Agricultural Finance Databook

NATIONAL TRENDS IN FARM LENDING

JANUARY 2014

FEDERAL RESERVE BANK *of* KANSAS CITY

Slump in Capital Spending Weighs on Farm Lending

by Nathan Kauffman, Omaha branch executive
Maria Akers, associate economist

A slowdown in lending for capital purchases contributed to lower farm loan volumes in the fourth quarter. In recent years, strong incomes and tax incentives prompted many producers to upgrade or replace farm machinery and equipment. According to national survey data collected during the first full week of November, the volume of loans for farm machinery and equipment purchases dropped to the lowest level in more than two years. This drop occurred despite attractive loan terms of low interest rates and longer average loan maturities.

> *"The volume of loans for farm machinery and equipment purchases dropped to the lowest level in more than two years."*

Elevated farm income and a decline in input costs dampened short-term lending to the farm sector in the fourth quarter. A rebound in crop production in most regions helped offset a sharp drop in corn prices at harvest, keeping farm income relatively high. In turn, lower corn prices reduced feed costs for livestock operators. Crop farmers also saw operating costs decline due, in part, to a decrease in fertilizer prices. With fewer operating loans being made, large lenders in particular competed for market share by offering further reductions in interest rates.

Farm real estate lending also eased during the fourth-quarter survey period. While farmland values generally were still rising, agricultural bankers reported gains had moderated from the brisk pace of the past few years. Most bankers felt that farmland values would hold steady at high levels heading into 2014.

With solid farm income, agricultural banks reported sound profits as the fall harvest season wound down. At the end of the third quarter, agricultural banks posted the second-highest average return on assets in five years. These returns have consistently surpassed returns reported at other small banks. Delinquency rates on both farm real estate and non-real estate loans continued to trend down as bankers reported relatively high loan repayment rates.

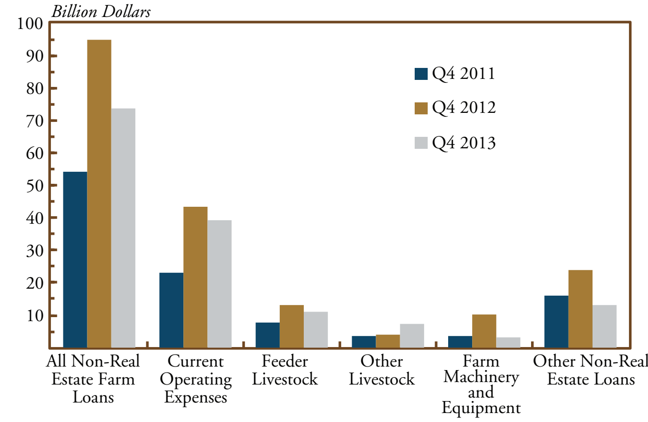
Section A
Fourth Quarter National Farm Loan Data

Commercial bank lending for non-real estate farm loans dipped in the fourth quarter, driven in part by a decline in farm capital spending (Chart 1). In 2012, intermediate-term loan volumes for farm machinery and equipment spiked as tax credits allowing accelerated depreciation on qualifying capital investments were set to expire at year-end. Even though the tax credits were extended through 2013, the most recent November survey data indicated loan volumes for farm machinery and equipment fell to their lowest level in more than two years. For qualified borrowers still wanting to finance machinery and equipment purchases, many commercial banks were extending loan maturities and lowering interest rates to lessen average monthly payments (Chart 2).

Strong incomes and a drop in key production costs limited the need for short-term financing to the farm sector. According to the U.S. Department of Agriculture (USDA), overall farm income remained high in 2013, although a sharp drop in corn and soybean prices at harvest limited income for some producers in the fourth quarter. Lower crop prices provided some relief to struggling livestock operators by reducing feed costs (Chart 3). Crop producers also saw a decline in production costs with a 13-percent drop in the price of fertilizer in the third quarter.

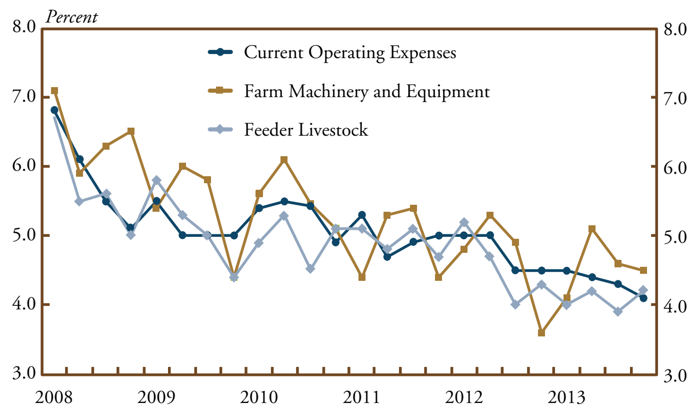
With solid incomes and lower operating costs, November survey data indicated fourth-quarter operating loan volumes fell 10 percent short of last year's levels, feeder livestock loans were 17 percent lower, and other loans for non-specified purposes plummeted by 45 percent. The only loan category experiencing an increase in volume was for livestock other than feeder animals, which includes poultry purchases.

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



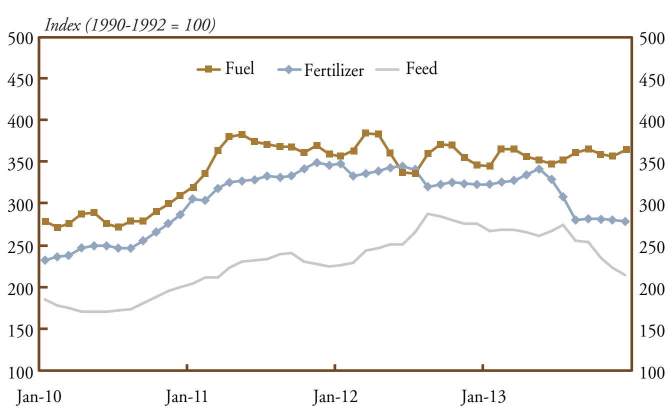
Source: Agricultural Finance Databook, Table A.3.

Chart 2: Average Effective Interest Rates on Non-Real Estate Farm Loans



Source: Agricultural Finance Databook, Table A.5.

Chart 3: Prices Paid by Agricultural Producers



Source: USDA

Agricultural Finance Databook

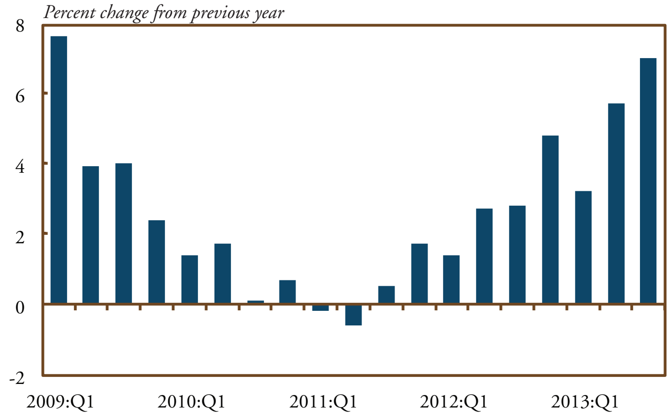
Section B
Third Quarter Call Report Data

During the third quarter, the pace of farm lending at commercial banks accelerated (Chart 4). The August 2013 Survey of Terms of Bank Lending to Farmers implied that loan volumes would continue to climb in the third quarter. Call report data as of Sept. 30, 2013, reflected a 7-percent jump in farm debt outstanding at all commercial banks compared with the previous year, the strongest gain since early 2009. Strong farmland markets and rising farmland values contributed to an 8.7 percent year-over-year increase in farm real estate loan volumes. Non-real estate farm loan volumes also rose in the third quarter, surpassing year-ago levels by 5 percent.

Commercial banks also reported better farm loan performance measures during the third quarter. Seasonally adjusted delinquency rates on non-real estate farm loans at the 100 largest banks trended down during 2013, reaching a five-year low of 2.2 percent in the fourth quarter (Chart 5). Non-real estate farm loan delinquency rates at all other commercial banks have held below 1 percent since early 2011. Delinquency rates on farm real estate loans at the 100 largest banks stabilized in the fourth quarter but edged down at all other commercial banks.

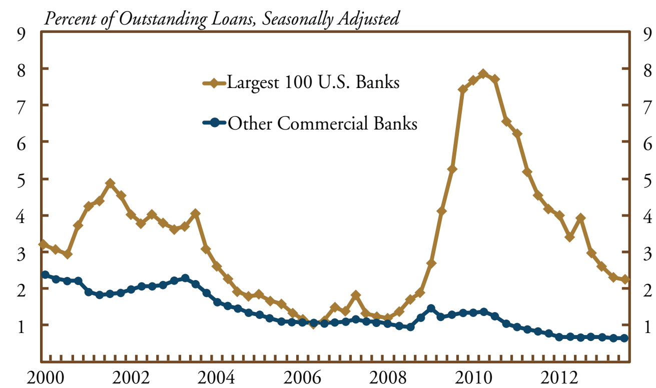
The financial performance of agricultural banks continued to best that of their peers in the third quarter. The rate of return on assets at agricultural banks was 0.85 percent at the end of the third quarter, slightly lower than 2012 but well above the 0.59 percent return at other small banks (Chart 6). Furthermore, the average rate of return on equity at agricultural banks was 7.8 percent during the third quarter compared with 5.6 percent at other small banks. Average capital ratios at both agricultural banks and other small banks dipped slightly from year-ago levels while average loan-to-deposit ratios at agricultural banks edged up.

Chart 4: Farm Debt Outstanding at Commercial Banks



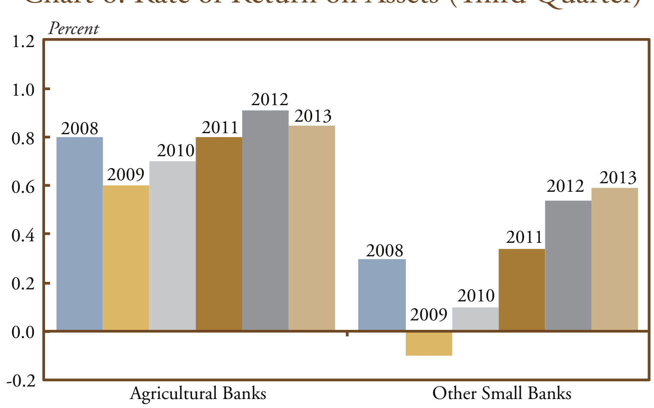
Source: Agricultural Finance Databook, Table B.1

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



Source: Federal Reserve Board of Governors.

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



Source: Agricultural Finance Databook, Table B.7.

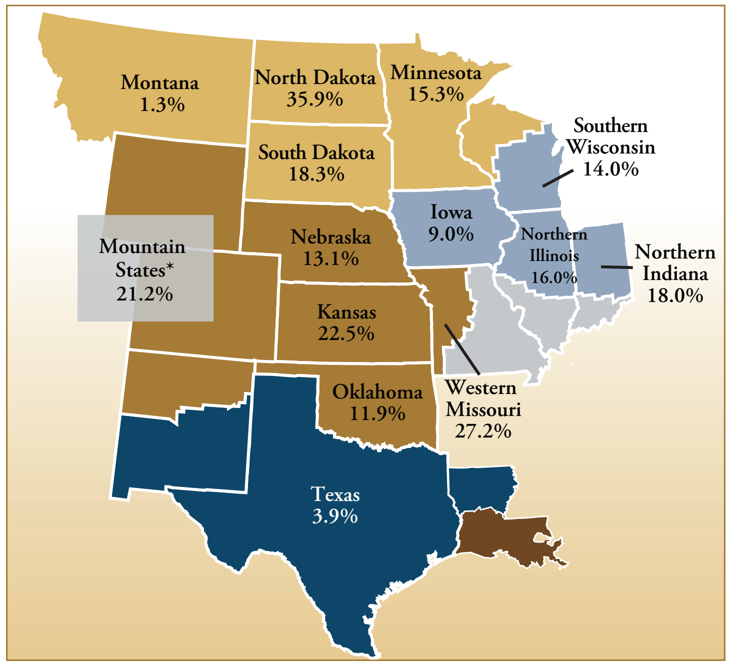
Section C
Third Quarter Regional Agricultural Conditions

In the third quarter, the pace of farmland value gains slowed somewhat from the rapid climb of recent years. Amid booming energy activity, North Dakota continued to report the strongest year-over-year increase in nonirrigated cropland values, far exceeding gains reported elsewhere in the Plains and the Corn Belt (Map 1). In contrast, drought-prone Texas reported the smallest annual increase in the value of nonirrigated cropland.

Many bankers reported farmland value gains have begun to moderate, particularly in corn-producing states. Most bankers in the Chicago, Dallas and Kansas City Federal Reserve Districts believed that farmland values would likely hold at current peak levels and did not expect a major decline heading into 2014. However, some bankers in the reporting Districts of Chicago and Dallas anticipated fewer farm real estate loans would be made in the fourth quarter compared with strong activity last year.

Map 1: Value of Nonirrigated Cropland (Third 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.
Sources: Federal Reserve District Agricultural Credit Surveys (Chicago, Minneapolis, Kansas City and Dallas).

According to Federal Reserve surveys, demand for farm operating loans rose modestly in most Districts in the third quarter. The Chicago, Dallas, Kansas City, St. Louis and San Francisco Districts indicated an uptick in demand for operating loans considering the effect that lower crop prices could have on farm income prospects. The potential for lower farm income also dampened capital spending plans in the Chicago, Kansas City, Minneapolis and St. Louis Districts.

Farm credit conditions generally held steady in the third quarter. According to Federal Reserve surveys, farm loan repayment rates remained above year-ago levels in all Districts and the number of loan renewals and extensions was relatively modest. Even with slightly higher loan demand, agricultural bankers reported that sufficient funds were available for farm loans. Collateral requirements for non-real estate farm loans eased modestly in the Kansas City and St. Louis Districts, held steady in the Chicago and Minneapolis Districts and tightened slightly in the Dallas and San Francisco Districts. Average fixed interest rates on short-term operating loans and long-term farm real estate loans edged up in the Minneapolis, San Francisco and St. Louis Districts but held steady or edged down in the Chicago, Dallas and Kansas City Districts. ■