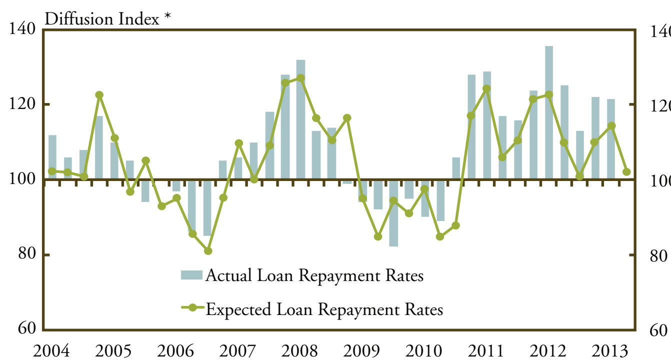
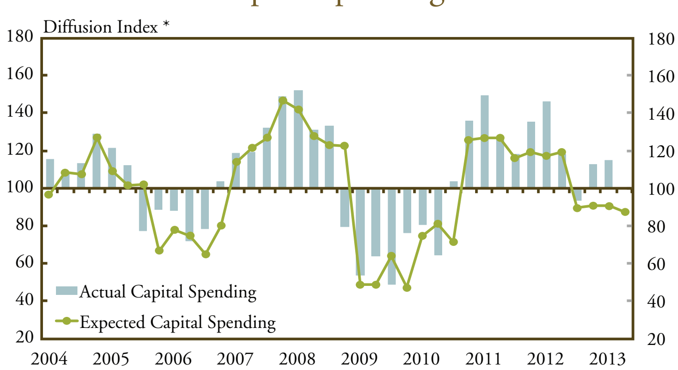


Chart 7
Tenth District Capital Spending



**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.*

Solid farm income at the end of 2012 dampened the demand for farm operating loans in the first quarter. Many farmers used proceeds from crop sales and insurance payments to pay cash for this season's crop inputs, such as fertilizer and seed. With larger cash payments, bankers have continued to report lower operating loan demand compared with the previous year (Chart 5). In addition, requests for farm loan renewals and extensions remained low. Interest rates for short-term farm operating loans, intermediate-term machinery loans and long-term farm real estate loans continued to trend down as lenders competed for qualified borrowers.

Farm credit conditions remained relatively stable in the first quarter. Producers continued to pay down debt, though bankers noted that improvement in first- quarter loan repayment rates was not quite as strong as last year (Chart 6). However, most bankers expected repayment rates would improve little over the coming months. The index of funds available for farm loans edged higher and was on par with year-ago levels. Referrals to nonbank credit agencies held steady and collateral requirements eased slightly.

Farm household and capital spending was expected to wane in the coming months with softer farm incomes. The surge in capital spending that took place during the fourth quarter of 2012, before accelerated depreciation rules were set to expire, continued into the first quarter of 2013 as the tax incentives were extended (Chart 7). However, bankers anticipated a slowdown in farm capital spending as producers faced rising production costs and a potential decline in crop prices. The prospect of lower farm income was also expected to restrain farm household spending as producers evaluated future cash flow needs.

BANKER COMMENTS *from* *the* TENTH DISTRICT

"Strong profitability makes for sufficient loan repayments. Farm profitability must hold to service increasing term debt." –South Central Nebraska

"Our agricultural borrowers enjoyed a very strong 2012 due to record high commodity prices. Most chose to retire debt or use cash for capital and/or operating needs." –Southeast Colorado

"The leveraged enterprises are mostly young, beginning farmers; and also those who are expanding their operations." –Southwest Kansas

"Farmers are quite often asset-rich but cash-poor." –Western Missouri

"There are lending institutions and finance companies that are loaning money to farmers on a collateral basis only." –Central Nebraska

"Those borrowers with a high concentration of farm debt are typically younger farmers who have started their enterprise with little help from established family members." –Eastern Colorado

"Dry weather conditions are having a big impact on our cattle producers." –Northeast New Mexico

"Banks may start requiring more collateral on farm real estate loans as a 'hedge' against a potential softening of the real estate market." –Eastern Kansas

Note: *A total of 223 banks responded to the First-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.*

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