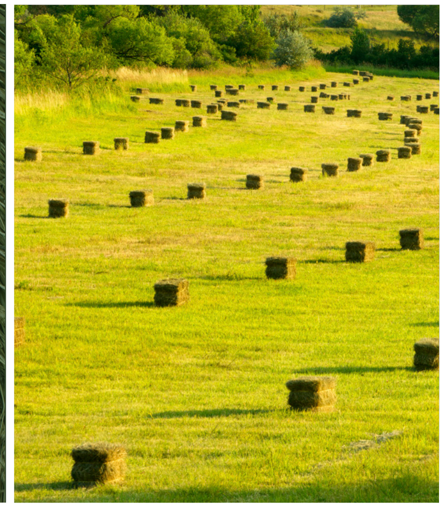
SURVEY *of* TENTH DISTRICT

Agricultural Credit Conditions



4th Quarter 2013

Federal Reserve Bank *of* Kansas City

Farmland Markets Show Signs of Cooling

By Nathan Kauffman, Omaha Branch executive, and Maria Akers, associate economist

Farmland markets in the Tenth District may have begun to cool. After several years of large increases, agricultural bankers indicated cropland value gains slowed dramatically in the fourth quarter and ranchland values declined slightly. Farmers continued to be the primary buyers of farmland, with most intending to expand their operations. However, the sharp slowdown in cropland price gains occurred despite there being less farmland for sale compared with last year. Looking ahead, more bankers expected farmland values to decline in 2014 while fewer expected prices to rise further.

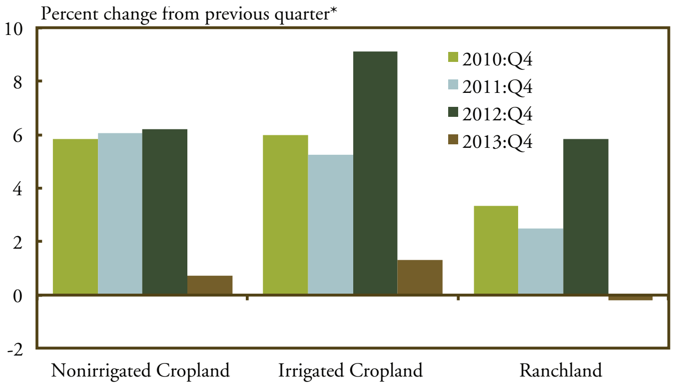
"…cropland value gains slowed dramatically in the fourth quarter and ranchland values declined slightly."

Cropland cash rental rates also stabilized in the fourth quarter. When farmland values were surging in recent years, landowners often negotiated substantial increases in cash rents around year-end. In the fourth quarter of 2013, though, rental rates on District cropland remained largely unchanged from the previous year. However, ranchland cash rental rates rose moderately, especially for pastures that had recovered from drought.

The slowdown in farmland value gains and increases in cash rent occurred amid expectations of weaker farm income. Agricultural bankers reported farm income fell short of year-ago levels for the third straight quarter, primarily due to lower corn prices. Weaker farm income boosted loan renewals, and demand for new operating loans held at a five-year high as producers prepared for spring planting. Some bankers also were concerned low crop prices and high production costs could squeeze profit margins for their farm customers and potentially affect the performance of their agricultural loans.

Chart 1: Tenth District Farmland Values

Quarterly Gains (Seasonally Adjusted)



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

Table 1: Farmland Value Gains by State

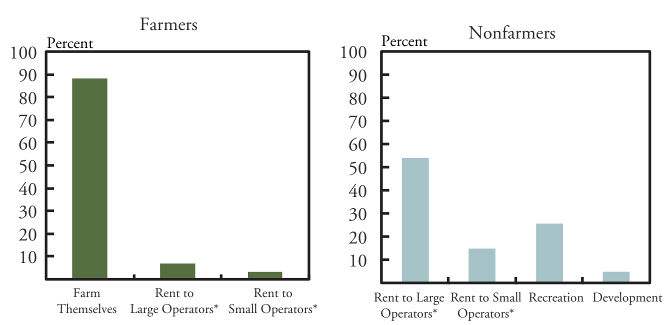
Percent change from previous year*

	Nonirrigated	Irrigated	Ranchland
Kansas	10.7	7.0	6.2
Missouri	15.9	n/a**	16.0
Nebraska	5.2	7.1	10.0
Oklahoma	9.5	8.4	7.8
Mountain States	8.3	1.0	7.0
Tenth District	9.2	7.4	9.7

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

**Not reported due to small sample size

Chart 2: Reasons for Farmland Purchases



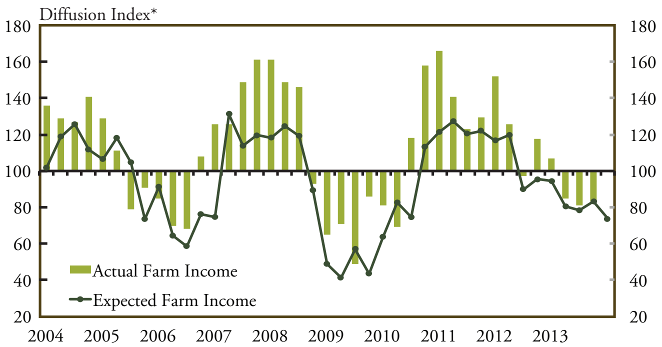
*Large operators had more than $250,000 in gross annual sales; small operators had less than $250,000 in gross annual sales

Cropland values increased only modestly in the fourth quarter compared with the rapid pace of the past few years. From 2010 to 2012, nonirrigated cropland values jumped more than 6 percent from the third to the fourth quarter of each year while irrigated cropland values surged an average of almost 7 percent (Chart 1). In contrast, cropland values rose only about 1 percent in the fourth quarter of 2013 despite fewer farms being for sale. Ranchland values actually dipped below third-quarter levels. Although farmland values remained higher than in 2012, the year-over-year gain was the lowest in more than three years (Table 1).

Farmers continued to be active buyers in farm real estate markets. Survey results showed the share of farmers buying farmland has grown from an average of 63 percent in 2007 to 76 percent in 2013. The vast majority of farmers who bought farmland in 2013 intended to farm the land themselves rather than rent to other farmers (Chart 2). The most common reason for farmland purchases by nonfarmers was to lease the land, primarily to large farm operators, though some bought farmland for recreational purposes and a few intended to use the land for development.

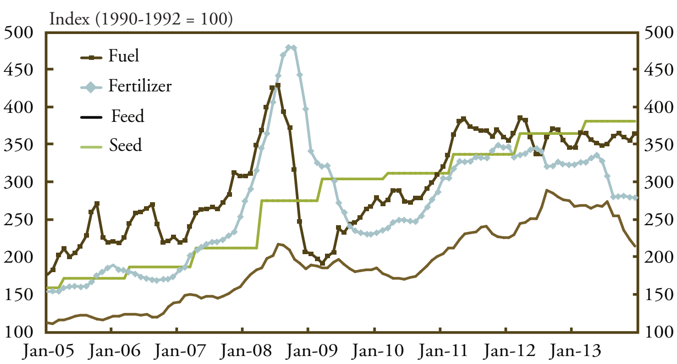
A growing number of District bankers felt that farmland values had topped out and could retreat from current highs. At the end of 2012, only 1 percent of survey respondents expected a decline in cropland values compared with 16 percent at the end of 2013. Several contacts cited land quality as a main driver of price appreciation and indicated there was still competition for highly productive farmland but little demand for marginal ground.

Chart 3: Tenth District Farm Income



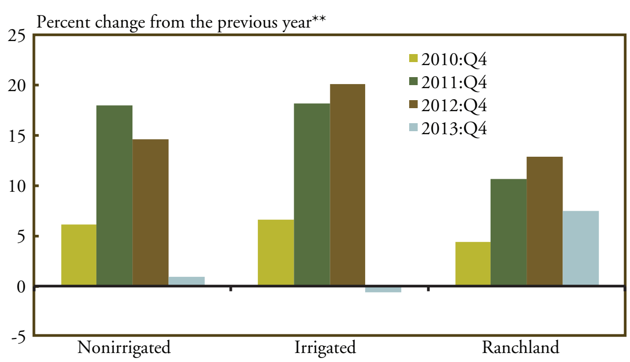
*Bankers responded to each item by indicating whether conditions during the current quarter were higher than, lower than, or the same as in the year-earlier period. The index is computed by subtracting the percentage of bankers who responded "lower" from the percentage that responded "higher" and adding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

Chart 4: Prices Paid by Farmers



Source: USDA.

Chart 5: Tenth District Farmland Cash Rental Rates Annual Gains



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Lower crop prices continued to dampen farm income (Chart 3). Despite some drought conditions during the growing season, fall crop yields in most of the District recovered to near-average levels. Still, the rebound in crop production was not enough to overcome the drag on income from lower prices that have prevailed since harvest, particularly for corn.

Looking forward, bankers expected farm income to remain weak in 2014 unless production costs begin to moderate. They noted that while fertilizer costs had declined 17 percent from their peak in May 2013, prices of other crop inputs had not adjusted (Chart 4). In fact, seed prices continued to climb and have doubled since 2007. Though more volatile, fuel costs have remained at a historically high level for almost two years.

The drop in corn prices, however, translated to an improved outlook for the livestock sector. Feed costs have fallen more than 20 percent since July while fed cattle prices increased 11 percent. Furthermore, historically low cow inventories supported rising prices for feeder cattle. In fact, strong demand from cow/calf producers for high-quality pastures supported higher cash rental rates for ranchland (Chart 5).

Conversely, the annual increase in cash rental rates for cropland may have been curbed by the prospect of lower crop income for 2014. Following several years of steep increases, cash rental rates for cropland generally held steady at the end of 2013. Still, cash rents had already reached historically high levels, which could put additional pressure on profit margins in 2014 if crop revenues decline.

Chart 6: Tenth District Farm Income and Farm Loan Demand

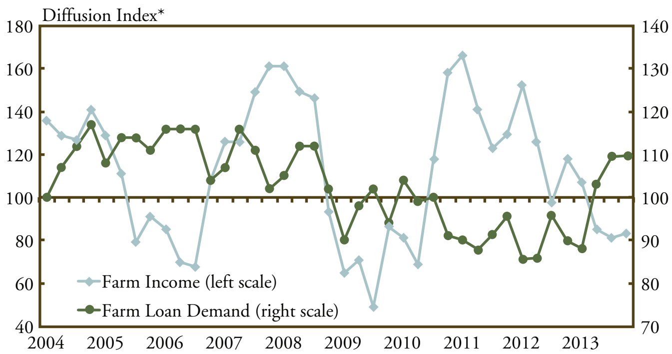


Chart 7: Tenth District Farm Loan Repayment Rates and Renewals and Extensions

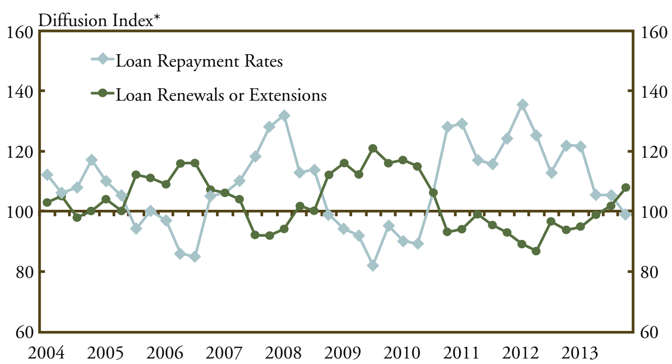
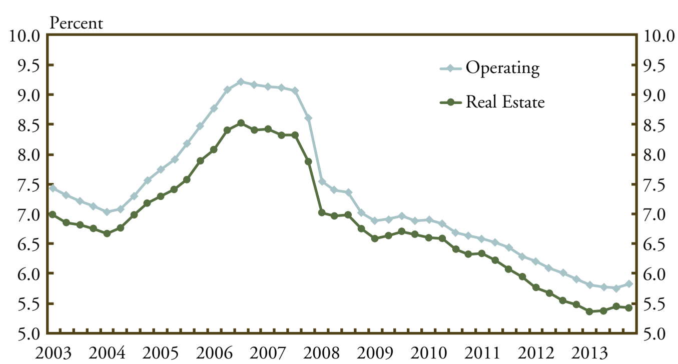


Chart 8: Tenth District Farm Fixed Interest Rates



Reduced farm income underpinned demand for operating loans during the fourth quarter. As the index of farm income fell in 2013, the index of demand for farm operating loans held at a five-year high in the fourth quarter (Chart 6). Preparation for spring planting boosted short-term borrowing needs, especially since some producers had not yet sold crops harvested in the fall. Agricultural bankers noted, however, they were competing for loan volume with agricultural vendors that offered financing. In fact, survey respondents indicated more than half of their farm customers also received credit from farm input and equipment suppliers.

With softer farm income, more bankers reported a decline in loan repayment rates and a rise in loan renewals and extensions compared with last quarter (Chart 7). Furthermore, farm loan repayment rates were not expected to improve during the next three months while loan renewals and extensions were expected to rise modestly. Lower income also appeared to have dampened farm capital spending, which had typically risen at year-end.

However, agricultural bankers continued to seek qualified borrowers by offering low interest rates on farm operating and real estate loans (Chart 8). The average fixed interest rate on farm operating loans has held below 6 percent for more than a year and the average fixed interest rate on farm real estate was about 5.4 percent throughout 2013. Despite heated competition for farm loans, agricultural bankers reported little change in collateral requirements.

**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 is computed by subtracting the percentage of bankers who responded "lower" from the percentage that responded "higher" and adding 100.*

BANKER COMMENTS *from* *the* TENTH DISTRICT

"Cattle prices remain strong but, as expected; crop revenue will be down this year."
– Western Missouri

"Farmland prices should decline with lower commodity prices."
– Northeast Colorado

"Falling commodity prices will reduce net farm income for 2014."
– North Central Oklahoma

"Cash flow for 2014 will be very tight."
– Northeast Nebraska

"Serious drop in commodity prices will increase operating lines for the coming year."
– Southwest Kansas

"Input prices and cash rents are not coming down; 2014 could be a painful year for producers."
– Northeast Nebraska

"High calf prices and lower crop prices will show up next year in land and equipment purchases."
– Southwest Nebraska

"There is more of a price differential with the quality of the land."
– Eastern Kansas

"Lower grain prices should decrease profits in 2014."
– Western Kansas

__Notes:__ A total of 226 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, Omaha branch executive, 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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