Agricultural Finance Databook

NATIONAL TRENDS IN FARM LENDING

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FEDERAL RESERVE BANK *of* KANSAS CITY

Agricultural Lending Shifts to Large Banks

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The market share of agricultural loans shifted more toward large commercial banks in the second quarter. According to national survey data from the second week of May, the share of non-real estate loans originated by large banks relative to their smaller counterparts jumped to the highest level in nearly 20 years. Rising production costs prompted some agricultural producers to take on more debt, and lenders continued to compete for market share. The shift to borrowing from larger lenders could be due, in part, to attractive and flexible loan terms. Typically, larger banks offered more floating interest rate loans at lower rates than small and midsized lenders, suggesting larger banks may be better able to accommodate the borrowing needs of large producers expanding their operations.

"Agricultural producers took on more debt, and lenders competed for market share."

According to survey data, total non-real estate farm loan volumes continued to trend higher in the second quarter. Commercial banks financed increased operating expenses and other non-real estate loans for unspecified purposes. As farm spending ramped up to pay high input costs for seed, fertilizer and feed, loan volumes for farm machinery and equipment fell sharply. Looking ahead, an anticipated drop in crop prices closer to harvest could further strain farm profit margins, potentially boosting the need for short-term loans and curtailing farm capital spending at year-end.

Agricultural banks started 2013 on a solid financial footing. Though slightly lower than year-ago levels, the return on assets at agricultural banks in the first quarter continued to exceed the returns at other small banks. Farm loan repayments remained strong, reducing delinquency rates and net charge-off amounts, most noticeably at large commercial banks. Rising farmland values also contributed to higher farm real estate loan volumes. However, more agricultural bankers expected farmland values to plateau in the coming months.

Section A
Second Quarter National Farm Loan Data

Intense competition between lenders reshaped farm loan portfolios at commercial banks. According to a national survey of commercial banks from the first full week of May, three-quarters of the new non-real estate farm loans generated during the survey period were originated by large lenders (Chart 1). In addition to a shift in market share, new loan volumes at large lenders were near record highs while volumes at smaller lenders were near record lows (Chart 2). This shift could be due to favorable loan terms and higher average loan amounts available at larger banks. Almost 90 percent of non-real estate loans at large lenders were made with floating interest rates, double the percentage at small and midsized banks. Moreover, the average effective interest rate offered by large banks on non-real estate loans was 3.6 percent, much lower than the average 5.4 percent effective interest rate at small and midsized banks.

Rising production costs and larger loans for unspecified purposes pushed agricultural loan volumes higher in the second quarter. Survey results indicated the total volume of non-real estate farm loans made during the quarter rose 5.8 percent from last year (Chart 3). Farm real estate loan originations also grew during the second quarter, rising from 9 percent to almost 12 percent of farm loan portfolios at large banks and more than doubling from 12 percent to 27 percent of farm loan portfolios at small and midsized lenders.

An increased need for short-term borrowing helped offset a decline in loans for farm machinery and equipment during the second quarter. Loans to fund current operating expenses exceeded year-ago levels by 5.3 percent as input costs trended up. Following a year-end spike in capital spending, the volume of loans for farm machinery and equipment tumbled by almost a third in the second quarter from last year. Agricultural lenders also extended a substantial amount of intermediate-term credit for other, general purposes, adding to farm sector debt obligations.

Chart 1: Share of New Non-Real Estate Farm Loan Volumes by Commercial Bank Size* (Second Quarter)

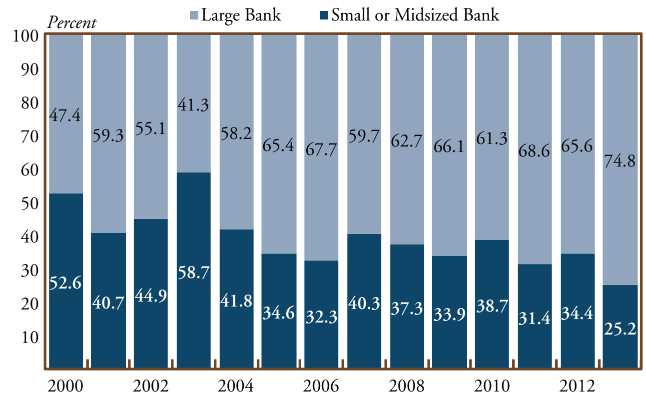
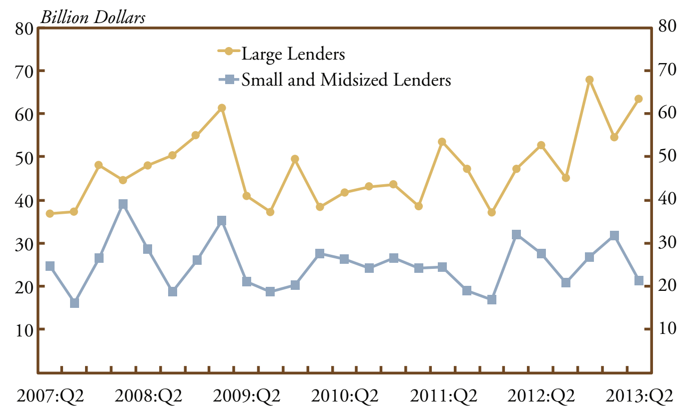
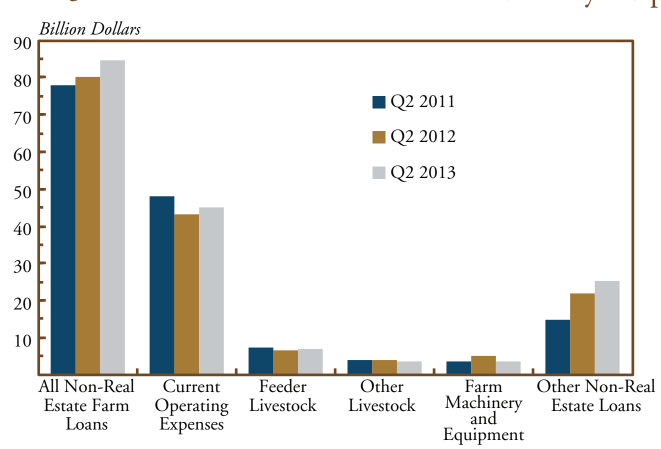


Chart 2: New Non-Real Estate Farm Loan Originations*



Source: Agricultural Finance Databook, Table A.3.
*Note: Large lenders had more than $25 million in their farm loan portfolios. Small and midsized lenders typically had less than $25 million in their farm loan portfolios.

Chart 3: Non-Real Estate Farm Loan Volumes by Purpose



Source: Agricultural Finance Databook, Table A.3.

Section B
First Quarter Call Report Data

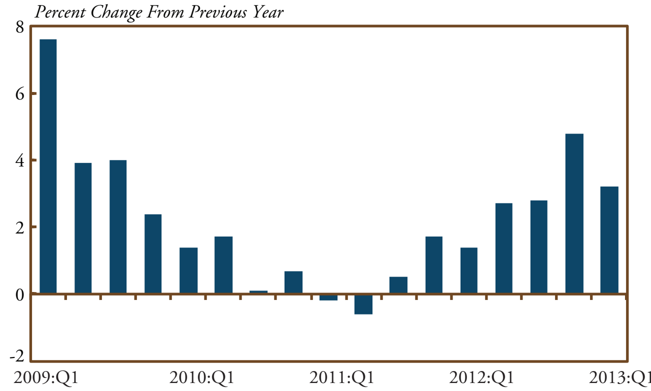
Farm lending at commercial banks remained strong following a fourth-quarter spike at the end of 2012. According to call report data as of March 31, 2013, farm debt outstanding at all commercial banks rose 3.2 percent, the largest year-over-year jump in the first quarter since 2009 (Chart 4). This increase marked the fourth consecutive quarter of annual farm debt growth higher than 2.5 percent, well above the previous two years.

High input costs drove non-real estate loan volume almost 2.0 percent higher in the first quarter from a year ago. This confirmed earlier results from the Survey of Term Lending to Farmers, indicating increased farm loan activity in the first quarter that may continue into the second quarter. Furthermore, strong sales momentum in farmland markets increased annual farm real estate loan volume by more than 4.0 percent for the second straight quarter.

Loan performance measures improved in the first quarter, particularly at large lenders. Delinquency rates on non-real estate farm loans edged down to 1.3 percent and charge-off rates fell dramatically. Improved non-real estate farm loan performance was driven by a drop in the percentage of nonperforming loans at the 100 largest banks, a potential motivation for increased agricultural loan volumes at large commercial banks (Chart 5). Delinquency rates on farm real estate loans also continued to trend down at both large banks and other commercial lenders.

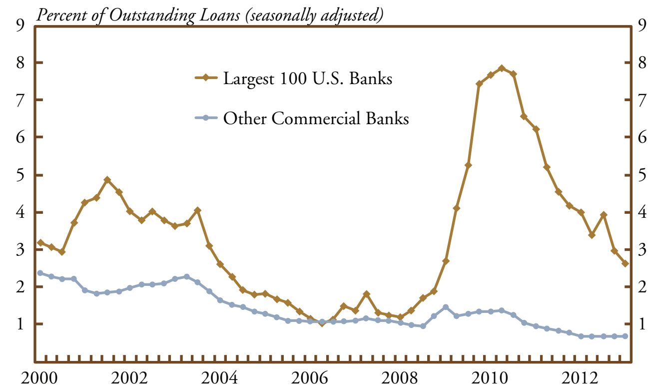
Agricultural banks reported solid financial returns in the first quarter though profitability was not quite as strong as a year ago. The rate of return on assets at agricultural banks was .27 percent at the end of March, slightly less than the .30 percent returns during the same period of 2012 (Chart 6). The average rate of return on equity at agricultural banks in the first quarter also eased, dipping from 2.7 percent in 2012 to 2.5 percent in 2013. Still, agricultural banks outperformed their peers, even though the average rate of return on assets and equity strengthened modestly at other small banks.

Chart 4: Farm Debt Outstanding at Commercial Banks



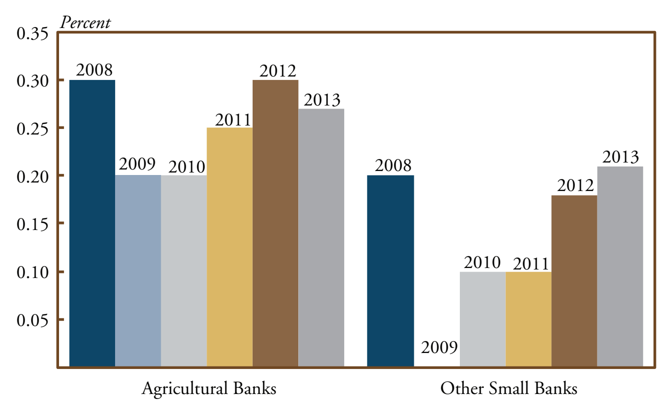
Source: Agricultural Finance Databook, Table B.1.

Chart 5: Delinquency Rates on Non-Real Estate Farm Loans



Source: Federal Reserve Board of Governors.

Chart 6: Rate of Return on Assets (First Quarter)



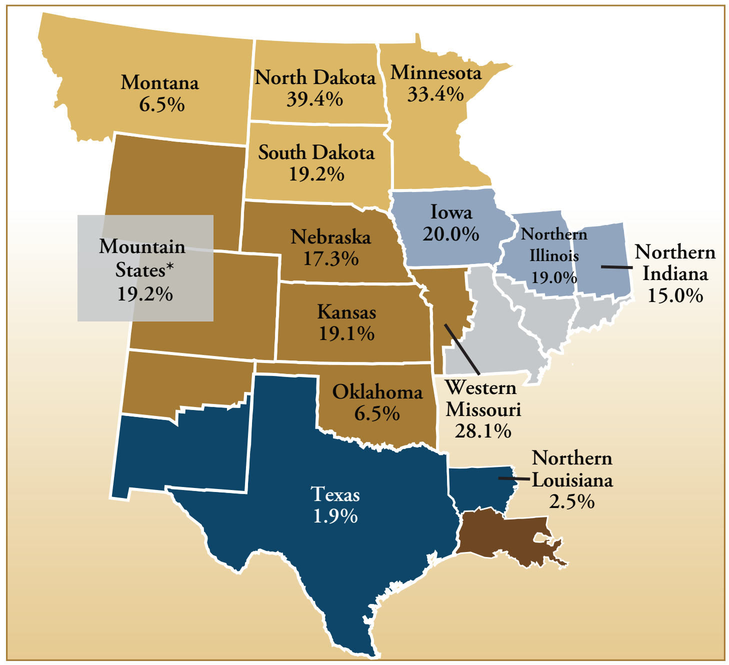
Source: Agricultural Finance Databook, Table B.7.

Section C
First Quarter Regional Agricultural Conditions

Farmland values across the country climbed higher in the second quarter although gains in some areas have begun to moderate. North Dakota continued to post the highest year-over-year gains in nonirrigated cropland values, followed by neighboring Minnesota (Map 1). However, annual cropland value gains slowed from record highs in other states, pulling back to 20 percent or less throughout most of the Corn Belt. Cropland values in the Southern Plains grew at a comparatively modest pace as drought conditions stretched into a third growing season. Ranchland values rose further with high feed and forage costs boosted demand for good-quality pasture ground. More bankers in the Chicago, Dallas and Richmond Federal Reserve Districts, however, expected farmland values to hold steady in the coming months compared with expectations at the end of 2012.

Map 1: Value of NonIrrigated Cropland (First Quarter, 2013)

Percent Change from Previous Year



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

Demand for farm loans remained relatively soft, particularly at community banks, according to Federal Reserve District surveys in the first quarter. Looking forward, bankers in the Chicago, Dallas and Richmond Districts did not anticipate much loan growth during the next three months. In the Kansas City and St. Louis Districts, farm income expectations for 2013 were dampened by an anticipated drop in crop prices later this year if production rebounds from last year's drought-reduced yields. Agricultural bankers in the Kansas City District also noted that lower farm income may curtail farm capital spending.

Farm credit conditions remained strong in the first quarter. According to Federal Reserve surveys, farm loan repayment rates remained high in all Districts and loan renewals and extensions generally held at low levels. With slack loan demand, ample funds were available for qualified farm borrowers. In fact, most agricultural bankers in the Chicago, Dallas and Richmond Districts classified loan-to-deposit ratios as lower than desired. Collateral requirements for non-real estate farm loans eased slightly in most Districts except Dallas, Richmond and San Francisco, where they held steady. Meanwhile, heated competition for high-quality farm loans pushed interest rates down further for short-term feeder cattle and operating loans, intermediate-term non-real estate loans and long-term real estate loans.