Agricultural Finance Databook

NATIONAL TRENDS IN FARM LENDING

April 2013

Federal Reserve Bank *of* Kansas City

Livestock Loans Raise Farm Lending

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Commercial banks boosted lending to livestock operators in the first quarter. According to a February survey of national commercial banks, bank lending for livestock purchases rose to its highest level in almost a decade. High feeder cattle prices kept loan volumes to cattle feedlots elevated. With expectations of further declines in crop and feed prices during 2013, the potential for improved profits also supported lending activity to other livestock operations. In addition, loan volumes for current operating expenses, including feed, rose further following a fourth quarter surge. Bankers also reported a rise in the share of loans made with a floating interest rate for both livestock purchases and current operating expenses.

Real estate loan volumes also trended higher as farmland markets remained active. Potential tax policy changes looming at the end of 2012 led to a flurry of farmland sales in the fourth quarter. Despite heightened sales activity, farmland prices surged further supported by strong farm incomes. Farmland value gains were most pronounced in the Central and Northern Plains. Irrigated cropland sold particularly well in the Central Plains due to concerns about water scarcity and land lease revenues from mineral rights pushed up farmland prices in the Northern Plains. Farmland values were expected to remain at record levels and real estate loan volumes appeared to advance modestly in the first quarter of 2013.

Profits at agricultural banks continued to improve in the fourth quarter. The average return on assets and return on equity reached their highest levels in five years. Ample funds were available for financing as agricultural banks competed for high-quality farm loans, driving interest rates for real estate and non-real estate loans to new lows. Loan repayment rates also edged higher as record crop insurance payments resulting from last year's drought boosted farm incomes. With rising loan repayment rates, delinquency rates on farm loans trended lower and net charge-offs, particularly for real estate loans, continued to fall.

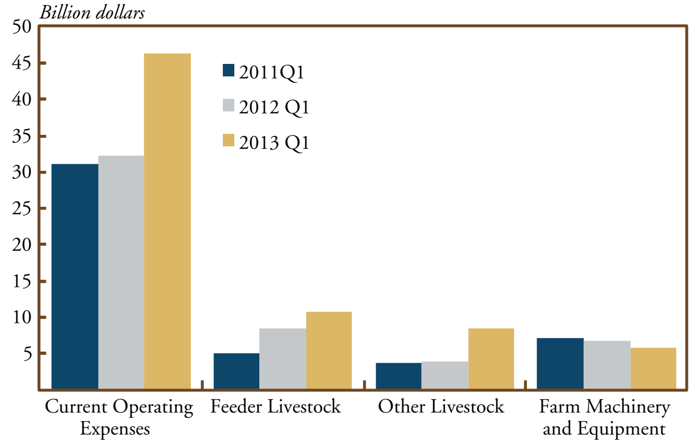
Section A
First Quarter National Farm Loan Data

Increased lending to the livestock sector helped push first-quarter farm loan volumes above year-ago levels. According to the national Survey of Terms of Bank Lending to Farmers conducted during the first full week of February, the total volume of non-real estate farm loans made during the quarter jumped 9.0 percent in the first quarter of the year. An increase in the number of loans to the farm sector more than made up for a slight decline in average loan amounts. Farm real estate loan originations also rose during the first quarter.

Loans to livestock enterprises surged to historically high levels as operators financed livestock purchases and production expenses. With feed costs expected to moderate throughout 2013, potentially improving livestock profitability, loans to purchase livestock rose sharply in the first quarter (Chart 1). However, low cow inventories underpinned high feeder cattle prices and contributed to higher loan volumes to feedlot operations. In addition, current operating loans jumped compared with last year as winter feeding expenses remained elevated. The crop sector also paid high input costs for fertilizer and seed, though crop insurance payments eased the effect of drought on crop incomes. After surging at the end of 2012, loan volumes for farm machinery and equipment purchases fell below year-ago levels, as did intermediate-term loans to farmers for other, unspecified purposes.

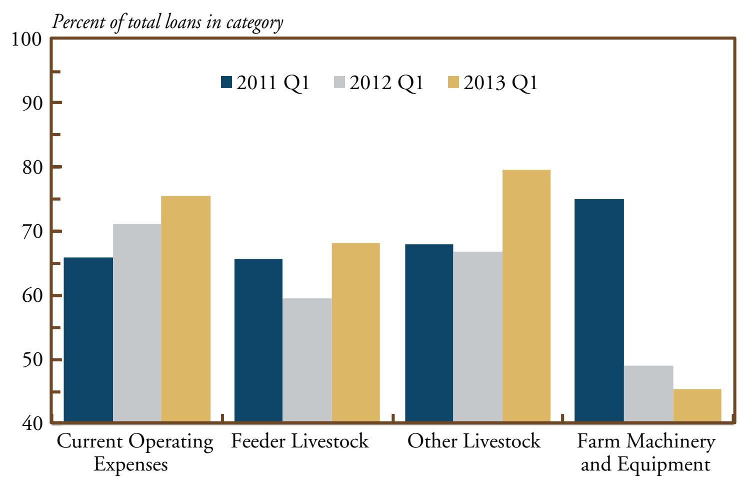
The share of loans with a floating interest rate made to livestock operations jumped in the first quarter. The share of loans made with a floating interest rate rose to almost 70 percent for feeder livestock and exceeded 75 percent for other livestock loans and current operating expenses (Chart 2). Commercial banks also competed intensely for agricultural loans, driving average effective interest rates to new lows. The lowest rates were reported in the Pacific Rim and the Corn Belt.

Chart 1: Farm Loan Volumes by Purpose



Source: Agricultural Finance Databook, Table A.3.

Chart 2: Share of Farm Loans with a Floating Interest Rate by Purpose



Source: Agricultural Finance Databook, Table A.6.

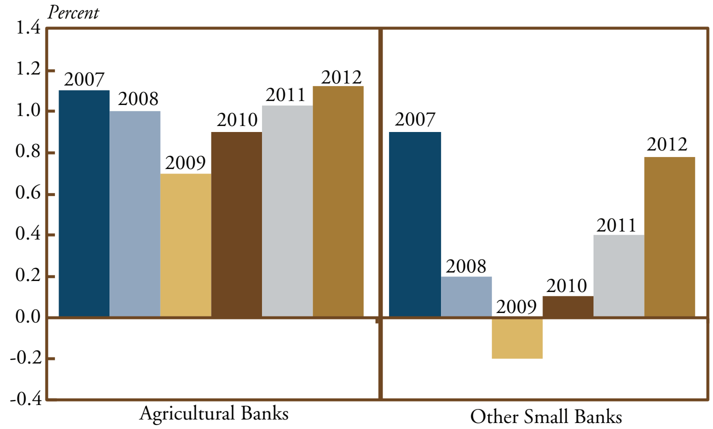
Section B
Fourth Quarter Call Report Data

Agricultural banks posted their best financial performance in five years with strengthening profits in 2012. The rate of return on assets at agricultural banks topped 1.1 percent at the end of the year, compared with 0.8 percent at other small banks (Chart 3). The average rate of return on equity at agricultural banks rose to 10.2 percent in the fourth quarter, well above the 7.3 percent reported for other small banks. In addition, the percentage of agricultural banks with negative income as a share of average equity fell to a five-year low. Furthermore, there were only two agricultural bank failures in 2012 from the more than 50 commercial bank closures during the year.

Farm lending at commercial banks soared at the end of the year. Farm debt outstanding at all commercial banks rose almost 5 percent in the fourth quarter, the largest year-over-year jump since early 2009. High input costs and a surge in farm machinery and equipment purchases to take advantage of tax incentives drove non-real estate loan volumes 5.0 percent higher than last year. Potential changes in tax policies also enticed more landowners to sell farmland before the end of 2012, pushing farm real estate loan volumes 4.6 percent above year-ago levels. Despite higher farm loan volumes, rising deposits at agricultural banks kept average loan-to-deposit ratios steady for much of 2012.

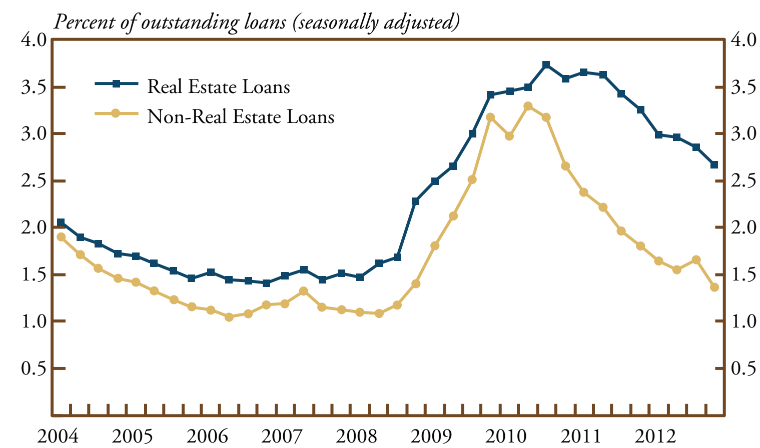
Farm loan delinquency rates fell during the fourth quarter. Following an uptick in the third quarter, delinquency rates on non-real estate farm loans dropped to 1.4 percent and loan charge-off rates held steady (Chart 4). Delinquency rates on farm real estate loans trended down for the second straight year, falling to 2.7 percent in the fourth quarter of 2012. In addition, charge-off rates on farm real estate loans fell to their lowest level in four years.

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



Source: Agricultural Finance Databook, Table B.7.

Chart 4: Delinquent Farm Loans



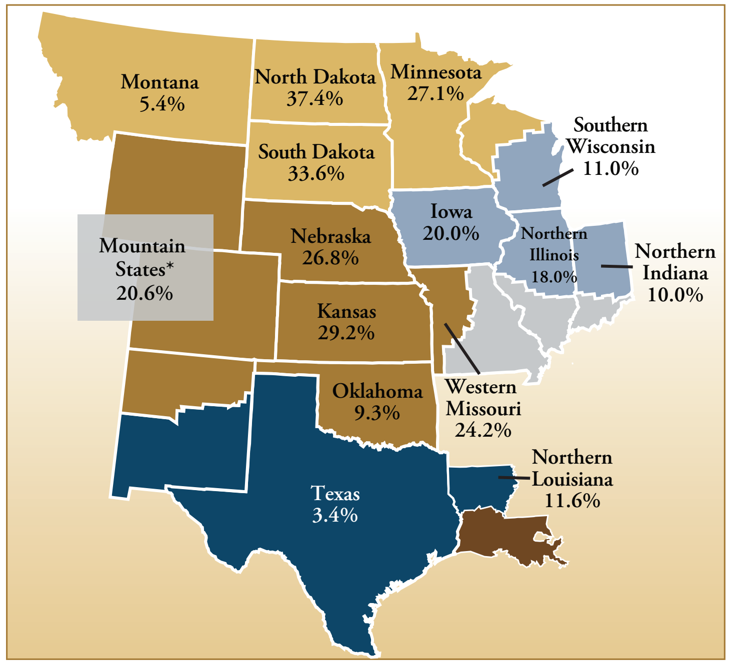
Source: Federal Reserve Board of Governors.

Section C
Fourth Quarter District Agricultural Conditions

Bankers in agricultural growing regions reported strong year-over-year farmland value gains in the fourth quarter (Map 1). Strong interest in farmland from both farmers and nonfarm investors drove real estate prices higher in many areas despite increased sales and lingering drought conditions. Robust energy production and less severe drought conditions in the Northern Plains helped push the value of non-irrigated farmland up substantially. Cropland values in the Corn Belt continued to build on previous gains. Back-to-back years of drought in the Southern Plains limited non-irrigated farmland value gains but fueled demand for irrigated acreage. Still, most bankers expected farmland values would hold at record levels regardless of weather patterns during the coming year. Interest rates to finance farm real estate loans continued to edge down.

Map 1: Value of Non-Irrigated Cropland (Fourth Quarter, 2012)

Percent Change from Previous Year



*Mountain States include Wyoming, Colorado, and Northern New Mexico, which are grouped together due to limited survey responses from each individual state.
Source: Federal Reserve District Agricultural Credit Surveys (Chicago, Minneapolis, Kansas City, Dallas)

Elevated crop prices and crop insurance payments due to drought supported farm incomes and capital spending in the fourth quarter. Bankers reported a surge in capital spending before year-end to take advantage of tax breaks on depreciation for qualified farm equipment. However, bankers indicated that strong farm income was limiting demand for some loans. The volume of dairy loans was expected to remain flat though feeder cattle loan volumes were expected to rise modestly in the Dallas District. As agricultural banks competed for qualified borrowers, interest rates on short and intermediate-term loans fell further in all Districts except Richmond.

With solid incomes, farm credit conditions generally improved in the fourth quarter. According to Federal Reserve District Agricultural Credit Surveys, more bankers reported higher loan repayment rates and fewer loan renewals and extensions at the end of the year as some farmers used income to pay off debt. In addition, the availability of funds for farm loans remained high and collateral requirements for non-real estate farm loans held relatively steady. Average loan-to-deposit ratios edged up in the Richmond District but dipped lower in the Chicago and Dallas Districts.