Agricultural Finance Databook

NATIONAL TRENDS IN FARM LENDING

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FEDERAL RESERVE BANK *of* KANSAS CITY

Cropland Values Climb and Agricultural Finances Strengthen

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Agricultural finance conditions strengthened amid soaring farmland values, booming farm incomes and rising commodity prices. Elevated farm incomes, especially in grain-producing regions, drove cropland values as much as 20 percent above year-ago levels. Strong farm and nonfarm investor demand and skyrocketing land prices enticed some landowners to list farms for sale. Robust energy markets also placed upward pressure on farmland values in the northern Plains, where land lease revenues for oil exploration surged. Farmland value gains, however, were more modest in the southern Plains as drought conditions intensified. Rising farmland values and brisk sales raised farm real estate loan volumes at commercial banks moderately at year-end.

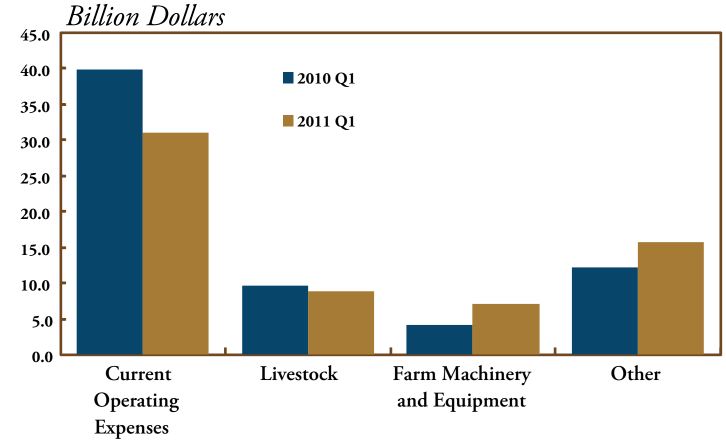
With stronger loan portfolios, agricultural banks ended the year with their best performance since the start of the financial crisis. Farm loan delinquencies fell as more farmers paid off loans at the end of 2010. Bankers also reported fewer loan renewals or extensions, potentially foreshadowing future declines in noncurrent loan volumes. The return on assets and equity at agricultural banks marched higher during the year, while the returns at other small banks held steady. Moreover, in a year when more than 150 commercial banks failed, fewer than 10 were agricultural banks.

Strong farm incomes transformed non-real estate loan portfolios at commercial banks. Rising incomes curbed demand for short-term production loans but fueled capital investment that lifted intermediate-term loan volumes for machinery and equipment. The volume of loans for operating expenses waned at the first of the year as both crop and livestock producers used current incomes to pay for operating expenses. In contrast, farm machinery and equipment loan volumes rose sharply with a rebound in capital spending. With softer non-real estate loan demand, more bankers reported a rise in funds available for farm loans. Collateral requirements generally held steady, and interest rates continued to trend down.

Section A Summary

Resurgent capital spending on farm machinery and equipment shifted lending activity toward intermediate-term loans. With rising incomes, farmers sharply increased their capital spending levels, in turn boosting intermediate-term loan volumes on farm machinery and equipment (Chart 1). In fact, farm machinery and equipment loan volumes jumped 73 percent above year-ago levels in the first quarter of 2011, and their average size almost doubled. These loans were extended for slightly shorter terms compared to last year but at much lower effective interest rates that averaged 4.4 percent (Chart 2).

Chart 1: Loan Volume by Purpose of Loan



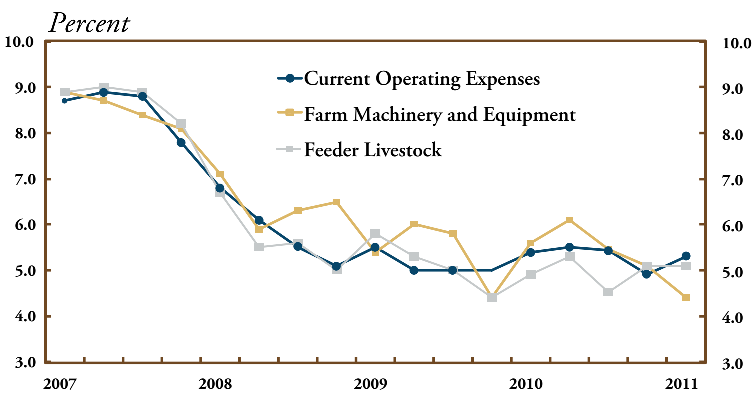
Source: Agricultural Finance Databook, Section A

In contrast, rising farm incomes trimmed operating loan demand as farmers used cash to pay for operating expenses. The volume of operating loans plunged 22 percent below year-ago levels in the first quarter. Bankers reported weak loan demand and strong pre-payment of operating expenses. Winter storms during the February survey period and the atypical timing of the survey might have exacerbated the declines in loan originations in the first quarter of 2011. Operating loan maturities were about 2 months longer than average at 11 months, and the average effective interest rate edged up to 5.3 from a fourth quarter low.

After rising substantially during the last half of 2010, the volume of feeder and other livestock loans at commercial banks posted modest declines. In the first quarter, the volume of feeder livestock loans fell 9 percent below year-ago levels, even though rising feeder cattle prices pushed average loan amounts higher. The average maturity for feeder livestock loans fell to just under 8 months, and the average effective interest rate held around 5 percent.

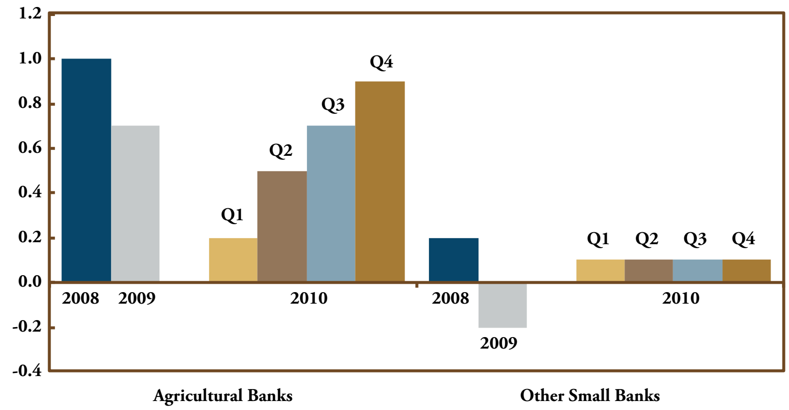
Small and mid-size commercial banks were more affected by shrinking non-real estate loan volumes than large commercial banks. The size of farm loan portfolios at banks with $25 million or less in farm loans contracted 12 percent year-over-year, while the size of farm loan portfolios at banks with more than $25 million in farm loans held steady. At the same time, the composition of farm loan portfolios shifted away from smaller loans toward larger loans of more than $100,000.

Chart 2: Average Effective Interest Rates on Farm Loans



Source: Agricultural Finance Databook, Section A

Chart 3: Rate of Return on Assets



Source: Agricultural Finance Databook, Section B

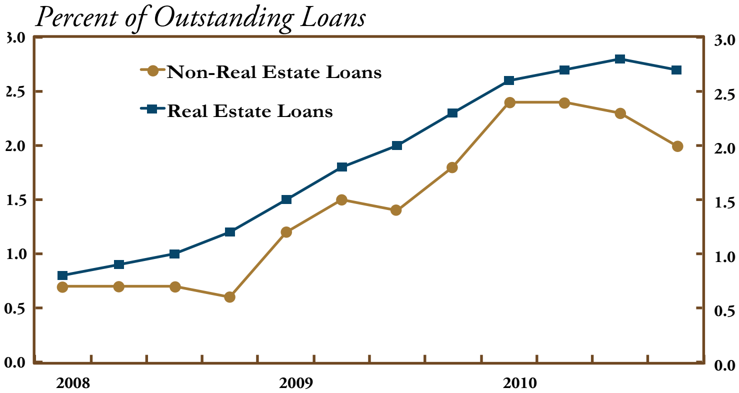
Section B Summary

Agricultural banks closed 2010 with their strongest financial performance in two years. The rate of return on assets at agricultural banks strengthened in the fourth quarter to 0.9 percent, in contrast to 0.1 percent at other small banks (Chart 3). Moreover, the average rate of return on equity at agricultural banks jumped to 8.4 percent in the fourth quarter, compared to 1.1 percent at other small banks. In addition, the percentage of agricultural banks with negative income as a share of average equity fell by more than a third. After rising during most of 2010, average capital ratios at both agricultural banks and other small banks edged down in the fourth quarter but remained near year-ago levels.

Non-real estate loan performance strengthened in the fourth quarter. The volume of outstanding non-real estate farm loans at all commercial banks ended the year slightly below 2009 levels. Delinquent non-real estate loans have trended down since early 2010, comprising just 2.0 percent of outstanding farm production loans in the fourth quarter (Chart 4). Also, the volume of non-real estate loans 30 to 90 days past due dropped to its lowest level since 2008. With declining delinquency rates, fourth quarter net charge-offs fell more than 25 percent below year-ago levels.

Chart 4: Nonperforming Loan Volumes

Percent of Outstanding Loans



Source: Agricultural Finance Databook, Section B

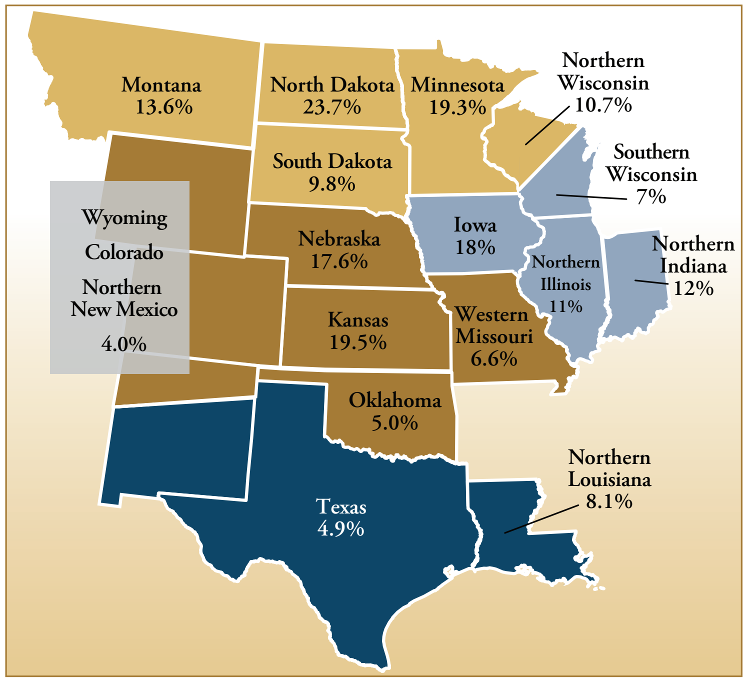
Loan performance measures for real estate loans improved at year-end. Farm real estate loan volumes at all commercial banks settled 2.0 percent above year-ago levels. After rising steadily during the past three years, the share of nonperforming farm real estate loans eased slightly in the fourth quarter to 2.7 percent. In addition, the volume of real estate loans 30 to 90 days past due leveled off, which could signal further declines in delinquency rates. Net charge-off amounts grew in the fourth quarter, but they accounted for about the same percentage of outstanding farm real estate loans as last year.

Section C Summary

Rising farm incomes propelled farmland values higher at the end of 2010. Large year-over-year farmland value gains were seen across the Corn Belt and into the northern Plains, where energy production is booming. In fact, North Dakota enjoyed the strongest annual increase in farmland values largely due to land lease revenues from expanded oil production (Map 1). Crop producing regions such as Northern Indiana, Northern Illinois, Iowa, Nebraska and Kansas reported another round of robust farmland price increases in the fourth quarter. Cropland values, however, increased more modestly in the southern Plains as drought conditions threatened crop yields and limited cattle grazing. Even with slightly more farms for sale at the end of the year, strong demand from farmers and nonfarm investors kept bidding brisk and pushed values higher. Bankers in the Chicago Federal Reserve District expected growth in farm real estate loan volumes relative to last year. Many Federal Reserve survey respondents anticipated that farm incomes and farmland values would rise further in the coming months.

Map 1: Good-Quality Farmland (Non-irrigated Cropland) Values

(Percent change fourth quarter 2009 to fourth quarter 2010)



Source: Federal Reserve District Surveys (Chicago, Minneapolis, Kansas City, Dallas)

Overall demand for farm loans stalled in the fourth quarter with less borrowing for production expenses and an upswing in loans for capital purchases. Several Districts noted a decline in operating loan demand as many farmers used income to pre-pay for crop inputs. In addition, bankers in the Chicago, Dallas and Richmond Districts reported fewer feeder cattle and dairy loans in the fourth quarter. Still, a majority of bankers expected operating loan volumes would rebound prior to spring planting. Federal Reserve surveys also noted a rush of machinery and equipment loans at the close of 2010 as farmers upgraded equipment and took advantage of new tax depreciation rules.

Farm credit conditions strengthened further as farmers paid off loans in earnest at year-end. According to Federal Reserve surveys, loan repayment rates at agricultural banks continued to climb and were markedly higher in the Chicago, Minneapolis, and Kansas City Districts. Moreover, loan renewals and extensions fell in all Districts but Richmond. Most bankers, but particularly those in the Chicago and Kansas City Districts, noted ample funds were available for loans, and very few loans were referred to non-bank credit agencies. Collateral requirements generally held steady or eased slightly. Interest rates trended down for both real estate and non-real estate loans.