Agricultural Finance Databook

NATIONAL TRENDS IN FARM LENDING

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FEDERAL RESERVE BANK *of* KANSAS CITY

Farm Lending Rises with Higher Production Costs

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The summer drought spurred higher feed costs and farm lending activity at commercial banks. During the second quarter, farm operating loans rose at their fastest pace in five years. An August survey of national commercial banks revealed additional demand for short-term farm operating loans in the third quarter as input costs soared. Lending to livestock operations jumped as feed costs spiked and herd liquidations boosted loans for feeder cattle. Higher fuel costs to power irrigation systems and harvest crops also increased lending to crop producers. Investment in farm machinery and equipment remained strong, although some bankers expected capital spending to slow as producers evaluated cash flow needs.

Drought conditions had little impact on farmland markets as markets followed seasonal trends. Farm sales typically slow during the summer growing season. Following this trend, farm real estate loan volumes held steady in the second quarter. Bankers continued to report higher farmland values, although the pace of appreciation slowed from the previous quarter. Many agricultural bankers expected farmland values to stabilize until after harvest, when more farms would be put up for auction. The strongest farmland value gains emerged in the central Plains, where irrigation is prevalent, and the northern Plains, where land lease revenues from mineral rights continued to climb.

Flush with deposits, bankers reported having ample funds to meet additional loan demand. Higher farm loan volumes helped lift loan-to-deposit ratios off recent lows, and competition among agricultural lenders for qualified borrowers remained heated. Effective interest rates inched lower as more loans were made with floating interest rates. Agricultural banks reported stronger profits as the average return on assets at agricultural banks rose to a four-year high. Farm loan delinquency rates declined further and banks expected loan repayment rates to remain solid as high crop prices compensate for lower yields and crop insurance payments support farm income.

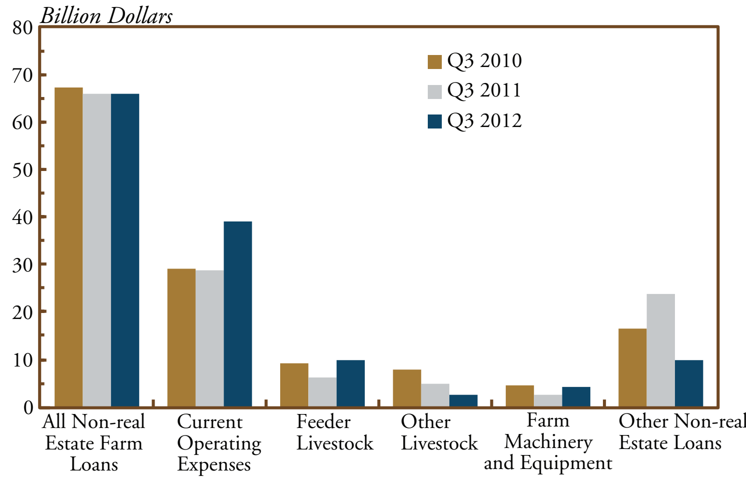
Section A
Third Quarter National Farm Loan Data

During the third quarter, short-term lending on operating loans surged as feed and fuel costs soared. According to national farm loan survey data from the first full week of August, the volume of short-term operating loans jumped 36 percent compared to last year, reaching a new survey high (Chart 1). Rising input costs spurred lending to both the livestock and crop sectors as feed costs soared and rising fuel prices increased irrigation and harvest costs. Agricultural bankers reported making more operating loans at higher loan amounts compared to a year ago, boosting total volumes. In addition, the volume of intermediate-term loans for farm machinery and equipment remained above year-ago levels with solid farm incomes.

Drought conditions also spurred short-term lending for feeder livestock. According to loan survey data, the volume of feeder livestock loans reached a two-year high and exceeded 2011 levels by 60 percent, more than offsetting a drop in other types of livestock loans. Poor grazing conditions and a shortage of forage forced many livestock and dairy operators to liquidate herds, boosting the number of cattle on feed above year-ago levels.

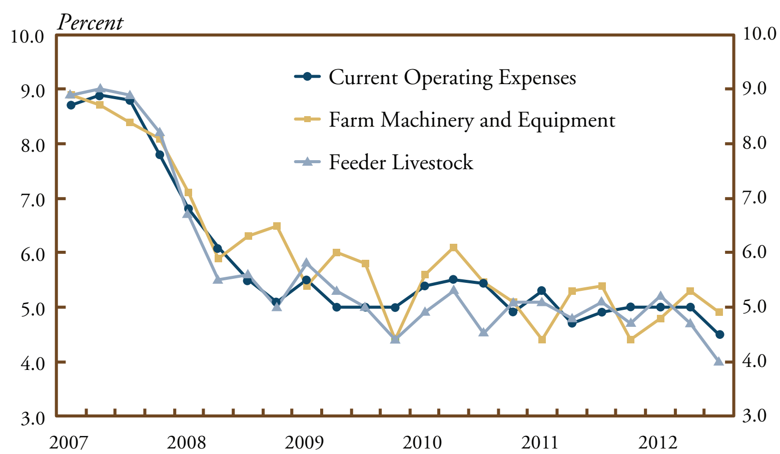
Increased lending on short-term operating loans shifted farm loan portfolios toward smaller loans at small- and mid-sized banks. Although non-real estate loan volumes at small- and mid-sized banks jumped 10 percent from year-ago levels in the third quarter, the average size of the loans fell by 12 percent. In contrast, non-real estate loan volumes declined 4 percent at large banks. Average effective interest rates trended down for most loan types, and agricultural banks shortened loan maturities for feeder livestock and farm machinery and equipment loans (Chart 2).

Chart 1: Non-real Estate Farm Loan Volumes by Purpose



Source: Agricultural Finance Databook, Section A.

Chart 2: Average Effective Interest Rates on New Farm Loans



Source: Agricultural Finance Databook, Section A.

Section B
Second Quarter Call Report Data

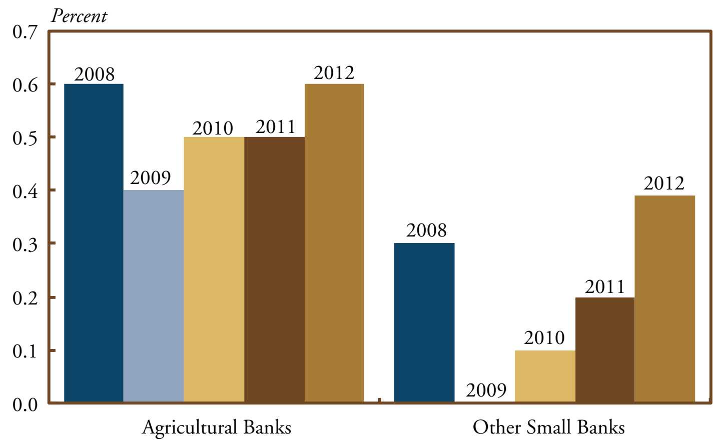
Nationally, agricultural banks continued to outperform their peers in the second quarter. The rate of return on assets at agricultural banks was 0.6 percent at the end of the second quarter, exceeding the 0.4 percent return at other small banks (Chart 3). The average rate of return on equity at agricultural banks was 5.3 percent in the second quarter compared to 3.6 percent at other small banks. With stronger profits, average capital ratios at both agricultural banks and other small banks rose further.

Commercial banks reported increased farm lending during the second quarter. Farm debt outstanding at all commercial banks rose 2.7 percent above year-ago levels in the second quarter, fueled by non-real estate loan originations. The volume of non-real estate farm loans jumped more than 5.0 percent compared to last year, while farm real estate loan volumes edged up less than 1.0 percent annually. Rising farm loan volumes increased the average loan-to-deposit ratio at agricultural banks.

In the second quarter, non-real estate farm loan performance continued to improve. After adjusting for seasonal trends, delinquency rates on non-real estate farm loans fell to 1.5 percent, their lowest level in four years (Chart 4). The largest 100 banks reported a steeper drop in delinquency rates than smaller banks. Still, large banks reported higher delinquency and charge-off rates than smaller banks. Delinquency rates for non-real estate farm loans averaged 3.4 percent at the 100 largest banks and 0.7 percent at all other commercial banks.

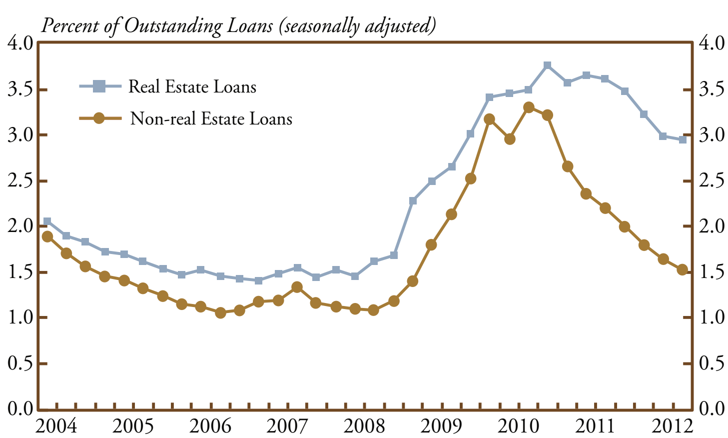
Farm real estate loan performance also improved during the second quarter as delinquency rates eased. Modest declines at smaller banks offset an uptick in delinquency rates at the 100 largest banks. Net charge-offs on farm real estate loans held steady at both large and small lenders.

Chart 3: Rate of Return on Assets (Second Quarter)



Source: Agricultural Finance Databook, Section B.

Chart 4: Delinquent Farm Loans



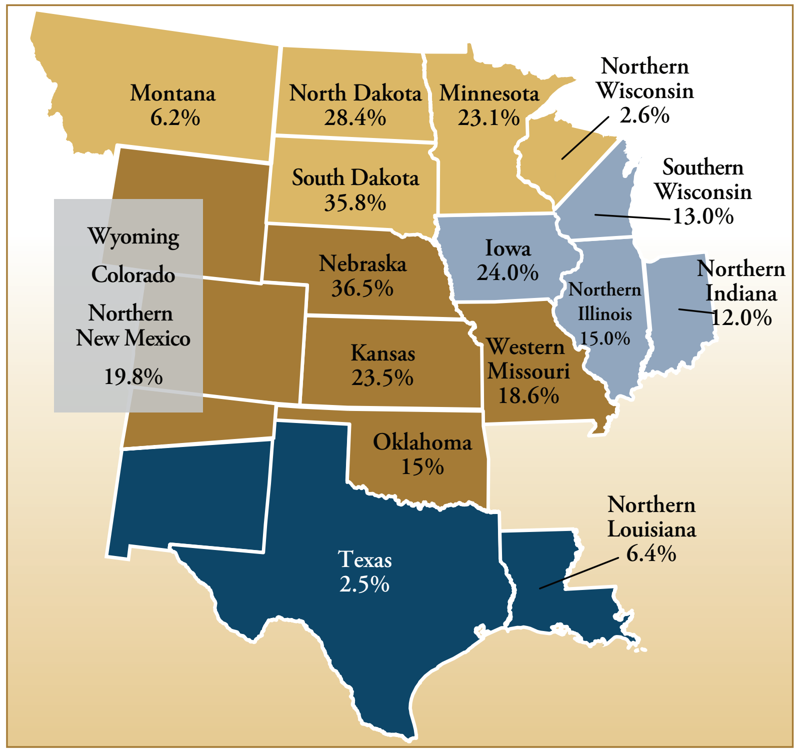
Source: Federal Reserve Board of Governors.

Section C
Second Quarter District Agricultural Conditions

Despite the drought, farmland values continued to rise across the nation's mid-section. Bankers in the Corn Belt and northern Plains reported strong year-over-year farmland value gains. In Nebraska and South Dakota, nonirrigated cropland values remained more than 30 percent above year-ago levels, and robust energy production continued to drive prices higher in North Dakota (Map 1). In the eastern Corn Belt, farmland values rose between 10 and 15 percent. In contrast, a second consecutive year of severe drought in Texas kept farmland values closer to year-ago levels. Agricultural bankers in the Kansas City, Dallas and San Francisco districts reported stronger annual gains in irrigated land values as dry conditions persisted. Most bankers expected farmland values to hold at current levels, though bankers in the Dallas and Richmond districts expected demand for farm real estate loans to soften in the coming months.

Map 1: Value of Non-Irrigated Cropland
Second Quarter 2012

Percent change from prior year



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

Despite poor growing conditions, record high crop prices and widespread crop insurance coverage supported farm incomes and loan demand. Bankers in the Chicago, Kansas City, Minneapolis and St. Louis districts reported that rising crop prices offset high input costs, boosting farm incomes. Profits in the livestock sector, however, suffered under high feed costs. In addition, drought prompted further herd reductions, which weighed on feeder cattle prices in the Kansas City District. Although operating loan activity increased with higher operating expenses, more bankers expected farm capital spending to cool as input costs rose.

Farm credit conditions remained healthy in the second quarter with solid loan repayment rates and fewer requests for loan renewals and extensions. According to Federal Reserve surveys, farm loan repayment rates were above year-ago levels in all districts except Richmond. Loan renewals and extensions held at low levels in most districts with further declines reported by Minneapolis. The availability of funds for farm loans remained high even with an uptick in loan-to-deposit ratios in the Chicago, Dallas and Richmond districts. Collateral requirements for non-real estate farm loans stabilized in most districts but moved higher in St. Louis. Most bankers reported lower interest rates for both real estate and non-real estate loans, with the exception of interest rates on short-term feeder cattle and operating loans in the Richmond District.