Agricultural Finance Databook

NATIONAL TRENDS IN FARM LENDING

JULY 2012 | FEDERAL RESERVE BANK *of* KANSAS CITY

Farm Lending Rises with Capital Spending and Farmland Investments

by: Jason Henderson, Omaha Branch Executive
Maria Akers, Associate Economist

Strong capital spending and investments boosted agricultural lending at commercial banks in the first half of 2012. During the first quarter, commercial banks reported a 1.4 percent increase in total agricultural loan volume, led by stronger gains in non-real estate farm loans. A national survey of agricultural loans pointed to additional gains in the second quarter as the volume of non-real estate farm loans issued during the first full week of May were almost 3 percent higher than year-ago levels. Farmers continued to invest heavily in farm machinery, equipment and structures such as grain bins, machine sheds and land improvements. Bankers expected farm capital spending to remain strong over the next few months. In contrast, farm operating loan demand remained sluggish as farmers paid off operating debts and used cash to prepay input costs.

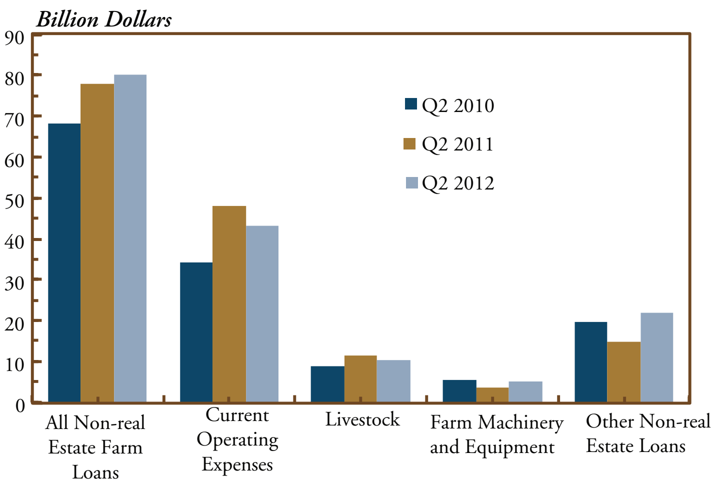
Strong farm incomes pushed farmland values higher. For the second straight year, many states in the Corn Belt and northern Plains reported double-digit annual gains in farmland values. Demand for good quality farmland, especially irrigated acreage, remained strong with lower quality ground garnering some increased interest as prices escalated. Record high land prices enticed more landowners to sell and farm real estate loan volumes pushed above year-ago levels in the first half of 2012.

At the same time, agricultural bank profits strengthened. During the first quarter, returns on assets and equity improved at agricultural banks. Rising farm loan repayment rates cut delinquency rates and net charge-offs on agricultural loans. The average risk rating on agricultural loans eased further. Nevertheless, bankers commented on the challenges in expanding profits. Sluggish operating loans were contributing to relatively low loan-to-deposit ratios at agricultural banks. Competition for qualified farm loans intensified among commercial banks, Farm Credit associations, and vendor financiers. Bankers reported low interest rates and shorter maturities on farm loans, especially at larger commercial banks that utilized more floating interest rate loans and more commitments.

Section A
Second Quarter National Farm Loan Data

A sampling of national agricultural loan activity during the first full week of May suggested strong agricultural lending during the second quarter. Non-real estate loans were up almost 3 percent from the previous year (Chart 1). Robust capital spending on farm machinery and equipment boosted intermediate-term loans. Farm machinery and equipment loan volumes rose sharply as farmers took out more loans with larger average loan volumes. In addition, agricultural banks also made more intermediate-term loans for other unspecified purposes compared to a year ago.

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



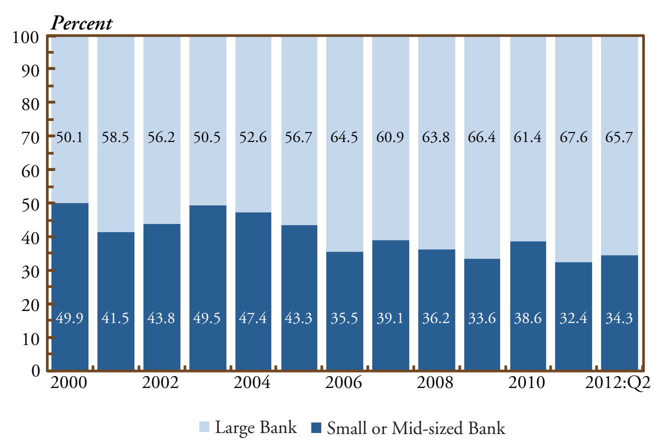
Source: Agricultural Finance Databook, Section A

In contrast, short-term borrowing at agricultural banks declined slightly as farm operators tended to use cash to pay for inputs. Despite an uptick in the number of short-term loans by agricultural banks, lower average loan amounts weighed on loan volumes during the first full week of May. As a result, total loan volumes for current operating expenses fell more than 10 percent below year-ago levels. Similarly, total loan volumes for livestock declined approximately 9 percent.

During the second quarter, small- and mid-sized commercial banks increased their non-real estate lending activity at a faster pace than large banks. The volume of non-real estate agricultural loans made during the week at small- and mid-sized commercial banks was 12 percent above year-ago levels, while loans at large banks edged down. As a result, small- and mid-sized banks' share of non-real estate farm loans edged up (Chart 2). The difference in loan growth was driven by changes in average loan size. Although banks of all sizes reported increases in the number of loans, small- and mid-sized banks reported stable average loan sizes compared with smaller average loan sizes at larger banks.

Terms on agricultural loans changed little from the previous quarter. Effective interest rates on agricultural loans edged up, but remained near historical lows. Average maturities on agricultural loans made during the quarter declined noticeably.

Chart 2: Share of Non-real Estate Loan Volumes by Bank Size



Source: Agricultural Finance Databook, Section A

Agricultural Finance Databook

July 2012 | Federal Reserve Bank of Kansas City

Section B
First Quarter Call Report Data

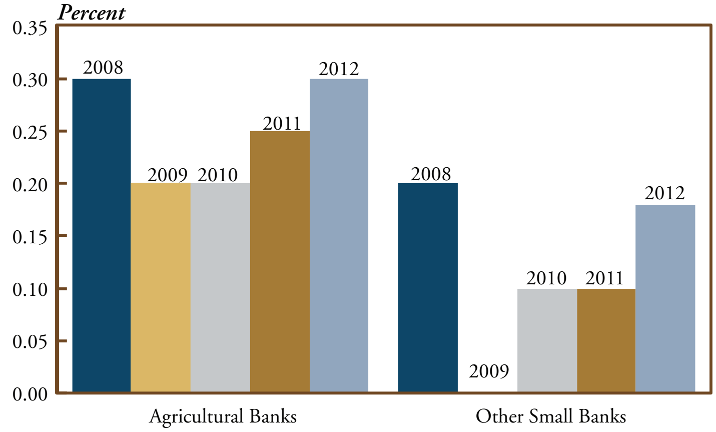
Agricultural bank profits improved with farm loan performance at the start of 2012. The rate of return on assets at agricultural banks rose to 0.3 percent during the first quarter, almost double the return at other small banks (Chart 3). Similarly, the average rate of return on equity at agricultural banks was 2.7 percent in the quarter compared with 1.7 percent at other small banks. At the same time, average capital ratios at agricultural banks rose above year-ago levels.

Compared to a year ago, farm loan performance improved during the first quarter of 2012. Delinquency rates on both real estate and non-real estate loans edged up seasonally during the first quarter, but remained well below year-ago levels. After adjusting for seasonal trends, delinquency rates on non-real estate loans fell to 1.7 percent, half the levels observed in 2010 (Chart 4). Similarly, seasonally adjusted delinquency rates on real estate loans slid below 3 percent for the first time since 2008. With improved loan performance, net charge-offs for both real estate and non-real estate loans fell sharply.

Large banks reported the most improvement in loan performance, although delinquency rates on agricultural loans remained higher at larger banks than other commercial banks. Delinquency rates on real estate loans at the 100 largest banks fell below 5 percent, but remained well above the rate of 2.5 percent observed at all other banks. Similarly, for non-real estate loans, the delinquency rate at the 100 largest banks fell 4 percent, well above the rate of 1 percent at other banks.

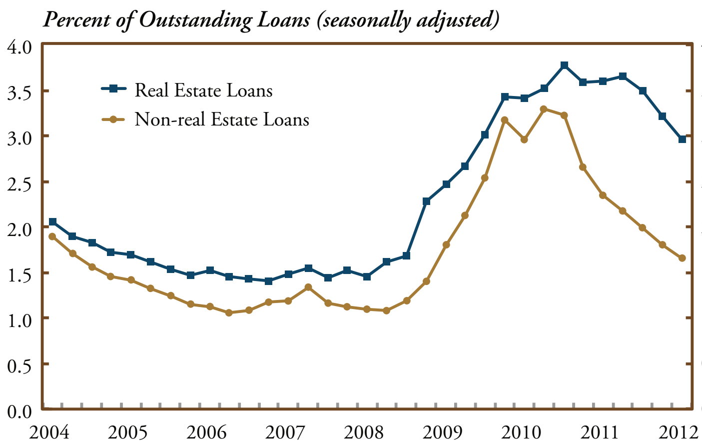
Commercial banks extended more credit to the agricultural sector at the start of the year. During the first quarter, total farm debt outstanding rose 1.4 percent above year-ago levels. Robust capital spending led to 1.6 percent annual gains in non-real estate debt outstanding. With additional farmland sales, farm real estate debt outstanding rose 1.3 percent above year-ago levels. Despite rising farm loan volumes, the average loan-to-deposit ratio declined further.

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



Source: Agricultural Finance Databook, Section B

Chart 4: Delinquent Farm Loans



Source: Federal Reserve Board of Governors

Section C
First Quarter District Agricultural Conditions

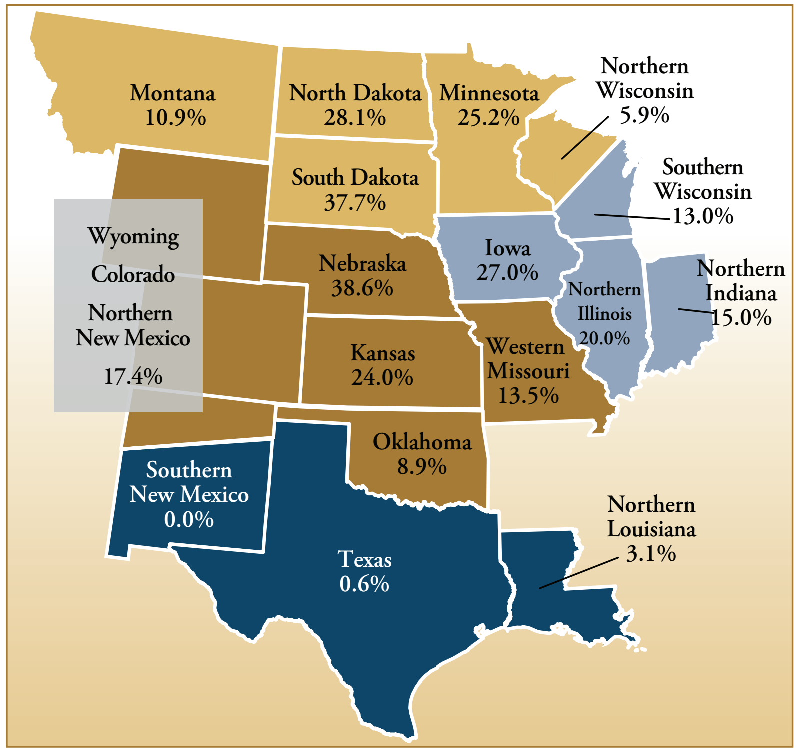
Farmland values climbed higher in many parts of the nation. Bankers in the Chicago and Kansas City Districts noted that record-high farmland values enticed more landowners to sell their land holdings. Still, elevated commodity prices and historically high farm incomes drove double-digit farmland value gains in many crop-producing and mineral-rich regions (Map 1). For example, Nebraska's non-irrigated cropland values jumped 24 percent above year ago levels in 2011 and surged another 39 percent annually in the first quarter of 2012. Most of the Corn Belt and the northern Great Plains also posted robust cropland value growth during the past two years. Compared with December 2011, more bankers in the Chicago, Dallas and Richmond Districts expected farmland values to stabilize at historically high levels in the coming months.

Farm credit conditions remained solid, with high operating loan repayment rates and plenty of funds available for qualified borrowers. According to Federal Reserve surveys, farm operating loan repayment rates strengthened at agricultural banks in the Chicago, Kansas City and Minneapolis Districts. Loan renewals and extensions generally held at low levels, but edged up in the Richmond and Minneapolis Districts. Several bankers noted that proceeds from mineral leases supplemented income levels in regions with booming energy production.

Strong farm incomes continued to dampen farm operating loan demand in most Federal Reserve Districts. Farmers borrowed less for operating expenses in the Chicago, Kansas City, Minneapolis and San Francisco Districts as they paid cash for crop inputs. High feed costs and strong feeder cattle prices prompted further herd reductions in the Dallas and Kansas City Districts. Herd liquidations have boosted current profits, but could limit growth in the future. With sluggish operating loan demand, the availability of funds for farm loans remained high. Collateral requirements on non-real estate farm loans eased slightly in all Districts except Chicago, where collateral requirements held steady. Bankers reported lower interest rates on farm loans in the first quarter.

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

Percent change from prior year



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