Agricultural Finance Databook

NATIONAL TRENDS IN FARM LENDING

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Agricultural Finance Conditions Turn

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Spurred by higher input costs, agricultural lending activity increased in the second quarter. After contracting at the beginning of the year, the total volume of farm loans at commercial banks ticked up as farmers and feedlot operators borrowed to pay for higher priced fuel, fertilizer and feed during the second quarter. Higher input costs increased the size of individual farm loans, supporting stronger loan growth at larger agricultural banks. With ample funds, most bankers were able to satisfy rising operating loan demand with low interest rates.

In contrast, intermediate-term loans for machinery and equipment purchases contracted during the second quarter. With rising input costs, farm income expectations eased and capital spending in the farm sector cooled. As a result, loan volumes for farm machinery and equipment dropped below year-ago levels, shrinking loan portfolios at small and mid-sized agricultural banks.

Despite higher costs for farm inputs, profits at agricultural banks strengthened in the first quarter, tripling the rate of return at other small banks. Still, a first quarter uptick in farm loan delinquency rates poses a slight risk to future profits. After easing at the end of 2010, delinquency rates on farm loans edged up, and higher input costs could further strain the ability of farmers to repay debt.

Commodity prices and farm profits remained elevated in the first quarter, fueling additional gains in farmland values. The strongest land value gains emerged in the Corn Belt, where cropland prices jumped more than 20 percent above year-ago levels in many states. Bankers in the Corn Belt also reported substantial increases in cash rental rates. Despite poor growing and pasture conditions due to drought, land lease revenues for energy exploration lifted farmland values in the Southern Plains. With rising land prices in the first quarter, farm real estate loan volumes rose above year-ago levels.

> *"Higher input costs increased the size of individual farm loans."*

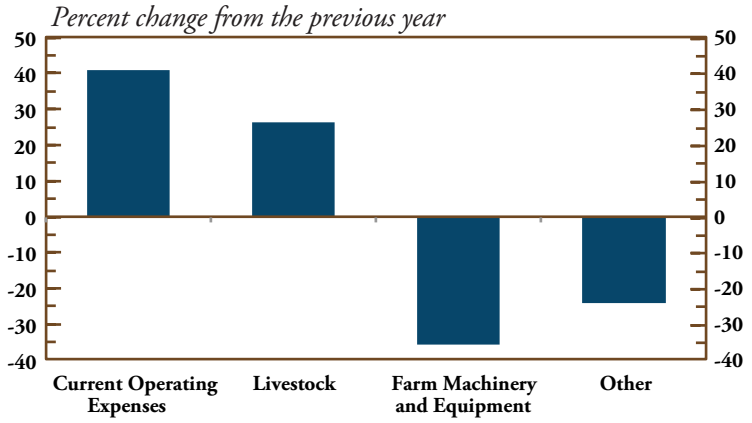
Section A Summary

Second Quarter National Farm Loan Data

Non-real estate farm loan volumes at commercial banks increased in the second quarter as crop producers and livestock operators paid higher input costs. In the second quarter, non-real estate farm loan volumes exceeded year-ago levels by 14 percent, primarily due to larger loans for operating expenses and feeder livestock (Chart 1). The average size of short-term operating loans jumped 36 percent above year-ago levels due to higher costs for fuel, fertilizer and feed. The cost of borrowing, however, fell as the average interest rate charged for operating loans dropped from 5.3 percent to 4.7 percent (Chart 2). The average maturity on operating loans held steady at just under a year.

Chart 1: Farm Loan Volumes by Purpose

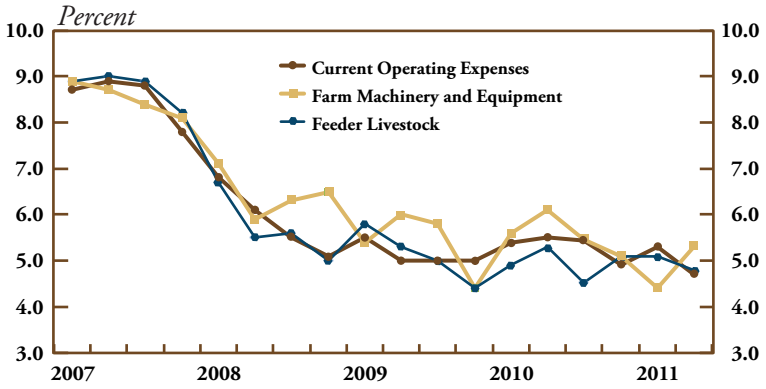
Second Quarter 2011



Source: Agricultural Finance Databook, Section A

Though the number of feeder livestock loans dipped slightly compared to last year, the average loan amount almost doubled, pushing the volume of livestock loans more than 25 percent higher. Tight supplies from previous herd reductions have kept feeder cattle prices high at the same time feedlot placements rose due to poor grazing in drought areas. Similar to operating loans, the average interest rate for feeder livestock loans fell to 4.8 percent and the average maturity was comparable to last year. Farm loan portfolios at larger agricultural banks rose faster as the number of large feeder livestock and operating loans of more than $100,000 increased.

Chart 2: Average Effective Interest Rates on Farm Loans



Source: Agricultural Finance Databook, Section A

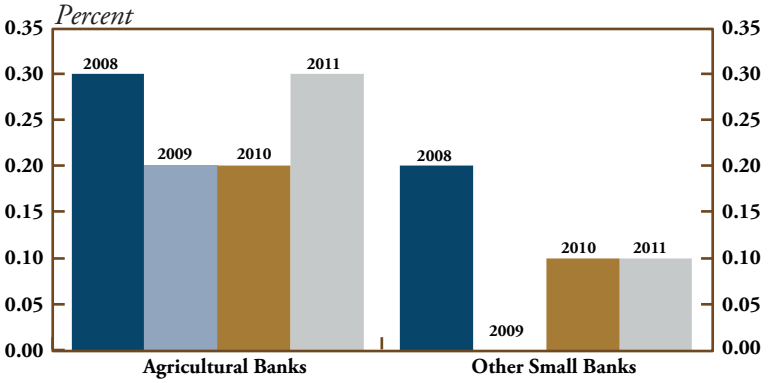
In contrast, capital spending in the farm sector cooled as planting season got under way, shrinking intermediate-term loan volumes at agricultural banks. Loan volumes for farm machinery and equipment plunged from a first quarter spike and were 36 percent below year-ago levels. Interest rates for farm machinery and equipment also reversed course and moved higher for the first time in a year, averaging 5.3 percent. Small and mid-sized agricultural banks saw their farm loan portfolios trimmed with the drop in farm machinery and equipment loans.

Section B Summary

First Quarter Bank Call Report Data

Agricultural bank profits strengthened in the first quarter, but a rise in farm loan delinquency rates could hinder future profits. Compared to a year ago, the rate of return on assets at agricultural banks rose to 0.3 percent, while returns held steady at 0.1 percent for other small banks (Chart 3). The average rate of return on equity at agricultural banks was 2.3 percent in the first quarter, up from a low of 1.8 percent in 2009, and more than double the levels at other small banks. Stronger profits helped lift capital ratios at agricultural banks and the loan-to-deposit ratio eased with stable loan volumes in the first quarter.

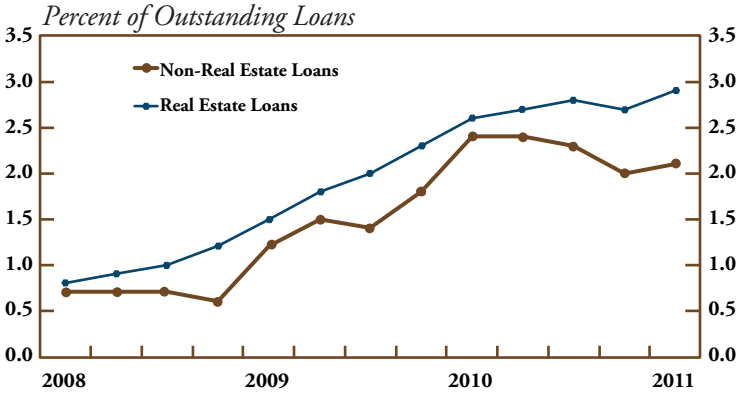
Chart 3: Rate of Return on Assets
First Quarter



Source: Agricultural Finance Databook, Section B

Non-real estate loan performance weakened slightly in the first quarter. After trending down last year, delinquent non-real estate loan volumes edged up and comprised 2.1 percent of outstanding farm production loans in the first quarter (Chart 4). In addition, the volume of non-real estate loans 30 to 89 days past due ticked up, which could nudge delinquency rates higher in the coming months. Still, net charge-offs of non-real estate farm loans have dropped sharply since year-end and were down by more than two-thirds compared to a year ago. The volume of outstanding non-real estate farm loans at all commercial banks fell 1.5 percent from year-ago levels as farmers used elevated incomes to pay off debt.

Chart 4: Nonperforming Farm Loans



Source: Agricultural Finance Databook, Section B
Note: Nonperforming loans are at least 90 days past due

Loan performance measures for real estate loans also deteriorated slightly in the first quarter. After dipping at the end of last year, farm loan delinquency rates rose to almost 3 percent during the first quarter of 2011. The share of real estate loans 30 to 89 days past due also rose, setting the stage for rising delinquency rates in the coming months. Yet, real estate loan net charge-offs amounts were on par with last year. Farm real estate loan volumes were slightly higher than 2010 levels in the first quarter.

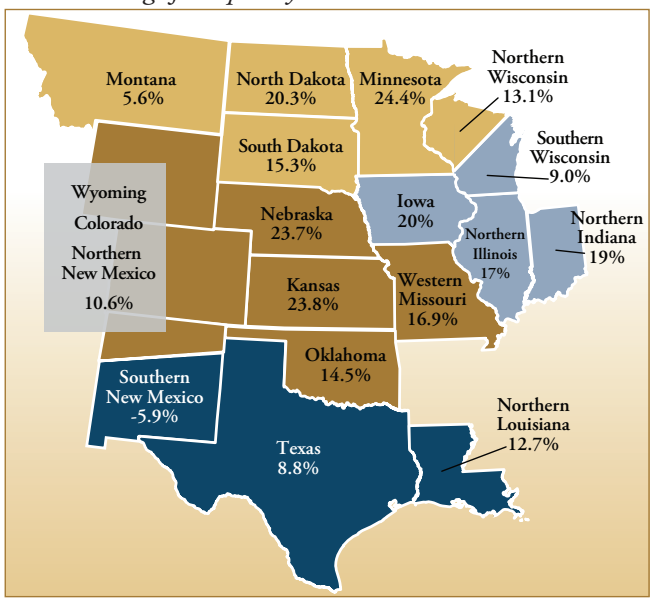
Section C Summary

First Quarter District Agricultural Conditions

High commodity prices in the first quarter strengthened farm income and spurred further farmland value gains. Most states in the Chicago, Minneapolis and Kansas City Districts posted double-digit gains in cropland value from the prior year, with gains approaching 25 percent in Kansas, Nebraska and Minnesota (Map 1). Even with extreme drought conditions in the Southern Plains, Oklahoma and Texas posted stronger farmland appreciation, reflecting the growing influence of energy markets on farmland values. Land lease revenues for mineral rights surged as energy exploration shifted from off-shore to inland and new reserves of oil and natural gas were identified. With the positive outlook for farm incomes, bankers in the Chicago, Dallas and Kansas City Districts noted that many farmland owners negotiated a substantial increase in cash rental rates for the coming year. Many survey respondents felt that farmland values had yet to peak as demand from farm and non-farm investors continued unabated.

Map 1: Value of Non-Irrigated Cropland
First Quarter 2011

Percent change from prior year



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

Demand for farm loans remained subdued in the first quarter with mixed expectations for future loan activity. Chicago and Richmond bankers forecasted declining volumes for feeder cattle, crop storage, and dairy loans. However, some survey respondents in the Kansas City and Dallas Districts anticipated modest growth in operating loan volumes during the second quarter as farmers and ranchers faced higher prices for production inputs. Although many producers paid for current expenses out-of-pocket during the first quarter, rising costs for fuel, fertilizer, seed and feed could strain cash positions and prompt increased borrowing in the second quarter. District surveys also reported strong demand for farm machinery and equipment in the first quarter, but noted that capital spending may wane through the rest of 2011 as large equipment purchases are completed.

During the first quarter, farm credit conditions strengthened further as farmers continued to use elevated incomes to pay off loans. Loan repayment rates at agricultural banks remained high during the first quarter and the number of loan renewals and extensions fell in all Districts except Richmond. With soft loan demand, ample funds were available for qualified borrowers. In fact, contacts in the Chicago and Richmond Districts indicated loan-to-deposit ratios were lower than desired and more bankers were actively seeking new loans. Interest rates for farm loans remained historically low, though the Chicago District reported a slight uptick in rates, most notably for operating loans. ■