

# SURVEY *of* TENTH DISTRICT

## *Agricultural Credit Conditions*



4th QUARTER 2012

FEDERAL RESERVE BANK of KANSAS CITY

### *Irrigated Cropland Values Surge with Drought*

*By Nathan Kauffman, Economist and  
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**P**ersistent drought sparked a rush in irrigated farmland sales during the fourth quarter of 2012. Stronger sales vaulted irrigated cropland values in the District 30 percent above year-ago levels, with a 13 percent jump in the fourth quarter alone. Cash rental rates for irrigated cropland also surged more than 20 percent from a year ago, as landowners factored in high farm incomes on land with consistent access to water when renegotiating lease terms. Farmers were the predominant buyers of farm real estate and placed a premium on irrigated land due to water scarcity stemming from drought. Non-irrigated cropland and rangeland also posted strong annual gains between 20 and 25 percent.

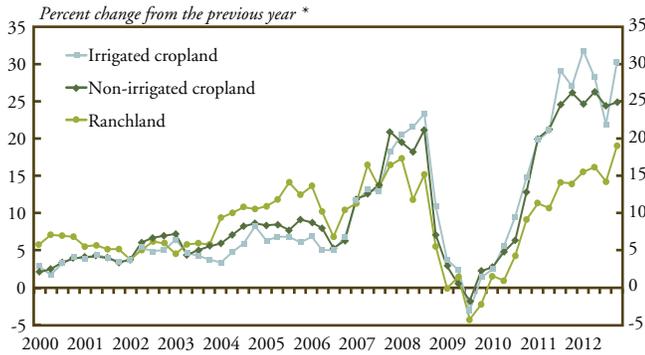
Farmland values rose with stronger-than-expected farm incomes. High pre-harvest crop prices lifted incomes, especially for farmers on irrigated land, while crop insurance payments compensated for yield losses on non-irrigated land. A post-harvest decline in crop prices and strengthening cattle and hog prices improved livestock profitability as losses narrowed. Although fourth-quarter incomes were better than

expected, bankers expressed concerns that drought could affect some areas further in coming months. Farm incomes were expected to drop in Kansas and Oklahoma, as pasture conditions generally remained poor due to ongoing drought. But strong farm incomes were expected to continue in areas with sufficient water availability.

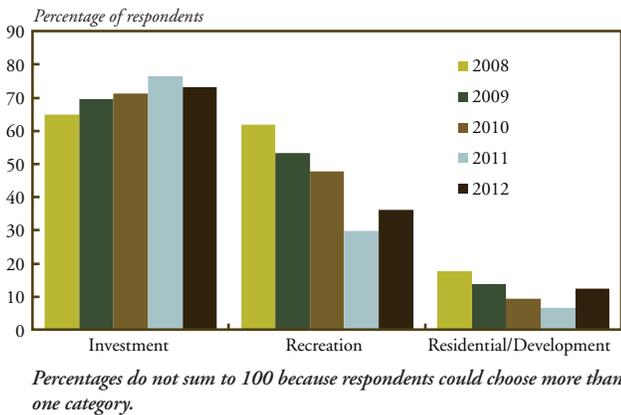
During the fourth quarter, higher farm incomes boosted capital spending and led to improved agricultural credit conditions. Capital spending rebounded in the fourth quarter, although overall loan demand remained low. Expectations for capital spending in the coming months varied, however, in a pattern similar to farm incomes. Bankers generally expected that areas still experiencing drought would make fewer capital improvements in early 2013. Loan repayment rates increased at the pace of the previous year, and fewer banks reported making referrals to correspondent banks. Interest rates for both operating and real estate loans continued to edge down.



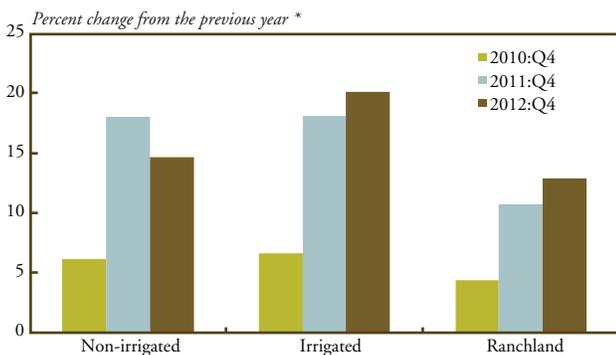
**Chart 1**  
Tenth District Farmland Values - Annual Gains



**Chart 2**  
Reasons for Farmland Purchases by Non-farmers



**Chart 3**  
Tenth District Farmland Cash Rental Rates - Annual Gains



District farmland values surged at the end of the year with strong demand for irrigated cropland. Both irrigated and non-irrigated cropland values posted year-over-year gains of more than 20 percent for the seventh consecutive quarter, according to survey respondents (Chart 1). Ranchland values surged nearly 20 percent. Irrigated cropland sold particularly well, as severe drought led to higher crop prices, bolstering incomes for farmers with steady access to water. Since the onset of the 2011 drought, annual gains in irrigated cropland have outpaced gains in non-irrigated cropland by 3 percent on average. Prior to the 2011 drought, the value of both types of cropland rose at approximately the same rate.

Farmland values posted strong quarterly gains as experienced farmers continued to expand their operations. With robust demand, irrigated and non-irrigated cropland values jumped 13.1 percent and 9.1 percent from the previous quarter, respectively, despite the rise in land sales driven by concerns regarding potential changes in capital gains and estate tax policies. According to banker contacts, farmers accounted for 74 percent of farmland sales in 2012 and used more cash to finance purchases, compared with a year earlier. Non-farmers continued to purchase land predominantly for investment purposes (Chart 2). After falling for four straight years, bankers reported more nonfarm purchases for recreation and residential/development purposes. However, bankers noted that young and beginning farmers were having difficulties acquiring land at today's high prices due to their holding less equity.

Cash rental rates for farmland also surged in the fourth quarter, as landowners renegotiated lease terms. Annual cash rental rates for irrigated and non-irrigated cropland rose 20.1 percent and 14.6 percent, respectively, amid expectations of high farm incomes partly supported by crop insurance (Chart 3). Cash rental rates for ranchland also jumped by 12.9 percent, supported by rising cattle prices.

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



Chart 4  
Tenth District Farm Income

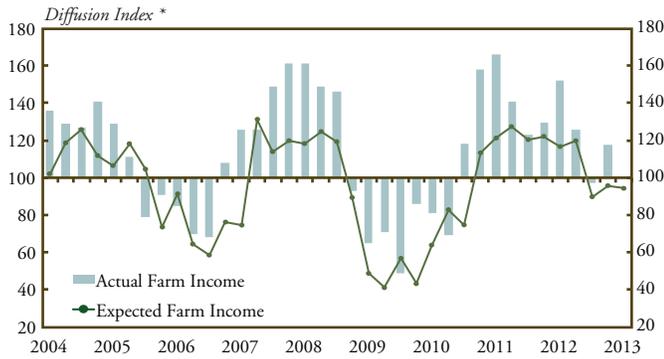


Chart 5  
Tenth District Farm Income by State

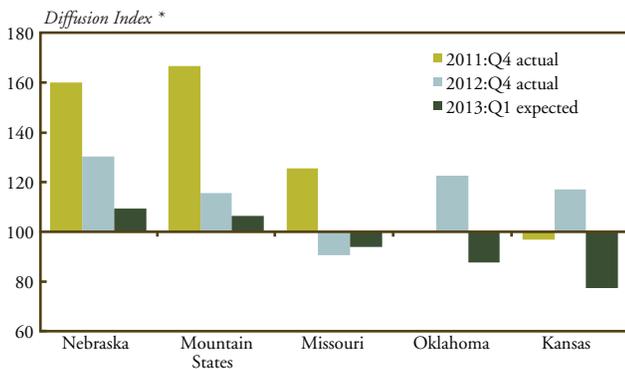


Table 1  
Farmland Value Gains by State  
Percent change from the previous year\*\*

	Nonirrigated	Irrigated	Ranchland
Kansas	29.2	33.8	26.0
Missouri	24.2	n/a***	10.3
Nebraska	26.8	32.0	27.0
Oklahoma	9.3	10.9	11.6
Mountain States	20.6	31.0	10.0
Tenth District	24.9	30.3	19.0

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

\*\*\*Not reported due to small sample size.

District farm incomes rebounded in the fourth quarter despite expectations that drought might keep profits subdued (Chart 4). Crop incomes remained high, as farm operations with irrigated cropland had less yield loss and sold crops at high prices, while many farm operations without irrigation received crop insurance payments, mitigating losses. Following the harvest season, crop prices fell, as export demand weakened and ethanol production slowed. Weaker crop prices provided some relief to livestock operators through lower feed costs. Firming prices for cattle and hogs also improved profitability in the livestock sector toward the end of the quarter.

Water scarcity led to differing farm incomes and farmland-value gains by state. With significant irrigated acreage, Nebraska led the District in farm incomes last quarter, according to bank contacts (Chart 5). Irrigated cropland values rose more than 30 percent from a year ago in Nebraska, Kansas, and the Mountain States (Table 1). Ranchland values surged more than 25 percent from the previous year in Kansas and Nebraska, as an ongoing lack of rainfall constrained the availability of quality pastures.

Farm income expectations also varied widely by state as bankers remained concerned that the effects of the drought might persist into 2013. Severe drought continued to linger in the District despite a substantial improvement in conditions east of the Mississippi River. Although crop prices have fallen from their 2012 peaks, bankers indicated that the price of livestock forage has remained high due to scarce feed supplies and dry pastures. Survey respondents expected significantly lower incomes in Kansas and Oklahoma over the next three months with slight gains in Nebraska.

\* 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 that responded "lower" from the percentage that responded "higher" and adding 100.

# Agricultural Credit Conditions



4th QUARTER 2012

FEDERAL RESERVE BANK of KANSAS CITY - TENTH DISTRICT

Chart 6  
Tenth District Agricultural Credit Conditions

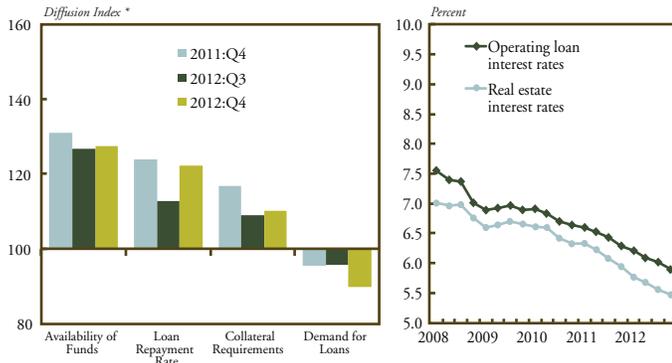


Chart 7  
Tenth District Capital Spending

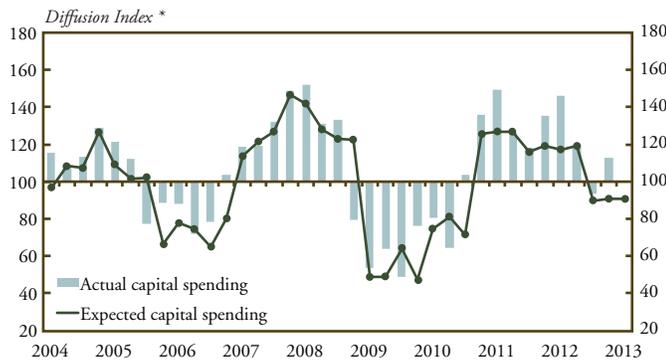
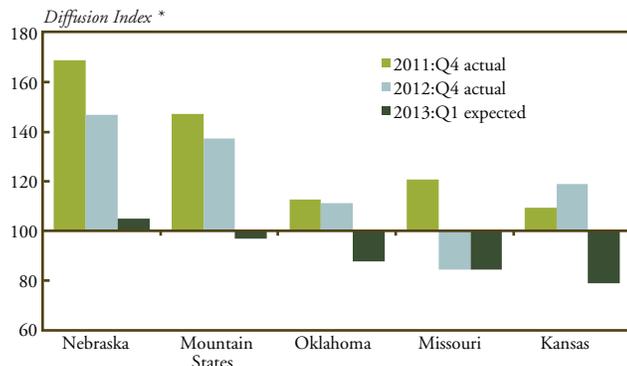


Chart 8  
Tenth District Farm Capital Spending by State



District farm credit conditions remained strong with the rebound in farm incomes. After dipping slightly the previous quarter, loan repayment rates strengthened at a pace closer to 2011. Bankers reported high levels of funds available for farm loans and a further decline in interest rates. The amount of collateral required for farm loans remained steady and bankers indicated fewer referrals to correspondent banks compared with a year ago. Loan demand, however, remained relatively soft and some bankers indicated that crop insurance would be required on all operating loans due to drought persistence.

Spending on capital investments jumped last quarter due to a rebound in farm incomes and potential changes in the tax code. Bankers reported stronger-than-expected capital spending, as an extension in the allowance for capital asset depreciation through 2013 was passed only after 2012 had ended (Chart 7). As in the fourth quarter of 2011, farmers rushed to take advantage of the 50 percent bonus depreciation allowance scheduled to expire at year's end. That allowance has now been renewed through 2013, however.

As with farm incomes, expectations for further capital spending varied by state. After strong fourth-quarter capital spending in Nebraska, bankers expected purchases to remain relatively strong over the next three months (Chart 8). Conversely, survey respondents expected capital spending to fall with lower incomes and potential water concerns throughout the District, especially in Kansas and Oklahoma. Bankers generally expected household spending across states to follow a pattern similar to that of 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 that responded "lower" from the percentage that responded "higher" and adding 100.*



## BANKER COMMENTS *from* *the* TENTH DISTRICT

*“Land sales and land prices have taken a big jump in our area in recent months.”* –Western Missouri

*“Many young farmers have difficulty purchasing real estate at these higher prices.”* –Southeast Colorado

*“Real estate remains very much in demand. We are now seeing more equity financing.”* –Southwest Nebraska

*“Almost all recent auctions were sold to the largest farmers in the area wanting to get bigger. The buyers are strong and most are cash sales.”* –Northwest Missouri

*“Crop insurance will be required on all operating loans. Proposed ‘shallow’ loss protection is not needed, but ‘deep’ loss protection is vital.”* –Western Kansas

*“Crop insurance checks are a big part of financial statements in this area.”* –Northeast Nebraska

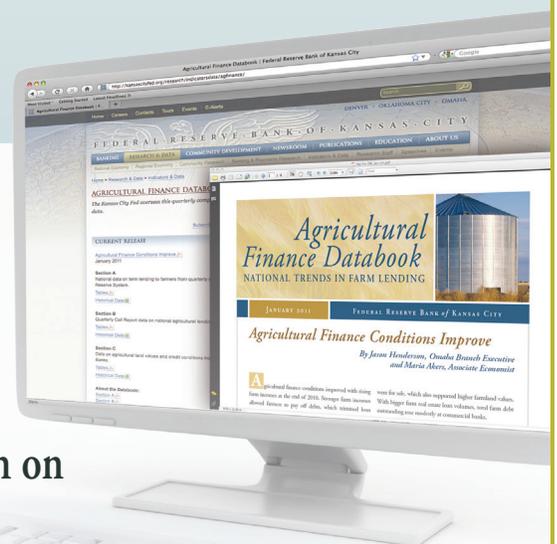
*“Most agriculture customers are just trying to maintain what they currently have and are not taking on additional debt or expanding their operations.”* –Southeast Colorado

*“Lenders are competing hard for good loans.”* –Eastern Kansas

*“Pasture conditions are very poor and livestock producers will continue to struggle without significant rainfall.”* –Southwest Kansas

*“This area continues to see the effects of the 2012 drought mainly in high prices for livestock forage.”* –Central Wyoming

**Note:** A total of 232 banks responded to the Fourth-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](mailto:Nathan.Kauffman@kc.frb.org) or [Maria.Akers@kc.frb.org](mailto: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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